Annual Report 2016

Royal Dutch Airlines

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Letter from the President

For KLM, 2016 was marked by compelling change. While 2015 was the year in which we launched our new strategy and took some initial steps towards implementation, 2016 became the year that our efforts had significant effect. Inspired by our motto *Change, Participate and Win* ("Veranderen, Meedoen en Winnen"), KLM worked hard to reclaim its position and I am proud that we are starting to win again.

In last year's report I stated that we would implement our plans at an accelerated pace. In 2016, our plans to reduce cost, invest in our future and transform our organisation were implemented. As a result, we improved our productivity and operating margin, we decreased net debt levels and unit cost and we revived our innovative power.
The improvement of our financial results may partly be attributed to our efforts with the Perform 2020 program and partly to lower fuel cost. Consequently, we were able to continue investments in fleet renewal and new products, which increased customer satisfaction and loyalty.
These and other achievements are living proof that our new strategy is paying off.

2016 was also a turbulent year in which the complexity of change became tangible for our employees.
We experienced difficulties regarding collective labour agreements, pension schemes and the implementation of the High Performance Organisation. While stressful and uncomfortable at times, these changes are inevitable in light of the challenges we are facing.

At the same time, the changes generated energy and enthusiasm, especially where our people took the opportunity to participate. One source of energy has been the introduction of the KLM Compass that derives from our in 2015 enriched purpose. It translates our company's purpose into clear values, staff behaviours, customer needs and leadership principles. The Compass is consistently rolled out across KLM.

Also in 2016, AIR FRANCE KLM launched Trust Together, an ambitious program aimed at rekindling growth. It provides – mainly for Air France – a number of strategic guidelines and is therefore a valuable supplement to Perform 2020. For KLM the program called on closer commercial co-operation between KLM and Transavia for increased efficiency. It also reiterated the soundness of KLM's path. I believe that the value of AIR FRANCE KLM ultimately depends on the strength of its two airlines. At KLM, we are working hard to restore the strength and health of our company. Based on this position, KLM will contribute to the success of the Group.

Overall, we can truly say that we are taking back our position and making major steps towards becoming Europe's most customer-centric, innovative and efficient network carrier. I am happy to see that our purpose of 'Moving Your World by creating memorable experiences' is coming to life.

But for multiple reasons we need to vigorously continue the execution of our strategy:

» Low fuel prices resulted in a temporary positive effect that we cannot count on in the future;
» We need to invest more to win the favour of our customers;
» We need to outplay our competitors, whom are also making efforts to improve their position;
» Productivity gains lead to growth, which in turn increases job opportunities for our staff;
» Our KLM staff benefits from better results through the (improved) profit-sharing scheme.

Looking back on the turbulent year behind us, I feel proud of all KLM staff and I am deeply grateful for their support and contribution. I also appreciate in particular all those within the commercial and field organisation of AIR FRANCE KLM who contributed to our 2016 results.

At KLM, we are proud of our history and committed to our future. In 2016, KLM celebrated its 97th birthday and we want to reach our centenary in sound health. We are not there yet, but I feel confident that our plan is working.

This gives us the energy and motivation to continue reclaiming our position in the competitive world in which we are operating. I am convinced that we can take *Change, Participate and Win* ("Veranderen Meedoen en Winnen") to even greater heights and I am confident that, together with all KLM staff, we will take our great company into a flourishing future.

Pieter Elbers
President and Chief Executive Officer

Key figures

REVENUES
9,800
9,905

EBITDAR
1,603
1,265

EBITDA
1,189
911

INCOME FROM CURRENT OPERATIONS
681
384

AS A % OF OPERATING REVENUES
3.9
6.9

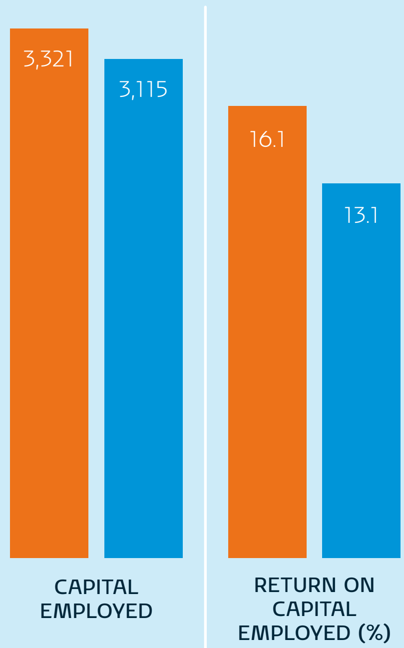
NET PROFIT FOR THE YEAR
519
54

EQUITY
988
396

AS A % OF TOTAL LONG-TERM FUNDS
19
8

RETURN ON EQUITY (%)
74.9
26.8

EARNINGS PER ORDINARY SHARE
(EUR)
11.03
1.14



ADJUSTED NET DEBT/EBITDAR RATIO
2.9
3.6

DIVIDEND PER ORDINARY SHARE
(EUR)
0.36
–

Financial position

CASH FLOW FROM OPERATING ACTIVITIES
1,133
748

CASH FLOW FROM INVESTING ACTIVITIES
(excluding (increase) / decrease in short-term deposits and commercial paper)
-755
-340

FREE CASH FLOW
408
378

● 2016 ● 2015
In millions of Euros, unless stated otherwise

Passenger

TRAFFIC (in millions of revenue passenger-kilometers, RPK)

97,737

93,228

CAPACITY (in millions of available seat-kilometers, ASK)

112,065

107,851

PASSENGER LOAD FACTOR (%)

87.2

86.4

NUMBER OF PASSENGERS (x 1,000)

30,399

28,562

Cargo

TRAFFIC (in millions of revenue ton freight-kilometers, RTFK)

4,872

5,429

CAPACITY (in millions of available ton freight-kilometers, ATFK)

7,393

8,059

CARGO LOAD FACTOR (%)

65.9

67.4

WEIGHT OF CARGO CARRIED (in tons)

635,590

704,840

Average number FTEs of KLM Group staff

PERMANENT	TEMPORARY	EMPLOYED BY KLM	AGENCY STAFF	TOTAL KLM
28,801	1,201	30,002	1,874	31,876
28,968	1,447	30,415	1,928	32,343

Headcount KLM Group staff

PER END FINANCIAL YEAR

34,363

35,488

Review 2016: Reclaiming our position

In 2016, KLM rigorously executed its plan to become a flourishing airline. This brought a rich stream of innovations, organisational changes, new aircraft and service improvements, as well as tough decisions and turbulence. Here, the Board of Managing Directors discusses the many actions that ensured KLM is reclaiming its position in a highly competitive industry.

KLM's ambition is to become Europe's most customer-centric, innovative and efficient network carrier. This means that we invest in innovations that increase customer intimacy and improve operational performance. We aim for lower and more flexible cost, as well as higher productivity. In addition, we strive to optimise our position as a network carrier by operating a competitive intercontinental and European network.

Our strategy to realise this ambition focuses on two areas.

Our strategy to realise this ambition focuses on two areas. First, we invest in the renewal and upgrade of our fleet, customer satisfaction and better working methods. Second, we reduce our cost base and make it more flexible.

We intend to do this by increasing labour productivity by 4% per year and reducing our cost per unit by at least 1.5% a year. These goals are part of the AIR FRANCE KLM Group strategic plan Perform 2020. We aim to increase our operating margin from 1.8% in 2014 to ~ 7% - 8% in 2020. In 2016, our operating margin was 6.9%.

Investments paying off

In 2016, KLM made good progress towards these goals and in doing so reclaimed a position from where it could resume growth. "The strategy and plan we determined in 2015 is bearing fruit. We are leaner, faster, financially healthier and more focused. Our staff is empowered by our new direction and purpose, and is working together to realise our ambitions," says President & Chief Executive Officer Pieter Elbers.

Chief Financial Officer Erik Swelheim agrees with Elbers when he summarises the financial results of the year. These include an operating profit of EUR 681 million, an increase in labour productivity of 4.2%, a reduction of the cost per unit of 1.7% and a lowering of net debt from EUR 2.1 billion in 2015 to EUR 1.8 billion in 2016. KLM aims to reduce the cost per unit by at least 1.5% a year. In 2015 we saved EUR 73 million. In 2016 we added a saving of EUR 139 million. "KLM achieved all its financial targets for the year and we will continue on this path so we can invest more in the future of our company," Swelheim comments.

These investments are key to KLM's ability to compete in a tough environment and service customers who expect more at lower prices. That is why KLM Group invested some EUR 750 million, roughly double its 2012 level, in new services and the ongoing renewal of its fleet. This, in combination with a revitalised effort by our staff to service our clients, increased our Net Promoter Score from 38 in 2015 to 40 in 2016.

Operational excellence

In addition, we streamlined and renewed our way of working in operations. "After introducing it in 2015, this year we implemented Operational Excellence. This is our new guiding principle to improve safety, efficiency and results and to deliver on our customer promise at the lowest integral cost," Chief Operating Officer René de Groot explains.

Faster and more integrated decision-making and better integration between staff of different divisions translated into tangible results. "This year, we were able to fly to 14 new destinations with the same number of aircraft. Due to increased flexibility of our network and the increase in the number of passengers, our European network returned to profitability," De Groot adds. KLM also continued with the X-gates, a bold approach to innovation that develops and tests new services in the live environment of Schiphol's gates. In this respect we consider the reward for most punctual airline 2016 by FlightStats the crowning glory.

Unfortunately, the year offered a sobering reminder that not only operational safety but also occupational safety is of paramount importance.

Last year was marred by the death of a KLM colleague after a collision with a vehicle at Schiphol Airport. "We feel deeply saddened by the death of one of our own and will work ceaselessly to prevent fatal accidents from ever happening again," De Groot comments.

Other businesses

KLM's other businesses contributed to the overall positive results. Engineering & Maintenance helped KLM further densify and upgrade its fleet, while increasing work for third parties on engines and components. Cargo lowered fixed cost by further reducing its full freighter fleet, but invested in its pharma and express offering, a new cargo hub at Schiphol and digital services. Transavia, which celebrated its 50th anniversary, served 10% more passengers and added six destinations to its network.

High performance organisation

In 2016, KLM continued the renewal of its organisation. It largely implemented a High Performance Organisation, which aims for a leaner, more cost-effective and above all more customer-centric organisation. Furthermore, it trained 4,000 people in the use of KLM's Compass, which gives staff a common language for realising the company's purpose.

During 2016, the Transition Centre was opened for those employees whose position had become redundant. At the end of the year, it had supported some 250 colleagues in finding new employment, either within or outside KLM. "It is hard to leave and say goodbye to those colleagues who left KLM after being with us for many years, but it is a necessary step towards the High Performance Organisation we are creating," Elbers reflects.

Collective labour agreements

Apart from HPO, 2016 was also a dynamic year because of turbulent collective labour agreements. Following labour action by FNV union members in summer, all of the ground unions signed the new collective labour agreement. This stipulates new productivity enhancing measures, as well as an improved profit sharing scheme and a modest structural salary increase in 2018. In 2016 an amount of EUR 93 million was recorded for profit sharing with all our staff, which will be paid out for the larger part in 2017. KLM was unable to negotiate a new collective labour agreement for cabin crew in 2016. To achieve its 4% labour productivity improvement objective also in the cabin domain KLM unilatery had to reduce the number of cabin attendants by one on 40% of its intercontinental flights at the start of the winter schedule. In 2017, we hope to arrive at a mutually acceptable collective labour agreement with the cabin unions.

Pensions

Historically low interest rates, new central bank rules and general developments and trends in the market are forcing us to redesign our pension schemes. "This is inevitable if we are to continue to invest in our future", Swelheim argues. Fortunately, in 2016 we were able to reach an agreement on the transition to a new pension system for cabin crew, which is expected to be implemented in 2017. The pension fund for ground was already derisked for the biggest part, facilitated by changes in fiscal and pension legislation. For its cockpit crew, KLM felt obligated to one-sidedly cancel the pension agreement, which lead to many discussions. By year-end, KLM and the VNV pilots union came to a temporary solution and will resume negotiations in good faith in 2017. "I am glad that mutual trust has been restored," Elbers comments.

2017 and beyond

While 2016 has been a year of far-reaching changes that has given KLM new confidence and strength, there is absolutely no time for the airline to rest on its laurels. "Competition remains fierce and we are not yet where we want to be. So in 2017, we will continue investing and innovating, improving our performance and making our customers more enthusiastic about KLM," Elbers adds.

The Flight plan for 2017 is as ambitious as the 2016 one. KLM intends to speed up its fleet renewal, further roll out working methods based on the philosophy of operational excellence, expand its network, improve cargo financial performance and take further steps to reach the desired customer experience. "For me, the key is that each and every employee of KLM can and will contribute. It's the pioneering spirit in the hearts and minds of our staff that has got us this far and that will make us a flourishing airline again," Elbers says.

Pieter Elbers
CEO

Erik Swelheim
CFO

René de Groot
COO

The world we operate in

Our operating environment

In 2016, the ability of people to travel was influenced by geopolitical tensions, an increase in terrorist threats and fear of the spread of global pandemics. The effect of this on travel and tourism has been mixed. While some destinations received fewer international visitors, others have remained unaffected. Uncertainty with respect to the future persists and complex forces are at play. On the one hand, advanced economies face persistent low economic growth, while the growth of emerging markets is starting to decelerate. On the other hand, the world continues to become more interconnected and globalised and global air traffic grew again in 2016.

Industry trends

The airline industry is in flux due to a large number of trends. Breakeven load factors are highest in Europe, caused by low yields due to the competitive open aviation area and high regulatory cost. Low-cost carriers continue to grow in business- and city trips, while legacy airlines continue to develop their own low-cost offering.

North American airlines are doing well financially. However, the attractive transatlantic market is facing competition that negatively affects the already decreasing yield. In Asia, airfares continue to decrease. In China, leisure travel continues to grow strongly, while Chinese carriers are further expanding outside of China. Gulf carriers, meanwhile, continue to grow rapidly and Latin American weak home markets and currencies confront Latin American airlines. Africa is the weakest region and losses have emerged again due to regional conflicts and the impact of low commodity prices. Few airlines in this region are able to achieve adequate results.

According to the International Air Transport Association (IATA), capacity increased by 7%, meaning revenues are under pressure, particularly on routes to Asia, North America and Europe. Overall, and in particular due to favourable fuel prices in 2016, airlines have improved their profitability, resulting in higher investments in their products, fleet and networks.

In the air cargo industry, we have seen load factors sharply decline as capacity has outpaced demand for many consecutive years, although global demand for air cargo showed strong growth in the latter part of 2016. In the Engineering & Maintenance business growth in the components and engines markets will continue.

New technologies are disrupting the airline industry. The proliferation of handheld devices and social media is empowering consumers and encouraging the industry to become more transparent. Data in general and big data in particular are further catalysing this trend, which means the ownership of customer data and effective use of operational data will become increasingly important. In addition, safety and sustainability remain key issues in the airline industry.

Europe

KLM looks forward to the implementation of the Aviation Package, which the European Commission presented in 2015 in a bid to make the European aviation industry more competitive. KLM agrees with other European airlines that Europe needs to act on airport monopolies, high charges, taxation and inefficiencies in the aviation supply chain.

We encourage the government to create a level playing field, particularly with respect to security cost.

We support the European Commission's efforts to promote a level playing field for aviation within and outside the EU. We also look forward to the realisation of a Single European Sky, which could lower CO_2 emissions by 10% and reduce cost by EUR 8 billion per year through more efficient flight routes. KLM thinks that it is encouraging to see that a great number of countries agreed within the International Civil Aviation Organisation to let airlines grow CO_2 neutral as of 2020 under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). It is our expectation that beyond 2020 global CORSIA will replace the EU Emission Trading System for aviation.

KLM supports regulations that protect passenger rights. Customers are at the heart of KLM's business. Safety, punctuality and reliability are important to us. In case of unforeseen events, KLM takes all measures necessary to minimise the inconvenience for passengers. We are, however, concerned that the existing regulation EU 261/2004 burdens the airline industry with unreasonably high cost. Uniform enforcement and interpretation of the revised regulation is essential across Europe. KLM continues to call upon the EU to create a more balanced approach of passenger rights.

Safety

In 2016, the airline industry was shocked and saddened by terrorist attacks on the Brussels and Istanbul airports. KLM remains vigilant when it comes to the safety of its passengers and crew. That is why KLM and a number of other Dutch industry partners in 2016 signed a covenant with the Dutch government to improve the sharing of security information. The covenant was developed in response to the tragedy with flight MH17 in 2014.

Schiphol and the local community

KLM is proud of the significant role it plays in the Dutch economy. In 2016, KLM was the third-largest private employer in the Netherlands, while the Dutch aviation industry accounts for some 300,000 jobs and contributes EUR 30 billion to the country's gross domestic product including catalytic effects. Amsterdam Airport Schiphol, of which KLM is the largest user, is Europe's largest airport in terms of number of air traffic movements and ranks third in terms of passengers. Amsterdam Airport Schiphol together with the KLM network are major contributors to the country's attractiveness to foreign investments.

In 2016, various initiatives aiming at growth, including the airline award program, made Schiphol attain the largest growth of all European airports. The number of passengers went up to 64 million, which is 4 million more than projected.

The number of air traffic movements increased with 6.3% to 478.864 air traffic movements. Due to this ongoing growth policy of Amsterdam Airport Schiphol and with that the foreseeable growth, it is expected that the ceiling of 500.000 air traffic movements, set for 2020, will already be reached in 2017.

Last year's growth at Schiphol however outpaces the required infrastructure improvements to facilitate this growth. As a consequence, KLM Group and partners experienced several operational challenges at Schiphol with a negative impact on the operational performance. We are facing several capacity constraints like gate and buffer shortages, as well as a shortage of border control and security capacity, making operations less efficient and less customer friendly.

Since we are also facing increasing congestion in Departure Hall 1 as well as at Security Filter 1, we are working together with Schiphol to build a temporary terminal on top of the South basement for additional KLM check-in capacity. This terminal will be ready in April 2017 and remain operational for three years.

In 2016, we continued to invest in and innovate at Schiphol. KLM is eagerly awaiting the intended upgrade of Schiphol train station and surrounding infrastructure. This will increase the accessibility of the airport to our passengers. We made a large investment in a state-of-the-art renewed cargo building, which enables us to handle mail and packages more efficiently. The facility should be up and running by the second half of 2017.

We encourage the government to create a level playing field, particularly with respect to security cost, which have risen 51% between 2003 and 2015. Currently, the Dutch government is requiring airlines to bear the cost of security, which in the case of KLM amounted to EUR 150 million in 2016. We expect these cost to rise over the next few years due to geopolitical events and international regulations. A structural reduction of security cost in line with those for airlines on other large airports is key to keeping all airlines operating from Schiphol competitive.

Flight Plan 2016

Each year, KLM translates its overall strategy and long-term goals into a Flight Plan. The following part of the annual report describes the year's actions and achievements for each of the five pillars of our Flight Plan, which are Customer & Product, Network & Fleet, Operations, People & Organisation and Finance.

Customer & Product

Network & Fleet

Operations

People & Organisation

Finance


KLM Royal Dutch Airlines

"People will not remember
what you did or said,
but will always
remember how you
made them feel."

–

Maya Angelou

(American Writer)

Customer & Product

In 2016 KLM stepped up investments in customers and products. We brought our purpose to life among our staff, empowered them to give customers a better experience and invested in products and services so as to make our customers feel recognised, comfortable and touched. An increase in the Net Promoter Score indicates the revamped customer intimacy strategy is bearing fruit.

Again, in 2016, KLM continued its lead in the field of social media

Along with its new company strategy in 2015, KLM took its customer intimacy strategy to the next level. To this end, KLM invested some EUR 2 million a day in new products, equipment and services, servicing customers along the entire customer journey. In 2016, KLM embedded a culture that fit our desired customer experience and more closely aligned the work of frontline staff with our operations. The KLM Compass that was launched this year outlines the importance we give to customers.

Customers

All frontline staff at Schiphol Airport and 9,500 staff on board our aircraft received a tablet, which allows them to better service customers, such as providing information about connecting flights, handling complaints or making payments with *Flying Blue* miles. The introduction of tablets also enabled us to introduce e-recovery, which means cabin crew can compensate customers for problems on board, such as the unavailability of a (special) meal, faulty seats or a glitch in the inflight entertainment system. Using their tablets, cabin crew can award frequent flyer miles, paid services, or a voucher for tax-free goods.

We rolled out *Gifts for Care*, which empowers staff to hand out small gifts to customers for meaningful events like birthdays and anniversaries. Such changes allow our staff to make our customers feel more recognised and valued. Furthermore, we upgraded the catering on all European flights and said farewell to paper-based flight plans and journey logs, switching instead to a specially developed app on the pilots' iPad.

Again, in 2016, KLM continued its lead in the field of social media with the introduction, as the first airline, of services via Facebook Messenger.

As a result, the Net Promoter Score (NPS), which is the comparison between the number of satisfied customers who are likely to recommend KLM and those who are likely to give negative word-of-mouth, continued to improve. In 2015, the NPS rose from 35 to 38 and in 2016 this upwards trend led to an all-time high of 43 in October and year-end result of 40. The goal for 2017 is to achieve an NPS of 42.

Investments in products

This excellent Net Promoter Score was clearly supported by investments in our fleet. KLM's eight new Boeing 787 Dreamliners provide customers with WIFI, a state-of-the-art inflight entertainment system, a more comfortable cabin climate and a more modern look. We increased the share of flatbeds in business class from 60% in 2015 to 77% in 2016. Furthermore, KLM completed the renewal of the interior of the World Business Class and Economy Class of all 15 Boeing 777-200 aircraft. They sport a modernised inflight entertainment system, full-flat seats in World Business Class and seats with extra legroom in Economy Class. Lastly, KLM almost completed the metamorphosis of its Boeing 777-300 fleet, consisting of 12 aircraft. In 2017, we will begin installing flat beds on our remaining A330-300 and A330-200 aircraft, so we will have 100% flatbeds by the end of 2018. The new Embraer 175, servicing the KLM Cityhopper network in Europe, is a comfortable and efficient aircraft that replaces the Fokker 70.

We continued to renovate our flagship World Business Class lounge at Schiphol. The lounge, which is scheduled for opening in 2018, will be completely redesigned and reorganised around our customers' journey.

"Difficult roads often lead to beautiful destinations."

–

Author unknown

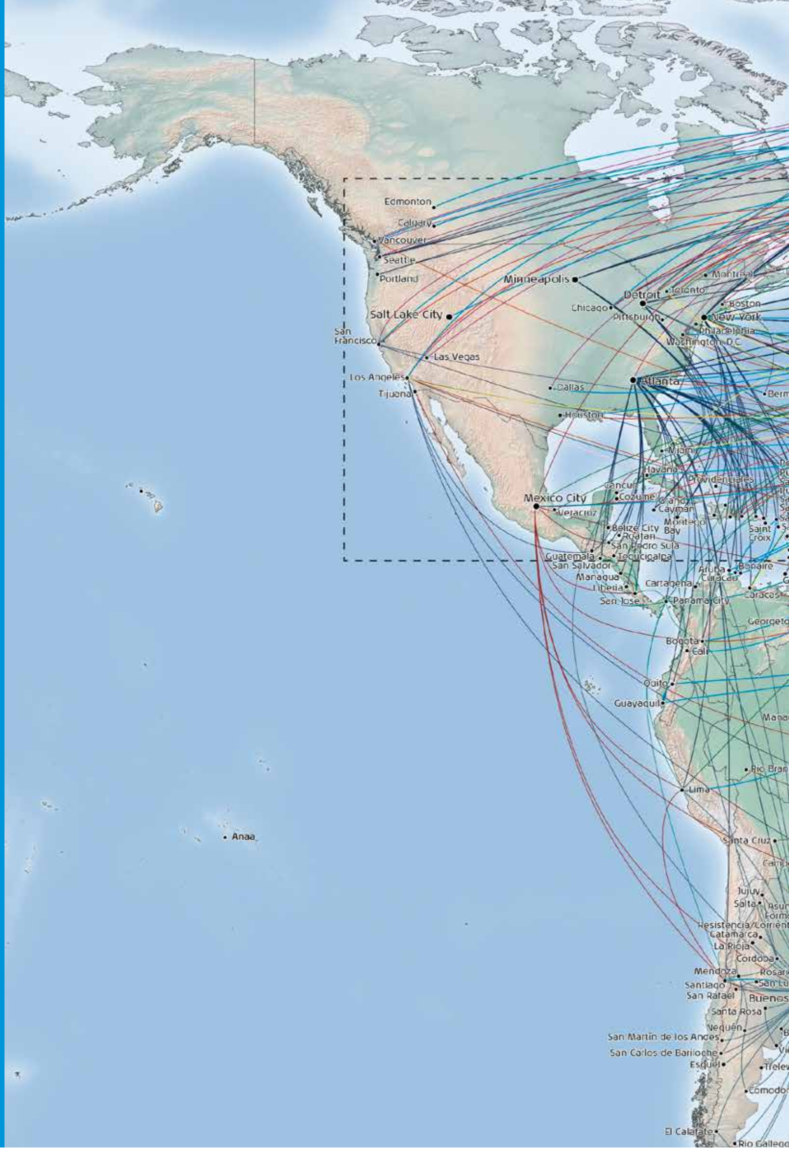
Network & Fleet

KLM's renewed focus and vigour were perhaps most clearly apparent in the rapid expansion of its network and the continued renewal of its fleet.

Network

KLM's purpose is to move the world of our customers and create memorable experiences for them. We guide people to their destinations, catalyse trade, and connect partners into an effective global network. This is the foundation of our strength. In 2016, we achieved the historic milestone of moving more than 30 million passengers to 148 destinations; Together with our partners, we provided direct routes to more than 190 destinations.

For the first time in years, our European network returned to profitability.



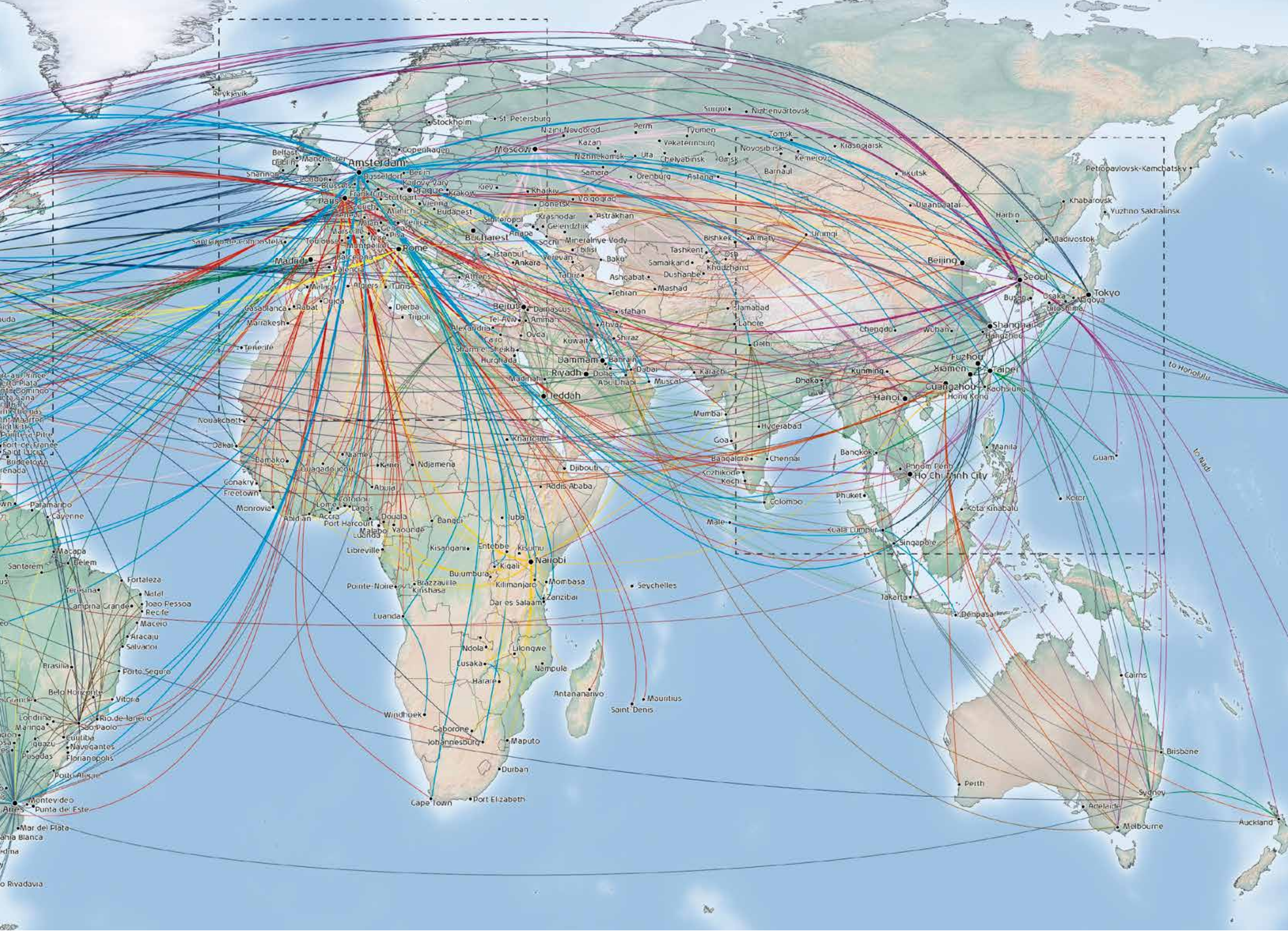
KLM expanded its European and intercontinental network with a record-breaking 14 new destinations. These include Southampton and Inverness (United Kingdom), Dublin (Ireland), Dresden (Germany), Genoa (Italy), Valencia, Ibiza (summer peak only) and Alicante (Spain). Intercontinentally, supported by new aircraft, we also resumed services to Teheran (Iran) after a three-year absence and opened Salt Lake City, Miami (United States), Astana (Kazakhstan), Windhoek (Namibia) and Colombo (Sri Lanka). Miami and Colombo are winter seasonal destinations to develop more leisure-oriented markets and increase fleet utilisation. KLM increased the number of flights on several destinations, such as Buenos Aires, Kuala Lumpur, Cape Town and Havana. KLM suspended flights to Cairo, Fukuoka, Dallas and Cologne (Germany).

The expansion of KLM's network will continue with 12 new destinations envisaged by the end of 2017. In order to facilitate this growth, KLM intends to take on 400 new cabin attendants and 100 new pilots. Some of these destinations are serviced in partnership with Transavia. This fits with our objective of enhancing commercial cooperation with Transavia in order to offer customers more choice.

For the first time in years, our European network returned to profitability. Aircraft utilization further increased in the summer season. Shorter turnaround times and maintenance seasonality in combination with smarter integral crew planning increased the efficiency of the network. Unit cost were further improved by seat densification. Higher revenues were achieved through enhanced revenue management, more flexible network planning and a further strengthening of the network hub structure.

Fleet

KLM accelerated the renewal of its fleet with the arrival of six new Boeing 787 Dreamliners and two new Boeing 777-300s, which offer more comfort and fuel efficiency. Two A330-200s and five Boeing 747s were phased out in 2016. In addition, we received four Embraer 175 aircraft, which are part of our program to replace all our Fokker 70s with modern Embraers. Transavia added seven new B737-800s to its fleet, partly to replace older aircraft. The modernisation of our fleet has lead to a reduction in the average age of KLM's long-haul fleet from 13 years at the end of 2014 to 11 years at the end of 2016. This not only boosts customer satisfaction, but also means lower cost and lower fuel consumption.



KLM Cityhopper

KLM Cityhopper, which operates a large part of KLM's European network and which celebrated its 50th anniversary, experienced growth on a number of levels. It added five destinations to its network and reduced turnaround times at our outstations, leading to lower cost per unit, higher asset utilisation and growth. The arrival of the more fuel-efficient Embraer 175 marked a new phase in the renewal of KLM Cityhopper's fleet of Fokker 70s, which will be completed late 2017.

Alliances

Co-operation with partners allows us to strengthen and expand our extensive network and contribute to the strength of our Schiphol hub. Our partner strategy has two main building blocks. First, KLM's participation in the Trans-Atlantic joint venture with Air France, Delta Air Lines and Alitalia. Second, our joint ventures with Kenya Airways, Alitalia, Ukraine International Airlines, China Southern Airlines and Xiamen Airlines and the recently concluded joint venture with China Eastern Airlines. Particularly due to the hub-to-hub and US West Coast operations, the Trans-Atlantic joint venture achieved positive financial results in 2016, in spite of fierce competition and new low-cost entrants on the North Atlantic Europe routes.

