2013

Íslandspóstur

ÁRSSKÝRSLA / ANNUAL REPORT 2013

INDEX

MAIL SERVICES AT A CROSSROADS

Ingimundur Sigurpálsson
CEO

Electronic mail and social media is becoming the dominant form of communication, letter volumes are declining and, with increased Internet shopping, package deliveries are growing substantially. These fundamental changes have already had a great impact on the operating environment of postal companies and may be expected to continue to do so. This will mean both new opportunities and threats for Iceland Post.

In 2013, letters declined as before, although the decline was not as steep as in previous years. The decline in volume was around 6.5% which corresponded closely to volume projections for the year. The decline in letter volumes in Iceland is comparable to that in our neighbouring countries and is a result of social and economic developments on the one hand and of government policy, as regards paper-free transactions, on the other. Information that most people are used to receiving on paper is now increasingly sent by electronic means in Iceland. Iceland Post has sought to respond to this change in communications by developing and offering electronic mail services in a manner similar to that of other postal operators in Europe and elsewhere.

According to the 2013 Annual Financial Statement of Iceland Post, loss from the company's operation amounted to approximately ISK 119m. In general, it could be said that the aspects of the budget for 2013 which are under the control of the company's management were achieved. On the other hand, the company was not permitted to make the changes to the pricing of letters within the exclusive right and the number of distribution days in rural areas that were necessary to meet the budget. This accounts for the ISK 235m lower income and ISK 100m less in cost reduction during 2013 than was anticipated.

Over the past few years the company has both raised prices to support postal services, as provided for by laws and regulations, as well as made extensive efforts to reduce the cost of the distribution system. While letters within the exclusive right have decreased, various other service categories have been growing. Income from logistics, retail sales and services has increasingly contributed to covering the costs of the universal service, which Iceland Post is under obligation to provide in accordance with its operating licence.

The pricing of letters within the exclusive right is subject to the approval of the Post and Telecom Administration in Iceland. Since the establishment of Iceland Post and until 2010, the company's proposals for price changes were for the most part approved. Since then, the company's pricing proposals have not been accepted, neither within acceptable deadlines nor to the extent that operational criteria require. In this unique operating environment that Iceland Post finds itself, i.e. drastic decline in letters within the exclusive right and universal services obligations, it is vital for the company that it can make necessary operational changes without undue delay. Otherwise, any delays will have a direct impact on the financial viability of the company as well as resulting in loss of income from international business and increased financial costs.

Since its establishment, Iceland Post has employed a number of measures to develop and secure the company's efficient post offices and distribution network to accord with social changes and evolving volumes. With new and improved premises in the company's main operating locations and the sale of older and less economical properties, the facilities operated by Iceland Post have decreased by around 30%. At the same time, the working environment for both customers

and employees has improved significantly, as well as resulting in considerable economisation.

The management of Iceland Post has repeatedly pointed out the importance of adapting postal services to the need of consumers. This must be done by adapting the laws and regulations that apply to postal services to the needs and expectations of those who use the services. According to surveys carried out both here in Iceland and overseas in recent years, it is clear that in most developed countries, the universal services obligation in postal services is not in tune with the needs of customers. The surveys clearly show that users of postal services are of the opinion that the speed of deliveries matters less than legislation on postal services presumes when it prescribes five distribution days each week. The surveys also show that customers are generally not willing to pay the higher price to receive mail every working day if a cheaper service is available every second or third working day. It is, therefore, important for the future of postal services that laws and regulations are revised to ensure that the postal service takes account of the actual needs of users, while making it possible to price the services in accordance with such needs.

In this context, there is reason to emphasise that, contrary to what many people think, Iceland Post does not enjoy any public support to maintain its extensive mandatory postal services throughout Iceland all working days of the year. This obligation extends to deliveries of up to 20 kg to locations that other distribution and transport companies have not seen as financially viable to service. At the same time as the exclusive right has decreased in recent years, and in view of its planned abolishment, it is necessary to change the regulatory framework that applies to the postal services to accord with such changes, making it clear how services to villages and rural areas are to be handled, how the pricing of such services should be determined and how the cost of such service as stipulated by law should be covered.

Iceland Post faces challenging changes and interesting opportunities. We can assume that the volume of addressed letters will continue to decrease over the next years while electronic mail will continue to increase significantly. In addition to the extensive decrease in the number of letters over the past few years, the volume of letters is expected to decrease by a further 17% by 2018. With the abolishment of the exclusive right, we can expect an even greater decreases in letters distributed by Iceland Post. If we are unable to adapt the postal services to such changed circumstances, we will face significant problems in operations and a forced retreat in all fields of the service. A correct and timely reaction, resulting in necessary and reasonable profits and laying the foundations of constructive business developments, can benefit us all, both the customers of Iceland Post and its owners.