Our partnership with GOL showed good results. We are enhancing the partnership both in the commercial and customer experience fields, in order to remain the first choice for each customer segment traveling between South America and Europe. Kenya Airways experienced a challenging year, and in our role as shareholder and joint venture partner, KLM fully supports the restructuring efforts. In 2015, Alitalia announced that it would refrain from renewing the existing partnership agreement, the cargo joint venture and the two European joint ventures with AIR FRANCE KLM. These partnerships have expired by the end of 2016. The Trans-Atlantic joint venture between AIR FRANCE KLM, Alitalia and Delta Air Lines remains in place.

The partnership with China Southern Airlines and its subsidiary Xiamen Airlines performs well. We have a joint venture on 6 routes and about 40 codeshare destinations beyond KLM's gateways in China, supporting KLM's operations in Greater China, including Hong Kong and Taiwan. Together with China Southern Airlines and Xiamen Airlines, Amsterdam remains the leading gateway from Europe to China and from China to Europe with eight destinations served non-stop from Amsterdam. Together with its partners, KLM offers 67 flights a week to Greater China.

In 2016, we celebrated the 20th anniversary of our partnership with China Southern Airlines. In these two decades, China Southern Airlines and KLM serviced 18 million passengers between Amsterdam and Greater China. Our goal is to create a joint venture with our Chinese partners just as we have with Delta Air Lines on the North Atlantic.

In December 2015, KLM and Delta Air Lines announced an extensive code sharing agreement with India's Jet Airways, which began when Jet Airways transferred its European hub from Brussels to Schiphol in March 2016. The partnership lead to a substantial exchange of customers between the airlines' networks and in September 2016 the cooperation was extended to include more codeshare destinations in North America and India.

		Included in balance sheet				
		Average age in years *	Owned **	Finance leases	Operating leases ***	Total
Consolidated fleet as at December 31, 2016						
Boeing 787-9	wide body	0.7	-	1	7	8
Boeing 747-400 PAX	wide body	24.1	6	-	-	6
Boeing 747-400 Combi	wide body	22.7	11	-	-	11
Boeing 747-400 ER Freighter	wide body	13.5	3	-	-	3
Boeing 747-400 BC Freighter	wide body	-	-	-	1	1
Boeing 777-300 ER	wide body	5.9	-	9	3	12
Boeing 777-200 ER	wide body	12.1	3	5	7	15
Airbus A330-300	wide body	-	-	-	5	5
Airbus A330-200	wide body	10.8	-	6	2	8
Boeing 737-900	narrow body	13.9	1	1	3	5
Boeing 737-800	narrow body	11.7	9	9	36	54
Boeing 737-700	narrow body	8.8	3	8	15	26
Embraer 190	regional	6.3	-	15	15	30
Embraer 175	regional	0.5	-	4	-	4
Fokker 70	regional	20.8	11	-	-	11
Training aircraft		-	4	-	-	4
Total consolidated fleet		12.5	51	58	94	203

* Excluding operating leases and training aircraft. The average age including operating leases is 10.2 years
** Excluding 2 Fokker 70, 1 B747-400 Pax and 2 B747-400 not in operation as per December 31, 2016
*** Excluding 1 Boeing 737-800 (subleased) not in operation as per December 31, 2016

Fleet composition

Boeing 777-300/200ER

Number of aircraft	12/15	Maximum passengers	408/316
Cruising speed (km/h)	920/900	Total length (m)	73.86/63.80
Range (km)	12,000/11,800	Wingspan (m)	64.80/60.90
Max. take-off weight (kg)	351,543/297,500	Personal inflight entertainment	

Boeing 747-400 Passenger/Combi

Number of aircraft	6/11	Maximum passengers	408/268
Cruising speed (km/h)	920	Total length (m)	70.67
Range (km)	11,500	Wingspan (m)	64.44
Max. take-off weight (kg)	390,100/396,900	Personal inflight entertainment	
Max. freight (kg)	35,000		

Boeing 747-400ER Freighter

Number of aircraft	3	Maximum freight (kg)	112,000
Cruising speed (km/h)	920	Total length (m)	70.67
Range (km)	11,500	Wingspan (m)	64.44
Max. take-off weight (kg)	412,800		

Airbus A330-300/200

Number of aircraft	5/8	Maximum passengers	292/243
Cruising speed (km/h)	880/880	Total length (m)	63.69/58.37
Range (km)	8,200/8,800	Wingspan (m)	60.30/60.30
Max. take-off weight (kg)	233,000/230,000	Personal inflight entertainment	

Boeing 787-9 Dreamliner

Number of aircraft	8	Maximum passengers	294
Cruising speed (km/h)	920	Total length (m)	62.80
Range (km)	15,100	Wingspan (m)	60.10
Max. take-off weight (kg)	252,650		

Boeing 737-900

Number of aircraft	5	Maximum passengers	188
Cruising speed (km/h)	850	Total length (m)	42,12
Range (km)	4,300	Wingspan (m)	35.80
Max. take-off weight (kg)	76,900		

Boeing 737-800/700

Number of aircraft KLM	25/18	Maximum passengers	186/142
Number of aircraft Transavia	29/8	Total length (m)	39.47/33.62
Cruising speed (km/h)	850/850	Wingspan (m)	35.80/35.80
Range (km)	4,200/3,500		
Max. take-off weight (kg)	73,700/65,317		

Embraer 190/175

Number of aircraft	30/4	Maximum passengers	100/88
Cruising speed (km/h)	850/850	Total length (m)	36.25/31.68
Range (km)	3,300/3,180	Wingspan (m)	28.72/28.65
Max. take-off weight (kg)	45,000/47,790/37,500		

Fokker 70

Number of aircraft	11	Maximum passengers	80
Cruising speed (km/h)	743	Total length (m)	30.91
Range (km)	2,400	Wingspan (m)	28.08
Max. take-off weight (kg)	38,000		

"If you want to go fast go alone if you want to go far go together."

—

African Proverb

Operations

KLM in 2016 translated its renewed strategy into a leaner, more integrated and more agile operation that has enabled the company to fly to more destinations with the same number of aircraft, increase customer appreciation and improve punctuality. KLM is proud that it has been named the most punctual airline of the world by FlightStats in 2016.

One of KLM's main achievements in 2016 was the implementation of the Operational Excellence philosophy and replacement of our process management approach to operations with a more integrated way of working and a redesign of our internal processes. In practice, this means that choices and decisions are made in an integral way and that the staff from various divisions will work closely together to align efficiency targets and NPS goals in the joint pursuit of realising our purpose.

Two integral teams, focussing on Intercontinental and European flights, now work on the structural improvement of the performance of the European and Intercontinental network. This radical move allowed us to scrap no fewer than 20 different operational meetings, which increased the focus and energy of our staff.

In similar vein, we took full advantage of our X-gates. This approach to innovation, unique in the airline industry, sees service and process prototypes being developed and tested in a live environment with staff from different departments working together. After introduction in September 2015 at three gates at Schiphol, we now tested several prototypes and were able to improve our services. Our first X-product was the Load Tool, which results in fewer baggage-related delays when passengers do not board their flights. In 2017, we intend to introduce this methodology across all our operational processes.

We conducted a successful pilot that saw us reduce the turnaround time of a Boeing 737-800 by 10 minutes, which enabled us to fly to more destinations in Europe with the same number of aircraft. Because of these and other efforts, our European network returned to profitability for the first time in years.

Our digitisation efforts are bearing more and more fruit, not only for customers, but also in terms of our internal working procedures. In 2016, the Digital Studio was opened, a nursery for digitisation in operational processes.

Safety and security

Safety and security are fundamental elements of our operations and a prerequisite for customer satisfaction and loyalty. KLM strives towards the best practices through an Integrated Safety Management System (ISMS), which focuses on operational, occupational and environmental safety, as well as operational security. The establishment of the Integrated Safety Service Organisation in October 2016 will further professionalise the integrated approach of safety and compliance throughout the company. In 2016, we organised two safety trainings, each stressing various safety topics. Also in 2016, KLM was rewarded safest European Airline and ranked fifth worldwide by the German Jet Airliner Crash Data Evaluation Center (JACDEC).

Traffic and capacity

Passenger	Passenger kilometers			Seat kilometers			Load factor	
In millions	2016	2015	% Change	2016	2015	% Change	2016 %	2015 %
Route areas								
Europe & North Africa	17,219	15,897	8.3	20,428	19,343	5.6	84.3	82.2
North America	20,344	19,691	3.3	22,888	22,145	3.4	88.9	88.9
Central and South America	13,632	12,985	5.0	15,500	14,902	4.0	87.9	87.1
Asia	26,607	25,955	2.5	29,973	29,540	1.5	88.8	87.9
Africa	10,648	10,202	4.4	12,407	12,092	2.6	85.8	84.4
Middle East	3,618	3,473	4.2	4,540	4,331	4.8	79.7	80.2
Caribbean and Indian Ocean	5,669	5,025	12.8	6,328	5,498	15.1	89.6	91.4
Total	97,737	93,228	4.8	112,065	107,851	3.9	87.2	86.4

Cargo	Traffic			Capacity			Load factor	
In million cargo ton-km	2016	2015	% Change	2016	2015	% Change	2016 %	2015 %
Route areas								
Europe & North Africa	22	24	(8.3)	337	337	-	6.5	7.1
North America	1,058	1,109	(4.6)	1,707	1,759	(3.0)	62.0	63.0
Central and South America	1,136	1,206	(5.8)	1,724	1,773	(2.8)	65.9	68.0
Asia	1,645	1,998	(17.7)	1,965	2,480	(20.8)	83.7	80.6
Africa	790	876	(9.8)	1,175	1,245	(5.6)	67.2	70.4
Middle East	150	149	0.7	250	251	(0.4)	60.0	59.4
Caribbean and Indian Ocean	71	67	6.0	236	214	10.3	30.1	31.3
Total	4,872	5,429	(10.3)	7,393	8,059	(8.3)	65.9	67.4

Other businesses

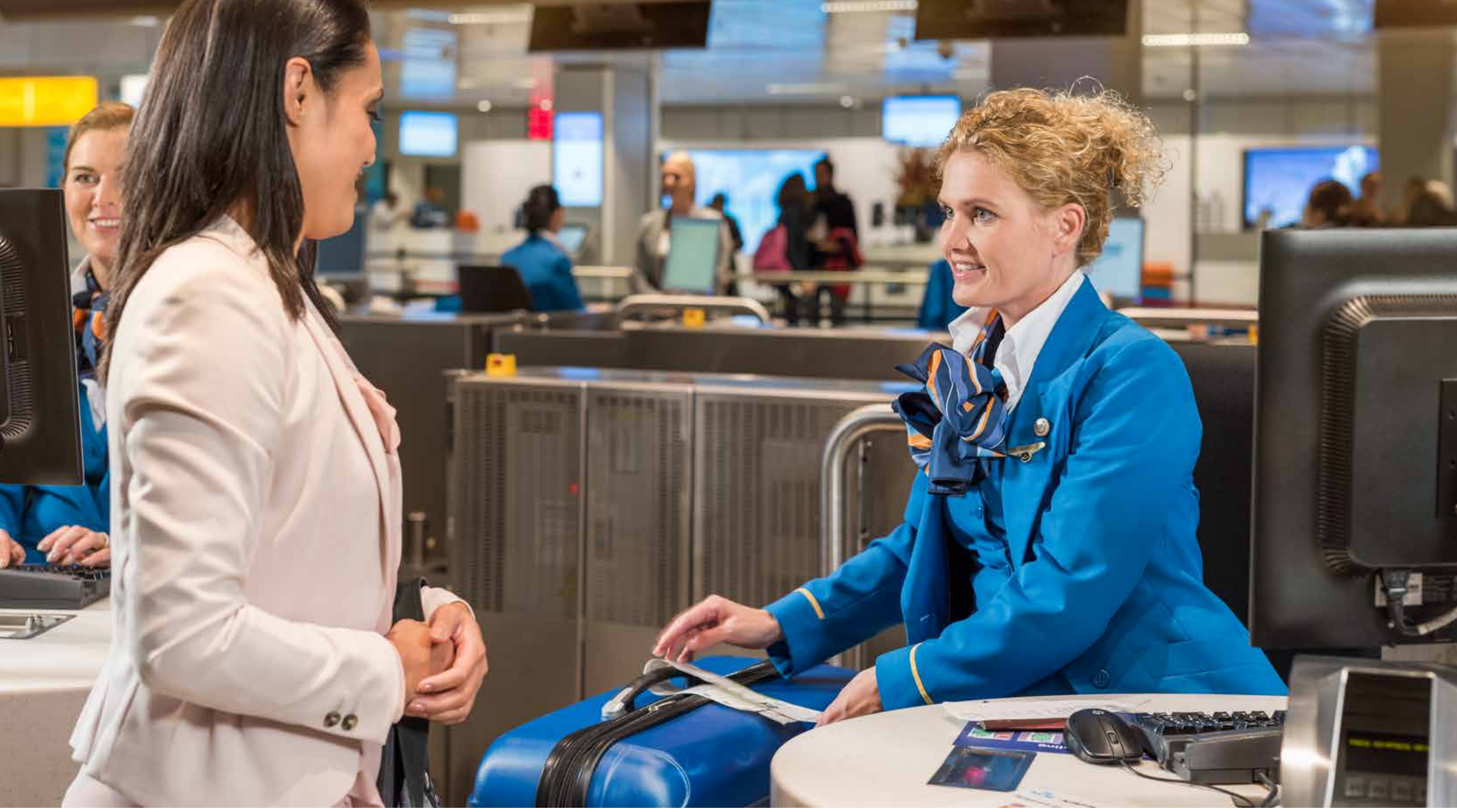
KLM's Passenger Business is complemented by our activities in Cargo, Engineering & Maintenance and Transavia. All three businesses performed better in 2016.

Cargo

The air cargo market experienced further pressure on load factors and prices due to fierce competition from Middle Eastern carriers and overcapacity. In response, we reduced our cargo fleet by three more aircraft, thereby lowering fixed cost. This means we will begin 2017 with a fleet of four full freighters, supplemented by the main deck capacity of 11 Boeing 747 Combi aircraft and the bellies of the other long-haul aircraft. Our full freighter network at Schiphol will concentrate on Africa and North, Central and South America. These and other focussed improvement measures will allow Cargo to remain an important player in the market.

Pharma and Express are important growth segments in air cargo. We strengthened our offer in Pharma by implementing full compliance with the guidelines for proper distribution of medical products and by investing in cool storage and specialised active container handling. For Express, we redesigned Freight Building 1, integrated our mail and express handling units and began installing a state-of-the-art sorting system. We also sharpened our commercial segmentation and introduced a loyalty program for small and medium-sized customers.

In order to be more efficient and responsive to our customers' needs, we began to implement the High Performance Organisation at our Schiphol operations, including a new central Cargo Control Centre. We embarked on a complete renewal of our backbone IT system, implemented a first release in 2016 and began working on a second release scheduled for 2017.



We are strengthening Schiphol as a cargo hub through digital developments. Together with industry and government partners, we are streamlining operational flows at Schiphol, including security and customs control.

Engineering & maintenance

KLM's Engineering & Maintenance business was key to the rejuvenation and improvement of our fleet. It launched a connectivity project on board of our long-haul flights. Furthermore, it started with the preparation of the seat densification and improvement of the business class on the Airbus 330 series and finalised the seat densification on the Boeing 737. Further steps were made with the phase in of new Boeing 787s and the phase out of Boeing 747s.

Engineering & Maintenance added several innovations to its portfolio of engineering capabilities. This includes the development and application of apps needed for the robotisation of engine maintenance and digitisation of cabin maintenance. It also started using big data analysis to predict engine maintenance.

Engineering & Maintenance contributed to KLM's financial result through revenues from third party contracts on engines and components as well as line maintenance. After the first quick turns on the Boeing 787 (GEnx) engines, it added its first new contract with Xiamen Airlines for Boeing 787 engine maintenance. Oman Air and Corendon Airlines were welcomed as new engine maintenance customers.

Finally, Engineering & Maintenance made first steps with a Boeing partnership on component support for the Boeing 737-MAX for customers Norwegian Air and TUI Airlines. We signed a long-term maintenance contract with Ethiopian Airlines for its Boeing 737-NG for all-round support of its operation, including part repairs and fast-track access to the Boeing 737 spares pool.

Transavia

Transavia celebrated its 50th anniversary in 2016 with a return to profitability on the back of low fuel prices and the improved performance of its operation in the Netherlands. The low-cost brand increased the number of passengers by 10%, added five new destinations to its European network, added seven new B737-800s to its fleet and increased productivity.

Transavia furthermore enjoyed better on time performance, renegotiated the lease of some of its aircraft and improved its offering to business travellers. In addition, Transavia adopted lean and agile processes, which increased efficiency and sped up innovation. It also continued to invest in its digital capabilities and became the first airline to use WhatsApp as its main customer service channel.

Transavia's transformation from a charter company to a modern point-to-point airline was ahead of schedule in 2016 and is expected to be completed in 2017. While charters accounted for 60% of flights in 2014, that number was reduced to 12% in 2016. At the beginning of 2017 it was decided to discontinue flights from the Munich hub as per the end of October 2017. Within the context of AIR FRANCE KLM project "Trust Together"emphasis will be given to the development of Transavia Netherlands out of its home market, strengthening its position as the leading low cost carrier in the Netherlands.

Transavia has a number of challenges ahead in 2017. The company aims to serve 12% more customers with 10% fewer ground staff and the company will need to renegotiate collective labour agreements with ground, cabin and pilot unions. Also in 2017 five new B737-800s will be entering the fleet.

Corporate social responsibility

KLM evaluated its Corporate Social Responsibility (CSR) strategy in 2015 and executed a more focused plan in 2016 that aligns with the company's targets and our purpose to move our customer's world. We ended our co-operation with UNICEF and the Worldwide Nature Fund, and focused on actions with a direct impact on our own operations and our customers' journey. Our efforts focused on the renewal of our fleet, operational measures, the adoption of biofuels and offsetting CO_2 emissions.

KLM, which in 2008 became the first airline with a climate change strategy, is committed to reducing its CO_2 emissions per passenger by 20% in 2020 compared to 2011 levels. In 2016, we reduced our emissions by 3% compared to 2015, in part because of the delivery of more fuel-efficient aircraft. The Dreamliners that joined our fleet generate 35% less CO_2 than the aircraft they replaced, while the new Embraer 175 has 35% lower emissions compared to the old Fokker 70. KLM compensated 632,000 tonnes of CO_2 in 2016 through the European Trading System, while our passengers offset 19,000 tonnes through our customer-offset program.

KLM was a key supporter of the historic agreement reached in October 2016 by the International Civil Aviation Organisation, a UN agency, to mitigate carbon emissions for the global airline industry. Some 60 countries committed to carbon neutral growth of the industry from 2020 onwards by using carbon offset measures between 2021 and 2035. KLM believes that only this global approach is more effective and creates a level playing field for all airlines, and that national or European systems should not be further pursued, once the global system is in place.

We were proud that AIR FRANCE KLM was ranked the world's most sustainable airline by the Dow Jones Sustainability Index for the 12th time in a row, although we ceded the top position in the overall Transport category to Dutch postal agency Post NL.

KLM struck a three-year deal to use biofuel on its flights from Los Angeles. This fuel is produced locally and is mixed in with Los Angeles airport's regular kerosene supply, as today it is still prohibitively expensive to fly an aircraft on biofuel only. The biofuel program is made possible by members of our Corporate BioFuel Program, which in 2016 was joined by ABN AMRO and the Dutch Ministry of Infrastructure and the Environment.

Looking ahead, KLM will continue to contribute to a more sustainable environment. We determined minimal requirements to meet our goal of offering responsible catering experience. Our goal is also to conform to Dutch legislation that calls for a 50% reduction of residual waste by 2025.

Overview of significant KLM participating interests

As at December 31, 2016

Subsidiaries	KLM interest in %
Transavia Airlines C.V.	100
Martinair Holland N.V.	100
KLM Cityhopper B.V.	100
KLM Cityhopper UK Ltd	100
KLM UK Engineering Ltd	100
European Pneumatic Component Overhaul & Repair B.V.	100
KLM Catering Services Schiphol B.V.	100
KLM Flight Academy B.V.	100
KLM Health Services B.V.	100
KLM Equipment Services B.V.	100
Cygnific B.V.	100
Jointly controlled entity	
Schiphol Logistics Park C.V.	53 (45% voting right)
Associate	
Kenya Airways Ltd.	27
Transavia France S.A.S.	40

"Each and every one of us can make a differene. Together we make change."

–

Barbara Mikulski

(longest sitting female senator in the USA)

People & organisation

With clear resolve and dialogue in mind, KLM made significant headway with the new organisational structure and culture it designed in 2015. The High Performance Organisation (HPO) was implemented in large parts of the organisation, collective labour agreements were negotiated and steps towards future-proof pensions were made. While these changes were tough, they also boosted clarity and confidence across KLM, which ended the year in a much better shape.

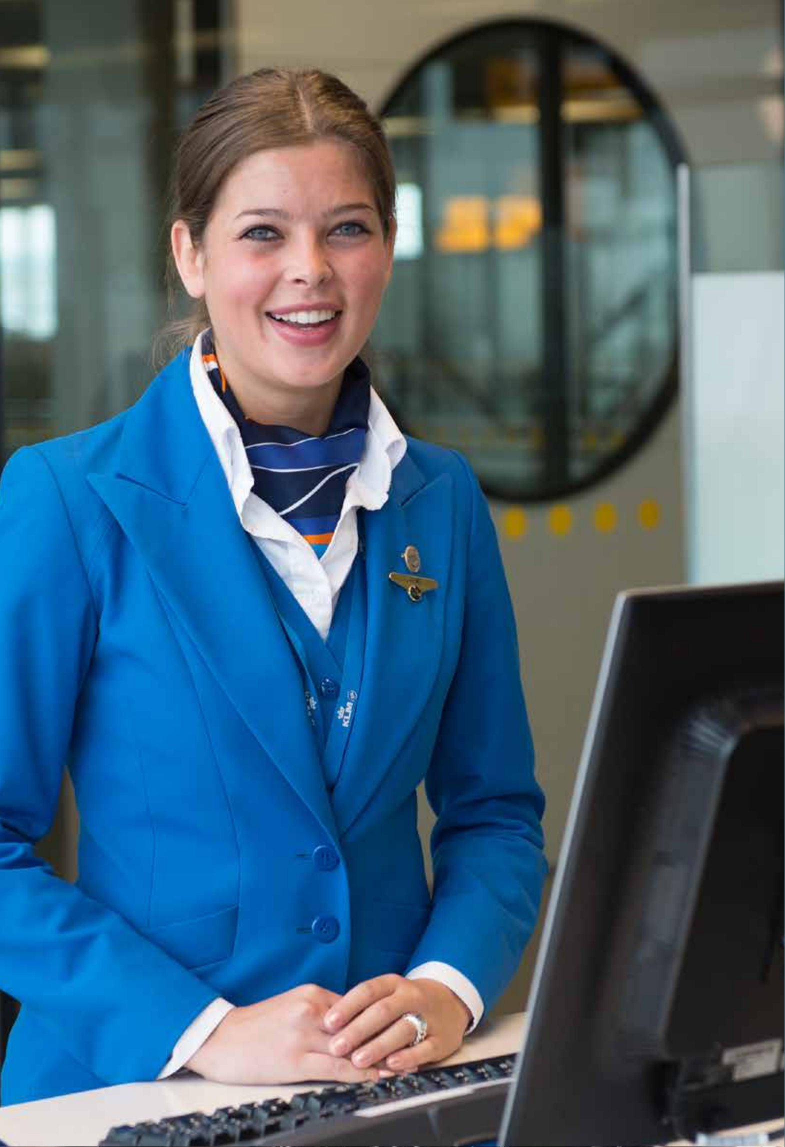
As part of its ambition to become Europe's most customer-centric, innovative and efficient network carrier, KLM designed in 2015 the HPO. In close co-operation with the Works Council, this has been fully implemented in eight parts of the organisation, with five more in the process of being implemented.

HPO aims for a leaner, more cost-effective and above all more customer-centric organisation through fewer management layers, clustered and centralised support services and digital services. This will serve as the foundation of a more energised, focused and streamlined organisation with fewer procedures and more empowered staff.

The ground unions signed a new collective labour agreement, stipulating new productivity-enhancing measures.

The implementation of HPO unfortunately led to the departure of colleagues, a painful loss for those involved. In 2016, some 250 colleagues were supported by the Transition Centre, which was established to help them finding new employment inside or outside of KLM. In 2016, some 130 collegues successfully transferred to another job, half of them within KLM, the other half outside KLM.

New collective labour agreement negotiations were another dominant theme for 2016. The ground unions signed a new collective labour agreement, stipulating new productivity-enhancing measures as well an improved profit sharing scheme and a modest structural salary increase in 2018. We were not yet able to negotiate a new collective labour agreement for cabin crew in 2016, but hope to arrive at a mutually acceptable one in 2017. For cockpit, we already negotiated a collective labour agreement in 2015.



A lot of work has been done in the area of pensions. A historical agreement was reached on the transition to a new pension system for cabin crew, which is expected to be implemented in 2017. KLM and the pilot union VNV, during the second half of 2016, had intense discussions on the de-risking of pensions that also resulted in two court cases. By the end of 2016, it was agreed to resume negotiations in good faith in 2017.

Culture change

In 2016, some 4,000 staff were immersed in a KLM Compass workshop that inspired them to work together towards greater efficiency and customer satisfaction. We target about 18,000 people to participate in these workshops, so that our purpose will guide our behaviour and working climate.

The KLM Compass outlines behaviours that apply to internal customers as much as they do to external ones. In 2016 the new HR Shared Services Centre, which has 30,000 internal KLM clients, started working in line with the Compass. To measure engagement as well as the underlying causes of engagement, we ran an Employee Promoter Score pilot. If deemed successful, this will be rolled out across the whole of KLM in 2017.

*"Great things
are done by
a series of
small things
brought together."*

—

Vincent van Gogh

Finance

KLM achieved its financial targets for 2016 because it diligently executed its plans. By innovating, investing and streamlining the organisation, KLM increased profit and productivity, cut cost and bolstered the company's ability to grow. With financial results improvement ahead of plan, KLM confirmed it is on the right path to health and vitality.

In 2016, KLM achieved an operating income of EUR 681 million on a turnover of EUR 9.8 billion. We were able to increase the investment level to more than EUR 750 million and mainly invested in fleet. On balance net debt, which was EUR 2.1 billion in 2015, lowered to EUR 1.8 billion at the end of 2016. The adjusted net debt/EBITDAR ratio improved from 3.6 to 2.9. Free cash flow amounted to EUR 378 million. Unit cost went down by 1.7%. Furthermore, KLM managed to realise its target of 4% annual labour productivity increase.

These financial results strengthened due to a strong performance across the entire KLM organisation. We improved the results of our passenger business, whereby the European network returned to profitability on the back of shorter turnaround times, densification of the fleet and fleet renewal. Cargo reduced its cost per unit through decrease of capacity. Engineering & Maintenance saw third-party work increase to the point where it accounts for half of all work. Transavia posted overall positive results in spite of losses incurred related to the launch of the new Munich hub.

In 2015, KLM already saved EUR 73 million cost while in 2016 we added EUR 139 million of savings. This contributed, in addition to the lower fuel prices, to a positive operating income development. The High Performance Organisation sliced off an average of two management layers, while the cost of Schiphol Airport, maintenance and external suppliers was reduced. KLM began the task of reducing its office footprint by emptying buildings.. As part of efforts to focus our portfolio around core activities, Cobalt our British handling operation was sold. In 2016, the first financial benefits of various digitisation initiatives became tangible.

As part of our financial risk management framework, also in 2016 KLM conducted going concern analyses including scenario and sensitivity analyses. These analyses reconfirmed the insights into the most important risks and led to the conclusion of the Board of Managing Directors that -based on the information available and analyses performed- there is no foreseeable reason to expect that the financial going concern of KLM is at stake in the next twelve months.

In order to secure our long-term financial health, we began to modernise our pensions in 2016. Historically, low interest rates and new government regulations mean that, without changes, KLM could be forced to make substantial pension payments that would hamper our ability to grow. Pensions will remain a key employment benefit, but the current pension schemes must be redesigned. We spent much of 2016 engaged in a tough and protracted dialogue with both the cabin and pilot unions to find solutions. In 2016, we agreed on a new pension scheme for cabin, which is expected to be implemented in 2017, and we will continue our dialogue with the pilots. New pension schemes will reduce the volatility of our balance sheet and give room for investments.

The 2016 financial results confirm that KLM is on the right path. Fierce competition in the airline industry will continue to put downward pressure on prices and we cannot rely on oil prices remaining low indefinitely. The pension burden continues to weigh heavily. We will remain committed to our strategy of investing on the one hand and reducing cost on the other hand.

Consolidated income statement

In millions of Euros	2016	2015	Variance %
Revenues	9,800	9,905	(1)
External expenses	(5,519)	(6,164)	(10)
Employee compensation and benefit expenses	(2,860)	(2,774)	3
Other income and expenses	182	298	(39)
Total expenses	(8,197)	(8,640)	(5)
EBITDAR	1,603	1,265	27
Aircraft operating lease costs	(414)	(354)	17
EBITDA	1,189	911	31
Amortisation, depreciation and movement in provisions	(508)	(527)	(4)
Income from current operations	681	384	77

Revenues

Revenues were 1.1% lower whereas traffic (passenger seat kilometers) went up almost 5% and cargo traffic decreased by 10%. Capacity (in equivalent available seat kilometers) was 2.7% higher than last year. Unit revenue decreased with 5.3% (-4.7% at constant exchange rates). Yield decreased with 5.9% (-5.3% at constant exchange rates), while load factor increased to 84.5% (+0.5% compared to 2015).

Expenses

Total expenses (excluding aircraft operating lease cost and amortisation, depreciation and the movement in provisions) of EUR 8,197 million, a decrease of EUR 443 million compared to 2015. Unit cost were -1.7% below 2015 at constant exchange rates.

Fuel prices

Overall fuel cost decreased with EUR 700 million compared to 2015, with a 26% lower jet fuel price after hedge and including a negative pay out of the hedge portfolio.
Fuel volume was 1.5% lower and a 1.2% weaker USD.

Income from current operations

In millions of Euros	2016	2015
Income from current operations	681	384
Other non-current income and expenses	3	71
Net cost of financial debt	(100)	(114)
Other financial income and expenses	1	(208)
Pre-tax income	585	133
Income tax (expenses)/benefit	(69)	(42)
Share of results of equity shareholdings	3	(37)
Profit for the period	519	54

The net profit in financial year 2016 sharply increased by EUR 465 million.

Other non-current income and expenses

The other non-current income and expenses show a positive amount of EUR 3 million. This includes, amongst others, EUR 13 million for voluntary leave plans at KLM, EUR 7 million addition to an onerous lease provision for a full freighter and which are more than offset by results on sale of assets amounting to EUR 27 million. These results on sale of assets include, amongst others, MD-11 aircraft, Boeing 747 and MD-11 engines, F70 aircraft, the sale of the 60% stake (and 40% by Air France) in Cobalt Ground Solutions Ltd. and other tangible assets.

The 2015 other non-current income and expenses mainly related to the sale of slots at Heathrow Airport (EUR 125 million), positive pension plan settlement from defined benefit to defined contribution for Transavia flight

deck crew (EUR 45 million), negative pension plan change related to a pension age increase from 56 to 58 years offset by an increased yearly accrual rate at KLM flight deck crew (EUR 25 million), provisions for severance payments at Martinair (EUR 40 million) and a voluntary leave plan at KLM (EUR 31 million).

Net cost of financial debt

The net cost of financial debt reduced from EUR 114 million to EUR 110 million, mainly as a result of the reduction of net debt and lower interest rates.

Other financial income and expenses

The profit of EUR 1 million in other financial income and expenses in 2016, mainly relates to the positive time value on fuel derivatives, which is almost off set by negative revaluation of KLM's debt in foreign currencies and negative USD impact on maintenance and phase out provisions.

Income tax

The income tax relates to the 25% corporate income tax on pre-tax income and reversal of the deferred tax provisions, recorded in 2014, of the KLM fiscal unity amounting to EUR 65 million and EUR 7 million related to Martinair pre-fiscal unity losses.

Equity shareholdings

This mainly reflects the KLM share in the results of Schiphol Logistics Park. Both main equity shareholdings, Kenya Airways Ltd. and Transavia France, have a negative equity per December 31, 2016. KLM is not responsible for losses below a net equity value of nil and therefore no additional losses have been recorded.

Cash flow statement

In millions of Euros	2016	2015
Cash flow from operating activities	1,133	748
Cash flow used in investment activities	(755)	(340)
Free cash flow	378	408
(Increase) / Decrease in short-term deposits and commercial paper	174	(7)
Cash flow from financing activities	(178)	(413)
Other	(6)	14
Changes in cash and cash equivalents	368	2

Operational cash flow reached EUR 1,133 million, composed of a cash flow from operating activities before working capital of EUR 1,007 million, and a positive working capital movement of EUR 126 million. The continuous focus on cash resulted in a positive free cash flow of EUR 378 million (2015: EUR 408 million) with EUR 290 million higher investments than 2015 (excluding the sale of KLM slots at Heathrow Airport to Delta Air Lines for an amount of EUR 125 million in 2015).

The investing cash flow included EUR 534 million for fleet renewal and modifications (2015: EUR 221 million) and fleet related investments amounted to EUR 200 million, including EUR 118 million for capitalised fleet maintenance. Other capital expenditure amounted to EUR 147 million (including EUR 93 million for capitalize software). Disposal of aircraft and other assets led to an income of EUR 120 million and mainly relates to sales of MD-11 aircraft and Boeing 747 and MD-11 engines, F70 aircraft and sale of Cobalt Ground Solutions Ltd, in which KLM had a 60% stake.

The financing cash flow was EUR 178 million negative. New financing included new external loans of EUR 318 million and near cash of EUR 83 million. Redemption of finance leases amounted to EUR 215 million, redemption on existing loans to EUR 92 million and redemption on AIR FRANCE KLM loans of EUR 105 million. Dividend was paid to a minority interest shareholder of a KLM subsidiary to EUR 1 million.

Equity

Equity increased to EUR 988 million at December 31, 2016, and includes the positive net result for the financial year 2016 amounting to EUR 519 million. It also includes the positive net variance of the value of fuel derivatives amounting to EUR 428 million and the net negative movements in the remeasurement of defined benefit pension plans amounting to EUR 344 million and, both reported in "Other Comprehensive Income" in equity.

Including the subordinated perpetual loans and the preference shares, the near equity amounts to EUR 1,620 million at December 31, 2016 (EUR 1,012 million at December 31, 2015).

The equity level increased in 2016 but remains volatile for movements in the value of fuel derivatives and the remeasurement of the current defined benefit pension plans. The non-cash changes in pension obligations together with the level of plan assets linked to the changes in actuarial assumptions (such as the current low discount rate) need to be recognised in the Company's equity and will never be taken in the statement of profit or loss.

Despite the increase compared to 2015 the equity is still low per end 2016. Going forward the balance sheet and thus the equity need to be strengthened and also an improvement of the adjusted net debt/EBITDAR ratio is needed.

KLM Flight Plan KPI's realisation

Flight Plan pillar	KPI	2014	2015	2016
	NPS	36	38	40
	% WBC full flat	37%	60%	80%
	KLM Passengers (mln)	27.7	28.6	30.4
	Destinations	135	138	149
	Dreamliners / E175	0/0	2/0	8/4
	A15	89.4%	88.4%	89.0%
	Productivity	1.1%	1.4%	4.2%
	Operating result (COI) (mln)	175	384	681
	Net result (mln)	341	54	519
	Operating margin	1.8%	3.9%	6.9%
	Unit cost	+0.6%	-0.9%	-1.7%
	Net debt (bln)	2.4	2.1	1.8

Risks and risk management

The airline industry is a cyclical, capital and labour intensive business with high levels of fixed cost and relatively small margins. In addition, the airline industry has to deal with strongly fluctuating oil prices and currencies, as well as with increasing numbers of laws and regulations, for instance in the areas of compliance, environment, flight safety, security and passenger rights.

This chapter focuses on the risks that KLM faces and how it manages and monitors them. A distinction is made between strategic, operational and financial risks. Strategic risks are related to KLM's strategic choices, operational risks are related to operational activities and financial risks are related to financial and market developments. The financial risks are elaborated upon in the section "Financial risk management" in the notes included in the consolidated financial statements.

Overall risks of AIR FRANCE KLM are explained in the relevant parts of the AIR FRANCE KLM financial disclosure reporting. These parts have a strong connection with this section, in which the most important KLM risks are discussed. These risks can have an impact on KLM's brand, reputation, profitability, liquidity and access to capital markets.

Risk management process

KLM has implemented a system to identify, monitor and control/manage risks, which is in line with international risk management standards (COSO Enterprise Risk Management) and complies with the risk management part of the 8th EU company law directive. Strategic and operational risk mapping processes have been established by all the relevant entities, facilitated by Internal Control and Internal Audit, where also consolidation of the risks at KLM level takes place.

Every three months, KLM entities update their own operational risks sheet which contains the risk itself, the probability it will occur, its potential financial impact and actions taken or proposed. Risks are discussed within the management teams owning the risks. Both specific risks to each entity and transversal risks affecting the whole Group are the subject of reporting.

For each reported risk, members of the Board of Managing Directors and the KLM Executive Team are responsible for reviewing measures implemented to control and mitigate the risks. On a quarterly basis, the most significant operational and financial risks are presented to the Board of Managing Directors, the KLM Executive Team and, twice a year, to the KLM Audit Committee of the Supervisory Board.

The AIR FRANCE KLM Group Strategic Framework determines the strategic risks (competition, economic growth, etc.) as well as the related action plans within the context of its work to establish the AIR FRANCE KLM Group's strategy. These risks and action plans are discussed by the AIR FRANCE KLM Group Executive Committee.

Monitoring

AIR FRANCE KLM continuously pays close attention to financial reporting, based on the Internal Control Framework for financial reporting. The existing risk management system supports this level of attention and contributes to compliance with Dutch corporate governance principles.

An annual internal process of issuing a Document of Representation (DOR) is used to facilitate in the internal accountability process. In its DOR, business management confirms to the Board of Managing Directors the reliability of the financial and other figures they have submitted and if control procedures have been applied. At the same time, business management acknowledges and certifies that it is responsible for:

- Reporting transparently the outcomes of its risk management process;
- Maintaining a reliable internal control framework in general (including KLM-wide controls) and for financial reporting in particular;
- Reporting open control issues and the measures to monitor and mitigate the risks and related consequences of these control issues;
- Reporting that there is no knowledge of any undisclosed material fraud or suspected fraud.

KLM fraud policy

By means of the KLM fraud policy, KLM mitigates the risk of intentional acts designed to deceive or mislead others mainly to obtain unjust or illegal advantage to the detriment of KLM. By facilitating workshops, fraud tables and compliance roadshows awareness is created for identification and prevention of fraud risks. As part of reporting on compliance to the Board of Managing Directors and Supervisory Board, fraud-related cases and their potential financial impact are prepared and discussed by the Compliance Committee and included in a more comprehensive reporting.

Risks relating to the air transport activity

Risks linked to competition from other air and rail transport operators

The air transport industry is extremely competitive with – as a general trend throughout the economic cycle - increasing volumes and reduced airfares. On its short and medium-haul flights to and from the Netherlands, KLM competes with alternative means of transportation, e.g. the high-speed rail network in Europe. In addition, KLM faces competition from low-cost airlines for European point-to-point traffic. With leisure travel reaching saturation, these airlines are shifting their focus to the business travel market. KLM expects continuation of downward pressure on airfares in Europe.

On its long-haul flights KLM competes, within the boundaries of governmental air transport agreements, with a multitude of airlines. Some low-cost airlines are establishing longer haul point-to-point operations, US carriers have consolidated and are bigger and stronger than ever and non-Western world carriers are rapidly expanding. Non-EU airlines operate under very different regulatory and state aid regimes that allow them to compete successfully in the global market and with lower cost bases. These carriers are actively building positions in the European airline market.

The accelerating capacity growth of Middle East carriers in combination with the capacity growth of Asian carriers will further increase the imbalance between supply and demand to and from the Far East, resulting in the expectation of lower airfares in general.

To respond to the competition from other airlines or railway networks, KLM constantly adapts its network strategy, capacity and commercial offers. Furthermore, KLM seeks opportunities in mutually reinforcing airline partnerships (codeshares, joint ventures, alliances) and other partnerships. KLM regularly discusses with the Dutch and European authorities the need to establish and maintain a fair competitive landscape.

Risks linked to the seasonal nature of the air transport industry

The air transport industry is seasonal, with demand weakest during the winter months, leading to a too high cost base in the winter, mitigated by using temporary personnel in peaks and projects to reduce seasonality cost.

Risks linked to the cyclical nature of the air transport industry

Local, regional and international economic conditions can have an impact on the KLM's activities and financial results. Periods of crisis are liable to affect demand for leisure and business travel. Furthermore, during such periods, KLM may have to take delivery of new aircraft or be unable to sell aircraft not in use under acceptable financial conditions. KLM monitors demand closely so as to adjust capacity while reinforcing the flexibility of the fleet.

Risks linked to the air cargo market

The air cargo market faces structural excess capacity on a relevant number of routes. This is the result of moderate demand growth, given moderate global trade developments and alternative transportation modes (trains between China and Europe, improved sea transport scenarios) in a market with ongoing capacity supply, mostly driven by passenger business growth. The new generation of passenger aircraft also have higher cargo capacities than the types they replace. As a result, cargo unit revenues are under pressure, which is countered by also lowering unit cost and reducing the freighter footprint of KLM and Air France.

Risks linked to terrorist attacks, the threat of attacks, geopolitical instability and (threats of) epidemics

Any terrorist attack or threat, or a military action has a negative effect on our business. This is notable by a decrease in demand and an increase of insurance and security cost. An epidemic, or the perception of an epidemic, can also have negative impact on passenger traffic. Geopolitical situations resulting in political volatility also have a significant impact on air transport activity.

KLM has an Integrated Safety Management System, contingency plans and procedures that enable it to adapt quickly to changing environments and anticipate and respond effectively to the above mentioned events. The aim of these plans is the effective protection of passengers and staff, operational and service continuity and the preservation of the long-term viability of KLM's businesses. These plans are regularly evaluated. KLM complies with national, European and international safety and security regulations and submits regular reports to the national authorities of the measures and procedures deployed.

Risks linked to changes in international, national or regional laws and regulations

Air transport activities remain highly regulated, particularly with regard to the allocation of traffic rights, time slots and conditions relating to operations like safety standards, aircraft noise, CO_2 emissions and airport access. Institutions like the European Commission or the national authorities decide on regulations that may restrict airlines and are liable to have a significant organisational and/or financial impact. The announcement of the Brexit by the UK government may influence EU decision-making in the near future.

Implementation of a Single European Sky will remain one of the European Commission's key priorities. The airline industry also closely follows the revision of the European Aviation Safety Agency (EASA) basic regulation, the unfair pricing practices regulation and the passenger rights regulation. KLM, in close coordination with Air France, actively defends its position towards the European institutions and the Dutch government, both directly and through industry bodies such as IATA, the trade body Airlines for Europe (A4E) and BARIN, regarding both changes in European and national regulations and a reasonable and balanced allocation of traffic rights to non European airlines.

For KLM it is important to monitor that the implementation of these laws and regulations does not lead to a distortion of the level playing field in the airline industry and does not disproportionately burden our industry.

On a national level, the Dutch government has continued the implementation of the air transport policy ("Luchtvaartnota"), which aims to strengthen the mainport function of Amsterdam Airport Schiphol and which recognises the essential role of the network of KLM and partners. The government asserted that Amsterdam Airport Schiphol is of major importance to the Dutch economy and will therefore be allowed to continue to grow within the context of the Alders agreement. The government policy has been complemented with an Action Agenda Aviation in 2016.

Risks of loss of airport slots or lack of access to airport slots

Due to congestion at major European airports, all air carriers must obtain airport slots, which are allocated in accordance with the terms and conditions defined in Regulation 95/93 issued by the EU Council of Ministers on January 18, 1993. Pursuant to this regulation, at least 80% of airport slots held by air carriers must be used during the period for which they have been allocated. Unused slots will be lost by the relevant carrier and transferred into a slot pool. Any loss of airport slots or lack of access to airport slots due to airport saturation could have an impact in terms of market share, results or even development.

Given the 80/20 utilisation rule applying to each pair of airport slots for the duration of the season concerned, KLM manages this risk at a preventive and operational level. Amsterdam Airport is almost at its current maximum capacity, therefore access to new airport slots will be limited.

Risks linked to the consumer compensation regulations

Passenger rights in the European Union are defined by European regulations. One of them (EU 261/2004) applies to all flights, departing from an airport located in a Member State of the European Union or flying to the EU if it concerns an EU carrier.

> Outside the Europe Union, air passenger rights apply, sometimes conflicting with other passenger rights.

Regulation 261/2004 establishes common rules for compensation, uniform enforcement and assistance on denied boarding or substantial delay in embarkation, flight cancellation or class downgrading. However, the interpretation of this regulation differs per jurisdiction. The European Commission therefore published a proposal to amend it in March 2013. The proposal is still under review by the Council of the European Union. The timetable for this regulation to become effective is unclear as the Gibraltar issue is currently blocking any review of this proposal. After this issue has been solved agreement must be reached at European Parliament and Council level, which will take time.

Also outside the Europe Union, air passenger rights apply, sometimes conflicting with other passenger rights. This can lead to regulatory conflicts. KLM supports a global standardisation of passenger rights, also in light of the competitive position of EU carriers.

Risks relating to the environment

The air transport industry is subject to numerous environmental laws and regulations to manage environmental risks, such as laws on aircraft noise and engine emissions, the use of dangerous substances and the treatment of waste and contaminated sites. Over the last few years, the Dutch and European authorities have adopted various measures, notably regarding noise pollution and emission trading, introducing taxes on air transport companies and obligations for them to ensure compliance of their operations.

The Dutch Aviation Act has a separate chapter relating to Amsterdam Airport Schiphol including environmental regulations covering local emissions, noise and security. The Alders agreement on minimizing noise hindrance is supported with an active dialogue in the Omgevingsraad Schiphol. Due to expected growth at Schiphol in the coming years, dialogues intensified to minimize noise hindrance and safeguarding connectivity in KLM's network within the agreed operational restrictions.

In 2010 the global aviation industry agreed to stabilise emissions from 2020. In 2016 ICAO concluded an agreement for the global market-based measure, and 66 countries will participate in the first stage, covering more than 60% of emissions from international aviation.

The European Commission implemented the Emissions Trading Scheme (EU ETS)[1] also for international aviation from 2012, covering global emissions from flights within, to and from Europe. Following strong international objectives the EU institutions decided to temporarily limit ETS in March 2013. This European directive applies now to all European and non-European airlines flying within Europe until 2017. In February 2017 the EU commission proposed to extend the current intra EU scope of EU ETS. It is uncertain yet how EU ETS will be aligned with the planned global ICAO based measure from 2021.

1) The principle of the European Emissions Trading Scheme is that each Member State is allocated an annual allotment of CO_2 emission allowances. Each Member State then, in turn, allocates a specific quantity of emission allowances to each relevant company. At the end of each year, companies must return an amount of emission allowance that is equivalent to the tons of CO_2 they have emitted in that year. Depending on their emissions, they can also purchase or sell allowances to certain markets in the EU. Furthermore, they can earn a limited amount of credits for their greenhouse gas reduction efforts in developing countries through Clean Development Mechanisms (CDMs).

KLM is best in class in fuel efficiency and reducing CO_2 emissions. In order to reduce our CO_2 emission by 20% by 2020 the KLM Group is acting to reduce its fuel consumption and carbon emissions by:

» Fleet renewal, improved fuel management, and continuous reductions in weight carried and improved operating procedures;
» Active engagements in sustainable biofuels for international aviation. Together with SkyNRG and corporate customers KLM supports research, development and creation of a market for sustainable biofuels;
» Cooperation with the relevant national, European and international authorities, e.g. on optimisation of traffic control and by creating effective marked-based solutions to manage climate impact in the aviation sector.

In addition to mandatory offsetting, we also offer a voluntary offsetting program to our customers to CO_2 neutral flights by means of high-quality offsets with Gold Standard certification.

For KLM flight operations and all relevant ground activities in the Netherlands, compliance to environmental rules and regulations and improving environmental performance is ensured by the externally verified Environmental Management system according to ISO 14001.

Risks linked to the oil price

The fuel bill is one of the largest cost items for an airline. The volatility of oil prices thus represents a material risk. Both an increase and decrease of the oil price may have an impact on the profitability. Furthermore, any change in the US dollar relative to the Euro also results in a deviating fuel bill.

AIR FRANCE KLM has a policy in place to manage these risks that are set out in the section "Financial risk management" in the notes attached to the consolidated financial statements.

Operating risks

Safety and security

Safety and security are fundamental elements of KLM operations and prerequisite for customer satisfaction. KLM is committed to continuously improving the safety of its operations, its personnel, its customers and passengers. This is achieved by building upon the best safety and security practices through an Integrated Safety Management System, a working environment of continuous learning and improvement and an orchestrated managerial approach of the four safety domains: operational, occupational and environmental safety, plus operational security.

Airline accident risk

Air transport is heavily structured by a range of regulatory procedures issued by both national and international civil aviation authorities. The required compliance with these regulations is governed through an Air Operator Certificate (AOC), awarded to KLM for an unlimited period.

Accident risk is inherent to air transport, each AOC holder is required to adopt a predictive and pro-active approach which forms an integral part of KLM's integrated safety management system ISMS. The civil aviation authority carries out a series of checks and audits on a continuous basis covering these requirements and associated quality system.

In addition to this regulatory framework, the IATA member airlines have defined and comply with the IATA Operational Safety Audit certification (IOSA) whose renewal audit took place in 2015 for KLM without any findings. Martinair passed the renewal audit in 2015 and KLM Cityhopper in 2016.

Transavia decided to comply only with EASA legislation, which covers most of the IOSA requirements, which most of the low cost competitor do (equal level playing field). However, Transavia will renew the IOSA certificate in 2017. The decision to codeshare also with Delta Air Lines, next to KLM, requires them (Skyteam requirement mandate) to be IOSA certificated again.

KLM aims to continuously improve its industry-leading, risk and performance-based safety management system in which risk-based decisions can be taken at all levels of KLM. Its Safety Culture program, which includes promotion, communication, training and learning interventions, is gradually expanding throughout the company in order to enhance safety awareness and relevant safe attitudes and behaviours on all levels.

Operational integrity
Operational integrity is one of the essential conditions for success in the aviation industry. Airline operations are sensitive to disruptions. Delays lead to loss of quality and are costly. KLM has taken a number of initiatives to safeguard its operational integrity, in order to deliver a high-quality service to its customers. The Operations Control Centre, where all network-related decisions on the day of operations are taken, plays a central role.

Natural phenomena leading to exceptional situations
Air transport depends on meteorological conditions, which can lead to flight cancellations, delays and diversions. Adverse weather conditions such as heavy fog and heavy (winter) storms may require the temporary closure of an airport or airspace and thus can represent a significant cost (repatriation and passenger accommodation, schedule modifications, diversions, etc.).

IT risks
Airlines depend on IT and telecommunications systems. These are operated in data centres or cloud solutions and are used across a network of workstations and an increasing number of mobile devices. The information and the systems are vulnerable to (cyber) threats from inside and outside the company, while IT changes occur ever faster and become increasingly pervasive. More information is exchanged with customers and third parties. Aircraft, data and mobile devices become connected and the number of (inter)national laws and regulations to comply with increases. KLM is aware of the importance and the sensitivity of IT systems. Within KLM programs are in place that focus on continuous development of its IT systems and related security measures. Increasingly IT systems are jointly developed and implemented by KLM, Air France and/or AIR FRANCE KLM, which emphasises the importance of clear responsibilities and governance. Within this context a high level of security, security knowledge and a likewise mandate for the Chief Information Officer and its security staff is demanded.

Control measures are in place to safeguard data and IT processing; dedicated support centres and redundant networks, IT disaster recovery and access controls to the systems and data. These are checked regularly by specialised companies and external and internal auditors.

Cybercrime
Cybercrime refers to a broad range of activities to misuse data and systems for economic, personal or psychological gain. The AIR FRANCE KLM IT committees and the Cybercrime program govern preventive and detective actions such as cyber threat watch, security assessments and intrusion protection. Awareness campaigns for staff are regularly organised.

Risks linked to KLM's activities

Risks linked to non-compliance with antitrust legislation and compliance in general
KLM and its subsidiaries have been exposed to investigations by authorities alleging breaches of antitrust legislation and subsequent civil claims.

On March 17, 2017, the European Commission announced that it would fine eleven airlines, including KLM, Martinair and Air France, for practices in the air cargo sector that are considered anti-competitive and relate mainly to the period between December 1999 and February 2006. This new decision follows the initial decision of the Commission of November 9, 2010. This decision, issued to the same airlines for the same alleged practices, was annulled on formal grounds by the General Court of the European Commission in December 2015. The EUR 156 million provision in respect of the fine however has been maintained as per December 31, 2016. The new fine for KLM and Martinair, as announced on March 17, 2017, amounts to EUR 142.6 million and is slightly lower than the initial fine imposed in 2010. KLM and Martinair (and Air France) will analyse this new decision and consider its options for response. Reference is made to note 21 "Contingent assets and liabilities" of the consolidated financial statements.

KLM, together with Air France, has reinforced its procedures to supplement its already extensive actions aimed at preventing a breach of antitrust legislation, such as online training modules and on-site and tailor-made training sessions. Furthermore, KLM, considering compliance in general a top priority, has further expanded its procedures to secure and monitor compliance.

Risks linked to the regulatory authorities' inquiry into commercial cooperation agreements between carriers (alliances)

In 2012, the European Commission started an investigation whether or not the transatlantic joint venture between KLM, Air France, Alitalia and Delta Air Lines is compatible with EU antitrust legislation. Commitments have been offered by the parties on certain routes, which the European Commission agreed with in May 2015. The joint venture is fully approved for 10 years. The joint venture was granted antitrust immunity from the US Department of Transport in 2008.

Risks linked to commitments made by KLM and Air France to the European Commission

For the European Commission to clear the merger between KLM and Air France, KLM and Air France had to make a certain number of commitments, notably with regard to the possibility of making landing and take-off slots available to competitors at certain airports. The fulfilment of these commitments should not have a material impact on the activities of KLM and Air France.

Financing risks

KLM finances a large part of its capital requirements via bank loans using aircraft as collateral, which constitutes an attractive guarantee for lenders, via bilateral unsecured loans and by issuing bonds at the holding AIR FRANCE KLM. Any long-term obstacle to its ability to raise capital would reduce the borrowing capability and any difficulty in securing financing under acceptable conditions could have a negative impact on the AIR FRANCE KLM and KLM activities and financial results.

Risks linked to labour disruptions

Labour cost account for around a quarter of the operating expenses of KLM. As such, the level of salaries has an impact on operating results. Any strike or cause for work to be stopped could have a negative impact on KLM's activity and financial results. KLM fosters social dialogue and employee agreements amongst others in order to prevent the emergence of a conflict.

Risks linked to the reduction of labour cost

A new collective labour agreement (CLA) for ground staff was concluded in September 2016. The CLA includes a productivity increase, a wage increase of 1% per January 1, 2018 and an improved profit-sharing plan. The identified risk regarding the willingness of our social partners to achieve further productivity improvement materialised during the summer of 2016. Both ground staff and cabin crew organised industrial action. The risk of a continuation of industrial action or even strikes remains. Strikes or other causes for industrial action could potentially harm KLM's activities and financial results.

Risks linked to tax losses carry forward

KLM has tax losses carry forward for which deferred tax assets have been recorded. These tax losses mainly relate to the Dutch KLM fiscal unity and originate from fiscal losses until financial year 2014.

Deferred tax assets are recognised only to the extent it is probable that future taxable profits, based on budget and medium term plan, will be available against which the asset can be utilised in the Dutch KLM fiscal unity. If these expected future taxable profits will not materialise, it could have a significant impact on the recoverability of these deferred tax assets. Reference is made to the paragraph "Accounting policies for the balance sheet - Deferred income taxes," note 16 Deferred income tax and note 29 Income tax expense/benefit.

Transfer pricing

The combination of KLM and Air France requires measures to ensure compliance with tax legislation including well documented cross-border intercompany transactions. Strong monitoring and mitigating controls have been introduced, such as an AIR FRANCE KLM guideline and an active monitoring of the arms-length character of the transactions.

Risks linked to pension plans

KLM's main commitments in terms of defined benefit schemes are the three KLM pension funds for ground staff, cabin crew and flight deck crew based in the Netherlands.

Both the fiscal rules for accruing pensions and the financial assessment framework (part of the Pension Act) in the Netherlands changed as per January 2015. This has resulted in amongst others higher minimum required solvency levels, but on the other hand pension funds have more time to recover from immediate and material shortages through a rolling ten year recovery plan. This also mitigates the short-term risk that in case of shortages, based on existing or future financing agreements, KLM could be required to make additional cash payments.

Under IAS 19 the KLM Group is exposed to changes in external financial parameters (e.g. discount rate, future inflation rate), which could lead to annual fluctuations in the income statement and KLM's equity with no impact on cash. The changes in pension obligations together with the level of plan assets linked to changes in actuarial assumptions will be recognised in KLM's equity and will never be taken against profit and loss. The current calculations lead to the three KLM pension funds figuring as an asset in the balance sheet, the assets in the funds being higher than the value of the defined benefit obligations. In the consolidated financial statements, the potential volatility is explained in the "Accounting policies for the balance sheet - Provisions for employee benefits" and in note 17 Provisions for employee benefits of the consolidated financial statements.

The sensitivity of the defined benefit cost recognised in profit and loss and the defined benefit obligation to variation to the change in discount rate, salary increase and pension rate are presented in note 17 of the consolidated financial statements.

In 2016 KLM began to modernise the three KLM pension plans. Extremely low interest rates and new government regulations mean that, without changes, KLM could be forced to make substantial pension payments that would hamper our ability to grow. Pensions will remain a key employment benefit, but the current pension schemes must be redesigned. We spent much of 2016 engaged in a tough and protracted dialogue with both the cabin crew and flight deck crew unions to find solutions. In 2016, we agreed on a new pension scheme for cabin crew, which is expected to be implemented in 2017, and we will continue our dialogue with the flight deck crew. Ultimately, new pension schemes will reduce the volatility of our balance sheet and give more room for investments.

Risks linked to the impact of external economic factors on equity

KLM's equity has become volatile, following the implementation of the revised IAS 19 for pensions, as of January 1, 2013. Not only results for the year and dividend distributions can have an impact on equity, but the non-cash impact of "Other Comprehensive Income" coming from the defined pension plans or the changes in the fair value of cash flow hedges (predominantly related to fuel hedges) can have a significant impact on equity. Please refer to note 9 Share Capital and note 10 Other reserves in the consolidated financial statements for more information.

KLM needs to strengthen its balance sheet and equity. Perform 2020 is well under way and results are improving and net debt is lowering. The non-cash changes in remeasurements of defined benefit plans and changes in fair value of cash flow hedges will however remain volatile.

For an elucidation on the volatility of defined pension plans, and actions to reduce the volatility, please refer to the paragraph Risks linked to pension plans in this Risks and risk management section.

In addition reference is made to the assessment of 'going concern' in this Risks and risk management section.

Risks linked to the use of third-party services

KLM's activities depend in part on services provided by third parties, such as air traffic controllers, airport authorities and public security officers. KLM also uses suppliers, which it does not directly control, like aircraft handling companies, aircraft maintenance companies and fuel supply companies. Any interruption in the activities of these third parties or any increase in taxes or prices of the services concerned could have a negative impact on KLM Group's activity and financial results.

In order to secure supplies of goods and services, the contracts signed with third parties include, whenever possible, clauses for service, continuity and responsibility. A Supplier Relation Management program has been developed with a growing number of strategic suppliers. Also business continuity plans are developed by KLM Group's different operating entities to ensure the long-term viability of all commercial and operational activities.

Legal risks and arbitration procedures

In relation to the normal exercise of activities, KLM and its subsidiaries are involved in disputes or subject to monitoring actions or investigations by authorities such as the Dutch Competition Authority, which either result in provisions being booked in the consolidated financial statements or information being included in the notes to the consolidated financial statements as to the possible liabilities. Please refer to note 21 Contingent assets and liabilities of the consolidated financial statements for more information.

Insurance coverage

KLM and Air France have pooled their airline risks in the insurance market in order to capitalise on their combined scale.

Insurance policies taken out by KLM

KLM has taken out an airline insurance policy for its operational risks on behalf of itself, its subsidiaries and Kenya Airways Ltd. which is to cover damage to aircraft, liability with regard to passengers and general third-party liability in connection with its activities. It covers KLM's legal liability up to USD 2.25 billion per event and also includes liability for damage to third parties caused by acts of terrorism up to an amount of USD 1 billion. In addition, KLM participates in the payment of claims for damage to its aircraft through a Protected Cell Company (PCC) whose maximum liability is limited to USD 8 million annually. Lastly, within the framework of its risk management and financing policy designed to ensure its activities, employees and assets are better safeguarded, KLM has taken out a number of policies to protect its industrial sites in the event of material damage and, consequently, loss of income, property portfolio and activities ancillary to air transportation, with different levels of cover depending on the capacity available in the market and on the quantification of risks that can reasonably be anticipated.

Assessment of 'going concern'

Since 2016, KLM provides a more extensive elaboration on the going concern analyses performed by the company. These analyses include the most important economic, financial and business risks (many of them described in this chapter), the uncertainties in relation hereto and their potential impact on the financial robustness and going concern basis of the company. In this context, scenario and sensitivity analyses have been performed and various time horizons have been considered. The analyses have been shared and discussed with the Audit Committee and the conclusions were shared with the Supervisory Board of KLM.

Several important observations following from this analyses are:

» One of the most relevant risks is that Equity remains volatile for movements of the re-measurement of the defined benefit pension plans (impacted by changing interest rates). KLM is actively in discussion with its internal social partners and other stakeholders to agree to steps that will further de-risk the pension plans;

» Another relevant risk is related to the future mandatory implementation of IFRS 16 (effective ultimately as per January 2019). The adoption of this new accounting standard prescribes that all off-balance sheet debt has to be recognised as on-balance sheet debt. This includes operating lease obligations. As a result, upon implementation of this new IFRS 16 standard, the on-balance sheet debt of KLM will increase and new EUR/USD volatility will be introduced into the balance sheet (debt) as many existing off-balance sheet obligations are predominantly denominated in US dollars. KLM is currently considering options to mitigate this future new volatility;

» Strong fuel price fluctuations remain an important factor for KLM, also due to the fact that there is generally a delay in any impact on air transport prices. Also, the correlation between fuel price development and air transport price development may fluctuate over time, depending on many factors underlying the ever-changing supply-demand balance. AIR FRANCE KLM has a policy in place to manage these risks that are set out in the section "Financial risk management" in the notes attached to the consolidated financial statements;

» In the financial sensitivity analyses performed, KLM has assessed the flexibility in executing committed as well as uncommitted (fleet) investments and the funding capacity. This flexibility proves to be an important element to mitigate risks on financial continuity in longer periods of strong and unexpected downturns;

» KLM has ensured that the scenario and financial sensitivity analyses were based on an up-to-date business plan that has been build up from realistic business and financial parameters, taking into consideration the trends in the current business environment as well as the implementation of internal reform programs.

KLM will continue to apply a low appetite for financial risks in order to compensate for the relatively high business risks that were identified in our analyses and that are inherent to our airline business and the different underlying business activities. This conservative approach includes clear and stringent risk management policies in order to mitigate fuel price, currency and interest risks. Our approach is also based on managing carefully the liquidity risk by maintaining sufficient liquidity in the form of available cash and cash equivalents as well as a committed standby credit facility.

With regard to the annual planning horizon, which has most emphasis in the context of this annual report, based on all information and analyses available and taking into account the current liquidity position, business outlook, investment plan, availability of funding and the redemption profile, the Board of Managing Directors concludes that there is no foreseeable reason to expect that the financial going concern of KLM is at stake in the next twelve months.