Iceland Post plays an important role in the dissemination of important information and goods to all Icelanders and their customers throughout the country. In addition, Iceland Post is in reliable partnership with postal companies all over the world, based on decades of co-operation and comprehensive distribution networks almost everywhere in the world, wherever people can be found. Iceland Post employees handle hundreds of thousands of letters and parcels every day, and the quality of the service is among the best. Their input, therefore, is extremely important for both Iceland Post and its customers. As I thank the customers of Iceland Post, I would like to extend my sincere thanks to our employees for their outstanding work over the past year.

Ingimundur Sigurpálsson
CEO

ANNUAL REPORT

Endorsement and statement by the Board of Directors and the Managing Director

Operations in 2013

The financial statements include the consolidated financial statements of Íslandspóstur ohf. and its subsidiaries, Trönur ehf., Samskipti ehf., Fraktmiðlun ehf. and ePóstur ehf. which was established at year end 2012 and its operation commenced at the beginning of 2013.

The Group's loss for the year amounted to ISK 119 million according to the income statement. Equity as at December 31, 2013 amounted to ISK 2.357 million according to the balance sheet. The Company's share capital as at December 31, 2013 amounted to ISK 1.448 million and is entirely owned by the State.

The Company's operating result for the year 2013 was unsatisfactory. In recent years it has become evident that the managements limited scope for pricing decisions and streamlining the Company's operation has significantly prevented efficient and necessary response to changes in the operational environment. Decisions regarding the pricing of letters within the exclusive right and rationalisation of the universal service have prevented the company from reaching an acceptable operating result see note 23. In a declining letter market, it is of vital importance that administrative decisions regarding pricing and scope of the postal service, be taken in a more timely manner than until now, so that the company be able to react in a timely and appropriate way to changes in the operational environment.

Corporate governance

The Board of Directors of Íslandspóstur endeavours to maintain good corporate governance in line with the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The Board of Directors operates on the basis of the Company's Articles of Association and the Board of Directors operating procedures. The procedures include among other things definition of the competences and division of tasks between the Directors of the Board, provisions on the qualification of the Directors of the Board, confidentiality rules.

Statement by the Board of Directors and the Managing Director

The annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

According to the best of our knowledge, it is our opinion that the consolidated financial statements give a true and fair view of the consolidated financial performance of the Group for the financial year 2013, its assets, liabilities and consolidated financial position as at December 31, 2013 and its consolidated cash flows for the financial year 2013.

Further, in our opinion the consolidated financial statements and the Endorsement of the Board of Directors and the Managing Director gives a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the Managing Director of Íslandspóstur ohf. have today discussed the Company's consolidated financial statements for the year 2013 and confirm them by means of their signatures. The Board of Directors and the Managing Director recommend that the consolidated financial statements be approved at the annual general meeting of Íslandspóstur ohf.

Reykjavik, 21st of February, 2014.

The Board of Directors:

Guðmundur Oddsson, Lilja Rafney Magnúsdóttir

Petrína Baldursdóttir, Jón Ingi Cæsarsson, Ellert Kristinsson

Managing Director:

Ingimundur Sigurpálsson

Auditor's report

To the Board of Directors and Shareholders of Íslandspóstur ohf.

We have audited the accompanying consolidated financial statements of Íslandspóstur ohf., and its subsidiaries, (the Group), which comprise the balance sheet as at December 31, 2013 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Íslandspóstur ohf. as at December 31, 2013 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavik, 21st of February, 2014.

The National Audit Office of Iceland:

Sveinn Arason

Auditor General CPA

Óskar Sverrisson

Auditor CPA

Income statement for the year 2013

	Notes	2013	2012
OPERATING REVENUES			
Postal services		5.934.931	6.004.502
Other revenues		851.890	749.575
		6.786.821	6.754.077
OPERATING EXPENSES			
Salaries and salary related expenses	5	3.751.412	3.711.562
Direct cost of postal distribution		1.607.110	1.565.503
Other operating expenses		1.078.780	991.706
		6.437.302	6.268.771
EBITDA		349.519	485.306
Depreciation	8	(349.862)	(306.331)
EBIT		(343)	178.975
Financial income		15.770	35.830
Financial expenses		(157.303)	(148.172)
Net financial expenses	7	(141.533)	(112.342)
(Loss) profit before income tax		(141.876)	66.633
Income tax	16	23.100	(13.985)
Comprehensive (loss) income for the year		(118.776)	52.648
TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO:			
Owners of the Company		(117.612)	54.335
Non-controlling interests		(1.164)	(1.687)
Total comprehensive (loss) income for the year		(118.776)	52.648
EARNINGS PER SHARE AND DILUTED EARNINGS PER SHARE			
Earnings and diluted earnings per share on each ISK 1 share	3.I	(0,08)	0,04

Amounts are in ISK thousand.