Board and governance

Koninklijke Luchtvaart Maatschappij N.V. ("KLM") is a non-listed, limited liability company incorporated under Dutch law. Supervision and management of KLM are structured in accordance with the two-tier model, meaning a Board of Managing Directors supervised by a Board of Supervisory Board members. KLM has been subject to the mitigated structure regime (as per Dutch company law, Book 2 Dutch Civil Code) for large companies since May 2007.

KLM's corporate governance is based on the applicable statutory requirements and on the company's Articles of Association. Furthermore, KLM has brought its corporate governance as far as possible in line with generally accepted principles of good governance, as laid down in the Dutch Corporate Governance Code.

This section considers KLM's corporate governance policy. There have been no material changes in the company's governance policy in comparison with financial year 2015.

Shareholder structure

KLM's shareholder structure is outlined below. Depositary receipts of shares carry beneficial (economic) ownership, but no voting rights on the underlying KLM shares.

AIR FRANCE KLM holds:

» All KLM priority shares;
» A proportion of the common shares, together with the priority shares representing 49% of the voting rights in KLM;
» The depositary receipts issued by Stichting Administratiekantoor KLM (SAK I) on common KLM shares and on the cumulative preference shares A. The depositary receipts issued by Stichting Administratiekantoor Cumulatief Preferente Aandelen C (SAK II) on the cumulative preference shares C.

On December 31, 2016, SAK I held 33.59% of the voting rights in KLM on the basis of common shares and cumulative preference shares A. SAK II holds 11.25% of the voting rights in KLM. The Dutch State directly holds cumulative preference shares A, which represents 5.92% of the voting rights.

Air France KLM

KLM and Air France share the same holding company, AIR FRANCE KLM S.A. The holding company's Board of Directors (*Conseil d'Administration*) has 15 members. The Board has four Dutch members, of which one is appointed upon nomination by the Dutch government and two upon nomination by the KLM Supervisory Board. The fourth Dutch member is the Chairman of the KLM Supervisory Board, who was appointed during the Annual General Meeting of AIR FRANCE KLM on May 19, 2016. In 2016, the KLM CEO attended the Board meetings as permanent guest/observer.

The AIR FRANCE KLM Group Executive Committee among others decides upon issues of a strategic nature within the framework of the strategy approved by the Board of Directors.

Supervisory board

As required by law KLM has a Supervisory Board that supervises the management by the Board of Managing Directors and the general performance of the company. It also provides the Board of Managing Directors with advice. The Supervisory Board consists of nine members. The Supervisory Board members fulfil their duties in the interests of the company, its stakeholders and its affiliates. Supervisory Board members are appointed and reappointed by the General Meeting of Shareholders. The KLM Works Council has the legal right to recommend one third of the Supervisory Board members.

Three committees are active within the Supervisory Board: an Audit Committee, a Remuneration Committee, and a Nomination Committee. All these committees have their own regulations, which lay down, amongst other things, the committees' tasks.

Board of managing directors

On December 31, 2016, the Board of Managing Directors consisted of three members. It is supervised by the Supervisory Board. The Managing Directors are appointed and dismissed by the General Meeting of Shareholders. The members of the Board of Managing Directors are appointed for a fixed term of four years. Further information on the members' terms and conditions of service as well as remuneration is presented in the section Remuneration Policy and Report. Regardless of the allocation of tasks among its members, the Board of Managing Directors acts as a single entity with joint responsibility. The Supervisory Board appoints one of the members of the Board of Managing Directors as President & Chief Executive Officer and may in addition appoint one or more Managing Directors as Deputy CEO. The Board of Managing Directors


De-icing in wintertime

shares its operational management tasks with an Executive Team, consisting of the Board of Managing Directors itself and the company's divisional managers.

General meeting of shareholders

KLM's yearly Annual General Meeting of Shareholders will be held on April 21, 2017. In addition to the Annual General Meeting of Shareholders, a General Meeting of Shareholders may be convened by the Board of Managing Directors, the President & Chief Executive Officer, the Supervisory Board, three Supervisory Board members, or the Meeting of Priority Shareholders, each of which has equal power to do so.

Staff participation

The Board of Managing Directors, represented by the President & Chief Executive Officer, meets with the company's Works Council on a regular basis. During these meetings, a number of topics is discussed such as the developments within AIR FRANCE KLM and the company's strategy and financial results. The KLM Works Council has 25 members. On June 1, 2016 a new Works Council was installed following the elections that took place in the first quarter of financial year 2016. The KLM Works Council met representives of the Board of Managing Directors on eleven occasions in financial year 2016.

At AIR FRANCE KLM level an European Works Council has been installed to jointly represent KLM and Air France. This council focuses on cross businesses subjects between Air France and KLM. The European Works Council met on five occasions in financial year 2016.

Dutch act on management and supervision

Among other topics, the Dutch Act on Management and Supervision (as laid down in article 2:276 section 2 of the Dutch Civil Code) contains a guideline for balanced gender diversity in the management board and supervisory board of a (large) company. At least 30% of the positions are to be held by women and at least 30% by men.

On December 31, 2016, the composition of the Supervisory Board complied with the gender diversity principle of the Act on Management and Supervision as one third of the directors of the Supervisory Board is female. Within the framework of the company's Diversity Policy, the aim is to increase over time the number of women in executive positions through promotion from within. In the event that candidates for new appointments to the Board of Managing Directors are to be selected, the Supervisory Board will duly consider the relevant diversity requirements, when searching, selecting and evaluating the candidates.

Corporate governance code

KLM's corporate governance is, insofar as possible, in line with generally accepted principles of good governance, such as laid down in the Dutch Corporate Governance Code. Although KLM as a non-listed company is not formally obliged to comply with the Code, it has committed itself to follow the Code voluntarily where possible. KLM has taken note of the amended Dutch Corporate Governance Code published in December 2016. In line with its practice today, the company intends to comply with the best practices of the new Code, whereby the company notes that it already acts in compliance with some of the new practices.

KLM deviates from the best practices described in the Code in a limited number of areas. These deviations are:

» Regulations and other documents are not made available on the Internet. Regulations and other documents are available upon written request;
» Best practice provision II.2.8 is only implemented in contracts of new external members of the Board of Managing Directors;
» In deviation of best practice provision III.3.5, and in order to enable a rotation plan that allows a more gradual rotation that secures continuity of the Supervisory Board, two Supervisory Board members were appointed for a fourth term in 2016;
» In deviation of best practice provision III.5.13, a limited number of consultants that can provide advice to the Remuneration Committee of the Supervisory Board, also provide advice to the Board of Managing Directors. However, in these cases separate agreements are made in order to create a so-called Chinese wall;
» In deviation from best practice provision III.6.5, KLM has not drawn up regulations governing ownership of and transactions in securities by Board of Managing Directors or Supervisory Board members, other than regarding securities issued by AIR FRANCE KLM.

Internal regulations

KLM has adopted regulations in respect of the Supervisory Board, the Audit Committee, the Remuneration Committee, the Nomination Committee, and the Board of Managing Directors. These regulations are reviewed on a regular basis. The Rules of Supervision, the Profile with Code of Conduct for the members of the Supervisory Board, the Board of Managing Directors Regulations, the Terms of Reference of the Audit Committee, the Nomination Committee and the Remuneration Committee, and the rotation schedule, insofar not published in this annual report, may all be viewed at the company's head office. Copies shall be made available to shareholders upon written request to the Company Secretary.

KLM has adopted regulations in respect of the Supervisory Board, the Audit Committee, the Remuneration Committee, the Nomination Committee, and the Board of Managing Directors.

Report of the supervisory board

Duties and powers

The Supervisory Board, which is a separate body and fully independent of the Board of Managing Directors in the two-tier corporate structure under Dutch law, consists of nine members. The Supervisory Board is entrusted with supervising and advising the Board of Managing Directors of the company, and overseeing KLM's strategy and the general course of its businesses.

Supervisory Board meetings

During financial year 2016, the Supervisory Board met on eight occasions, either in person or by means of a conference call. Six meetings were planned in line with the regular schedule. Four of these six meetings were held shortly after the quarterly close. The deliberations during the February, April, July and October meetings concentrate on KLM's (quarterly, semi-annual and annual) financial results. One meeting focused on KLM's strategy and the implementation thereof. Like previous years, one meeting was dedicated for discussion of the company's three-year plan (budget, investment plan and financial plan) and the Internal Audit plan. Two additional Supervisory Board meetings were held to discuss actual topics that follow from the general course of KLM's business.

The Supervisory Board performed its duties in close cooperation with the Board of Managing Directors, which attended all meetings of the Board. All regular Board meetings were followed by an Executive Session – meetings of the Supervisory Board without the presence of members of the Board of Managing Directors. Average attendance of the Supervisory Board meetings was 90 percent.

Highlights 2016

In 2016, KLM made important steps in implementing its updated strategy that was adopted in 2015 in order to make the company fit for the future. Over the years, the landscape of the airline industry has evolved and the operating environment continues to be complex and dynamic. Steep capacity growth (helped by the low fuel prices), changes in customer demand, market convergence (and by consequence business model convergence) require continuous attention and swift adaption. In addition to this, consolidation in the sector and strong competition from low-cost carriers and Middle-Eastern carriers persist. From a deep and company-wide consciousness that KLM needs to transform in order to ensure a healthy future, the company, its management and workforce embarked on a transformation process. The aim is to create a winning and flourishing KLM able to face and respond to the fast and continuous changing environment and competition.
In order to realise the ambition to become Europe's most customer-centric, innovative and efficient network carrier, KLM continued on the course set in 2015: investing in customers and staff on the one hand, while striving for productivity gains and cost reduction on the other. Consistent with the AIR FRANCE KLM Perform 2020 program, KLM defined goals to achieve cost reduction, productivity increase and net debt reduction, essential to make the necessary investments in its customers. In the course of the year, the effects of the strategy became visible, confirming its efficacy.

During the annual strategy meeting the Supervisory Board reviewed with the Board of Managing Directors KLM's strategy against the background of industry trends and competitor's benchmark information as well as the execution of the strategy. An important focus area of the Supervisory Board in 2016 was to review progress of the implementation of KLM's strategy in line with its purpose and ambition. Key indicators were defined to measure the progress in implementation as well as realization of the predefined results. In addition, a number of strategic topics, directly and indirectly related to KLM's businesses and relevant for KLM as a whole, were reviewed and discussed.

During the second half of 2016, the Supervisory Board was introduced to the background of Trust Together, a number of key strategic guidelines, particularly for Air France, that will make a valuable supplement to Perform 2020. For KLM, the Trust Together plan reconfirms its earlier adopted strategy and associated plans, and the need to continue implementing the plans and related productivity increases and cost savings.

The Supervisory Board closely followed KLM's transformation towards a High Performance Organisation (HPO). HPO aims for a leaner, more cost-effective and more customer-centric organisation and will serve as the foundation of a more focused and streamlined organisation with fewer management layers and procedures and more empowered staff. Achievements in the field of productivity figures and cost improvements already indicate that the transformation of KLM's organisation contributes to the realisation of KLM's ambitions. The Supervisory Board is grateful to the Works Council for its contribution in the process of the transformation to a High Performance Organisation.

On several occasions, the Supervisory Board discussed KLM's customer-centricity. The Supervisory Board concluded that passenger appreciation as expressed in the Net Promotor Score is increasing as a result of KLM's staff efforts to let the customers feel that 'KLM is creating a memorable experience for each and every customer. Next to this, the Supervisory Board looked into the launch of the KLM Compass that was designed to guide the KLM staff to work towards greater efficiency and a higher customer appreciation.

The situation in the KLM pilot pension fund appeared complex and risky

The Supervisory Board followed attentively the negotiations of new collective labour agreements. Discussions on necessary adjustments in the labour agreements aiming at productivity increase and cost reduction caused turbulence and some incomprehension in the domains of ground staff and cabin crew with consequential labor actions in both domains. In the second half of 2016, all ground unions signed the new collective labour agreement. Unfortunately, no collective labour agreement was yet reached with the cabin crew unions, which meant that KLM had to reduce the cabin crew on board of certain long haul flights in order to realise productivity targets, also for cabin crew. The Supervisory Board is confident that KLM will find solutions that better coincide with its vision on customer service and crew composition.

On multiple occasions, the Supervisory Board discussed KLM's pension schemes, given new legislation and the objective to de-risk pension schemes by introducing a collective defined contribution system. Despite successful de-risking efforts, KLM does not yet fully follow the trend of de-risking pensions and in that respect KLM pensions hamper the execution of the strategy. More specifically, the situation in the KLM pilot pension fund appeared complex and risky with a large impact on the profit and loss statement as well as the balance sheet. In concert with the Board of Managing Directors, scenarios for the future were analyzed and discussed. Experts in the field of pensions were invited to provide the relevant expertise, supporting the decision making process of the Supervisory Board.

Financial topics

The Supervisory Board continuously discussed progress on the budget and annual plan. Quarterly reports and figures were discussed during the regular meetings. The Supervisory Board held intense discussions with the Board of Managing Directors on developments in the markets and the best way to respond to these developments, in particular margin improvement and risk mitigation. KLM's equity position was reviewed on several occasions. Particular attention has been paid to the fuel hedging policy in light of the fuel price development. Given the complexity of certain topics, amongst others pension schemes and risk management, two extra audit committees were held. Next to that, the Board discussed and approved the company's financing plan, including the financing of new aircraft.

The Supervisory Board, together with the Board of Managing Directors, discussed the conclusions regarding the financial robustness of KLM, focussing on the going concern basis of the company. The going concern analyses included scenario and sensitivity analyses and confirmed the most important risks that the airline industry and specifically KLM is exposed to from a financial (risk management) perspective. The financial robustness for the next twelve months was confirmed by the Board of Managing Directors. The Supervisory Board encourages these analyses and continuous efforts to understand the most relevant financial risks and corresponding mitigating measures.

Other topics

As an annually recurring topic on its agenda, the Supervisory Board was informed about the performance of the company's intercontinental and European network, as well as future network scenarios and partner developments. The same applies to the annual update of the operational safety and quality assurance program.

As risk is intrinsic to the airline industry, the Supervisory Board payed close attention to the topic of risk management. In addition, risks in terms of cybersecurity were analyzed and discussed.

During the year, the Supervisory Board monitored Transavia's transformation towards a modern point-to-point airline as well as the financial and operational results of the new Munich hub. In addition, developments at KLM's associate Kenya Airways were discussed.

Other topics discussed during the financial year, some of which are recurring, were:

» The company's fleet development planning;
» Developments at partner airlines;
» Developments within Engineering & Maintenance and Cargo;
» Developments at Amsterdam Airport Schiphol;
» Discussions with the unions and Works Council;
» Negotiations on collective labor agreements;
» Performance of the company's pension funds;
» Performance and remuneration of the Board of Managing Directors.

In keeping with previous years, members of the Supervisory Board took turns to attend meetings of the Works Council. The Supervisory Board was periodically informed about the process that was agreed with the Works Council with respect to the treatment of the pending HPO requests for advice.

Corporate governance and compliance

With respect to its responsibility towards corporate governance and compliance, the Supervisory Board discussed the company's Legal & Business Ethics Compliance framework and the Compliance Charter as well as ongoing improvements within the compliance framework.

Composition of the Supervisory Board

As per the closing of the Annual General Meeting of 2016, Mr. Guillaume and Mr. Laan stepped down as Supervisory Board member. The Supervisory Board wishes to express its gratitude to Mr. Guillaume and Mr. Laan for their contributions to the company during 12 years of service.

As per the closing of the Annual General Meeting of 2016, Mrs. Asscher was reappointed as Supervisory Director for a final term of one year. Mr. Calavia was reappointed as Supervisory Board member for a second term of four years. Mr. Enaud and Mr. Riolacci were appointed as Supervisory Board members for a first term of four years.

Mrs. Irene Asscher is due to retire by rotation as per the closure of the Annual General Meeting of Shareholders in 2017. The Works Council has the right to recommend a candidate that will arise following her resignation. The Works Council advised the Supervisory Board it wishes to propose Mrs. De Gaay Fortman. The Supervisory Board has positively endorsed the recommendation.

The Supervisory Board hereby announces that Mrs. Dautry and Mr. 't Hart are due to retire by rotation as per the closure of the Annual General meeting of Shareholders in 2018. Both members are in principle eligible for reappointment.

Shareholders are entitled to make recommendations for the vacancies. It should however be noted that for the position of Mrs. Dautry AIR FRANCE KLM has the right to propose a candidate.

Independence

The Supervisory Board considers all but two of its members to be independent pursuant to the Dutch Corporate Governance Code. Mr. Calavia, in his capacity of former Chief Financial Officer of AIR FRANCE KLM, is not considered independent. Mr. Calavia resigned as Chief Financial Officer of AIR FRANCE KLM as per the end of January 2014. Mr. Riolacci, in his former capacity of Chief Financial Officer of AIR FRANCE KLM is also not considered independent.

Composition of the Board of Managing Directors

The Board of Managing Directors consists of three members, Mr. Pieter Elbers, Chief Executive Officer, Mr. Erik Swelheim, Chief Financial Officer, and Mr. René de Groot, Chief Operating Officer. No changes materialized in the composition of the Board of Managing Directors during the year 2016 and no changes are foreseen for 2017.

Committees

The Supervisory Board has three committees: an Audit Committee, a Remuneration Committee, and a Nomination Committee. These committees prepare policy and decision-making and report on their activities to the full Supervisory Board.

Due to the retirement of Mr. Guillaume and Mr. Laan, the composition of the committees was amended during financial year 2016 and is as follows per year end:

Audit Committee: Jean Peyrelevade (Chairman), Cees 't Hart, Annemieke Roobeek

Remuneration Committee: Hans Smits (Chairman), Irene Asscher and François Enaud

Nomination Committee: Hans Smits (Chairman), Irene Asscher and François Enaud

Committee meetings are open to all members of the Board, regardless of membership of the Committees.

The Audit Committee met on four occasions during the financial year. Two meetings were scheduled in line with the regular schedule. Two additional meetings were planned to discuss in depth the topics of KLM retirements schemes, KLM risk management, hedging and the going concern analysis. These two additional meetings were held without the presence of external auditors.

Apart from the financial results, the Audit Committee discussed the main (financial and non-financial) risks based on Management's risk assessments, the results of the different internal audits, performed under the authority of the company's internal auditor as well as the external auditors KPMG and Deloitte.

The Chairman of the Audit Committee reported on the main topics during the meetings of the full Supervisory Board.

The regular Audit Committee's meetings were attended by the Supervisory Board's Chairman (as an observer) and the President & Chief Executive Officer, the Chief Financial Officer, the external auditors, the internal auditor, and the corporate controller. In keeping with previous years, the Audit Committee met with the external auditors without the members of the Board of Managing Directors being present, to discuss the closing process and course of affairs during the financial year.

The Remuneration Committee met on one occasion during the financial year. At its February meeting, the Committee evaluated the performance of the members of the Board of Managing Directors against the collective and individual targets set for financial year 2015. The Supervisory Board subsequently established the variable remuneration based on the recommendations of the Remuneration Committee. The Committee furthermore developed a proposal for targets for the new financial year, which targets have been endorsed by the Supervisory Board. For further information, reference is made to the section Remuneration Policy and Report of this annual report.

The Nomination Committee met on one occasion during the financial year. During this meeting, the composition of both the Supervisory Board and the Board of Managing Directors, was discussed.

The meetings of both the Remuneration Committee and the Nomination Committee were partly attended by the President & Chief Executive Officer and the Senior Vice President Corporate Center and General Counsel.

Distribution to shareholders

Article 32 of KLM's Articles of Association provides for the appropriation of profit. Paragraph 1 of that article gives the Meeting of Priority Shareholders (AIR FRANCE KLM) the right to set aside an amount of the disclosed profit to establish or increase reserves. The Meeting of Priority Shareholders may do so only after consultation of the Board of Managing Directors and the Supervisory Board.

After having consulted both Boards and under the condition that the financial statements 2016 would be adopted by the Annual General Meeting of Shareholders on April 21, 2017, the Meeting of Priority Shareholders, after due consideration of KLM's 2016 results, the financial situation of the company, its balance sheet and adjusted net debt/EBITDAR ratio, specific required investment levels as from 2017, as well as the economic outlook that stays uncertain and the competition that remains fierce, decided to add an amount of EUR 499,682,714 of the disclosed profit to the reserves.

In accordance with further provisions of Article 32, payments to holders of priority shares and holders of A and C cumulative preference shares will require an amount of approximately EUR 1,173,759.

As a consequence of the foregoing, there will be EUR 16,851,492 or EUR 0.36 per common share available for distribution to the shareholders.

Financial statements 2016

The Supervisory Board hereby presents the annual report and the financial statements for financial year 2016. The financial statements have been audited by KPMG Accountants N.V. and Deloitte Accountants B.V. The Supervisory Board has discussed the financial statements and the annual report with the external auditors and the Board of Managing Directors. The unqualified auditors' report as issued by KPMG and Deloitte can be found in the Other Information section of the financial statements.

The Supervisory Board is satisfied that the annual report and the financial statements comply with all relevant requirements and proposes that the shareholders adopt the financial statements and endorse the Board of Managing Directors' conduct of KLM Group's affairs and the Supervisory Board's supervision thereof in the financial year 2016.

Closing remarks

Looking back, 2016 has been a challenging year. KLM set ambitious objectives and it is good to see that most of these are realised. Productivity went up, cost went down and investments in products and services for the customer were made. The implementation of six new Boeing 787 Dreamliners is the best example hereof. Throughout the year, everyone in the company worked hard to implement the defined strategy that will transform KLM towards a healthy and strong company with a promising and sustainable future. As a result KLM was able to close the year with a good operating income. The Supervisory Board is pleased that under the leadership of the Board of Managing Directors, KLM demonstrated entrepreneurship, strength and perseverance. The implementation of the High Performance Organisation as well as the execution of the Perform 2020 program has demanded a lot from all employees, but their dedication has proven to be key to a successful transformation.

The members of the Supervisory Board are grateful for the work undertaken by the Board of Managing Directors and the Executive Team in order to meet KLM's strategic and business objectives. The Supervisory Board also wishes to thank KLM's employees for their hard work, dedication and commitment to KLM's customers across the world and the company.

Amstelveen, March 21, 2017

Hans N.J. Smits
Chairman

Remuneration policy and report

Remuneration policy for the Board of Managing Directors

The Supervisory Board's Remuneration Committee is responsible for formulating, implementing and evaluating the remuneration policy of KLM with regard to the terms and conditions of service and remuneration of the members of the Board of Managing Directors and the remuneration of the members of the Supervisory Board. The remuneration policy is formulated and proposed by the Supervisory Board and, in accordance with the Articles of Association, adopted by the General Meeting of Shareholders. KLM's remuneration policy was last changed in April 2015.

In accordance with the Articles of Association and the remuneration policy, and subject to prior approval of the Meeting of Priority Shareholders (AIR FRANCE KLM), the Supervisory Board sets the remuneration and further terms and conditions of service of the individual members of the Board of Managing Directors. These decisions are prepared by the Supervisory Board's Remuneration Committee.

Each year, the Remuneration Committee evaluates whether there is reason to change the remuneration for the members of the Board of Managing Directors. The following factors are considered in the evaluation: (i) developments in the remuneration of AIR FRANCE KLM's directors, whereby also external benchmark data regarding directors' remuneration (reference group is large Dutch companies) are taken into account as well as (ii) inflation and developments in KLM's Collective Labour Agreement. Any changes in individual remuneration further to the evaluation are proposed by the Remuneration Committee to the Supervisory Board. The Supervisory Board in turn adopts the remuneration subject to approval of the Meeting of Priority Shareholders.

Objective of the policy

The main objective of the remuneration policy is to create a remuneration structure that enables the company to attract and retain qualified Managing Directors and to offer them a stimulating reward. Furthermore, the remuneration policy objective is to focus KLM and its Managing Directors on improving the performance of KLM and on achieving KLM's long-term objectives within the context of AIR FRANCE KLM.

As a consequence, the remuneration package includes a short-term incentive in cash relating to the performance in the past financial year and a long-term incentive in the form of phantom shares, relating to certain pre-determined financial and non-financial targets with a longer-term focus.

Structure

The remuneration package for the members of KLM's Board of Managing Directors consists of three basic components:

1. Base salary;
2. Short-term incentive in cash related to performance in the past financial year;
3. Long-term incentive in the form of phantom shares related to certain predetermined financial and non-financial targets.

1. Base salary

The amount of the base salary is related to the requirements and responsibilities pertaining to the function of the relevant member of the Board of Managing Directors. The Remuneration Committee determines an appropriate level for the base salary with the aid of external reference data issued by independent remuneration experts and also takes into account the base salaries for directors at AIR FRANCE KLM level. The job grade is determined on the basis of KLM's size, the complexity of the activities, the national and international environment in which KLM operates and the specific responsibilities pertaining to the position. On the basis of this job grade, a base salary level is set at around the median of the market level. This salary level as established then serves as the maximum achievable base salary for the respective Managing Director.

Managing Directors may retain payments they receive from other remunerated positions (such as membership of a supervisory board or similar body) with the maximum number of remunerated positions set at two per Managing Director. Acceptance of such position requires the prior approval of the Supervisory Board. Any payment in connection with Supervisory Board memberships with KLM Group companies or with other airline companies remains due to KLM.

Members of the Board of Managing Directors are furthermore entitled to make use of travel facilities comparable to the travel facilities as detailed in the travel regulations for KLM employees.

2. Short-term incentive plan

The purpose of the short-term incentive plan is to reward members of the Board of Managing Directors for achieving pre-agreed and measurable targets relating to performance in the past financial year. The short-term incentive is paid in cash as a percentage of base salary. The criteria on which the short-term incentive plan is based, are: (i) financial targets relating to KLM (25%), (ii) financial targets relating to AIR FRANCE KLM (25%) and (iii) individual targets (50%).

The maximum pay-out percentage is connected to the position of the Board member. Depending on the performance level achieved, the pay-out percentages are as follows:

For the CEO position:

» The maximum percentage that can be paid out on a score of 'excellent' is 100%;
» On a score of 'at target' for each of the three short-term incentive targets, this percentage is 70%;
» On a score below a set limit (target less than 80% achieved), no payment is made.

For the Managing Director position:

» The maximum percentage that can be paid out on a score of 'excellent' is 60%;
» On a score of 'at target' for each of the three short-term incentive targets, this percentage is 40%;
» On a score below a set limit (target less than 80% achieved), no payment is made.

The Remuneration Committee evaluates the agreed targets each year and proposes new targets. Both the evaluation and the proposals are submitted to the Supervisory Board for approval. In line with the Dutch Corporate Governance Code, the Remuneration Committee – in establishing both the policy and actual remuneration for individual members of the Board of Managing Directors – analyses the possible outcomes of the intended new short-term incentive target setting (in case of a change to the policy) or the agreed short-term incentive pay-out percentage. The Committee will relate such outcomes against the results of KLM as a whole.

The Remuneration Committee may use its discretionary powers in case the evaluation of the short-term incentive targets would produce an unfair result due to extraordinary circumstances by adjusting the pay-out downwards or upwards. Together with its proposal to the Supervisory Board, the Remuneration Committee will provide an explanation for using its discretionary powers.

3. Long-term incentive plan

Members of the Board of Managing Directors participate in KLM long-term incentive (LTI) plan, which is in the form of phantom shares, relating to certain predetermined financial and non-financial targets. The LTI plan aims to encourage members of the Board of Managing Directors to achieve long-term profitable growth for KLM as part of AIR FRANCE KLM. The phantom performance shares plan provides for the conditional award of an amount in cash that, at the time of selling of the performance shares, is equal to the number of phantom shares that have vested during the performance period and are offered for sale times the AIR FRANCE KLM share price at the time of sale.

Granting of the phantom shares will only take place if the individual performance of the Board members is at least 'at target'. The granted shares will vest in three years, provided certain predetermined performance criteria are met. The vested shares may then be sold after three years from the granting date during a period of two years.

The KLM performance criteria for the LTI plan are:
(a) AIR FRANCE KLM total shareholders return (30%);
(b) KLM Group Return on Capital Employed (40%), and
(c) AIR FRANCE KLM position Dow Jones Sustainability Index, sector transport (30%)

The number of phantom performance shares (in the case of 'at target' performance) that will conditionally be granted to the members of the Board of Managing Directors under the long-term incentive plan amounts to 10,000 shares in respect of the Chief Executive Officer, and 6,000 shares in respect of the Managing Director.

Claw back clause

The Supervisory Board has the authority to reclaim payments on the basis of article 2:135 sub 8 of the Dutch Civil Code.

Pensions

In accordance with KLM's pension policy, the Pension Plan for members of KLM's Board of Managing Directors is a career average salary scheme, whereby any variable income is excluded from pensionable salary. In line with the new fiscal regime, applicable per January 1, 2015, pensionable income is capped at EUR 100,000.
In addition Managing Directors are entitled to an allowance, comparable to the premium available for pension accrual for the part of base salary above EUR 100,000, which can be used as a premium (deposit) for a net pension scheme that is offered by KLM's pension fund.

Employment contracts with members of the Board of Managing Directors

Members of the Board of Managing Directors have a contract of employment with KLM. In case of newly appointed external members of the Board of Managing Directors, the term of the employment contract is set at a maximum of four years. When Board members are appointed from within KLM, the years of service are respected in their new employment contract, and the appointment as a board member has a fixed term of four years.

With regard to the current members of the Board of Managing Directors:

- Pieter Elbers' employment contract contains a fixed-term clause for a period of four years until the Annual General Meeting of 2019;
- Erik Swelheim's employment contract contains a fixed-term clause for a period of four years until the Annual General Meeting of 2018;
- René de Groot's employment contract contains a fixed-term clause for a period of four years until the Annual General Meeting of 2019;

Severance pay

In case of newly appointed members of the Board of Managing Directors from outside the company, the maximum severance pay in the event of dismissal is established at one year's base salary. In case of newly appointed members of the Board from within KLM, the severance pay in the event of dismissal has been set at a maximum of two years' base salary, whereby in establishing the amount due consideration will be given to the years of service with KLM.

Remuneration of the Board of Managing Directors in financial year 2016

1. Base salary

The base salaries of Pieter Elbers (EUR 450,000), Erik Swelheim (EUR 300,000) and René de Groot (EUR 310,000) remained unchanged in 2016. As explained in last year's annual report, the three Managing Directors waived the proposed increases of the base salaries for 2016 in light of the Company's situation. The base salaries of Pieter Elbers and Erik Swelheim have not changed since April 2014. René de Groot's base salary was established upon his appointment to the Board in 2015 and has not changed since.

The Supervisory Board decided that, effective 2017, the base salary of Pieter Elbers will be raised to EUR 475,000, which is an increase of 5%. Pieter Elbers' base salary will then be at the level of his immediate predecessor, however it remains significantly below the median of the applicable market benchmark as well as below that of previous KLM CEOs. The Supervisory Board also decided to increase the base salaries of Erik Swelheim and René de Groot by 5% to EUR 315,000 and EUR 325,000 respectively. Including this increase, also their base salaries still remain below the median of the applicable benchmarks.

Details of the base salary received by the individual members of the Board of Managing Directors are presented in note 32 of the financial statements.

2. Short-term incentive plan

The Remuneration Committee has evaluated KLM's actual results against the collective and individual targets set for 2016 in accordance with the remuneration policy and its proposal has subsequently been endorsed by the Supervisory Board. This resulted in a short-term incentive payment for financial year 2016 of 90% (out of 100% maximum) of the base salary for Pieter Elbers, 51% (out of 60% maximum) for Erik Swelheim and 53.4% (out of 60% maximum) for René de Groot. For 2016, the Board of Managing Directors did not receive any payments under the company-wide profit sharing scheme.

Details of the amounts involved are included in note 32 of the financial statements.

3. Long-term incentive plan

Pursuant to the long-term incentive phantom shares plan and based on the performance evaluation of financial year 2016, phantom shares will be conditionally granted to each member of the Board of Managing Directors in April 2017. The number of granted phantom shares will amount to 10,000 for Pieter Elbers and 6,000 for Erik Swelheim and René de Groot. The phantom shares are granted conditionally in accordance with the provisions of the long-term incentive phantom shares plan.

At its February 2017 meeting, the Remuneration Committee has evaluated the results achieved against the targets set for the long-term incentive plan. In respect of financial year 2016, all targets were met in full.

Therefore the first (one third) increment of the 2017 phantom shares series, the second (one third) increment of the 2016 phantom shares series and the third (one third) increment of the 2015 phantom shares series will vest for 116%. These phantom shares will be unconditionally awarded in April 2017 to the members of the Board of Managing Directors.