Notes no. 1-25 are an intergral part of these Consolidated Financial Statement.

Balance sheet December 31, 2013

ASSETS	Notes	2013	2012
Property, plant and equipment	8	3.243.710	3.324.155
Shares in other companies	9	80.372	80.372
Bonds	10	20.973	25.083
NON-CURRENT ASSETS		3.345.055	3.429.610
Inventories	11	200.390	194.470
Accounts receivable and other receivables	12	981.146	936.518
Cash and cash equivalents	13	276.175	282.956
Assets held for sale	14	27.140	27.140
CURRENT ASSETS		1.484.851	1.441.084
TOTAL ASSETS		4.829.906	4.870.694
EQUITY			
Share capital		1.447.500	1.447.500
Statutory reserve		351.378	351.378
Retained earnings		557.137	689.749
EQUITY ATTRIBUTABLE TO OWNERS OF THE COMPANY	15	2.356.015	2.488.627
Non-controlling interests		554	(2.032)
EQUITY		2.356.569	2.486.595
LIABILITIES			
Debenture loans	19	1.484.459	1.325.744
Income tax liability	17	20.704	43.804
LONG TERM LIABILITIES		1.505.163	1.369.548
Accounts payable and other short term liabilities	18	968.174	1.014.551
SHORT TERM LIABILITIES		968.174	1.014.551
LIABILITIES		2.473.337	2.384.099
TOTAL EQUITY AND LIABILITIES		4.829.906	4.870.694

Notes no. 1-25 are an intergral part of these Consolidated Financial Statement.

Amounts are in ISK thousand.

Statement of changes in equity for the year 2013

	Share capital	Statutory reserve	Retained earnings	Total	Non-controlling interests	Total equity
YEAR 2013						
Equity 1.1.2013	1.447.500	351.378	689.749	2.488.627	(2.032)	2.486.595
Dividends to shareholders			(15.000)	(15.000)		(15.000)
Contribution from non-controlling shareholders				0	3.750	3.750
Net loss for the year			(117.612)	(117.612)	(1.164)	(118.776)
Equity 31.12.2013	1.447.500	351.378	557.137	2.356.015	554	2.356.569
YEAR 2012						
Equity 1.1.2012	1.447.500	348.661	638.131	2.434.292	(345)	2.433.947
Statutory reserve contribution		2.717	(2.717)	0		0
Net earnings (loss) for the year			54.335	54.335	(1.687)	52.648
Equity 31.12.2012	1.447.500	351.378	689.749	2.488.627	(2.032)	2.486.595

Amounts are in ISK thousand.

Notes no. 1-25 are an intergral part of these Consolidated Financial Statement.

Statement of cash flows for the year 2013

CASH FLOWS FROM OPERATING ACTIVITIES	Notes	2013	2012
(Loss) profit for the year		(118.776)	52.648
Operating items not affecting cash flow:			
Gain on sale of assets		(12.180)	(6.795)
Depreciation	8	349.862	306.331
Net financial expenses	7	141.533	112.342
Income tax	16	(23.100)	13.985
WORKING CAPITAL FROM OPERATING ACTIVITIES		337.339	478.511
Changes in operating assets and liabilities:			
Inventories, (increase)		(5.920)	(1.575)
Short term receivables, (increase)		(172.150)	(26.490)
Short term liabilities, increase		8.220	119.936
CASH GENERATED FROM OPERATING ACTIVITIES		(169.850)	91.871
Interest received		14.858	21.754
Interest paid		(78.600)	(86.621)
NET CASH FROM OPERATING ACTIVITIES		103.747	505.515
CASH FLOWS FROM INVESTING ACTIVITIES			
Real estates and land	8	(31.788)	(120.297)
Machinery, equipment and vehicles	8	(262.019)	(486.727)
Proceeds from the sales of fixed assets		36.591	41.220
Changes in bonds		6.189	17.911
NET CASH USED IN INVESTING ACTIVITIES		(251.027)	(547.893)
CASH FLOWS FROM FINANCING ACTIVITIES			
New loans		250.000	0
Dividends paid		(15.000)	0
Contribution from non-controlling shareholders		3.750	0
Repayment on long-term loans		(98.251)	(107.694)
NET CASH USED IN FINANCING ACTIVITIES		140.499	(107.694)
DECREASE IN CASH AND CASH EQUIVALENTS		(6.781)	(150.072)
CASH AND CASH EQUIVALENTS AT YEAR BEGINNING		282.956	433.028
CASH AND CASH EQUIVALENTS AT YEAR END	13	276.175	282.956

Notes no. 1-25 are an intergral part of these Consolidated Financial Statement.

Amounts are in ISK thousand.

Notes

1. REPORTING ENTITY

Íslandspóstur ohf. ("the Company") is a company domiciled in Iceland. The address of the Company's registered office and headquarters is Stórhöfði 29, Reykjavík. The consolidated financial statements of the Company as at and for the year ended December 31, 2013 comprise the Company and its subsidiaries, together referred to as the "Group".

2. BASIS OF PREPARATION

a. Statement of compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRSs) as approved by EU.

The Company's Board of Directors approved the consolidated financial statements on February 21, 2014.

b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for shares in other companies, which are stated at fair value.

c. Functional and presentation currency

These consolidated financial statements are presented in Icelandic kronas, which is the Company's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest thousand.

d. Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a. Basis of consolidation

(i) *Business combinations*

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; plus
- if the business combination in achieved in stages, the fair value of the existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

a. Basis of consolidation, cont.

(i) *Business combinations, cont.*

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transactions costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognised in profit or loss.

When share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree's employees (acquiree's awards) and relate to past services, then all or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based value of the replacement awards compared with the market-based value of the acquiree's awards and the extent to which the replacement awards relate to past and/or future service.

Acquisitions prior to January 1, 2010

For acquisitions prior to January 1, 2010 goodwill represents the excess of the cost of the acquisition over the Group's interest in the recognised amount (generally fair value) of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess was negative, a bargain purchase gain was recognised immediately in profit or loss.

Transaction costs, other that those associated with the issue of debt or equity securities, that the Group incurred in connection with business combinations were capitalised as part of the cost of the acquisition.

(ii) *Acquisitions of non-controlling interests*

Acquisitions of non-controlling interests are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognised as a result. Adjustments to non-controlling interests arising from transactions that do not involve the loss of control are based on a proportionate amount of the net assets of the subsidiary.

(iii) *Subsidiaries*

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

(iv) *Transactions eliminated on consolidation*

Intra-group balances and transactions and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

b. Foreign currency

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss arising is recognised in the income statement.

c. Financial instruments

Financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits.

(i) *Available-for-sale financial assets*

The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised directly in equity. When investments in equity securities do not have a quoted market price in an active market and whose fair value cannot be reliably measured they are measured at cost less any impairment recognised. Fair value changes recognised in equity are transferred to the income statement when the recognition of the available-for-sale financial asset in the financial statements is discontinued.

d. Property, plant and equipment

(i) *Recognition and measurement*

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within "other income" in the income statement.

(ii) *Subsequent costs*

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. All other cost is recognised in the income statement as incurred.

(iii) *Depreciation*

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are specified as follows:

Buildings	20-25 years
Machines, equipment and vehicles	3-10 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

e. Inventories

Inventories are measured at the lower of cost and net realisable value. The net realisable value is the estimated sales value in transactions between unrelated parties less estimated cost of selling the goods. The cost of inventories is based on the average cost principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

f. Impairment

(i) *Financial assets*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the income statement. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in the income statement.

(ii) *Other assets*

The carrying amounts of the Group's non-financial assets, other than inventories (see accounting method e) are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, the recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

g. Fixed assets held for sale

Fixed assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets (or disposal group) are measured at the lower of their carrying amount and net fair value.

Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property and biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in the income statement. Gains are not recognised in excess of any cumulative impairment loss.

h. Obligations

An obligation is recognised in the financial statements if the Group has a present legal or constructive obligation due to past events, it is likely that payment will take place and it can be measured reliably.

The Company has engaged in paying a pension fund contribution to the Pension Fund of State Employees amounting to 6% of the difference betweeen total salaries and standard salaries of those employees exploiting their right to payment of pension fund premium while working for the Company.

i. Revenue

The Group's revenues on service are recognised in the income statement in the month, in which the service is rendered without regard for when settlement therefore is received. Revenue on sale of goods is recognised in the income statements when the ownership is transferred to the buyer.

j. Financial income and expenses

Finance income comprises interest income on funds invested and foreign exchange gain on foreign currencies. Interest income is recognised as it accrues in the income statement.

Finance expenses comprise interest expense on borrowings and foreign exchange loss on foreign currencies.

k. Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the temporary differences due to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future and that the parent company can manage when differences are reversed. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Notes cont.