Details of the granting and vesting of the phantom shares are included in note 30 of the financial statements.

Loans and advances

No loans or advances have been granted to members of the Board of Managing Directors.

Remuneration policy for the Supervisory Board

The remuneration policy for members of the Supervisory Board has not been changed since 2008. The remuneration consists of a fixed fee per annum and a fee for each meeting of the Board's Committees attended. Members of the Supervisory Board do not receive a performance-related reward or shares or rights to shares by way of remuneration, nor are they granted loans, advances or guarantees. The remuneration of the members of the Supervisory Board is fixed by the General Meeting of Shareholders.

Remuneration of the Supervisory Board members in financial year 2016

The remuneration for the Supervisory Board is as follows. The fixed fee payable for services amounts to EUR 42,500 for the Chairman, EUR 34,500 for the Vice-Chairman and EUR 26,500 for the other members of the Supervisory Board.

The fee per meeting of the Audit Committee attended amounts to EUR 2,000 for the Chairman and EUR 1,000 for the other members of the Audit Committee. The fee per meeting of the Remuneration Committee and the Nomination Committee attended amounts to EUR 1,500 for the Chairman and EUR 1,000 for the other members of the Remuneration Committee and the Nomination Committee.

Members of the Supervisory Board are furthermore entitled to make use of travel facilities comparable to the travel facilities as detailed in the travel regulations for KLM employees.

Details on the remuneration received by the individual members of the Supervisory Board are presented in note 31 of the financial statements.

Supervisory Board and Board of Managing Directors

Supervisory Board (situation as at december 31, 2016)

Name	Year of birth	Nationality	First appointment/ Current term	Function / Supervisory Board memberships and other functions*
Hans N.J. Smits ** Chairman	1950	Dutch	2004 / (fourth) 2016-2019	Chairman Janssen en de Jong Group. Former Chairman Board of Managing Directors Havenbedrijf Rotterdam N.V., former Chairman and CEO Rabobank, former Chairman and CEO Amsterdam Airport Schiphol.
Irene P. Asscher-Vonk **	1944	Dutch	2004 / (fourth) 2016 - 2017	Former Professor of labour law and social security law Radboud University Nijmegen / Arriva Personenvervoer Nederland B.V., Philip Morris Holland, Rabobank Nederland.
Philippe Calavia ***	1948	French	2012 / (second) 2016 - 2020	Senior advisor Accuracy. Former CFO AIR FRANCE KLM, former CEO AIR FRANCE KLM Finance, former deputy CEO Natexis / Director to Servair.
Alice Dautry-Varsat ***	1950	French	2014 / (first) 2014 - 2018	Former President of the Institute Pasteur / Board member UCB (BE), various board memberships in non-profit, educational and research institutions.
François Enaud ***	1959	French	2016 / (first)	President & CEO FE Development / Director Arkema, Board member of Aston Finance respectively Premium Peers / Chairman of Shadline and DejaMobile / President ANSA / Senior advisor Oddo Finance.
Cees 't Hart	1958	Dutch	2014 / (first) 2014 - 2018	CEO Carlsberg Group / director Supervisory Board Aids Fonds.
Jean Peyrelevade ***	1939	French	2007 / (third) 2015 - 2019	Board member of Banque Degroof Petercam France, former CEO of Suez, former CEO Stern Bank, former CEO of the Union des Assurances de Paris, former CEO Credit Lyonnais / Director of SAUR / BG Switzerland..
Pierre François Riolacci ***	1965	French	2016 / (first)	CFO ISS Facility Services / former CFO AIR FRANCE KLM, former CFO Veolia Environment, Director of Finance Veolia.
Annemieke J.M. Roobeek **	1958	Dutch	2011 / (second) 2015 - 2019	Professor for Strategy and Transformation Management Nyenrode Business Universiteit, CEO and founder of MeetingMoreMinds B.V. / Non-Executive Director of ABN AMRO Group, Abbott Healthcare Products. Chairman Advisory Board for Responsible Investing of PGGM Investments.

* Only memberships of Supervisory Boards and functions with large companies on December 31, 2016 are shown here
** Appointed upon recommendation of the KLM's Works Council
*** Appointed upon recommendation of AIR FRANCE KLM

Board of Managing Directors (situation as at december 31, 2016)

Name	Year of birth	Nationality	First appointment	Function
Pieter J.TH. Elbers	1970	Dutch	2012	President and Chief Executive Officer KLM
René M. de Groot	1969	Dutch	2015	Managing Director and Chief Operating Officer KLM
Erik R. Swelheim	1965	Dutch	2014	Managing Director and Chief Financial Officer KLM

Company Secretary & General counsel

Name	Year of birth	Nationality
Barbara C.P. van Koppen	1966	Dutch

2016 Financial Statements

KLM Royal Dutch Airlines Consolidated balance sheet

In millions of Euros	Note	December 31, 2016	December 31, 2015
Before proposed appropriation of the result for the year			
ASSETS			
Non-current assets			
Property, plant and equipment	1	3,783	3,526
Intangible assets	2	343	308
Investments accounted for using the equity method	3	22	24
Other non-current assets	4	317	282
Other financial assets	5	365	277
Deferred income tax assets	16	119	214
Pension assets	17	1,462	1,773
		6,411	6,404
Current assets			
Other current assets	4	224	281
Other financial assets	5	28	194
Inventories	6	193	161
Trade and other receivables	7	964	845
Cash and cash equivalents	8	1,208	840
		2,617	2,321
TOTAL ASSETS		9,028	8,725
EQUITY			
Capital and reserves			
Share capital	9	94	94
Share premium		474	474
Other reserves	10	(2,191)	(2,305)
Retained earnings		2,610	2,129
Total attributable to Company's equity holders		987	392
Non-controlling interests		1	4
Total equity		988	396
LIABILITIES			
Non-current liabilities			
Loans from parent company	11	288	288
Finance lease obligations	12	1,365	1,481
Other non-current liabilities	4	171	267
Other financial liabilities	13	1,208	1,184
Deferred income	15	204	162
Provisions for employee benefits	17	474	399
Other provisions	18	593	547
		4,303	4,328
Current liabilities			
Trade and other payables	19	1,983	1,750
Loans from parent company	11	–	105
Finance lease obligations	12	395	209
Other current liabilities	4	66	632
Other financial liabilities	13	85	87
Deferred income	15	1,017	922
Provisions for employee benefits	17	28	32
Other provisions	18	163	264
		3,737	4,001
Total liabilities		8,040	8,329
TOTAL EQUITY AND LIABILITIES		9,028	8,725

The accompanying notes are an integral part of these consolidated financial statements

KLM Royal Dutch Airlines Consolidated statement of profit or loss

In millions of Euros	Note	2016	2015
Revenues	22	9,800	9,905
Expenses			
External expenses	23	(5,519)	(6,164)
Employee compensation and benefit expenses	24	(2,860)	(2,774)
Other income and expenses	25	182	298
Total expenses		(8,197)	(8,640)
EBITDAR		1,603	1,265
Aircraft operating lease costs		(414)	(354)
EBITDA		1,189	911
Amortisation, depreciation and movements in provisions	26	(508)	(527)
Income from current operations		681	384
Other non-current income and expenses	27	3	71
Income from operating activities		684	455
Gross cost of financial debt	28	(116)	(135)
Income from cash and cash equivalents	28	16	21
Net cost of financial debt		(100)	(114)
Other financial income and expenses	28	1	(208)
Pre-tax income		585	133
Income tax (expense)/benefit	29	(69)	(42)
Net result after taxation of consolidated companies		516	91
Share of results of equity shareholdings		3	(37)
Profit for the year		519	54
Attributable to:			
Equity holders of the Company		517	53
Non-controlling interests		2	1
		519	54
Net profit attributable to equity holders of the Company		517	53
Dividend on priority shares		-	-
Net profit available for holders of ordinary shares		517	53
Average number of ordinary shares outstanding		46,809,699	46,809,699
Average number of ordinary shares outstanding (fully diluted)		46,809,699	46,809,699
Profit per share (in EUR)		11.03	1.14
Diluted profit per share (in EUR)		11.03	1.14

The accompanying notes are an integral part of these consolidated financial statements

KLM Royal Dutch Airlines Consolidated statement of profit or loss and other comprehensive income

In millions of Euros	2016	2015
Profit for the year	519	54
Cash flow hedges		
Effective portion of changes in fair value of cash flow hedges recognised directly in equity	205	(439)
Change in fair value transferred to profit or loss	344	559
Exchange differences on translation foreign operations	8	(4)
Tax on items of comprehensive income that will be reclassified to profit or loss	(137)	(30)
Total of comprehensive income that will be reclassified to profit or loss	420	86
Remeasurement of defined benefit pension plans	(455)	329
Tax on items of comprehensive income that will not be reclassified to profit or loss	114	(82)
Total of comprehensive income that will not be reclassified to profit or loss	(341)	247
Total of other comprehensive after tax	79	333
Recognised income and expenses	598	387
- Equity holders of the company	596	386
- Non-controlling interests	2	1

The accompanying notes are an integral part of these consolidated financial statements

KLM Royal Dutch Airlines Consolidated statement of changes in equity

In millions of Euros	Share capital	Share premium	Other reserves	Retained earnings	Total	Non-controlling interests	Total equity
	Attributable to Company's equity holders						
As at January 1, 2016	94	474	(2,305)	2,129	392	4	396
Net gain/(loss) from cash flow hedges	-	-	549	-	549	-	549
Exchange differences on translation foreign operations	-	-	8	-	8	-	8
Remeasurement of defined benefit pension plans	-	-	(455)	-	(455)	-	(455)
Transfer from retained earnings	-	-	35	(35)	-	-	-
Tax on items taken directly to or transferred from equity	-	-	(23)	-	(23)	-	(23)
Net income/(expense) recognised directly in equity	-	-	114	(35)	79	-	79
Profit for the year	-	-	-	517	517	2	519
Total recognised income/(expenses)	-	-	114	482	596	2	598
Dividends paid	-	-	-	-	-	(1)	(1)
Other movements	-	-	-	(1)	(1)	(4)	(5)
As at December 31, 2016	94	474	(2,191)	2,610	987	1	988

In millions of Euros	Share capital	Share premium	Other reserves	Retained earnings	Total	Non-controlling interests	Total equity
	Attributable to Company's equity holders						
As at January 1, 2015	94	474	(2,662)	2,099	5	4	9
Net gain/(loss) from cash flow hedges	-	-	120	-	120	-	120
Exchange differences on translation foreign operations	-	-	(4)	-	(4)	-	(4)
Remeasurement of defined benefit pension plans	-	-	329	-	329	-	329
Transfer from retained earnings	-	-	24	(24)	-	-	-
Tax on items taken directly to or transferred from equity	-	-	(112)	-	(112)	-	(112)
Net income/(expense) recognised directly in equity	-	-	357	(24)	333	-	333
Profit for the year	-	-	-	53	53	1	54
Total recognised income/(expenses)	-	-	357	29	386	1	387
Dividends paid	-	-	-	-	-	(1)	(1)
Other movements	-	-	-	1	1	-	1
As at December 31, 2015	94	474	(2,305)	2,129	392	4	396

The accompanying notes are an integral part of these consolidated financial statements

KLM Royal Dutch Airlines consolidated cash flow statement

In millions of Euros	Note	2016	2015
Profit for the year		519	54
Depreciation and amortisation	26	516	511
Changes in provisions	26	(7)	16
Results of equity shareholdings		(3)	37
Result on sale of equity shareholdings		(3)	-
Changes in pension assets		(23)	(18)
Changes in deferred income tax	29	69	42
Other changes		(61)	74
Net cash flow from operating activities before changes in working capital		**1,007**	**716**
(Increase) / decrease in inventories		(43)	43
(Increase) / decrease in trade receivables		(98)	24
Increase / (decrease) in trade payables		49	(84)
(Increase) / decrease in other receivables and other payables		218	49
Change in working capital requirement		**126**	**32**
Net cash flow from operating activities		**1,133**	**748**
Capital expenditure on intangible fixed assets	2	(93)	(73)
Capital expenditure on aircraft	1	(734)	(378)
Disposal of aircraft		91	29
Capital expenditure on other tangible fixed assets	1	(54)	(63)
Disposal of other (in-)tangbile fixed assets		15	144
Sale of equity shareholdings		14	-
Dividends received		5	1
(Increase) / decrease in short-term deposits and commercial paper		174	(7)
Net cash flow used in investing activities		**(582)**	**(347)**
Increase in long-term debt		318	490
Decrease in long-term debt		(412)	(943)
Increase in long-term receivables		(107)	(45)
Decrease in long-term receivables		24	86
Dividends paid		(1)	(1)
Net cash flow used in financing activities		**(178)**	**(413)**
Effect of exchange rates on cash and cash equivalents		(5)	14
Change in cash and cash equivalents		**368**	**2**
Cash and cash equivalents at beginning of period		840	838
Cash and cash equivalents at end of period *	8	1,208	840
Change in cash and cash equivalents		**368**	**2**

The accompanying notes are an integral part of these consolidated financial statements

* Including unrestricted Triple A bonds, deposits and commercial paper the overall cash position and other highly liquid investments amounts to EUR 1,541 million as at December 31, 2016 (December 31, 2015 EUR 1,233 million)

In millions of Euros	2016	2015
Cash flow from operating activities	1,133	748
Cash flow used in investing activities (excluding (increase)/decrease in short-term deposits and commercial paper)	(755)	(340)
Free cash flow	**378**	**408**

Financial Statements financial year 2016

Notes to the consolidated financial statements

General

Koninklijke Luchtvaart Maatschappij N.V. (the "Company") is a public limited liability company incorporated and domiciled in The Netherlands. The Company's registered office is located in Amstelveen.

The Company is a subsidiary of AIR FRANCE KLM S.A. ("AIR FRANCE KLM"), a company incorporated in France. The Company financial statements are included in the financial statements of AIR FRANCE KLM which can be obtained from the AIR FRANCE KLM Financial communication department. AIR FRANCE KLM's shares are quoted on the Paris and Amsterdam stock exchanges.

The Company together with its subsidiaries (the "Group") has as its principal business activities the air transport of passengers and cargo, aircraft maintenance and any other activity linked to air transport.

These financial statements have been authorised for issue by the Board of Managing Directors on March 21, 2017 and will be submitted for approval to the Annual General Meeting (AGM) of shareholders on April 21, 2017.

Subsequent events paragraph

On March 17, 2017, the European Commission announced that it would fine eleven airlines, including KLM, Martinair and Air France, for practices in the air cargo sector that are considered anti-competitive and relate mainly to the period between December 1999 and February 2006. This new decision follows the initial decision of the Commission of November 9, 2010. This decision, issued to the same airlines for the same alleged practices, was annulled on formal grounds by the General Court of the European Commission in December 2015. The EUR 156 million provision in respect of the fine however has been maintained as per December 31, 2016. The new fine for KLM and Martinair, as announced on March 17, 2017, amounts to EUR 142.6 million and is slightly lower than the initial fine imposed in 2010. KLM and Martinair (and Air France) will analyse this new decision and consider its options for response. Reference is made to note 21 "Contingent assets and liabilities" of the Consolidated Financial Statements.

Basis of presentation

The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards adopted by the European Union (EU-IFRS) and effective at the reporting date December 31, 2016. The consolidated financial statements have also been prepared in accordance with Section 362(9) of Book 2 of The Dutch Civil Code. As permitted by Section 402 of Book 2 of The Dutch Civil Code the company statement of profit or loss has been presented in condensed form.

All amounts (unless specified otherwise) are stated in millions of Euros (EUR million)

Significant accounting policies

The consolidated financial statements are prepared on historical cost basis unless stated otherwise. The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Recent accounting pronouncements

The following IFRS standards, amendments and IFRIC interpretations, have been published by the IASB, and are applicable on a mandatory basis to the 2016 financial statements:

IFRS standards and IFRIC interpretations which are applicable on a mandatory basis to the 2016 financial statements:

» Amendment to IFRS 11 "Joint Arrangements", effective for the period beginning January 1, 2016;
» Amendment to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets", effective for the period beginning January 1, 2016, and
» Amendment to IAS 1 "Presentation of Financial Statements", effective for the period beginning January 1, 2016.

These amendments had no significant impact on the Group's financial statements as of December 31, 2016.
IFRS standard which is applicable on a mandatory basis to the 2018 financial statements:

» Standard IFRS 9 "Financial Instruments", effective for the period beginning January 1, 2018, and
» Standard IFRS 15 "Revenue Recognition from Contracts with Customers", effective for the period beginning January 1, 2018, and replacing the standards IAS 18 "Revenues", IAS 11 "Construction Contracts" and IFRIC 13 "Customer Loyalty Programmes".

The implementation of IFRS 9 began mid-2015. Jointly with AIR FRANCE KLM and Air France we have set up dedicated working groups within head-accounting departments and middle-office treasury departments. Two major impacts are expected following the implementation of this new standard. The first impact relates to the recognition of the variation in the time value of options to be booked in "Other Comprehensive Income" whereas it is currently recognized in the income statement. The second impact relates to the valuation of equity instruments either assessed at fair value through the income statement, or at fair value through Other Comprehensive Income. The methodology for the classification the equity instruments is being investigated. The impacts cannot yet be quantified.

The joint implementation of IFRS 15 started 2015 in project mode. We have set up dedicated working groups within the relevant business segments and departments to establish an inventory of customer contract types throughout the Group and to analyze each contract type using the five-step approach outlined within IFRS 15. In parallel, we have worked with other airlines through the IATA (International Air Transport Association) Industry Accounting Working Group (IAWG) in coordination with the Airlines Revenue Recognition Task Force of the AICPA (American Institute of Certified Public Accountants) to agree on harmonized accounting treatments for issues requiring clarity under the new standard. The main impact on the Group is expected to relate to the recognition of Passenger Network and Cargo segments revenue and are being evaluated: agent versus principal recognition, unearned revenue recognition and customer loyalty programs recognition. Furthermore, with regard to the maintenance services segment, the Group has worked in collaboration with other airlines within the IAWG facing the same maintenance revenue issues. The impacts in this area are being identified.

Other texts potentially applicable to the Group, published by the IASB but not yet adopted by the European Union, are described as follows:

» Standard IFRS 16 "Leases", effective for the period beginning January 1, 2019;
» Amendment to IAS 7 "Cash Flow Statement", effective for the period beginning January 1, 2017;
» Amendment to IAS 12 "Income tax", effective for the period beginning January 1, 2017;
» Amendment to IFRS 2 "Classification and Measurement of Share-based Payment Transactions", effective for the period beginning January 1, 2018, and
» Amendment to IFRS 15 Clarification on "Revenue Recognition from Contracts with Customers", effective for the period beginning January 1, 2018.

Regarding the implementation of IFRS 16, the project was launched as of the publication of the standard in January 2016. Jointly within AIR FRANCE KLM and Air France we have set up dedicated working groups within the relevant business segments and departments to firstly explain all the changes introduced by the new standard relative to the current standard, IAS 17, and secondly, to determine contract typologies within the scope of IFRS 16. Based on the inventory of current contracts as of December 31, 2015, a preliminary assessment of the financial impact of this standard has been carried out.
Our net debt is expected to significantly increase by the application of this standard. However, as the analyst community already adjusts net debt by adding to the accounting net debt seven times the aircraft operating lease cost, the impact should be limited. The main expected impact relates to the balance-sheet recognition of the aircraft right-of-use assets.

We do not expect any significant impacts related to the application of the amendments to IAS 12 and IFRS 2.

Use of estimates and the exercise of judgments

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from the estimates. The preparation of these financial statements also requires management to exercise its judgment in the process of applying the Company's accounting policies.

The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed further in the note Accounting policies for the consolidated balance sheet.

Consolidation principles

Subsidiaries

In conformity with IFRS 10 "Consolidated Financial Statements", the Group's consolidated financial statements comprise the financial statements for all entities that are controlled directly or indirectly by the Group, irrespective of its level of participation in the equity of these entities. The companies over which the Group exercises control are fully consolidated.

An entity is controlled when the Group has power on it, is exposed or has rights to variable returns from its involvement in this entity, and has the ability to use its power to influence the amounts of these returns. The determination of control takes into account the existence of potential voting rights if they are substantive, meaning they can be exercised in time when decisions about the relevant activities of the entity need to be taken.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control begins until the date this control ceases.

Non-controlling interests are presented within equity and on the statement of profit or loss separately from Company's equity holders and the Group's net result, under the line "non-controlling interests".

The effects of a buyout of non-controlling interests in a subsidiary already controlled by the Group and divestment of a percentage interest without loss of control are recognised in equity. In a partial disposal resulting in loss of control, the retained equity interest is remeasured at fair value at the date of loss of control. The gain or loss on the disposal will include the effect of this remeasurement and the gain or loss on the sale of the equity interest, including all the items initially recognised in equity and reclassified to profit and loss.

Intra-group operations

All intra-group balances and transactions, including income, expenses and dividends are fully eliminated. Profits and losses resulting from intra-group transactions are also eliminated. Gains and losses realised on internal sales with associates and jointly-controlled entities are eliminated, to the extent of the Group's interest in the entity, providing there is no impairment.

Interest in associates and jointly controlled entities

In accordance with IFRS 11 "Joint arrangements", the Group applies the equity method to partnership over which it exercises control jointly with one or more partners (jointly controlled entities). Control is considered to be joined when decisions about the relevant activities of the partnership require the unanimous consent of the Group and the other parties sharing the control. In cases of a joint activity (joint operation), the Group recognizes assets and liabilities in proportion to its rights and obligations regarding the entity. In accordance with IAS 28 "Investments in Associates and Joint Ventures", companies in which the Group has the ability to exercise significant influence on financial and operating policy decisions are also accounted for using the equity method. The ability to exercise significant influence is presumed to exist when the Group holds more than 20% of the voting rights.

The consolidated financial statements include the Group's share of the total recognised global result of associates and jointly controlled entities from the date the ability to exercise significant influence begins to the date it ceases, adjusted for any impairment loss.

The Group's share of losses of an associate that exceed the value of the Group's interest and net investment (long-term receivables for which no reimbursement is scheduled or likely) in this entity are not accounted for, unless:
» the Group has incurred contractual obligations; or
» the Group has made payments on behalf of the associate.

Any surplus of the investment cost over the Group's share in the fair value of the identifiable assets, liabilities and contingent liabilities of the associate company on the date of acquisition is accounted for as goodwill and included in the book value of the investment accounted for using the equity method.

The investments in which the Group has ceased to exercise significant influence or joint control are no longer accounted for by the equity method and are valued at their fair value on the date of loss of significant influence or joint control.

Scope of consolidation

A list of the significant subsidiaries is included in note 36 of the consolidated financial statements.

Foreign currency

Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Euro, which is the Company's functional and presentation currency. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or at the exchange rate of the related hedge, if applicable. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Group companies

The financial statements of Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- » Assets and liabilities are translated at the closing rate;
- » The statement of profit or loss and the cash flow statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- » All resulting translation differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to equity.

When control is given up, such exchange differences are recognised in the statement of profit or loss as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

The exchange rates used for the most significant currencies were as follows:

	Balance Sheet December 31, 2016 EUR	Average in Statement of profit or loss 2016 EUR	Balance Sheet December 31, 2015 EUR
1 US Dollar (USD)	0.95	0.90	0.92
1 Pound sterling (GBP)	1.17	1.24	1.36
1 Swiss franc (CHF)	0.93	0.92	0.92
100 Japanese yen (JPY)	0.81	0.83	0.76
100 Kenya Shilling (KES)	0.94	0.89	0.90

Business combinations

Business combinations are accounted for using the purchase method in accordance with IFRS 3 revised standard "Business combinations". The cost of a business combination is measured at the fair values, at the date of exchange, of assets given, liabilities incurred or assumed and equity instruments issued in exchange for control of the acquirer.
Any other costs directly attributable to the business combination are recorded in the statement of profit or loss.

When a business combination agreement provides for an adjustment to the cost contingent on future events, then the adjustment is taken into account when determining the cost if the adjustment is probable and can be measured reliably.

Where goodwill has been initially determined on a provisional basis, adjustments arising within twelve months of the acquisition date are recognised on a retrospective basis.
Goodwill acquired in a business combination is no longer amortised, but instead is subject to annual impairment test or more frequently if events or changes in circumstances indicate that goodwill might be impaired.

Segment reporting

The Company defines its primary segments on the basis of the Group's internal organisation, main revenue generating activities and the manner in which the Board of Managing Directors manages operations.

Business segments

The activities of each segment are as follows:

» **Passenger**

The Passenger Business segment's main activity is the transportation of passengers on scheduled flights that have the Company's airline code. Passenger revenues include receipts from passengers for excess baggage and inflight sales. Other Passenger revenues are derived from commissions from SkyTeam alliance partnership arrangements and revenues from block-seat sales.

» **Cargo**

Cargo activities relate to the transportation of freight on flights under the Company's code and the sale of Cargo capacity to third parties.

» **Maintenance**

Maintenance revenues are generated through maintenance services (engine services, component services and airframe maintenance) provided to other airlines and clients around the world.

» **Leisure**

This segment covers primarily the provision of charter flights and (low-cost) scheduled flights operated by transavia.com.

» **Other**

This segment covers primarily catering and handling services to third-party airlines and clients around the world.

Geographical segments

Revenues are allocated to geographical segments on the basis of destination as follows:

» Direct flights: Revenue is allocated to the geographical segment in which the destination falls;
» Flights with stopovers: Revenue is allocated to the geographical segments in which the various sections of the route fall in accordance with IATA guidelines (based on weighted Passenger-kilometers).

The greater part of the Group's assets comprises aircraft and other assets that are located in The Netherlands. Inter-segment revenues are determined using the prices actually used for invoicing. These prices have been determined on a consistent basis.

Distinction between income from current operations and income from operating activities

The Group considers it relevant to the understanding of its financial performance to present on the face of the statement of profit or loss a subtotal within the income from operating activities. This subtotal, named "Income from current operations", excludes those elements that have little predictive value due to their nature, frequency and/or materiality.

Such elements are as follows:

» Sales of aircraft equipment and disposals of other assets;
» Income from the disposal of subsidiaries and affiliates;
» Restructuring costs when they are significant;
» Significant and infrequent elements such as the recognition of badwill in the statement of profit and loss, the recording of an impairment loss on goodwill and significant provisions for litigation.

Aggregates used within the framework of financial communication

EBITDA (Earnings Before Interests, Taxes, Depreciation, Amortisation and movements in provision): by extracting the main line of the income statement which does not involve cash disbursement ("Amortisation, depreciation and movements in provision") from income from current operations, EBITDA provides a simple indicator of the Group's cash generation on operational activities.

EBITDAR (Earnings Before Interests, Taxes, Depreciation, Amortisation, movements in provision and Rents): this aggregate is adapted to sectors like the air transport industry which can finance a significant proportion of their assets using operating leases. It is obtained by subtracting aircraft operating lease costs from EBITDA (as defined above).

Operating free cash flow corresponds to the cash available after investment in (prepayments in) aircraft, other tangible fixed assets and intangible fixed assets less the proceeds of disposals. It does not include the other cash flows linked to investment operations, particularly investments in subsidiaries and other financial assets and net cash flow from the operating activities.

Accounting policies for the balance sheet

Impairment of assets

The Group's assets, other than inventories, deferred tax assets, assets arising from construction contracts, assets arising from employee benefits, financial assets that are within the scope of IAS 39 and non-current assets held for sale are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill, intangible assets with indefinite lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. Goodwill is allocated to Passenger Business and software to the business unit which uses the software.

An impairment loss is recognised in the statement of profit or loss for the amount by which the asset's carrying amount exceeds its recoverable amount.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units (CGUs)), which correspond to the Group's Business segments.

Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to CGUs (or groups of CGUs) and then, to reduce the carrying amount of the other assets in the CGU (or group of CGUs) on a pro-rata basis.

The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. To determine the value in use, 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. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGU to which the asset belongs.

An impairment loss is reversed only to the extent that the asset's increased 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. An impairment loss in respect of goodwill is not reversed.

Property, plant and equipment

With the exception of leased assets, and except as described in the following paragraph property, plant and equipment are stated initially at historical acquisition or manufacturing cost. Leased assets are stated initially at their fair value or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease.
Flight equipment acquired in foreign currency is translated at the exchange rate applicable at the date of acquisition or the hedged rate where a hedging instrument has been used. Manufacturers' discounts are deducted from the acquisition cost.
Interest incurred in connection with the financing of aircraft (including other flight equipment) during the period prior to commissioning is included in cost. The interest rate adopted is the applicable interest rate for debts outstanding at the balance sheet date unless capital expenditure or advance payments are themselves funded by specific loans.

The cost of major maintenance operations (airframes and engines excluding parts with limited useful lives) which are carried out in accordance with specifications and schedules defined by manufacturers and regulating authorities are capitalised when incurred. Other maintenance costs are expensed as incurred.

Depreciation

Property, plant and equipment are depreciated to estimated residual values using the straight-line method over average estimated useful lives.

Aircraft fixtures and fittings and spare parts are classified as separate components from the airframe and depreciated separately.

During the annual operational planning cycle, the Group reviews the depreciation methods, useful lives and residual values and, if necessary amends these.

The useful lives of property, plant and equipment are as follows:

Category	Useful life (years)
Aircraft	20 to 25
Aircraft fixtures and fittings, and spare parts	3 to 20
Land	Not depreciated
Buildings	10 to 40
Equipment and fittings	3 to 15
Other property and equipment	5 to 20

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or when shorter, the term of relevant use. Gains and losses on disposals are determined by comparing the proceeds of disposal with the carrying amount.

Intangible assets

Goodwill

Goodwill is stated at cost less accumulated impairment losses. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets, liabilities and contingent liabilities of the acquired subsidiaries and associates. Goodwill on acquisition of subsidiaries is included in intangible assets. If the cost of acquisition is less than the fair value of the net identifiable assets, liabilities and contingent liabilities, the difference is recognised directly in the statement of profit or loss. Goodwill on acquisition of associates is included in investments in associates. On disposal of a subsidiary the attributable amount of goodwill is included in the determination of profit or loss on disposal. The useful life of goodwill is indefinite.

Computer software

Computer software is stated at historical cost less accumulated amortisation and accumulated impairment losses. Only the costs incurred in the software development phase are capitalised. Cost incurred in respect of feasibility studies and research etc. and post-implementation and evaluation phases are charged to the statement of profit or loss as incurred. The costs comprise the cost of KLM personnel as well as external IT consultants.
Amortisation takes place over the estimated useful lives (mainly 5 years and with a maximum of 10 years) of the software using the straight-line method. The useful life of each software application is determined separately. Amortisation commences when the software is taken into use. Prior to this moment the cost are capitalised as prepaid intangible assets.
The estimated useful life and amortisation method are reviewed during the annual operational planning cycle, including the effect of any changes in estimates being recognised prospectively if the change relates to future periods.

Investments accounted for using the equity method

Associates are all entities over which the Group has significant influence but not control or joint control, is presumed to exist when the Group holds more than 20% of the voting rights. Jointly controlled entities are entities whereby the Group together with one or more parties undertakes activities related to the Group's business that are subject to joint control.
Investments in associates and jointly controlled entities are accounted for by the equity method and are initially recognised at cost. The Group's investment includes goodwill (net of any accumulated impairment loss) identified on acquisition. The Group's share of post-acquisition profits or losses is recognised in the statement of profit or loss, and its share of post-acquisition movements in reserves is recognised in reserves.

The cumulative post-acquisition movements are adjusted against the carrying amount of the investment, taking into account other than temporary losses (impairment). When the Group's share of losses in an associate/jointly controlled entity equals or exceeds its interest in the associate/jointly controlled entity, including unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate/jointly controlled entity.
Unrealised gains on transactions between the Group and its associates/jointly controlled entities are eliminated to the extent of the Group's interest in the associates/jointly controlled entities. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates/jointly controlled entities have been changed where necessary to ensure consistency with the policies adopted by the Group.

Derivative financial instruments and hedge accounting

Derivative financial instruments are recognised initially (trade date), and are subsequently re-measured, at fair value. Fair values are obtained from quoted market prices in active markets or by using valuation techniques where an active market does not exist.
Valuation techniques include discounted cash flow models and option pricing models as appropriate. All derivatives are presented as assets when their fair value is positive and as liabilities when their fair value is negative.