3. SIGNIFICANT ACCOUNTING POLICIES, CONT.

k. Income tax, cont.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

l. Earnings per share

The Group presents basic and diluted earnings per share data for its ordinary shares, which are calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. The Company has neither concluded option agreements nor acquired new loans convertible into share capital so diluted earnings per share equals basic earnings per share.

m. New standards and interpretations

All new standards and amendments to standards effective for annual periods beginning after January 1, 2013, have been applied in preparing these consolidated financial statements. The effect on the consolidated financial statements of the Group is immaterial.

4. FINANCIAL RISK MANAGEMENT

Overview

The Group has exposure to the following risks:

* credit risk
* liquidity risk
* market risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has assigned to the Director of the parent company the task of monitoring the Group's daily risk management.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, has less of an influence on credit risk.

Notes cont.

4. FINANCIAL RISK MANAGEMENT, CONT.

Credit risk, cont.

Trade and other receivables, cont.

The Group has established a credit policy under which all new customers are measured before the Group's standard payment and delivery terms and conditions are offered. Each new customer is analysed individually for creditworthiness and credit limits are set. When managements feel it is needed a guarantee is requested.

Most of the Group's customers have been its customer for many years and there have been insubstantial losses on receivables in proportion to turnover. Credit risk management due to customers mainly involves age of receivables and financial standing of single customers. The Group's accounts receivable and other receivables both regard individuals and companies. Customers classified as "high risk" may not have further credit transactions with the Group unless their debt is settled.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

The allowance for impairment of accounts receivables at year end amounts to ISK 112 million (2012: ISK 111 million) and the allowance for impairment of notes receivables at year end amount to ISK 3 million (2012: ISK 4 million).

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

Residual contractual maturities of financial liabilities are specified as follows at year-end:

2013	Book value	Within 1 year	2-3 years	4-5 years	More than 5 years
Debenture loans	1.612.505	224.796	437.207	417.241	1.782.365
Accounts payable and short term payables	968.174	968.174			
	2.580.679	1.192.970	437.207	417.241	1.782.365
2012					
Debenture loans	1.424.797	184.541	361.924	347.337	1.704.224
Accounts payable and short term payables	1.014.551	1.014.551			
	2.439.348	1.199.092	361.924	347.337	1.704.224

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Notes cont.

4. FINANCIAL RISK MANAGEMENT, CONT.

Market risk, cont.

Currency risk

Of the Group's borrowing which totals 4% in foreign currency, a curve of EUR, CHF and JPY, proposes currency risk which is not hedged. Intrest rates on these borrowings are much lower than on borrowings by the Parent Company denominated in ISK.

The Group is exposed to currency risk on receivables from foreign postal managements and customers denominated in a currency other than the respective functional currencies of Group entities. Those currencies mainly creating foreign exchange risk are SDR and EUR. The Group does not, in general hedge against currency risk but foreign exchange rate changes would have insignificant effect on the Group's return.

Interest rate risk

The Group's borrowings in ISK are bound by consumer price index and carry both fixed and variable interests. Borrowings in foreign currencies carry fixed interests. If the interest rate would have been 1% higher the Group's return would have been ISK 16 million lower in the year 2013 but ISK 16 million higher had the interest rate been 1% lower. If interest rates in the year 2012 had been 1% higher the return for the year 2012 would have been ISK 14 million lower and at the same time ISK 14 million higher had the interest rate for the year 2012 been 1% lower.

Other market price risk

Other market price risk is limited, as investments in bonds and shares are an insubstantial part of the Group's operation.

Capital management

The Board's policy is to maintain a strong capital base to sustain future development of the business. The Company's Board of Directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. The Company is not obliged to comply with external rules on minimum equity.

5. SALARIES AND SALARY RELATED EXPENSES

Salaries, salary related expenses and other personnel expenses are specified as follows:	2013	2012
Salaries	2.988.652	2.939.790
Contribution to defined contribution fund	288.316	285.395
Salary related expenses	290.109	288.881
Other personnel expenses	184.335	197.496
Total salaries and salary related expenses	3.751.412	3.711.562
Full-time equivalent units	786	816

Salaries and perquisite of the Board of Directors and executive management amounted to ISK 95 million (2012: ISK 89 million) during the year, whereof the salaries of the President amounted to ISK 14 million (2012: ISK 12 million) and the salaries of Directors of the Board amounted to ISK 7 million (2012: ISK 7 million). Salaries of the Chairman of the Board are the double of the salaries of a Director of the Board. Agreements with the Company's management neither include provisions on option rights to shares in the Company nor special employment termination payments.

The remaining balance of employment termination agreements amounted to ISK 18 million (2012: ISK 18 million), which is accounted for in the financial statements.

Notes cont.

6. AUDITOR'S FEE

Payments to the Icelandic National Audit Office are specified as follows:

	2013	2012
Audit of financial statements	5.785	5.384
Interim financial statements review	4.488	3.243
Total	10.273	8.627

7. FINANCIAL INCOME AND EXPENSES

Financial income and expenses are specified as follows:

	2013	2012
Interest earned and indexation	15.770	23.800
Foreign exchange difference	0	12.030
Total financial income	15.770	35.830
Interest expenses and indexation	(129.524)	(148.172)
Foreign exchange difference	(27.779)	0
Total financial expense	(157.303)	(148.172)
Total net financial expense	(141.533)	(112.342)

8. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment and depreciation are specified as follows:

	Real estates and land	Machinery, equipment and vehicles	Total
Cost price			
Balance at 1.1.2012	3.074.094	2.302.720	5.376.814
Additions during the year	120.297	486.727	607.024
Disposals	(66.317)	(68.450)	(134.767)
Balance at 31.12.2012	3.128.074	2.720.997	5.849.071
Balance at 1.1.2013	3.128.074	2.720.997	5.849.071
Additions during the year	31.788	262.019	293.807
Disposals	(25.226)	(72.174)	(97.400)
Balance at 31.12.2013	3.134.636	2.910.842	6.045.478
Depreciation			
Balance at 1.1.2012	983.700	1.303.184	2.286.884
Depreciation for the year	128.218	178.113	306.331
Disposals	(14.782)	(53.517)	(68.299)
Balance at 31.12.2012	1.097.136	1.427.780	2.524.916
Balance at 1.1.2013	1.097.136	1.427.780	2.524.916
Depreciation for the year	127.042	222.820	349.862
Disposals	(14.715)	(58.295)	(73.010)
Balance at 31.12.2013	1.209.463	1.592.305	2.801.768
Book value			
1.1.2012	2.090.394	999.536	3.089.930
31.12.2012 and 1.1.2013	2.030.938	1.293.217	3.324.155
31.12.2013	1.925.173	1.318.537	3.243.710
Depreciation rates	0-5%	10-33%	

Amounts are in ISK thousand.

Notes cont.

8. PROPERTY, PLANT AND EQUIPMENT, CONT.

Insurance and evaluation of assets

Insurance value, rateable value and book value of real estates and land at year end were as follows:

	2013	2012
Insurance value of real estates	3.597.731	3.491.480
Rateable value of real estates and land	1.871.729	1.818.175
Book value of real estates and land	1.925.173	2.030.938

Mortgages

The Group's operating assets are pledged for an insurance bill and bonds to secure liabilities amounting to ISK 864 million at year end (2012 : ISK 644 million.)

9. SHARES IN OTHER COMPANIES

Shares in other companies are specified as follows:	2013		2012	
	Nominal value	Book value	Nominal value	Book value
Internet á Íslandi hf.	3.781	45.352	3.781	45.352
Vörusjá ehf.	27.500	27.500	27.500	27.500
Unimaze	25	5.000	25	5.000
Eurogiro, nominal value 100 thousand DKK		2.520		2.520
Total shares in other companies		80.372		80.372

10. BONDS

Bonds are specified as follows:	2013	2012
Balance at 1.1	32.889	48.384
Indexation	1.168	2.418
Maturities	(6.921)	(19.811)
Change in allowance	734	1.898
Next year's maturities	(6.897)	(7.806)
Bonds at 31.12	20.973	25.083

11. INVENTORIES

Inventories at year end are specified as follows:	2013	2012
Inventories, consumables	96.867	95.851
Inventories, postage stamps	103.523	98.619
Total inventories	200.390	194.470

Inventories recognised as cost of sales amounted to ISK 130 million. (2012: ISK 123 million.)

12. ACCOUNTS RECEIVABLE AND OTHER RECEIVABLES

Accounts receivable and other receivables are specified as follows:	2013	2012
Nominal value of accounts receivable	776.327	842.205
Write down of probable loss on accounts receivable	(112.286)	(110.869)
Next year's payment on bonds	6.897	7.806
Various short term receivables	310.208	197.376
Total accounts receivable and other receivables	981.146	936.518

Notes cont.

13. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are specified as follows:	2013	2012
Market securities	22.523	21.862
Current bank deposits	248.984	257.318
Funds	4.668	3.776
Total cash and cash equivalents	276.175	282.956

14. ASSETS HELD FOR SALE

Fixed assets held for sale are specified as follows:	2013	2012
Balance at 1.1	27.140	27.140
Total fixed assets held for sale	27.140	27.140

15. EQUITY

Share capital

The Company's total share capital according to its Articles of Association amounts to ISK 1.448 million and have all been paid for. One vote is attached to each ISK 1 share in the Company.