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterpart, a legal right to off-set exists and the cash flows are intended to be settled on a net basis.

Recognition of fair value gains and losses

The method of recognising fair value gains and losses on derivative financial instruments depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if so, the nature of the risk being hedged.

All derivative financial instruments are held for hedging purposes. It is KLM's policy not to hold derivative financial instruments for trading purposes. The derivatives, which do not qualify for hedge accounting, are described as items not qualifying for hedge accounting in these notes to the financial statements.

Categories of hedging transactions

Derivatives are used to hedge the risks associated with changes in interest rates, foreign currency rates and fuel prices.

Forward currency contracts and options are used to cover exposure to exchange rate movements. The Group also uses swaps to manage its exposure to interest rate risk. Finally, the exposure to fuel price risks is covered by swaps or options on jet fuel and fuel related indices such as Gasoil and Brent.

Hedging transactions fall into two categories:

1. Fair value hedges;
2. Cash flow hedges.

1. Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of profit or loss, together with changes in the fair value of the asset or liability or group thereof that are attributable to the hedged risk.

2. Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. Any gain or loss relating to an ineffective portion is recognised immediately in the statement of profit or loss.

Amounts accumulated in equity are recycled to the statement of profit or loss in the periods in which the hedged item will affect profit or loss. However, when a forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

Hedge effectiveness testing

To qualify for hedge accounting, at the inception of the hedge, and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must be demonstrated on an ongoing basis.

The documentation at inception of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method used to assess effectiveness will depend on the risk management strategy.

For interest rate and foreign exchange derivatives used as fair value and cash flow hedges, the offset method is used as the effectiveness testing methodology. For fuel derivatives used as cash flow hedges regression analysis and offset methodologies are used.
If the hedging instrument no longer meets the criteria for hedge accounting, is sold, is terminated or designation is revoked, then hedge accounting is discontinued prospectively.
The cumulative gain or loss previously recognised in equity remains there until the forecast transaction affects profit or loss. If the forecasted transaction is no longer expected to occur, then the balance in equity is recognised immediately in profit or loss.

Fair value hierarchy

Based on the requirements of IFRS 7, the fair values for financial assets and liabilities are classified following a scale that reflects the nature of the market data used to make the valuations. This scale has three levels of fair value:

- Level 1: Fair value calculated from the exchange rate / price quoted on the active market for identical instruments;
- Level 2: Fair value calculated from valuation techniques based on observable data such as active prices or similar liabilities or scopes quoted on the active market; or
- Level 3: Fair value from valuation techniques which rely completely or in part on non observable data such as prices on an inactive market or the valuation on a multiple basis for non quoted securities.

Financial instruments: Recognition and measurement of financial assets and liabilities

For the purposes of determining the basis on which they are to be recognised and measured financial instruments are classified into the following categories:

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the intention and ability to held until maturity. Held-to-maturity investments are initially recognised at fair value and subsequently at amortised cost using the effective interest method less any impairment. Interest is recognised in the statement of profit or loss.

Medium term notes and bank deposits held by the Group as natural hedges for foreign currency liabilities and debts are generally classified as held-to-maturity investments.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognised at fair value and subsequently at amortised cost using the effective interest method, less any impairment. Interest calculated using the effective interest method is recognised in the statement of profit or loss.
Loans to associates, other loans and trade and other receivables are classified as loans and receivables, except for short-term receivables where the recognition of interest would be immaterial.

Effective interest method

For held-to-maturity investments and loans and receivables, the Group applies the effective interest rate method and amortises the transaction cost, discounts or other premiums included in the calculation of the effective interest rate over the expected life of the instrument.

At fair value through profit or loss

At fair value through profit or loss financial assets are other financial assets which have not been classified under either held-to-maturity or loans and receivables. At fair value through profit or loss financial assets are measured at fair value both on initial recognition and subsequently. Gains and losses arising from changes in fair value, including any interest or dividend income, are recognised in the statement of profit or loss.

Cash and cash equivalents

Cash and cash equivalents cover all highly liquid instruments with original maturities of three months or less and include cash in hand, deposits held at call and on short-term with banks and bank overdrafts. Bank overdrafts are shown under "Financial liabilities" in "Current liabilities" in the balance sheet.

Where the Company has a practice and legally enforceable right to offset bank balances, the net balance is included under cash and cash equivalents or bank overdrafts as applicable. Cash and cash equivalents are stated in the balance sheet at fair value.

Financial liabilities

Financial liabilities are initially recognised at fair value. Transaction costs are included in this initial measurement. Subsequent to initial recognition, liabilities are, with the exception of derivative financial instruments carried at amortised cost.

Financial liabilities are derecognised when the Group's obligations specified in the contract expire or are discharged or cancelled. Any costs that were attributable to financial liabilities are expensed through the statement of profit or loss.

Inventories

Inventories consist primarily of expendable aircraft spare parts, fuel stock and other supplies and are stated at the lower of cost and net realisable value. Cost, representing the acquisition cost, is determined using the weighted average method. Net realisable value is the estimated selling price in the ordinary course of business, less applicable selling expenses.

Leases

Finance leases

The Group has entered into a number of finance lease contracts (exclusively for aircraft). Under the terms of these contracts substantially all the risks and rewards in connection with the ownership of the underlying assets are transferred to the Group and the lease payments are treated as repayment of principal and finance cost to reward the lessor for its investment. The assets which are the subject of finance leases are presented as property, plant and equipment in the balance sheet.

Finance lease liabilities are stated initially at the present value of the minimum lease payments. Finance cost is recognised based on a pattern that reflects an effective rate of return to the lessor.

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Sale and leaseback transactions resulting in a finance lease with a deferred credit are initially established at present value and credited to net cost of financial debt over the remaining term of the associated financial lease contracts.

Operating leases
In addition to finance leases, the Group also leases aircraft, buildings and equipment under operating lease agreements. Operating leases are lease contracts which are not classified as finance leases, i.e. the risks and rewards in connection with the ownership of the underlying assets are not substantially transferred to the lessee.

Lease expense of operating leases is recognised in the statement of profit or loss on a straight-line basis over the lease term. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss is recognised immediately in the statement of profit or loss. If the sale price is below fair value, any profit or loss is recognised immediately. However, if the loss is compensated for by future lease payments at below market price, the loss is deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above the fair value, the excess over fair value is deferred and amortised in proportion over the period for which the asset is expected to be used.

If the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and the fair value is recognised immediately in the statement of profit or loss.

Deferred income

Advance ticket sales
Upon issuance, both Passenger and Cargo sales, including fuel and security surcharges, are recorded as deferred income under Advance ticket sales. The Company applies an estimation policy with respect to the recognition of those revenues in order to determine which part of the tickets sold and related surcharges will expire without any transport commitment for the Company.

Deferred gains on sale and leaseback transactions
This item relates to amounts deferred arising from sale and leaseback transactions.

Flying Blue frequent flyer program
KLM and Air France have a common frequent flyer program "Flying Blue". This program allows members to acquire "miles" as they fly on KLM, Air France or with other partner companies. These miles entitle members to a variety of benefits such as free flights with the two companies. The probability of air miles being converted into award tickets is estimated using a statistical method. The value of air miles is estimated based on the deferred revenue approach, based on its fair value. This estimate takes into consideration the conditions of the use of free tickets and other awards.

The estimated value of air miles is recorded as a deduction from revenues and recorded under the caption "Deferred income" as liability on the balance sheet at the same time the qualifying flight for which air miles are awarded is recognised.

The Group also sells miles to partner companies participating in current loyalty programs, such as credit card companies, hotel chains and car rental firms. The Group defers a portion of the miles sold representing the value of the subsequent travel award to be provided, in a manner consistent with the determination of the liability for earned flight awards discussed above. The remainder is recognised as revenue immediately.

Deferred income taxes
Deferred tax assets and liabilities arising from the tax losses carried forward and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for tax purposes are determined using the balance sheet liability method and calculated on the basis of the tax rates that have been enacted or substantively enacted at the balance sheet date and that are expected to apply to the period when the asset is realised or the liability is settled. Except for goodwill arising from a business combination, deferred tax assets are recognised to the extent that is probable that taxable profit will be available against which the tax losses carried forward and the temporary difference can be utilised.

Deferred tax assets and deferred tax liabilities are set off only when the Group has a legally enforceable right to offset current tax assets against current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same authority.

A deferred tax asset is recognised for all deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except to the extent that is not probable that the temporary difference will reverse in the foreseeable future and taxable profit will not be available against which the temporary difference can be realised.
A deferred tax liability is recognised for all taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except to the extent that the Group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Provisions for employee benefits

Pensions and other post-employment benefits

Pensions and other post-employment benefits relate to provisions for benefits (other than termination benefits) which are payable to employees on retirement.
The provisions cover defined benefit pension plans, early-retirement schemes and post-employment medical benefits available to employees. The Group has various defined benefit and defined contribution pension plans, which are generally funded through payments to separately administered funds or to insurance companies.

The amount recognised as a liability or an asset for post-employment benefits at the balance sheet date is the net total of:

1. The present value of the defined benefit obligations at the balance sheet date; and
2. Minus the fair value of the plan assets at the balance sheet date.

The actuarial gain and losses are recognised immediately in Other Comprehensive Income (part of equity).

The present values of the defined benefit obligations are calculated using the projected unit credit method. The calculations of the obligations have been performed by independent qualified actuaries. This benefit/years-of-service method not only takes into account the benefits and benefit entitlements known at the balance sheet date, but also increases in salaries and benefits to be expected in the future. When a plan is curtailed or settled, gains or losses arising are recognised immediately.

The determination of the liability or asset to be recognised as described above is carried out for each plan separately. In situations where the fair value of plan assets, adjusted for any unrecognised positions, exceeds the present value of a fund's defined benefit obligations then an asset is recognised if available.
The service cost and the interest accretion to the provisions are included in the statement of profit or loss under "Employee compensation and benefit expense".

Other long-term employment benefits

The provision for other long-term employment benefits relates to benefits (other than pensions and other post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service. The provision covers jubilee benefits. The benefits are unfunded.

The amount recognised as a liability for other long-term employment benefits at the balance sheet date is the present value of the defined benefit obligations. Appropriate assumptions are made about factors such as salary increases, employee turnover and similar factors impacting the measurement of the obligations.

The service cost, the interest accretion to the provisions and the remeasurement of the net defined liability are included in the statement of profit or loss under "Employee compensation and benefit expense".

Termination benefits

Termination benefits are employee benefits payable as a result of either the Group's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept voluntary redundancy. The provision is recognised when, and only when, a formal employee termination plan has been drawn up and approved and there is no realistic possibility of it being withdrawn.
Where the benefits fall due in more than 12 months after the balance sheet date the provision is the present value of the expenditures expected to settle the obligation.

Other provisions

Provisions are recognised when:

- There is a present legal or constructive obligation as a result of past events;
- It is probable that an outflow of economic benefits will be required to settle the obligation; and
- A reliable estimate of the amount of the obligation can be made.

The provisions are carried at face value unless the effect of the time value of money is material, in which case the amount of the provision is the present value of the expenditures expected to settle the obligation. The effect of the time value of money is presented as a component of financial income.

Emission Trading Scheme

European airlines are subject to the Emission Trading Scheme (ETS). In the absence of an IFRS standard or interpretation regarding ETS accounting, the Group chose the following scheme known as the "netting approach". According to this approach, the quotas are recognised as intangible assets:

- Free quotas given the State are valued at nil; and
- Quotas purchased on the market are accounted at the acquisition cost.

These intangible assets are not amortised.

If the difference between recognised quotas and real emissions is negative then the Group recognises a provision. This provision is assessed at acquisition cost for acquired rights and, for the non-hedged part, with reference to the market price as of each closing date. At the date of the restitution of the quotas corresponding to real emissions, the provision is written-off and the intangible assets are returned.

Accounting policies for the statement of profit or loss

Revenues

Air transport
Revenues from air transport transactions are recognised as and when transportation service is provided. Air transport revenues are stated net of external charges such as commissions paid to agents, certain taxes and volume discounts. The revenues however include (fuel) surcharges paid by passengers.

Maintenance contracts
The Group uses the "percentage of completion method" to determine the appropriate amount of revenue and cost relating to third-party maintenance contracts to be recognised in the statement of profit or loss in a given period, when the outcome can be estimated reliably. When the outcome of a maintenance contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract cost incurred that are likely to be recoverable.

Maintenance revenues from time and material contracts are recognised together with incurred direct maintenance expenses as a percentage of completion of the individual maintenance visits in progress. The degree of progress to completion is measured with use of recorded progress and expenses incurred per individual maintenance visit. Revenues on maintenance/power by the hour contracts, that are billed on logged flight hours customers' engines and components, are recognised to the extent that actual maintenance services, valued at sales prices against the amounts billed on logged flight hours have actually been carried out. Any amount billed for services not yet performed are recorded as liability for unearned revenues.

External expenses
External expenses are recognised in the statement of profit or loss using the so called matching principle which is based on a direct relationship between cost incurred and obtaining income related to the operation. Any deferral of cost in view of applying the matching principle is subject to these costs meeting the criteria for recognising them as an asset on the balance sheet. In order to minimize the financial risks involved with such transactions the Company makes use of financial derivatives such as fuel forward contracts, foreign currency options and swaps. The gains and losses arising from the use of the derivatives are included in these costs.

Gains/losses on disposals of property, plant and equipment
The gain on disposal of an item of property, plant and equipment is the difference between the net disposal proceeds and the carrying amount of the item. Gains on disposal are netted against losses on disposal.

Reversal of impairment losses on financial assets
This item represents increases in the carrying amounts of financial assets arising from reversals of previously recognised impairment losses. The amount of the reversal does not exceed the carrying amount of the assets that would have been determined had no impairment losses been recognised in prior years.

Other income and expense items

Gross cost of financial debt
Gross cost of financial debt includes interest on loans of third parties and finance leases using the effective interest rate method.

Income from cash and cash equivalents
Interest income includes interest on loans, interest-bearing marketable securities, short-term bank deposits and money at call. Interest income is recognised on an accrual basis.

Foreign currency exchange gains and losses
Foreign exchange gains and losses resulting from the translation of transactions in foreign currencies and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Fair value gains and losses

Fair value gains / losses represent the total of increases / decreases during the year in the fair values of assets and liabilities, excluding derivative financial instruments designated as cash flow hedges.

Share-based compensation

Phantom shares

The Group has cash-settled long-term incentive plans in which it grants to its employees phantom shares.
The phantom shares are shares, generating an amount of cash, which is equal to the AIR FRANCE KLM share price at the moment of selling of shares. Phantom shares are accounted for as a liability at the fair value at each reporting date. The liability will be built up monthly during a 3-year vesting period.
The fair value of the phantom shares is measured at the AIR FRANCE KLM share closing price at the end of the month. Changes in the fair value of the liability are recognised as employee benefit expense in profit and loss.

Cash flow statement

The cash flow statement is prepared using the indirect method. Changes in balance sheet items that have not resulted in cash flows such as translation differences, financial leases and fair value changes have been eliminated for the purpose of preparing this statement. Assets and liabilities acquired as part of a business combination are included in investing activities (net cash acquired). Dividends paid to ordinary shareholders are included in financing activities. Dividends received are classified as investing activities. Interest paid is included in operating activities.

Accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Key sources of estimation uncertainty

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the corresponding actual results. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of assets

Factors may exist which require the recognition of an impairment of certain assets and/or CGUs. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units (CGUs)), which correspond to the Group's business segments. Such impairment is based on estimates of the fair value less cost to sell and the value in use. The fair value less cost to sell is derived from assumptions in relation to the possible selling price of a certain asset. The value in use is based on the discounted value of the cash flows that the asset/CGU is expected to generate in the future. These future cash flows are based on the business plans for the coming years. The value in use also takes into account possible adverse developments, which may lead to impairment. It is possible that the Group may have to recognise additional impairment charges in the future as a result of changes in (market) conditions that may take place in future periods.

Useful lives of property, plant and equipment

The carrying amount of flight equipment and other property and equipment is determined by using estimates of the depreciation periods, which are derived from the expected technical and economic useful life of the assets involved. Due to advancing technology, evolving market circumstances and changes in the use of the assets involved, the expected technical and economic life of the asset may be subject to alteration.

Valuation of inventories

The Group records its inventories at cost and provides for the risk of obsolescence using the lower of cost or market principle. The expected future use of inventory is based on estimates about future demand and past experience with similar inventories and their usage.

Valuation of accounts receivable and the allowance for bad or doubtful debts

The Group periodically assesses the value of its accounts receivable based on specific developments in its customer base. The allowance for bad or doubtful debts is formed on the grounds of this assessment. The actual outcome may diverge from the assumptions made in determining the allowances.

Valuation of deferred tax assets and liabilities

In the process of estimating the value of deferred tax assets, in particular with regard to tax losses carried forward, assumptions are made regarding the degree to which these losses can be offset in the future. This is based, among other things, on business plans. In addition, in the preparation of the Financial Statements, assumptions are made with regard to temporary differences between the valuation for tax purposes and the valuation for financial reporting purposes. The actual outcome may diverge from the assumptions made in determining the current and deferred tax positions, e.g. as a result of disputes with the tax authorities or changes in tax laws and regulations.

Accounting for pensions and other post-employment benefits

Post-employment benefits represent obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Post-employment benefit accounting is intended to reflect the recognition of future benefit cost over the employee's approximate service period, based on the terms of the plans and the investment and funding decisions made by the Group.

The accounting standards require management to make assumptions regarding variables such as discount rate, rate of compensation increase, mortality rates, and future healthcare cost. Periodically, management consults with external actuaries regarding these assumptions. Changes in these key assumptions and in financing agreements between pension funds and the Company can have a significant impact on the recoverability of the net pension assets (IFRIC 14), projected benefit obligations, funding requirements and defined benefit cost recognised in profit or loss incurred. For details on key assumptions and policies, see note 17.

It should be noted that when discount rates decline or rates of compensation increase pension and post-employment benefit obligations will increase. Defined benefit cost recognised in profit or loss and post-employment cost also increase, when discount rates decline, since this rate is also used for the expected return on fund assets.

Other provisions

A provision will be recognised in the balance sheet when the Group has a present legal or constructive obligation to a third party as a result of a past event and it is probable that an outflow of economic benefits will require settling the obligation.

Management must make estimates and assumptions as at the balance sheet date concerning the probability that a certain obligation will crystallise as well as the amount that is likely to be paid. Future developments, such as changes in market circumstances or changes in legislation and judicial decisions may cause the actual obligation to diverge from the provision. The Group is involved in legal disputes and proceedings. Management decides on a case-by-case basis whether a provision is necessary based on actual circumstances. This assessment comprises both a determination of the probability of a successful outcome of the legal action and the expected amount payable.

Determination of fair value

The Group uses available market information and appropriate valuation techniques to determine the fair values of financial instruments. However, judgement is required to interpret market data and to determine fair value. Management believes that the carrying value of financial assets and financial liabilities with a maturity of less than one year approximates their fair value.
These financial assets and liabilities include cash and cash equivalents, trade accounts receivable and trade accounts payable. Details of the assumptions used and the results of sensitivity analyses recognising these assumptions are provided in note 4.

Financial Risk Management

Risk management organisation and fuel hedging policy

Market risk coordination and management is the responsibility of the Risk Management Committee (RMC) which comprises the Chief Executive Officer and the Chief Financial Officer of KLM, the Chief Executive Officer and the Chief Financial Officer of Air France and the Chief Financial Officer of AIR FRANCE KLM. The RMC meets each quarter to review AIR FRANCE KLM reporting of the risks relating to the fuel price, the principal currency exchange rates and interest rates, and to decide on the hedging to be implemented: targets for hedging ratios, the time periods for the respect of these targets and, potentially, the preferred types of hedging instrument.

The aim is to reduce the exposure of AIR FRANCE KLM and, thus, to preserve budgeted margins. The RMC also defines the counterparty-risk policy.

The decisions made by the RMC are implemented by the treasury and fuel purchasing departments within each company, in compliance with the procedures governing the delegation of powers. In-house procedures governing risk management prohibit speculation. Regular meetings are held between the fuel purchasing and treasury departments of both companies in order to exchange information concerning matters such as hedging instruments used, strategies planned and counterparties.

The treasury departments of each company circulate information on the level of cash and cash equivalents to their respective executive managements on a daily basis. Every month, a detailed report including, amongst other information, interest rate and currency positions, the portfolio of hedging instruments, a summary of investments and financing by currency and the monitoring of risk by counterparty is transmitted to the executive managements. The instruments used are swaps and options.

The policy on fuel hedging is the responsibility of the fuel purchasing departments, which are also in charge of purchasing fuel for physical delivery. A weekly report, enabling the evaluation of the net-hedged fuel cost of the current financial year and the two following ones, is supplied to the executive managements. This mainly covers the transactions carried out during the week, the valuation of all positions, the hedge percentages as well as the breakdown of instruments and the underlying used, average hedge levels, the resulting net prices and stress scenarios, as well as market commentary. Furthermore, a weekly AIR FRANCE KLM report consolidates the figures from the two companies relating to fuel hedging and to physical cost. The instruments used are swaps and options.

Financial Risk Management

The Group is exposed to the following financial risks:
1. Market risk;
2. Credit risk; and
3. Liquidity and solvency risk.

1. Market risk

The Group is exposed to market risks in the following areas:
a. Currency risk;
b. Interest rate risk; and
c. Fuel price risk.

a. Currency risk

Most of AIR FRANCE KLM revenues are generated in euros. However, because of its international activities, AIR FRANCE KLM incurs a foreign exchange risk. The principal exposure is to the US dollar, and then, to a lesser extent, to British pound sterling and the Japanese yen. Thus, any changes in the exchange rates for these currencies relative to the euro may have an impact on AIR FRANCE KLM's financial results.

With regard to the US dollar, since expenditures such as fuel, operating leases or component cost exceed the level of revenue, AIR FRANCE KLM is a net buyer. This means that any significant appreciation in the US dollar against the euro could result in a negative impact on the Group's activity and financial results. Conversely, AIR FRANCE KLM is a net seller of the Japanese yen and of British pound sterling, the level of revenues in these currencies exceeding expenditure. As a result, any significant decline in these currencies relative to the euro could have a negative effect on the Group's activity and financial results. In order to reduce its currency exposure, AIR FRANCE KLM has adopted hedging strategies. Both KLM and Air France hedge progressively their net exposure over a rolling 24-month period.

Aircraft are purchased in US dollars, meaning that AIR FRANCE KLM is highly exposed to a rise in the dollar against the euro for its aeronautics investments. The hedging policy plans the progressive and systematic implementation of hedging between the date of the aircraft order and their delivery date.

Despite this active hedging policy, not all exchange rate risks are covered. AIR FRANCE KLM might then encounter difficulties in managing currency risks, which could have a negative impact on AIR FRANCE KLM business and financial results.

b. Interest rate risk
At both KLM and Air France, most financial debt is contracted in floating-rate instruments in line with market practice. However, given the historically low level of interest rates, KLM and Air France have used swap strategies to convert a significant proportion of their floating-rate debt into fixed rates. At the end of December 2016, KLM's net exposure to changes in market interest rates is neutral.

c. Fuel price risk
Risks linked to the jet fuel price are hedged within the framework of a hedging strategy for the whole of AIR FRANCE KLM.

Main characteristics of the hedge strategy:
» Hedge horizon: 2 years.
» Minimum hedge percentage:
  Quarter underway: 65% of the volumes consumed;
  Quarter 1 to quarter 2: 65% of the volumes consumed;
  Quarter 3: 60% of the volumes consumed;
  Quarter 4: 50% of the volumes consumed;
  Quarter 5: 40% of the volumes consumed;
  Quarter 6: 30% of the volumes consumed;
  Quarter 7: 20% of the volumes consumed; and
  Quarter 8: 10% of the volumes consumed.
» Underlying: Brent, Gasoil and Jet CIF.
  At least 25% of volumes consumed during the two first quarters of the program (excluding the quarter underway) must be hedged in average distillates (Jet Fuel and Gasoil).
» Instruments: Swap, call, call spread, three ways, four ways, collar and collar put spread.

2. Credit risk
Credit risks arise from various activities including investing and operational activities as well as hedging activities with regard to financial instruments. The risk is the loss that could arise if a counterpart were to default in the performance of its contractual obligations. The Group has established credit limits for its external parties in order to mitigate the credit risk. These limits are determined on the basis of ratings from organisations such as Standard & Poor's and Moody's Investors Services.

As of December 31, 2016, KLM identified the following exposure to counterparty risk

LT Rating (Standards & Poors)	Total exposure in EUR millions
AAA	556
AA+	271
AA	118
A+	44
A	494
Total	1,483

At December 31, 2016, the exposure consists of the fair market value of marketable securities, deposits and bonds.

3. Liquidity and solvency risk
Liquidity and solvency risk is related to the risk that the Group might be unable to obtain the financial resources it requires to meet its short- and long-term obligations on time. All anticipated and potential cash flows are reviewed regularly. These include, amongst others, operational cash flows, dividends, debt and interest payments and capital expenditure. The objective is to have sufficient liquidity, including committed credit facilities, available that are adequate for the liquidity requirements for the short- and long-term.

The Group aims to maintain the level of its cash and cash equivalents and other highly marketable debt investments at an amount in excess of expected cash outflows on financial liabilities (other than trade payables) over the next 60 days. The Group also monitors the level of expected cash inflows on trade and other receivables together with expected cash outflows on trade and other payables.

1. Property, plant and equipment

	Flight equipment				Other property and equipment					
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total	Pre-payments	Total
Historical cost										
As at Jan. 1, 2016	1,737	2,740	1,893	6,370	618	452	205	1,275	65	7,710
Additions	122	144	268	534	13	32	2	47	207	788
Disposals	(674)	-	(435)	(1,109)	(4)	(24)	(22)	(50)	-	(1,159)
Other movements	157	(308)	280	129	(1)	(1)	2	-	(34)	95
As at Dec. 31, 2016	1,342	2,576	2,006	5,924	626	459	187	1,272	238	7,434
Accumulated depreciation										
As at Jan 1, 2016	1,263	1,150	989	3,402	272	361	149	782	-	4,184
Depreciation	88	127	192	407	31	28	7	66	-	473
Disposals	(670)	-	(377)	(1,047)	(3)	(25)	(16)	(44)	-	(1,091)
Other movements	182	(236)	150	96	(1)	(9)	(1)	(11)	-	85
As at Dec. 31, 2016	863	1,041	954	2,858	299	355	139	793	-	3,651
Net carrying amount										
As at Jan. 1, 2016	474	1,590	904	2,968	346	91	56	493	65	3,526
As at Dec. 31, 2016	479	1,535	1,052	3,066	327	104	48	479	238	3,783

	Flight equipment				Other property and equipment					
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total	Pre-payments	Total
Historical cost										
As at Jan. 1, 2015	1,379	3,106	1,768	6,253	604	548	114	1,266	211	7,730
Additions	20	95	260	375	25	3	36	64	2	441
Disposals	(181)	14	(256)	(423)	(11)	(28)	(22)	(61)	-	(484)
Other movements	519	(475)	121	165	-	(71)	77	6	(148)	23
As at Dec. 31, 2015	1,737	2,740	1,893	6,370	618	452	205	1,275	65	7,710
Accumulated depreciation										
As at Jan 1, 2015	1,082	1,287	928	3,297	237	443	81	761	-	4,058
Depreciation	103	115	198	416	31	21	9	61	-	477
Disposals	(185)	14	(229)	(400)	(11)	(28)	(16)	(55)	-	(455)
Other movements	263	(266)	92	89	15	(75)	75	15	-	104
As at Dec. 31, 2015	1,263	1,150	989	3,402	272	361	149	782	-	4,184
Net carrying amount										
As at Jan. 1, 2015	297	1,819	840	2,956	367	105	33	505	211	3,672
As at Dec. 31, 2015	474	1,590	904	2,968	346	91	56	493	65	3,526

Other movements mainly relates to the reclassification of finance leased aircraft to owned aircraft at the end of the lease.

Property, plant and equipment include assets which are held as security for mortgages and loans as follows:

As at December 31,	2016	2015
Aircraft	57	98
Land and buildings	122	126
Other property and equipment	23	27
Carrying amount	202	251

Borrowing cost capitalised during the year amount to EUR 3 million (2015 EUR 4 million). The interest rate used to determine the amount of borrowing cost to be capitalised was 2.8% (2015 3.2%).

Land and buildings include buildings located on land which have been leased on a long-term basis. The book value of these buildings at December 31, 2016 amounts to EUR 212 million (December 31, 2015 EUR 225 million).

2. Intangible assets

	Goodwill	Software	Software under development	Total
Historical cost				
As at Jan. 1, 2016	39	416	56	511
Additions	-	44	49	93
Disposals	-	(20)	(13)	(33)
Reclassifications	-	(2)	-	(2)
As at December 31, 2016	39	438	92	569
Accumulated amortisation and impairment				
As at Jan. 1, 2016	29	174	-	203
Amortisation	-	42	-	42
Disposals	-	(20)	-	(20)
Reclassifications	-	1	-	1
As at December 31, 2016	29	197	-	226
Net carrying amount				
As at January 1, 2016	10	242	56	308
As at December 31, 2016	10	241	92	343
Historical cost				
As at January 1, 2015	39	301	157	497
Additions	-	146	(73)	73
Disposals	-	(35)	(19)	(54)
Reclassifications	-	4	(9)	(5)
As at December 31, 2015	39	416	56	511
Accumulated amortisation and impairment				
As at January 1, 2015	29	176	-	205
Amortisation	-	34	-	34
Disposals	-	(35)	-	(35)
Reclassifications	-	(1)	-	(1)
As at December 31, 2015	29	174	-	203
Net carrying amount				
As at January 1, 2015	10	125	157	292
As at December 31, 2015	10	242	56	308

As at December 31, 2016, software additions mainly relate to replacement of departure and flight control systems and aircraft maintenance systems.

3. Investments accounted for using the equity method

As at December 31,	2016	2015
Associates	-	(1)
Jointly controlled entities	22	25
Carrying amount	**22**	**24**

Investments in associates

	2016	2015
Carrying amount as at January 1	**(1)**	**34**
Movements		
Share of profit/(loss) after taxation	-	(37)
Foreign currency translation differences	1	2
Net movement	**1**	**(35)**
Carrying amount as at December 31	**-**	**(1)**

The share of profit/(loss) after taxation as at December 31 has been adjusted to reflect the estimated share of result of the associate for the year then ended.

The Group's interest in its associate and with which it has a joint venture, Kenya Airways Ltd., can be summarised as follows:

As at December 31,	2016	2015
Country of incorporation	Kenya	Kenya
Percentage of interest held	26.73%	26.73%
Assets	1,411	1,756
Liabilities	1,729	1,814
Revenues	1,035	970
Loss after taxation	(234)	(227)
Share of loss after taxation	**(63)**	**(61)**

Above table of Kenya Airways Ltd.'s assets, liabilities and revenues is based on the audited financial statements for the years ended March 31, 2016 and March 31, 2015.

The shares of Kenya Airways Ltd. are quoted on the Nairobi stock exchange. Based on the quoted price of the shares at the close of business on December 31, 2016 the fair value of KLM's interest in Kenya Airways Ltd. was EUR 21 million (2015 EUR 18 million) compared to a carrying amount of EUR nil million as at December 31, 2016 (2015 EUR nil million). No dividend was received in 2016 (2015 EUR nil million). Kenya Airways has a negative equity as at December 31, 2016. KLM has no contractual commitments towards Kenya Airways and consequently no further losses below a book value of nil are accounted for.

The Group's interest in its associate Transavia France S.A.S. can be summarised as follows:

As at December 31,	2016	2015
Country of incorporation	France	France
Percentage of interest held	40%	40%
Assets	277	151
Liabilities	349	183
Revenues	454	381
Profit/(loss) after taxation	(40)	(43)
Share of loss after taxation	(16)	(17)

Transavia France is an associate controlled by Air France (60%) and Transavia Airlines C.V. (40%). The carrying amount of the 40% in Transavia France S.A.S. is EUR nil million (2015 EUR nil million) as at December 31, 2016.

In the shareholders' agreement it has been stated that when losses exceed the book value, the book value is written down to nil and no further losses are accounted for, unless and to the extent that Transavia has entered into a legally enforceable or constructive obligation or has made payments on behalf of Transavia France.