Dividends

Dividends paid in the year 2013 amounted to ISK 15 million or 0,01 kr. Per share. (2012: ISK 0)

Statutory reserve

The Company has the obligation to allocate at least 10% of its profit, which is not used to meet possible losses of previous years and is not allocated into other statutory reserves, into a legal reserve until reaching 10% of share capital. When that target has been reached, contributions must be at least 5% until the reserve amounts to 25% of share capital. The Company has received payments exceeding the nominal value for shares when share capital was increased, and the paid amount in excess of the nominal value has been allocated to the premium account. The Company may use the legal reserve to settle against a loss that can not be settled with other reserves. When the reserve amounts to more than 25% of share capital, the amount in excess may be used to increase share capital or, in accordance with provisions of Article 53 of the Act on Limited Companies, no. 2/1995, for other concerns.

16. INCOME TAX EXPENSE

Income tax in the income statement is specified as follows:	2013	2012
Deferred taxes		
Temporary differences	(23.100)	13.985
Income tax recognised in the income statement	(23.100)	13.985

Effective income tax is specified as follows:		2013		2012
(Loss) profit for the year		(118.776)		52.648
Income tax		(23.100)		13.985
(Loss) profit before income tax		(141.876)		66.633
Income tax according to current income tax rate	20,0%	(28.375)	20,0%	13.327
Effects of taxable losses	(3,7%)	5.302	1,5%	970
Other	0,0%	(27)	(0,5%)	(312)
Effective tax rate	16,3%	(23.100)	21,0%	13.985

Amounts are in ISK thousand.

Notes cont.

17. INCOME TAX LIABILITY

The Company's income tax liability is specified as follows:	2013	2012
Income tax liability at 1.1	43.804	29.819
Calculated income tax for the year	(23.100)	13.985
Income tax liability at 31.12	20.704	43.804

Income tax liability is specified as follows at year end:		
Property, plant and equipment	38.071	55.790
Accounts receivable	(13.460)	(12.255)
Deferred foreign exchange difference	(3.631)	1.871
Tax loss carry-forwards	0	(1.242)
Inventories	64	54
Other items	(340)	(414)
Total	20.704	43.804

18. ACCOUNTS PAYABLE AND OTHERS SHORT-TERM PAYABLES

Accounts payable and other short-term payables are specified as follows:	2013	2012
Accounts payable	415.930	508.360
Other short-term payables	552.244	506.191
Total accounts payable and other short-term payables	968.174	1.014.551

19. INTEREST BEARING LIABILITIES

Interest bearing liabilities are specified as follows:	2013	2012
Loans bound by consumer price index	1.520.955	1.315.412
Loans in ISK, non-indexed	19.288	23.900
Loans in EUR	33.976	38.502
Loans in CHF	28.736	33.205
Loans in JPY	9.550	13.778
Next year's mortgages	(128.046)	(99.053)
Long term liabilities at 31.12	1.484.459	1.325.744

Payments on long-term liabilities at year end are specified as follows over the coming years:		
Year 2013	-	99.053
Year 2014	128.046	102.610
Year 2015	131.817	106.381
Year 2016	135.164	107.778
Year 2017	137.450	112.015
Year 2018	141.941	116.839
Later	938.087	780.121
Total long-term liabilities	1.612.505	1.424.797

20. RELATED PARTIES

The Groups related parties is the State and companies and institution that are part of the State, Board of Directors, key management and their close family members. The Group has transactions with its related parties on an arm‘s length basis.

Notes cont.

21. GROUP ENTITIES

Subsidiaries:	Ownership interest	
	2013	2012
Samskipti ehf.	100%	100%
Trönur ehf.	100%	100%
Fraktmiðlun ehf.	62,5%	62,5%
ePóstur ehf.	100%	100%

At year end 2012, Íslandspóstur ohf. established its subsidiary, ePóstur ehf. Its operation commenced at the beginning of 2013 and its purpose is the development and processing of electronic communication and distribution solutions, lending and other relative activities.

22. REVENUES AND EXPENSES BY OPERATING SEGMENTS

Regulation 313/2005 includes requirements on accounting and financial separation of postal operators. The regulation includes provisions on implementation of such separation and on disclosure requirements to the Post and Telecom Administration (PTA).

Previously Íslandspóstur has disclosed in its financial statements information on revenue and expenses by operating segments. The separation is based on the regulation. In ruling 18/2013 made by the PTA the accounting separation and cost accounting was assessed. Their main conclusion was that cost accounting and separation was in all material respect in line with the requirements of the Postal Services Act no 19/2002 and regulation 313/2005. It was also the opinion of PTA that certain improvements regarding assumptions used and application needed improvement.