Jointly controlled entities

	2016	2015
Carrying amount as at January 1	25	24
Movements		
Dividends received	(5)	-
Share of profit/(loss) after taxation	4	1
Other movements	(2)	-
Net movement	(3)	1
Carrying amount as at December 31	22	25

The Group's interest in its principal jointly controlled entity, Schiphol Logistics Park C.V., which is an unlisted company, can be summarised as follows:

As at December 31,	2016	2015
Country of incorporation	The Netherlands	The Netherlands
Percentage of interest held	53%	53%
Percentage of voting right	45%	45%
Non-current assets	43	62
Current assets	11	4
Profit/(loss) after taxation	7	2
Share of profit after taxation	4	1

4. Other assets and liabilities

	ASSETS		LIABILITIES	
	Current	Non-current	Current	Non-current
Exchange rate risk				
Fair value hedges	67	147	(10)	(9)
Cash flow hedges	45	16	(4)	-
Items not qualifying for hedge accounting	17	27	(17)	(27)
Total exchange rate risk hedges	129	190	(31)	(36)
Interest rate risk				
Fair value hedges	-	36	-	-
Cash flow hedges	-	7	(2)	(46)
Items not qualifying for hedge accounting	-	2	-	(11)
Total interest rate risk hedges	-	45	(2)	(57)
Commodity risk hedges				
Cash flow hedges	95	26	(33)	-
Total commodity risk hedges	95	26	(33)	-
Total derivative financial instruments	224	261	(66)	(93)
Others	-	56	-	(78)
Total as at December 31, 2016	224	317	(66)	(171)

	ASSETS		LIABILITIES	
	Current	Non-current	Current	Non-current
Exchange rate risk				
Fair value hedges	96	144	(61)	(8)
Cash flow hedges	98	5	(11)	(2)
Items not qualifying for hedge accounting	-	40	-	(37)
Total exchange rate risk hedges	194	189	(72)	(47)
Interest rate risk				
Fair value hedges	3	28	-	-
Cash flow hedges	-	7	(1)	(62)
Items not qualifying for hedge accounting	-	-	-	(4)
Total interest rate risk hedges	3	35	(1)	(66)
Commodity risk hedges				
Cash flow hedges	84	2	(559)	(78)
Total commodity risk hedges	84	2	(559)	(78)
Total derivative financial instruments	281	226	(632)	(191)
Others	-	56	-	(76)
Total as at December 31, 2015	281	282	(632)	(267)

Exposure to exchange rate risk

In the frame of cash flow hedges, maturities relate to realisation dates of hedged items. Therefore, amounts of fair value presented in equity are recycled in the statement of profit or loss at realisation dates of hedged items.

As at December 31, 2016 the types of derivatives used, their nominal amounts and fair values are as follows:

In millions of Euros	Nominal amount	<1 year	>1 year and <2 years	>2 years and <3 years	>3 years and <4 years	>4 Years and <5 years	> 5 years	Fair Value
Exchange rate risk hedges								
Fair value hedges								
Forward purchases								
USD	2,237	592	474	214	309	239	409	208
JPY	25	25	-	-	-	-	-	3
Forward sales								
USD	607	203	81	34	78	64	147	(16)
Total fair value hedges	2,869	820	555	248	387	303	556	195
Cash flow hedges								
Options								
GBP	152	117	35	-	-	-	-	4
JPY	41	25	16	-	-	-	-	(1)
Forward purchases								
USD	867	570	297	-	-	-	-	41
GBP	7	7	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-
Forward sales								
GBP	173	131	42	-	-	-	-	12
JPY	69	52	17	-	-	-	-	(1)
CHF	41	41	-	-	-	-	-	-
KRW	11	11	-	-	-	-	-	1
NOK	55	55	-	-	-	-	-	-
SGD	11	11	-	-	-	-	-	1
Other	1	1	-	-	-	-	-	-
Total cash flow hedges	1,428	1,021	407	-	-	-	-	57
Items not qualifying for hedge accounting								
Forward purchases								
USD	200	64	72	17	33	14	-	45
Forward sales								
USD	(200)	(64)	(72)	(17)	(33)	(14)	-	(45)
Other	-	-	-	-	-	-	-	-
Total items not qualifying for hedge accounting	-	-	-	-	-	-	-	-
Total exchange rate risk derivatives	4,297	1,841	962	248	387	303	556	252

Exposure to interest rate risk

In the frame of cash flow hedges, maturities relate to realisation dates of hedged items. Therefore, amounts of fair value presented in equity are recycled in the statement of profit or loss at realisation dates of hedged items.

	In local currency millions							In millions of Euros
As at December 31, 2016	Nominal amount	<1 year	>1 year and <2 years	>2 years and <3 years	>3 years and <4 years	>4 Years and <5 years	>5 years	Fair Value
Interest rate risk hedges								
Fair value hedges								
Swaps	300	-	-	-	-	95	205	36
Total fair value hedges	300	-	-	-	-	95	205	36
Cash flow hedges								
Swaps	819	81	127	54	52	187	318	(41)
Total cash flow hedges	819	81	127	54	52	187	318	(41)
Items not qualifying for hedge accounting								
Swaps	81	-	-	81	-	-	-	(9)
Total Items not qualifying for hedge accounting	81	-	-	81	-	-	-	(9)
Total interest rate risk derivatives	1,200	81	127	135	52	282	523	(14)

Exposure to commodity risk

In the frame of cash flow hedges, maturities relate to realisation dates of hedged items. Therefore, amounts of fair value presented in equity are recycled in the statement of profit or loss at realisation dates of hedged items.

In the normal course of its business, the Group conducts transactions on petroleum product markets in order to effectively manage the price risks related to its purchases of fuel.

The nominal amounts of the Group's commitments on the crude and refined oil markets as at December 31, 2016 are shown below:

	In USD millions							In millions of Euros
	Nominal amount	<1 year	>1 year and <2 years	>2 years and <3 years	>3 years and <4 years	>4 Years and <5 years	>5 years	Fair Value
Commodity risk hedges								
Cash flow hedges								
Swaps	294	230	64	-	-	-	-	10
Options	1,017	720	297	-	-	-	-	78
Total cash flow hedges	1,311	950	361	-	-	-	-	88
Total commodity risk derivatives	1,311	950	361	-	-	-	-	88

Valuation methods for financial assets and liabilities at their fair value

As at December 31, 2016, the breakdown of the Group's financial assets and derivative instruments, based on the three classification levels, is as follows:

	Level 1	Level 2	Total
Financial assets available for sale			
Shares	6	-	6
Assets at fair value through profit and loss			
Marketable securities	556	595	1,151
Cash and cash equivalents	-	36	36
Derivatives instruments (asset and liability)			
Currency exchange derivatives	-	252	252
Interest rate derivatives	-	(14)	(14)
Commodity derivatives	-	88	88

No significant changes in levels of hierarchy, or transfers between levels, have occurred in the reporting period.

For the explanation of the three classification levels, reference is made to "fair value hierarchy" paragraph in the accounting policies for the balance sheet section.

Sensitivity analysis

The sensitivity is calculated solely on the valuation of derivatives at the closing date of the period presented. The hypotheses used are coherent with those applied in the financial year ended as at December 31, 2016.

The impact on "other reserves" corresponds to the sensitivity of effective fair value variations for instruments and is documented in the hedged cash flow (options intrinsic value, fair value of closed instruments). The impact on the "income for tax" corresponds to the sensitivity of ineffective fair value variations of hedged instruments (principally time value of options) and fair value variations of transactions instruments. For fuel, the downward and upward sensitivity are not symmetrical when taken into account the utilisation, in respect of the policy of optional hedged instruments in which the risk profile is not linear.

For further information reference is made to the Financial Risk Management paragraph in the text to the notes to the consolidated financial statements.

Fuel price sensitivity

The impact on "income before tax" and "other reserves" of the variation of +/- USD 10 on a barrel of Brent is presented below:

	December 31, 2016		December 31, 2015	
	Increase of 10 USD	Decrease of 10 USD	Increase of 10 USD	Decrease of 10 USD
Pre-tax income	(19)	(36)	(7)	9
Other reserves	215	(157)	224	(227)

The fuel price sensitivity is only calculated on the valuation of derivatives at the closing date of each period presented.

Currency sensitivity

Values as of the closing date of all monetary assets and liabilities in other currencies are as follows:

	Monetary Assets		Monetary Liabilities	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
USD	457	347	333	268
JPY	-	-	271	255
CHF	-	-	349	346

The amounts of monetary assets and liabilities disclosed above do not include the effect of derivatives.

The impact on "change in value of financial instruments" and on "other reserves" of the variation of a 10% weakening in exchange rates in absolute value relative to the Euro is presented below:

	USD		JPY		GBP	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Change in value of financial instruments	(11)	(7)	25	23	-	-
Other reserves	(76)	(84)	7	10	20	22

The impact on "change in value of financial instruments on financial income and expenses" consists of:

» Change in value of monetary assets and liabilities (in accordance with IAS 21, including the effect of fair value and cash flow hedges);
» Changes in time value of currency exchange options (recognised in financial income);
» The changes in fair value of derivatives for which fair value hedges accounting is applied or no hedging accounting is applied.

The impact on "other reserves" is explained by the change in exchange rates on changes in fair value of currency derivatives qualified for cash flow hedging, recognised in "other reserves".

Interest rate sensitivity

The Group is exposed to the risk of changes in market interest rates. The variation of 100 basis points of interest rates would have an impact on income before tax of EUR nil million for 2016 (EUR nil million for 2015).

5. Other financial assets

	Held-to-maturity investments		Loans and receivables		At fair value through profit or loss		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
Carrying amount as at January 1	204	217	18	19	249	198	471	434
Movements								
Additions and loans granted	114	45	5	1	4	8	123	54
Loans and interest repaid	-	(82)	(4)	(4)	(210)	-	(214)	(86)
Interest accretion	5	4	-	-	-	-	5	4
Foreign currency translation differences	9	20	-	-	(1)	4	8	24
Other movements	-	-	-	2	-	39	-	41
Net movement	128	(13)	1	(1)	(207)	51	(78)	37
Carrying amount as at December 31	332	204	19	18	43	249	393	471

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
Held-to-maturity investments				
Triple A bonds and long-term deposits	19	313	-	204
Loans and receivables				
Other loans and receivables	5	14	2	16
At fair value through profit or loss				
Other restricted deposits	1	-	3	-
Other deposits	-	-	186	-
Deposits on operasting leased aircraft	3	32	2	49
AIR FRANCE KLM S.A. shares	-	6	-	8
Other financial assets	-	-	1	-
	4	38	192	57
Carrying amount	28	365	194	277

Regarding the restricted deposit EU anti-trust investigations (Other deposits) as per December 31, 2015, reference is made to note 21 Contingent assets and liabilities – guarantees and to note 18 Other provisions – Legal issues. As a consequence of a court ruling dated December 16, 2015, the European Commission (EC) has released in January 2016 KLM N.V. and Martinair Holland N.V. of their respective obligation to provide bank guarantees to cover the imposed fines. After receipt of the guarantee release notification from the EC, the involved banks have informed KLM in February 2016 of the cancellation of the counter guarantee and the pledge on deposits, which were provided as security for the counter guarantee by KLM to the banks. As a result the restricted deposit for the EU anti-trust investigations is shown in Other deposits as per December 31, 2015.

The carrying amounts of financial assets denominated in currencies other than the Euro are as follows:

As at December 31,	2016	2015
USD	287	207
GBP	1	1
Total	288	208

The interest-bearing financial assets have fixed interest rates. The weighted average effective interest rates at the balance sheet date are as follows:

	December 31, 2016		December 31, 2015	
in %	EUR	USD	EUR	USD
Held-to-maturity investments	-	3.0	-	2.4
Loans and receivables	0.1	0.6	1.3	1.8
At fair value through profit or loss	-	0.3	1.6	-

The triple A bonds and long-term deposits are held as a natural hedge to mitigate the effect of foreign exchange movements relating to financial lease liabilities. Except as described below these securities are at the free disposal of the Company. Access to triple A bonds and long-term deposits, loans and receivables amounting to EUR 35 million (December 31, 2015 EUR 3 million) is restricted.

The maturities of held-to-maturity investments are as follows:

As at December 31,	2016	2015
Held-to-maturity		
Less than 1 year	19	-
Between 1 and 2 years	93	14
Between 2 and 3 years	11	43
Between 3 and 4 years	-	1
Between 4 and 5 years	64	-
Over 5 years	145	146
Total	332	204

The maturities of loans and receivables are as follows:

As at December 31,	2016	2015
Loans and receivables		
Less than 1 year	5	3
Between 1 and 2 years	5	5
Between 2 and 3 years	-	1
Between 3 and 4 years	-	-
Between 4 and 5 years	-	-
Over 5 years	9	9
Total	19	18

The fair values of the financial assets are as follows:

As at December 31,	2016	2015
Held-to-maturity		
Triple A bonds and long-term deposits	**338**	**213**
Loans and receivables		
Other loans and receivables	**11**	**16**
At fair value through profit or loss		
Restricted deposit other	1	3
Other deposits	-	186
Deposits on operating leased aircraft	35	49
AIR FRANCE KLM S.A. shares	6	8
Other financial assets	-	2
	42	**248**
Total fair value	**391**	**477**

The fair values listed above have been determined as follows:

- Triple A bonds and long-term deposits: The fair values are based on the net present value of the anticipated future cash flows associated with these instruments;
- Deposits and commercial paper: The carrying amounts approximate fair value because of the short maturity of these deposits and commercial paper;
- AIR FRANCE KLM S.A. shares: Quoted price as at close of business on December 31, 2016 and December 31, 2015;
- Other assets: The carrying amounts approximate fair value because of the short maturity of these instruments or, in the case of equity instruments that do not have a quoted price in an active market, the assets are carried at cost.

The contractual re-pricing dates of the Group's interest bearing assets are as follows:

As at December 31,	2016	2015
Less than 1 year	62	193
Between 1 and 2 years	99	19
Between 2 and 3 years	-	44
Between 3 and 4 years	-	1
Between 4 and 5 years	61	-
Over 5 years	125	148
Total interest bearing financial assets	**347**	**405**

6. Inventories

As at December 31,	2016	2015
Carrying amount		
Maintenance inventories	212	177
Allowance for obsolete inventories	(62)	(58)
Maintenance inventories - net	150	119
Other sundry inventories	43	42
Total	**193**	**161**

7. Trade and other receivables

As at December 31,	2016	2015
Trade receivables	553	508
Provision trade receivables	(32)	(34)
Trade receivables - net	521	474
Amounts due from:		
- AIR FRANCE KLM group companies	54	61
- associates and jointly controlled entities	2	3
- maintenance contract customers	208	156
Taxes and social security premiums	36	31
Other receivables	51	61
Prepaid expenses	92	59
Total	964	845

As at December 31,	2016	2015
< 90 days	503	437
90-180 days	3	18
180-360 days	14	14
> 360 days	1	5
Total trade receivables	521	474

In the financial year EUR nil million (December 31, 2015 EUR 7 million increase) increase of provision trade receivables has been recorded in other operating income and expenses in the consolidated statement of profit or loss.

Maintenance contract cost incurred to date for contracts in progress at December 31, 2016 amounted to EUR 173 million (December 31, 2015 EUR 173 million).

Advances received for maintenance contracts in progress at December 31, 2016 amounted to EUR 28 million (December 31, 2015 EUR 11 million).

8. Cash and cash equivalents

As at December 31,	2016	2015
Cash at bank and in hand	57	68
Short-term deposits	1,151	772
Total	1,208	840

The effective interest rates on short-term deposits are in the range from 0% to 1.14% (2015 range 0% to 5.26%). The short-term deposits are invested in money market instruments or in liquid funds with daily access to cash.

The part of the cash and cash equivalents held in currencies other than the Euro is as follows:

As at December 31,	2016	2015
USD	29	29
GBP	-	2
Other currencies	5	12
Total	34	43

The fair value of cash and cash equivalents does not differ materially from the book value.

9. Share capital

Authorised share capital

No movements have occurred in the authorised share capital since April 1, 2004. The authorised share capital of the Company is summarised in the following table:

	Authorised		
	Par value per share (in EUR)	Number of shares	Amount in EUR 1,000
Priority shares	2.00	1,875	4
Ordinary shares	2.00	149,998,125	299,996
A Cumulative preference shares	2.00	37,500,000	75,000
B Preference shares	2.00	75,000,000	150,000
C Cumulative preference shares	2.00	18,750,000	37,500
Total authorised share capital			562,500

Issued share capital

No movements have occurred in the issued share capital since April 1, 2004. No shares are issued but not fully paid.

	Issued and fully paid			
	December 31, 2016		December 31, 2015	
	Number of shares	Amount in EUR 1,000	Number of shares	Amount in EUR 1,000
Included in equity				
Priority shares	1,312	3	1,312	3
Ordinary shares	46,809,699	93,619	46,809,699	93,619
		93,622		93,622
Included in financial liabilities				
A Cumulative preference shares	8,812,500	17,625	8,812,500	17,625
C Cumulative preference shares	7,050,000	14,100	7,050,000	14,100
		31,725		31,725
Total issued share capital		125,347		125,347

The rights, preferences and restrictions attaching to each class of shares are as follows:

Priority shares

All priority shares are held by AIR FRANCE KLM S.A. Independent rights attached to the priority shares include the power to determine or approve:

a. To set aside an amount of the profit established in order to establish or increase reserves (art. 32.1 Articles of Association (AoA));
b. Distribution of interim dividends, subject to the approval of the Supervisory Board (art. 32.4 AoA);
c. Distribution to holders of common shares out of one or more of the freely distributable reserves, subject to the approval of the Supervisory Board (art. 32.5 AoA);
d. Transfer of priority shares (art. 14.2 AoA).

Before submission to the General meeting of Shareholders prior approval of the holder of the priority shares is required for:

a. Issuance of shares (art. 5.4 AoA);
b. Limitation of or exclusion from pre-emptive rights of the holders of other classes of shares (art. 5.4 AoA);
c. Repurchase of own shares (art. 10.2 AoA);
d. Alienation of own priority shares and C cumulative preference shares (art. 11.2 AoA);
e. Reduction of the issued share capital (art. 11.3 AoA);
f. Remuneration and conditions of employment of the Managing Directors (art.17.4 AoA);
g. Amendments of the Articles of Association and/or dissolution of the Company (art. 41.1 AoA).

A Cumulative preference shares, B Preference shares, C Cumulative preference shares and Ordinary shares

Holders of preference and ordinary shares are entitled to attend and vote at shareholders meetings. Each share entitles the holder to one vote.

As at December 31, 2016 the State of The Netherlands held 3,708,615 A cumulative preference shares to which a voting right attaches of 5.9%. This has not changed since financial year 2006/07. For details of the right to dividend distributions attaching to each class of share see the section Other information.

10. Other reserves

	Hedging reserve	Remeasurement of defined benefit pension plans	Translation reserve	Other Legal reserve	Total
As at January 1, 2016	(367)	(2,221)	(11)	294	(2,305)
Gains/(losses) from cash-flow hedges	549	-	-	-	549
Exchange differences on translating foreign operations	-	(3)	11	-	8
Remeasurement of defined benefit pension plans	-	(455)	-	-	(455)
Transfer from retained earnings	-	-	-	35	35
Tax on items taken directly to or transferred from equity	(137)	114	-	-	(23)
As at December 31, 2016	45	(2,565)	-	329	(2,191)
As at January 1, 2015	(457)	(2,461)	(14)	270	(2,662)
(Losses)/gains from cash-flow hedges	120	-	-	-	120
Exchange differences on translating foreign operations	-	(7)	3	-	(4)
Remeasurement of defined benefit pension plans	-	329	-	-	329
Transfer from retained earnings	-	-	-	24	24
Tax on items taken directly to or transferred from equity	(30)	(82)	-	-	(112)
As at December 31, 2015	(367)	(2,221)	(11)	294	(2,305)

The Company's equity has become volatile, following the implementation of the revised IAS 19 for pensions, as of January 1, 2013. Not only results for the year and dividend distributions can have an impact on equity, but moreover the impact of "Other Comprehensive Income" coming from the remeasurement of defined pension plans or the changes in the fair value of cash flow hedges (predominantly related to fuel hedges) can have a significant impact on equity.

The Company needs to strengthen its balance sheet and equity. The perform 2020 program is well under way and results are improving and net debt is lowering. The non-cash changes in remeasurements of defined benefit plans and changes in fair value of cash flow hedges will however remain volatile going forward. In the event that the Company's equity would become negative, the Company foresees no immediate issues given that its operational cash flow is strong enough and that this accounting situation has no consequences on the Company's operations and liabilities. Reference is made to the assessment of 'going concern' in the Risks and risk management section.

For an elucidation on the volatility of defined pension plans, reference is made to the paragraph Risks linked to the impact of external economic factors on equity and Risks linked to pension plans in the Risks and risk management section.

The legal reserves consist of the following items:

Hedging reserve
The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Remeasurement of defined benefit plans
Comprises all actuarial gains and losses related to the remeasurement of defined benefit plans.

Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the consolidated figures of non Euro foreign subsidiaries, as well as from the translation of the Company's net investment in foreign associates and jointly controlled entities.

Other legal reserve
The other legal reserve is maintained equal to the non distributable reserves of investments accounted for using the equity method and the amount of development cost incurred on computer software and prepayments thereon at the balance sheet date, as required by Article 365.2 of Book 2 of The Dutch Civil Code.

11. Loans from parent company

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
AIR FRANCE KLM S.A.	-	288	105	288
Others	-	-	-	-
Total	-	288	105	288

AIR FRANCE KLM S.A., Air France and KLM have agreed that the proceeds of capital market transactions will be made available to Air France and KLM by means of intercompany loan agreements.

Loans from parent company – Non current

On December 14, 2012, AIR FRANCE KLM S.A. issued a plain vanilla bond of a principal amount of EUR 500 million. Of the total proceeds, AIR FRANCE KLM S.A. has granted to KLM by means of an intercompany loan facility, dated December 14, 2012, a total amount of EUR 180 million. On December 31, 2016, KLM has drawn an amount of EUR 90 million on this intercompany loan facility. The drawn amount bears a fixed rate of 6.25%.

On March 28, 2013, AIR FRANCE KLM S.A. issued a convertible bond of a principal amount of EUR 550 million. Of the total proceeds, AIR FRANCE KLM S.A. has granted to KLM by means of an intercompany loan facility, dated June 7, 2013, a total amount of EUR 198 million. On December 31, 2016, KLM has drawn the intercompany loan facility in full. The drawn amount bears a fixed interest rate of 2.03%.

According to the two above mentioned intercompany loan agreements, KLM may repay the drawn amounts at any time before the maturity date. Any advance repaid can be borrowed again.

The carrying amounts for the loans from parent company approximate the fair value.

For the guarantees from KLM to AIR FRANCE KLM reference is made to note 21.

12. Lease obligations

	December 31, 2016			December 31, 2015		
	Future minimum lease payment	Future finance charges	Total financial lease liabilities	Future minimum lease payment	Future finance charges	Total financial lease liabilities
Lease obligations						
Within 1 year	403	8	395	228	19	209
Total current	403	8	395	228	19	209
Between 1 and 2 years	368	16	352	391	24	367
Between 2 and 3 years	228	12	216	346	15	331
Between 3 and 4 years	166	10	156	206	12	194
Between 4 and 5 years	226	8	218	141	10	131
Over 5 years	442	19	423	475	17	458
Total non-current	1,430	65	1,365	1,559	78	1,481
Total	1,833	73	1,760	1,787	97	1,690

The finance leases relate exclusively to aircraft leasing. At the expiry of the leases, KLM has the option to purchase the aircraft at the amount specified in each contract. The lease agreements provide for either fixed or floating interest payments. Where the agreements are subject to a floating interest rate, this is normally the 3 or 6 month EURIBOR or the USD LIBOR rate. The average interest rate, without taking into account the impact of hedging (and the deferred benefits arising from sale and leaseback transactions) is 1.85% (average fixed rate 2.65%, average floating rate 1.28%). Taking into account the impact of hedging the average interest rate is 3.10% (average fixed rate 3.56%, average floating rate 1.29%). After hedging 73% of the outstanding lease liabilities have a fixed interest rate.

The fair value of finance lease liabilities amounts to EUR 1,414 million as at December 31, 2016 (December 31, 2015 EUR 1,503 million). The fair value of the financial liabilities is based on the net present value of the anticipated future cash flows associated with these instruments. For the lease liabilities restricted deposits are used as collateral.

The total future minimum lease payments under operating leases are as follows:

	Aircraft		Buildings		Other equipment		Total	
	December 31,		December 31,		December 31,		December 31,	
	2016	2015	2016	2015	2016	2015	2016	2015
Operating lease commitments								
Within 1 year	504	461	35	37	13	11	552	509
Total current	504	461	35	37	13	11	552	509
Between 1 and 2 years	482	476	32	35	12	11	526	522
Between 2 and 3 years	445	460	30	31	10	9	485	500
Between 3 and 4 years	399	422	22	29	6	7	427	458
Between 4 and 5 years	339	383	17	22	3	4	359	409
Over 5 years	561	817	152	175	6	7	719	999
Total non-current	2,226	2,558	253	292	37	38	2,516	2,888
Total	2,730	3,019	288	329	50	49	3,068	3,397

13. Other financial liabilities

	2016	2015
Carrying amount as at January 1	1,271	1,394
Additions and loans received	92	71
Loans repaid	(92)	(242)
Foreign currency translation differences	15	65
Other changes	7	(17)
Net movement	22	(123)
Carrying amount as at December 31	1,293	1,271

The financial liabilities comprise:

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
A Cumulative preference shares	-	18	-	18
C Cumulative preference shares	-	14	-	14
Subordinated perpetual loans	-	600	-	584
Other loans (secured/unsecured)	85	576	87	568
Total	85	1,208	87	1,184

The subordinated perpetual loans are subordinated to all other existing and future KLM debts. The subordinations are equal in rank. Under certain circumstances KLM has the right to redeem the subordinated perpetual loans, with or without payment of a premium.

The Swiss Franc subordinated perpetual loans amounting to EUR 349 million as at December 31, 2016 (December 31, 2015 EUR 346 million) are listed on the SWX Swiss Exchange, Zurich.

The maturity of financial liabilities is as follows:

As at December 31,	2016	2015
Less than 1 year	85	87
Between 1 and 2 years	131	259
Between 2 and 3 years	134	129
Between 3 and 4 years	148	133
Between 4 and 5 years	152	31
Over 5 years	643	632
Total	1,293	1,271

The carrying amounts of financial liabilities denominated in currencies other than the Euro are as follows:

As at December 31,	2016	2015
USD	5	9
CHF	349	346
JPY	251	238
Total	605	593

The fair values of financial liabilities are as follows:

As at December 31,	2016	2015
A Cumulative preference shares	18	18
C Cumulative preference shares	14	14
Subordinated perpetual loans	544	516
Other loans (secured/unsecured)	681	677
Fair value	1,257	1,225

The fair value of the financial liabilities is based on the net present value of the anticipated future cash flows associated with these instruments.

The exposure of the Group's borrowing interest rate changes and the contractual re-pricing dates are as follows:

	<1 year	>1 and < 5 years	> 5 years	Total
As at December 31, 2016				
Total borrowings	671	-	622	1,293
Effect of interest rate swaps	(64)	-	64	-
	607	-	686	1,293
As at December 31, 2015				
Total borrowings	673	-	598	1,271
Effect of interest rate swaps	(67)	-	67	-
	606	-	665	1,271

The effective interest rates at the balance sheet date, excluding the effect of derivatives, are as follows:

in %	December 31, 2016 EUR	December 31, 2016 Other	December 31, 2015 EUR	December 31, 2015 Other
Cumulative preference shares	3.70	-	3.70	-
Subordinated perpetual loans	-	3.96	-	3.66
Other loans	1.60	-	1.90	-

The interest rates of the subordinated perpetual loans and other loans, taking into account the effect of derivatives, are as follows:

	Variable interest loans	Fixed interest loans	Average variable %-rate	Average fixed %-rate	Average %-rate
Subordinated perpetual loans	-	600	-	4.05	4.05
Other loans	597	64	1.69	1.59	1.60

The variable interest rates are based on EURIBOR or the USD LIBOR rate.

In July 2015, KLM signed a EUR 575 million revolving credit facility for a period of 5 years with 10 international banks. No amounts were withdrawn in 2016 or 2015.

14. Net debt

As at December 31,	2016	2015
Current and non-current financial debt	3,343	3,354
Financial debt	3,343	3,354
Cash and cash equivalents	1,208	840
Restricted deposits	44	196
Cross currency element of CCIR swaps	40	36
Near cash	298	204
Financial assets	1,590	1,276
Total net debt	1,753	2,078

	2016	2015
Carrying amount as at January 1	2,078	2,420
Free cash flow	(378)	(408)
Other (including currency translation adjustment)	53	66
Net movement	(325)	(342)
Carrying amount as at December 31	1,753	2,078

15. Deferred income

	December 31, 2016 Current	December 31, 2016 Non-current	December 31, 2015 Current	December 31, 2015 Non-current
Advance ticket sales	907	-	810	-
Sale and leaseback transactions	2	13	3	8
Flying Blue frequent flyer program	95	188	94	149
Others	13	3	15	5
Total	1,017	204	922	162

16. Deferred income tax

The gross movement on the deferred income tax account is as follows:

	2016	2015
Carrying amount as at January 1	(214)	(365)
Income statement (credit) /charge	69	42
Tax (credited)/charged to equity	23	112
Other movements	3	(3)
Net movement	95	151
Carrying amount as at December 31	(119)	(214)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The amounts of deferred tax assets recognised in the other tax jurisdictions (i.e. in The United Kingdom) and in Dutch subsidiaries not included in KLM income tax fiscal unity in The Netherlands are included in the deferred tax asset line within non-current assets on the balance sheet. Of the total amount involved, being EUR 38 million, EUR nil million is expected to be recovered in 12 months or less and EUR 3 million is expected to be recovered after more than 12 months. An amount of EUR 35 million related to taxes on remeasurement via Other Comprehensive Income of defined benefit pension plans and will not be recycled through the statement of profit or loss.

The split between deferred tax assets, net (offset) deferred tax liabilities and current income tax liability is as follows:

As at December 31,	2016	2015
Deferred tax asset other tax jurisdictions	(38)	(32)
Net Deferred tax asset KLM income tax fiscal unity (offset)	(81)	(182)
	(119)	(214)

The net deferred tax liability is built up as follows:

As at December 31,	2016	2015
Deferred tax assets		
Deferred tax assets to be recovered in 12 months or less	90	75
Deferred tax assets to be recovered after more than 12 months	119	324
	209	399
Deferred tax liabilities		
Deferred tax liabilities to be settled in 12 months or less	2	2
Deferred tax liabilities to be settled over more than 12 months	126	215
	128	217
Net Deferred tax asset KLM income tax fiscal unity (offset)	(81)	(182)

The movements in deferred tax assets and liabilities, without taking into consideration the offsetting of balances within the same tax jurisdiction, are as follows:

	Carrying amount as at January 1	Income statement (charge)/ credit	Tax (charged)/ credited to equity	Other	Carrying amount as at December 31
Deferred tax assets					
Fiscal 2016					
Tax losses	280	(56)	-	(1)	223
Fleet assets	2	(1)	-	-	1
Fleet related assets (maintenance)	-	-	-	-	-
Provisions for employee benefits	35	-	10	-	45
Financial lease obligations	-	-	-	-	-
Derivative financial instruments	121	-	(136)	-	(15)
Other	3	-	-	-	3
Total	441	(57)	(126)	(1)	257

	Carrying amount as at January 1	Income statement (charge)/ credit	Tax (charged)/ credited to equity	Other	Carrying amount as at December 31
Deferred tax assets					
Fiscal 2015					
Tax losses	484	(211)	-	7	280
Fleet assets	6	(4)	-	-	2
Fleet related assets (maintenance)	1	(1)	-	-	-
Provisions for employee benefits	30	-	5	-	35
Financial lease obligations	-	-	-	-	-
Derivative financial instruments	152	-	(31)	-	121
Other	6	-	-	(3)	3
Total	679	(216)	(26)	4	441

	Carrying amount as at January 1	Income statement charge/ (credit)	Tax (charged) / credited to equity	Other	Carrying amount as at December 31
Deferred tax liabilities					
Fiscal 2016					
Other tangible fixed assets	(6)	(2)	-	-	(8)
Pensions and benefits (asset)	415	14	(100)	-	329
Maintenance provision	(131)	-	-	-	(131)
Other	(51)	(1)	-	-	(52)
Total	227	11	(100)	-	138

	Carrying amount as at January 1	Income statement charge/ (credit)	Tax (charged) / credited to equity	Other	Carrying amount as at December 31
Deferred tax liabilities					
Fiscal 2015					
Other tangible fixed assets	(3)	(3)	-	-	(6)
Pensions and benefits (asset)	315	13	87	-	415
Maintenance provision	1	(132)	-	-	(131)
Other	1	(52)	-	-	(51)
Total	314	(174)	87	-	227

The Group has tax loss carry forwards in The Netherlands amounting to EUR 0.9 billion (December 31, 2015 EUR 1.1 billion) and in The United Kingdom amounting to EUR 17 million (December 31, 2015 EUR 31 million) for which a deferred tax asset has been recognised to the extent that expected future taxable profits in excess of the profit arising from the reversal of existing temporary differences, are sufficient for utilisation of those tax loss carry forwards. If these expected future taxable profits will not materialise, this could have a significant impact on the recoverability of these deferred tax assets.
Under Income Tax law in The Netherlands, the maximum future period for utilising tax losses carried forward is nine years. In The United Kingdom, this period is indefinite.