In accordance to the conclusion of PTA, Íslandspóstur is currently working on necessary improvements on the cost accounting applied and subsequently the improved process will be put for PTA for review as stipulated in regulation 313/2005.

23. ADDITIONAL INFORMATION

The Icelandic Government has the exclusive rights to distribute letters up to 50 grams but has entrusted Íslandspóstur to execute these rights. Associated with these rights is the universal service obligation which ensures all citizens equal access to certain aspects of the postal service with specific quality and at affordable prices. The universal service obligation of Íslandspóstur requires the company to distribute shipments up to 20 kilograms. The service obligation requires the Company to provide certain types of services that are not profitable but revenue from the exclusive rights is intended to compensate for those losses.

Over the past five years the volume of letters within the exclusive right has decreased significantly. This development is expected to continue in coming years but at a lower level. This decrease in revenue from letters within the exclusive right has resulted in the revenue not being sufficient to cover the cost that relates to the universal service obligation and therefore the Company's operating result has not been satisfactory. The Company's financial position is still strong with an equity ratio of 49% at year end. The Company's cash and cash equivalents at year end was however only ISK 276 million which is inadequate at year end and management expects that it will need to borrow funds shortly to enable the Company to provide its service obligations and meet commitments.

Management is of the opinion that it is of the upmost importance that the Company can under these exceptional circumstances react quickly to new market conditions. In recent years it has become evident that the current process regarding pricing has significantly limited the Company's abilities to increase efficiency. The universal service obligation also limits possibilities to streamline the Company's operation. Management believes that the process for price changes and other necessary actions needed to improve operating results needs to be accelerated to enable the Company to react timely and appropriately to changes.

Notes cont.

24. KEY RATIOS

The Company's key ratios are as follows:	2013	2012
Current ratio - current assets / short term liabilities	1,53	1,42
Equity ratio - equity / total capital	0,49	0,51
Internal value of share capital - equity / share capital	1,63	1,72
EBITDA ratio on total earnings	5,1%	7,2%
EBIT ratio on total earnings	0,0%	2,6%
Return on equity	-4,8%	2,2%

Notes cont.

Unaudited information

25. INTERIM FINANCIAL STATEMENTS

The Group's operation is divided as follow by quarters:

Year 2013	Q4	Q3	Q2	Q1	Total
Postal services	1.724.811	1.387.957	1.380.565	1.441.598	5.934.931
Other revenues	284.075	186.333	202.204	179.278	851.890
	2.008.886	1.574.290	1.582.769	1.620.876	6.786.821
Salaries and salary related expenses	1.051.630	856.730	937.589	905.463	3.751.412
Direct cost of postal distribution	453.432	384.404	377.144	392.130	1.607.110
Other operating cost	341.777	244.342	259.360	233.301	1.078.780
	1.846.839	1.485.476	1.574.093	1.530.894	6.437.302
EBITDA	162.047	88.814	8.676	89.982	349.519
Depreciation	(75.749)	(92.336)	(90.408)	(91.369)	(349.862)
EBIT	86.298	(3.522)	(81.732)	(1.387)	(343)
Financial expenses	(44.069)	(25.516)	(22.268)	(49.680)	(141.533)
Profit (loss) before income tax	42.229	(29.038)	(104.000)	(51.067)	(141.876)
Income tax	1.410	28	16.178	5.484	23.100
Profit (loss)	43.639	(29.010)	(87.822)	(45.583)	(118.776)

Year 2012					
Postal services	1.773.668	1.383.039	1.364.638	1.483.157	6.004.502
Other revenues	254.149	130.906	171.515	193.005	749.575
	2.027.817	1.513.945	1.536.153	1.676.162	6.754.077
Salaries and salary related expenses	1.051.560	838.098	924.556	897.348	3.711.562
Direct cost of postal distribution	457.417	329.051	390.091	388.944	1.565.503
Other operating cost	305.974	206.832	242.785	236.115	991.706
	1.814.951	1.373.981	1.557.432	1.522.407	6.268.771
EBITDA	212.866	139.964	(21.279)	153.755	485.306
Depreciation	(82.139)	(75.653)	(73.862)	(74.677)	(306.331)
EBIT	130.727	64.311	(95.141)	79.078	178.975
Financial expenses	(22.000)	(6.762)	(48.593)	(34.987)	(112.342)
Profit (loss) before income tax	108.727	57.549	(143.734)	44.091	66.633
Income tax	(20.515)	(11.809)	28.146	(9.807)	(13.985)
Profit (loss)	88.212	45.740	(115.588)	34.284	52.648

Amounts are in ISK thousand.