The expected future taxable profits assessment per December 31, 2016, shows that all tax loss carry forwards is expected to be recovered in the nine year window. Therefore the deferred tax assets provision of EUR 65 million (corresponding to a basis of EUR 260 million) recorded at December 31, 2014 has been reversed per December 31, 2016. Also the deferred tax assets provision on pre-fiscal unity income tax losses of Martinair Holland N.V. recorded at December 31, 2014 has been partly reversed for an amount of EUR 7 million (corresponding to a basis of EUR 30 million) per December 31, 2016.

In 2015, some accounting principles in the KLM income tax fiscal unity have been changed as a result of which the result for tax purposes increased with EUR 730 million. This decrease in tax losses carried forward is fully offset by an increase in temporary differences.

The Group has tax loss carry forwards in The United Kingdom in the amount of EUR nil million (December 31, 2015 EUR nil million) as well as deductible temporary differences for which no deferred tax asset has been recognised, due to the uncertainty whether there are sufficient future tax profits against which such temporary differences and tax losses can be utilised. The unrecognised deferred tax assets relating to temporary differences amount to EUR 31 million (December 31, 2015 EUR 26 million).

17. Provisions for employee benefits

As at December 31,	2016	2015
Pension and early-retirement obligations	357	279
Post-employment medical benefits	37	52
Other long-term employment benefits	96	89
Termination benefits	12	11
Total Liabilities	502	431
Less: Non-current portion		
Pension and early-retirement obligations	337	258
Post-employment medical benefits	35	49
Other long-term employment benefits	92	82
Termination benefits	10	10
Non-current portion	474	399
Current portion	28	32

As at December 31,	2016	2015
Assets		
Pension assets non current portion	1,462	1,773
Total assets	1,462	1,773

Pension plans

The Company sponsors a number of pension plans for employees world-wide. The major plans are defined benefit plans covering Cabin Crew, Cockpit Crew and Ground Staff based in The Netherlands, The United Kingdom, Germany, Hong Kong, and Japan. The major plans are funded through separate pension funds which are governed by independent boards and are subject to supervision of the local regulatory authorities.

In addition to these major plans there are various relatively insignificant defined benefit and defined contribution plans for employees located in- and outside The Netherlands.

Characteristics of Cabin Crew plan

The pension plan relating to Cabin Crew of the Company is a defined benefit plan with reversion to the spouse in case of death of the beneficiary. The pension is based on final wage. For a closed group of active members the pension is based on an average wage. The age of retirement defined in the plan is 60 years old. The duration of the pension plan is 23 years.

The board of the pension fund is composed of members appointed by the employer, employees and pensioners. The board is fully responsible for the execution of the plan. The Company can only control the financing agreement between the Company and the pension fund. The financing agreement is part of the Collective Labour Agreement between the Company and the Cabin Crew Unions.

To satisfy the requirements of the Dutch regulations and rules set between the employer and the board of the pension fund, the plan imposes a mandatory funding level of approximately 125% of the projected long-term commitment. The projection of these commitments is calculated according to local funding rules. The mandatory funding ratio is based on the new Financial Assessment Framework (nFTK) applicable as per January 1, 2015. The impact of the nFTK amongst others resulted in higher minimum required solvency levels. On the other hand pension funds have more time to recover from immediate and material shortages through a rolling 10 year recovery plan that also includes projected future return on investment. As a consequence the existing recovery plan for the Cabin Crew plan has been updated as per April 1, 2016.

If the coverage ratio is under the funding rules detailed above, the pension fund is required to implement a recovery plan that aims for compliance with the threshold of 125% within 10 years and includes projected future return on investment. If the threshold cannot be realised within 10 years (transitionary period of 12 years as from 2015) additional contributions are payable by the Company and the employees. The amount of regular and additional employer contributions is limited to 48% of the pensionable basis. The amount of possible additional employee contributions is limited to 0.7% of the pensionable basis. A reduction of contribution is possible if the indexation of pensions is fully funded. This reduction in a year is limited to twice the normal contributions. Given the new Dutch fiscal rules, amongst others, a lower future accrual rate is applicable as from 2015.

The return on plan assets, the discount rate used to value the commitments, the longevity and the characteristics of the active population are the main factors that impact both the coverage ratio and the level of the regular contribution for future pension accrual. The funds, fully dedicated to the Company, are mainly invested in bonds, equities and real estate.

The required funding of this pension plan also includes buffer against the following risks: interest rate mismatch, equity risk, currency risk, credit risk, actuarial risk and real estate risk. For example, to reduce the sensitivity to a decline of the interest rate, approximately 50% of the sensitivity to an interest rate shock on all maturities is covered by an interest hedge.

For developments regarding the Cabin Crew plan, see the paragraph 'Developments 2016' in this note.

Characteristics of Cockpit Crew plan

The pension plan relating to Cockpit Crew of the Company is a defined benefit plan based on the average salary, with reversion to the spouse in case of death of the beneficiary. For the year 2015 the age of retirement defined in the plan is 56 years. As of July 2016 the retirement age for pension accrual will gradually increase to 58 years. Implementation of the increase is phased in four steps of a half year starting July 2016. As of July 2019 the retirement will be 58 years for all members. The duration of the pension plan is 19 years.

The board of the pension fund is composed of members appointed by the employer, employees and pensioners. The board is fully responsible for the execution of the plan. The Company can only control the financing agreement between the Company and the pension fund. The financing agreement is part of the Collective Labour Agreement between the Company and the Cockpit Crew Union.

To satisfy the requirements of the Dutch regulations and rules set between the employer and the board of the pension fund, the plan imposes a mandatory funding level of approximately 123% to 125% of the projected long-term commitment. The projection of these commitments is calculated according to local funding rules. The mandatory funding ratio is based on the new Financial Assessment Framework (nFTK) applicable as per January 1, 2015. The impact of the nFTK amongst others resulted in higher minimum required solvency levels. On the other hand pension funds have more time to recover from immediate and material shortages through a rolling 10 year recovery plan that also includes projected future return on investment. As a consequence a recovery plan for the Cockpit Crew plan has been issued for the first time as per April 1, 2016.

If the coverage ratio is under the funding rules detailed above, the pension fund is required to implement a recovery plan that aims for compliance with the threshold of 125% within 10 years and includes projected future return on investment. If the threshold cannot be realised within 10 years (transitionary period of 12 years as from 2015) additional contributions are payable by the Company and the employees. In an additional agreement between the Company and the Cockpit Crew Union it is stipulated that in case of unconditional indexation and of a coverage under the funding ratio, no delay for additional contributions is applicable to reach the required funding ratio for the financing of indexation of pre-2007 rights. The amount for regular and additional employer contributions is not limited. The employee contributions cannot be increased in case of non-compliance with these minimum funding.

A reduction of the employer contribution is possible if the indexation of pensions is fully funded. This reduction is not limited and can be performed either by a reimbursement of contributions, or by a reduction in future contributions. Given the new Dutch fiscal rules, amongst others, a maximum pensionable salary of EUR 100,000 and lower future accrual rate are applicable since 2015.

The return on plan assets, the discount rate used to value the commitments, the longevity and the characteristics of the active population are the main factors that impact the coverage ratio and could lead to a risk of additional contributions for the Company on the long term. The funds, fully dedicated to the Company, are mainly invested in bonds, equities and real estate.

The required funding of this pension plan also includes a buffer against the following risks: interest rate mismatch, equity risk, currency risk, credit risk, actuarial risk and real estate risk.

For developments regarding the Cockpit Crew plan, see the paragraph 'Developments 2016' in this note.

Characteristics of Ground Staff plan

The pension plan relating to ground staff of the Company is a defined benefit plan based on the average salary with reversion to the spouse in case of death of the beneficiary. The age of retirement defined in the plan is 67 years. The duration of the pension plan is 20 years. The board of the pension fund is composed of members appointed by the employer, employees and pensioners. The board is fully responsible for the execution of the plan. The Company can only control the financing agreement between the Company and the pension fund. The financing agreement is part of the Collective Labour Agreement between the Company and the Ground Staff Unions/ Works council.

To satisfy the requirements of the Dutch regulations and rules set between the employer and the board of the pension fund, the plan imposes a mandatory funding level of approximately 125% of the projected long-term commitment. The projection of these commitments is calculated according to local funding rules. The mandatory funding ratio is based on the new Financial Assessment Framework (nFTK) applicable as per January 1, 2015. The impact of the nFTK amongst others resulted in higher minimum required solvency levels. On the other hand pension funds have more time to recover from immediate and material shortages through a rolling 10 year recovery plan that also includes projected future return on investment. As a consequence the existing recovery plan for the Ground Staff plan has been updated as per April 1, 2016.

If the coverage ratio is under the funding rules detailed above, the pension fund is required to implement a recovery plan that aims for compliance with the threshold of 125% within 10 years and includes projected future return on investment. If the threshold cannot be realised within 10 years (transitionary period of 12 years as from 2015) additional contributions are payable by the Company and the employees. The amount of regular and additional employer contributions is not limited. The amount of possible additional employee contributions is limited to 2% of the pensionable basis. A reduction of contribution is possible if the indexation of pensions is fully funded. This reduction is not limited and can be performed either by a reimbursement of contributions, or by a reduction in future contributions. Given the new Dutch fiscal rules, amongst others, a maximum pensionable salary of EUR 100,000 and lower future accrual rate are applicable since 2015.

The return on plan assets, the discount rate used to value the commitments, the longevity and the characteristics of the active population are the main factors that impact both the coverage ratio and the level of the regular contribution for future pension accrual. The regular contributions are limited to 22% of the pensionable base. The funds, fully dedicated to the Company, are mainly invested in bonds, equities and real estate.

The required funding of this pension plan also includes buffer against the following risks: interest rate mismatch, equity risk, currency risk, credit risk, actuarial risk and real estate risk. For example, to reduce the sensitivity to a decline of the interest rate, approximately 50% of the sensitivity to an interest rate shock on all maturities is covered by an interest hedge.

Investment strategy

The boards of the funds of the aforementioned Cabin, Cockpit and Ground plan, consult independent advisors as necessary to assist them with determining investment strategies consistent with the objectives of the funds. These strategies relate to the allocation of assets to different classes with the objective of controlling risk and maintaining the right balance between risk and long-term returns in order to limit the contribution to the Company of the benefits provided. The funds use asset and liability management studies that generate future scenarios to determine their optimal asset mix and expected rates of return on assets.

Investments are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets. The plans invest a large proportion of their assets in equities which is believed offer the best returns over the long term commensurate with an acceptable level of risk. Also a proportion of assets is invested in property, bonds and cash. The management of most assets is outsourced to a private institution, Blue Sky Group, under a service contract.

Developments 2016

In 2016 the financial markets were very positive and plan assets increased with EUR 1,428 million. The discount rate used to calculate the pension obligations further decreased from 2.35% end 2015 to 1.9% end 2016. Consequently the defined benefit obligations sharply increased with EUR 1,817 million. Overall the funded status decreased by EUR 389 million in 2016.

Cockpit Crew plan

As a result of the further decrease in discount rates also the funding ratio decreased in 2016. Consequently the Company could have to pay a very significant additional contribution without being able to spread the amount. In December 2016 the Company and the Cockpit Crew Union agreed on the funding of the 2017 indexation. This agreement indicates that the Company and the Cockpit Crew Union must agree on a new de-risked pension plan in 2017 and that the Company could have to pay a maximum of EUR 94 million contribution according to the future agreement. Since it is not clear whether an agreement on a de-risked pension will be reached in 2017 the EUR 94 million has not been recorded as per December 31, 2016. An agreement on a de-risked pension plan could lead to derecognizing the pension asset related to the Cockpit Crew Plan in 2017 and the EUR 94 million would then be deducted from the potential dowry payment.

Cabin Crew plan

In December 2016, the Company and the Cabin Crew Unions started discussions with the aim to draw up a protocol to arrive to a future proof pension agreement. This agreement could have the characteristics of a collective defined contribution scheme. It will require before implementation, amongst others, the agreement of the Dutch fiscal authorities and should qualify as a collective defined contribution scheme, thus derecognizing of the pension asset and is expected to be implemented in 2017 and the EUR 94 million would then be deducted from the potential dowry payment.

The funding ratios (based on the average 12 months rolling policy coverage), as set by the Dutch Central Bank, are as follows as at December 31, 2016 (and as at December 31, 2015):

» Cabin Crew pension fund	100.0 %
(December 31, 2015:	108.5%)
» Cockpit Crew pension fund	114.6 %
(December 31, 2015:	122.9%)
» Ground Staff pension fund	103.4 %
(December 31, 2015:	111.1%)

As per yearend 2016 all three plans are below the required coverage ratio and therefore have to issue an updated recovery plan before April 1, 2017. As a result of the 10 year rolling recovery plans no additional recovery payments are needed for 2017.

Recognition of pension assets and liabilities in the balance sheet

The Group's pension funds have together a surplus totalling EUR 1,105 million as at December 31, 2016 (December 31, 2015 EUR 1,494 million).

No limit (i.e. after the impact of IAS 19 and IFRIC 14 "The limit on a defined benefit asset, minimum funding requirements and their interaction" on IAS 19) on the net assets recognised in the balance sheet is applied since, based on the current financing agreements between these pension funds and the Company, future economic benefits are available in the form of a reduction in future contributions. These net assets recognised are not readily available for the Company.

The accounting standards require management to make assumptions regarding variables such as discount rate, rate of compensation increase and mortality rates. Periodically, management consults with external actuaries regarding these assumptions. Changes in these key assumptions and in financing agreements between pension funds and the Company can have a significant impact on the recoverability of the net pension assets (IFRIC 14).

As at December 31, 2016 the net assets recognised in the balance sheet of the three main funds amount to EUR 1,462 million (December 31 2015 EUR 1,773 million).

Assumptions used for provisions for employee benefits

The provisions were calculated using actuarial methods based on the following assumptions (weighted averages for all plans):

	Pension and early-retirement obligations	
	As at December 31,	
in %	2016	2015
Weighted average assumptions used to determine benefit obligations		
Discount rate for year ended	1.92	2.39
Rate of compensation increase	0.93	1.32
Rate of price inflation	1.80	1.70
Weighted average assumptions used to determine net cost		
Discount rate for year ended	2.39	2.39
Rate of compensation increase	1.32	1.48
Rate of price compensation	1.70	1.75

For the main Dutch pension plans, the 2016 Generation mortality tables (with certain plan specific adjustments) of the Dutch Actuarial Association were used.

As from 2016, the Company refined its calculations, by retaining the adequate flows, on the discount rate used for the service-cost calculation. In the Euro zone, this leads to the use of a discount rate of 0.15% higher for the service-cost calculation compared to the one used for the discount of the benefit obligation.

	Pension and early-retirement obligations	
As at December 31,	2016	2015
Present value of wholly or partly funded obligations	18,539	16,722
Fair value of plan assets	(19,644)	(18,216)
Net liability/(asset) relating pension and other post-retirement obligations	(1,105)	(1,494)

	Pension and early-retirement obligations	
As at December 31,	2016	2015
Amounts in the balance sheet		
Liabilities	357	279
Assets	(1,462)	(1,773)

The movements in the present value of wholly or partly funded obligations in the year are as follows:

	Pension and early-retirement obligations	
	2016	2015
Carrying amount as at January 1	16,722	17,354
Current service cost	230	344
Interest expense	395	412
Past service cost (reference is made to note 27)	-	26
Past service cost	37	-
Curtailments/settlements	-	(437)
Actuarial losses/(gains) demographic assumptions	10	1
Actuarial losses/(gains) financial assumptions	1,657	(451)
Actuarial losses/(gains) experience adjustments	3	(145)
Benefits paid from plan/company	(431)	(416)
Exchange rate changes	(84)	34
Net movement	1,817	(632)
Carrying amount as at December 31	18,539	16,722

The movements in the fair value of assets of the wholly or partially funded pension plans in the year can be summarised as follows:

	2016	2015
Fair value as at January 1	18,216	18,470
Interest income	431	440
Return on plan assets excluding interest income	1,197	(260)
Employer contributions	181	214
Member contributions	100	130
Settlements	-	(394)
Benefits paid from plan / company	(423)	(411)
Other	-	-
Exchange rate changes	(58)	27
Net movement	1,428	(254)
Fair value as at December 31	19,644	18,216

The experience adjustments are as follows:

	2016	2015
Benefit obligation	3	(145)
Plan asset	1,197	(260)

The sensitivity of the defined benefit cost recognised in profit or loss and the defined benefit obligation to variation in the discount rate is:

	Sensitivity of the assumptions for the year ended December 31,	
In millions of Euros	2016	2015
0.25% increase in the discount rate		
Impact on service cost	(22)	(19)
Impact on defined benefit obligation	(878)	(776)
0.25% decrease in the discount rate		
Impact on service cost	25	22
Impact on defined benefit obligation	1,010	894

The sensitivity of the defined benefit cost recognised in profit or loss and the defined benefit obligation to variation in the salary increase is:

	Sensitivity of the assumptions for the year ended December 31,	
In millions of Euros	2016	2015
0.25% increase in the salary increase		
Impact on service cost	5	5
Impact on defined benefit obligation	73	65
0.25% decrease in the salary increase		
Impact on service cost	(4)	(4)
Impact on defined benefit obligation	(59)	(59)

The sensitivity of the defined benefit cost recognised in profit or loss and the defined benefit obligation to variation in the pension increase rate is:

	Sensitivity of the assumptions for the year ended December 31,	
In millions of Euros	2016	2015
0.25% increase in the pension increase rate		
Impact on service cost	20	19
Impact on defined benefit obligation	909	809
0.25% decrease in the pension increase rate		
Impact on service cost	(14)	(13)
Impact on defined benefit obligation	(715)	(635)

The major categories of assets as a percentage of the total pension plan assets are as follows:

	As at December 31,	
in %	2016	2015
Debt securities	49	53
Real estate	12	13
Equity securities	39	32
Other	-	2

Debt securities are primarily composed of listed government bonds, equally split between inflation linked and fixed interest, at least rated BBB, and invested in Europe, the United States of America and emerging countries. Real estate are primarily invested in Europe and the United States of America and equally split between listed and unlisted. Equity securities are mainly listed and invested in Europe, the United States of America and emerging countries.

Post-employment medical benefits

This provision relates to the obligation the Company has to contribute to the cost of employees' medical insurance after retirement in The United States of America and Canada.

	Post-employment medical benefits	
As at December 31,	2016	2015
Present value of unfunded obligations	37	52
Net liability/(asset) relating pension and other post-retirement obligations	**37**	**52**

The movements in the present value of wholly or partly funded obligations in the year are as follows:

	Post-employment medical benefits	
	2016	2015
Carrying amount as at January 1	**52**	**51**
Interest expense	2	3
Actuarial losses/(gains) demographic assumptions	(1)	(2)
Actuarial losses/(gains) financial assumptions	(7)	4
Actuarial losses/(gains) experience adjustments	(7)	2
Past service cost	(1)	(9)
Benefits paid from plan/company	(2)	(2)
Exchange rate changes	1	5
Net movement	**(15)**	**1**
Carrying amount as at December 31	**37**	**52**

The provisions were calculated using actuarial methods based on the following assumptions (weighted averages for all plans):

	Post-employment medical benefits As at December 31,	
in %	2016	2015
Weighted average assumptions used to determine benefit obligations		
Discount rate for year	3.60	4.15
Weighted average assumptions used to determine net cost		
Discount rate for year	4.15	4.20
Medical cost trend rate assumptions used to determine net cost *		
Immediate trend rate Pre 65	11.90	6.90
Immediate trend rate Post 65	11.90	6.90
Ultimate trend rate	4.00	4.40
Year that the rate reaches ultimate trend rate	2079	2089

* The rates shown are the weighted averages for The United States of America and Canada

Other long-term employee benefits

	2016	2015
Jubilee benefits	71	66
Other benefits	25	23
Total carrying amount	96	89
Less: Non-current portion		
Jubilee benefits	67	61
Other benefits	25	21
Non-current portion	92	82
Current portion	4	7

The provision for jubilee benefits covers bonuses payable to employees when they attain 25 and 40 years of service.

The provision for other benefits relates to existing retirement entitlements.

Termination benefits

	2016	2015
Redundancy benefits		
Non-current portion	10	10
Current portion	2	1
Total carrying amount	12	11

Termination benefits relate to a provision for supplements to unemployment benefits to former employees.

18. Other provisions

	Phasing-out costs of operating lease aircraft	Aircraft maintenance provision	Legal Issues	Other	Total
As at January 1, 2016	90	433	186	102	811
Additional provisions and increases in existing provisions	47	105	1	56	209
Unused amounts reversed	-	(32)	(21)	(8)	(61)
Used during year	(34)	(104)	-	(110)	(248)
Foreign currency translation differences	4	8	-	-	12
Other changes	(32)	39	-	26	33
As at December 31, 2016	75	449	166	66	756
Current/non-current portion					
Non-current portion	75	346	166	6	593
Current portion	-	103	-	60	163
Carrying amount as at December 31, 2016	75	449	166	66	756

Phasing-out cost of operating lease aircraft

For a number of aircraft operated under operating lease contracts, there is a contractual obligation to the lessor to redeliver the aircraft in an agreed state of maintenance. The provision represents the estimated cost to be incurred or reimbursed to the lessor at the balance sheet date.

Aircraft maintenance provision

The provision for aircraft maintenance relates to contractual commitments for aircraft financed under operating leases. The provision has a variable term between one and seven years and is in 2016 discounted at 5.2% (2015 6.0%).

Legal issues

The provision as at December 31, 2016 relates to the Cargo anti-trust investigations in Europe for KLM and Martinair and anti-trust investigations in Switzerland. For more details reference is made to note 21 Contingent assets and liabilities.

Other provisions

Other provisions include provisions for onerous leases of aircraft and site restoration cost for land and buildings under long term lease agreements.

19. Trade and other payables

As at December 31,	2016	2015
Trade payables	972	952
Amounts due to AIR FRANCE KLM Group companies	96	86
Taxes and social security premiums	261	231
Other payables	577	332
Accrued liabilities	77	149
Total	1,983	1,750

20. Commitments

As at December 31, 2016, KLM has commitments for previously placed orders amounting to EUR 3,177 million (December 31, 2015 EUR 3,299 million). EUR 3,069 million of this amount relates to aircraft (December 31, 2015 EUR 3,212 million) of which EUR 507 million is due in 2017. The balance of the commitments as at December 31, 2016 amounting to EUR 108 million (December 31, 2015 EUR 87 million) is related to other tangible fixed assets. As at December 31, 2016 prepayments on aircraft orders have been made, amounting to EUR 329 million (December 31, 2015 EUR 167 million).

21. Contingent assets and liabilities

Contingent liabilities

Antitrust investigations and civil litigation

a. Actions instigated by the EU Commission and several competition authorities in other jurisdictions for alleged cartel activity in air cargo transport.

Air France, KLM and Martinair have been involved, since February 2006, with up to twenty-five other airlines in investigations initiated by the antitrust authorities in several countries with respect to allegations of anti-competitive agreements or concerted actions in the airfreight industry.

As of December 31, 2016, most of these investigations and related public proceedings have been concluded, with the following exceptions.

On March 17, 2017, the European Commission announced that it would fine eleven airlines, including KLM, Martinair and Air France, for practices in the air cargo sector that are considered anti-competitive and relate mainly to the period between December 1999 and February 2006. This new decision follows the initial decision of the Commission of November 9, 2010. This decision, issued to the same airlines for the same alleged practices, was annulled on formal grounds by the General Court of the European Commission in December 2015. The EUR 156 million provision in respect of the fine however has been maintained as per December 31, 2016 (excluding accrued interest). The accrued interest related to the previous fine, amounting to EUR 21 million, has been released to the consolidated statement of profit or loss in 2016.

The new fine for KLM and Martinair, as announced on March 17, 2017, amounts to EUR 142.6 million and is slightly lower than the initial fine imposed in 2010. KLM and Martinair (and Air France) will analyse this new decision and consider its options for response. Reference is made to the Subsequent events paragraph in the Notes to the Consolidated Financial Statements

In Switzerland, Air France and KLM are challenging a decision imposing a EUR 3.2 million fine before the relevant court. Taking into account the part thereof that external counsel assesses to be for the account of KLM, a provision of EUR 0.6 million was recorded.

As of December 31, 2016, the total amount of provisions in connection with antitrust cases amounts to EUR 166 million.

b. Related civil lawsuits

Following the initiation of various investigations by competition authorities in 2006 and the EU Commission decision in 2010, several collective and individual actions were brought by forwarders and airfreight shippers in civil courts against KLM, Air France and Martinair, and the other airlines in several jurisdictions.

Under these civil lawsuits, shippers and freight forwarders are claiming for damages to compensate alleged higher prices as a consequence of the alleged anticompetitive behaviours.

Air France, KLM and/or Martinair remain defendants, either as main defendants or as third party interveners brought in these cases by other main defendants under "contribution proceedings". Where Air France, KLM and/or Martinair are main defendants, they have initiated contribution proceedings against other airlines.

No provision has been recognised at present in connection with these disputes as KLM and Martinair are not in a position at this stage of the judicial proceedings to give a reliable estimate of the maximum potential loss that would be incurred if the outcome of these proceedings were to be negative. In particular, although significant amounts have been reported by the media, plaintiffs are mostly claiming for unspecified and/or insufficiently substantiated damages against defendants taken as a whole (and not individually) and the EU decision to which the plaintiffs generally refer to was annulled by the General Court in its decision of December 16, 2015.

c. Civil actions relating to the Passenger Business

Litigations concerning anti-trust laws

Canada

A civil class action was reinitiated in 2013 by claimants in Ontario against seven airlines including KLM and Air France. The plaintiffs allege the defendants participated in a conspiracy in the passenger air transport service from/ to Canada on the cross-Atlantic routes, for which they are claiming damages. KLM and Air France strongly deny any participation in such a conspiracy.

d. Other

US department of Justice investigation related to United States Postal Services

In March 2016, the US Department of Justice (DOJ) informed KLM and Air France of a civil inquiry regarding contracts with the United States Postal Service for the international transportation of mail by air. In September 2016, a Civil Information Demand from the DOJ has been received seeking certain information relating to these contracts. The DOJ has indicated it is investigating potential violations of the False Claims Act. KLM and Air France are cooperating with the DOJ investigation.

ACM investigation

The Netherlands Authority for Consumers and Markets (ACM) has launched an investigation into the 'shared vision' project of KLM, Schiphol Group and the Dutch government in 2013. More in particular the ACM investigates whether certain actions between KLM and Schiphol Group are in violation with competition rules. The investigation is still ongoing and the outcome is yet unclear.

Other

The Company and certain of its subsidiaries are involved as defendant in litigation relating to competition issues, commercial transactions, and labour relations. Although the ultimate disposition of asserted claims and proceedings cannot be predicted with certainty, it is the opinion of the Company's management that, with the exception of the matters discussed above, the outcome of any such claims, either individually or on a combined basis, will not have a material adverse effect on the Company's consolidated financial position, but could be material to the consolidated results of operations of the Company for a particular period.

Site cleaning up cost

The Group owns a number of Cargo and Maintenance buildings situated on various parcels of land which are the subject of long lease agreements.
At the expiry of each of these agreements the Company has the following options:

1. To demolish the buildings and clean up the land prior to return to the lessor;
2. To transfer ownership of the building to the lessor; or
3. To extend the lease of the land.

No decision has been taken regarding the future of any of the buildings standing on leased land. Therefore, it cannot be determined whether it is probable that site cleaning up cost will be incurred and to what extent. Accordingly, no provision for such cost has been established.

Guarantees

Bank guarantees and corporate guarantees given by the Company on behalf of subsidiaries, unconsolidated companies and third parties, including the guarantees provided by the Company for the four bond loans issued by AIR FRANCE KLM S.A. (see note 11), amount to EUR 216 million as at December 31, 2016 (December 31, 2015 EUR 528 million).

The guarantees that the Company provides for the two bonds issued by AIR FRANCE KLM S.A. (see note 11) covers the principal amount as well as the remaining interest obligations.

With respect to the plain vanilla bond loan, issued by AIR FRANCE KLM S.A. in December 2012 (see note 11) as well as the convertible bond, issued by AIR FRANCE KLM S.A. in March 2013 (see note 11), the Company has irrevocably and unconditionally agreed to act as several but not as joint guarantors (the Company for 40%). For these two bonds the total guaranteed amount outstanding is reduced by the total amount drawn as at December 31, 2016 on the existing related intercompany loan facilities (see note 11). The total net guarantee exposure for the Company, related to these two bonds, is EUR 173 million as at December 31, 2016 (December 31, 2015 EUR 454 million).

Section 403 guarantees

General guarantees as defined in Book 2, Section 403 of The Dutch Civil Code have been given by the Company on behalf of several subsidiaries in The Netherlands. The liabilities of these companies to third parties and unconsolidated companies amount to EUR 551 million as at December 31, 2016 (December 31, 2015 EUR 373 million).

Contingent assets

Other Litigation

The Company and certain of its subsidiaries are involved as plaintiff in litigation relating to commercial transactions and tax disputes. Although the ultimate disposition of asserted claims and proceedings cannot be predicted with certainty, it is the opinion of the Company's management that the outcome of any such claims, either individually or on a combined basis, will not have a material favourable effect on the Company's consolidated financial position, but could be material to the consolidated results of operations of the Company for a particular period.

22. Revenues

	2016	2015
Services rendered		
Passenger transport	7,114	7,143
Cargo transport	1,123	1,376
Maintenance contracts	759	625
Charter and low cost business	773	727
Other services	31	34
Total revenues	9,800	9,905

23. External expenses

	2016	2015
Aircraft fuel	1,994	2,694
Chartering costs	61	61
Landing fees and route charges	792	819
Catering	209	206
Handling charges and other operating costs	544	560
Aircraft maintenance costs	1,009	943
Commercial and distribution costs	319	315
Insurance	25	28
Rentals and maintenance of housing	198	199
Sub-contracting	168	139
Other external expenses	200	200
Total external expenses	5,519	6,164

In Aircraft fuel expenses an amount of EUR 411 million negative (2015 EUR 691 million negative) is included which was transferred from OCI to the consolidated statement of profit or loss.

24. Employee compensation and benefit expense

	2016	2015
Wages and salaries	2,326	2,211
Social security premiums other than for state pension plans	225	216
Share-based remuneration	-	-
Hired personnel	128	134
Pension and early-retirement plan costs	164	206
Post-employment medical benefit costs	1	(6)
Other long-term employee benefit costs	16	13
Total employee compensation and benefit expenses	2,860	2,774

Pension and early-retirement plan cost comprise:

	2016	2015
Defined benefit plans	131	187
Defined contribution plans	33	19
Total	164	206

Defined benefit plans and early-retirement plan cost comprise:

	2016	2015
Current service cost	153	199
Interest expense	395	412
Interest income	(431)	(440)
Losses/(gains) arising from plan amendments and curtailments	-	-
Administration cost	14	16
Total	131	187

In the financial year 2016 the defined benefit cost recognised in profit or loss for the major defined benefit plans recognised in the statement of profit or loss amounted to EUR 131 million (2015 EUR 187 million) and the total contributions paid by the Group amounted to EUR 181 million (2015 EUR 214 million). The contributions paid in the financial year 2016 include additional deficit funding for the Dutch KLM plans amounting to EUR nil million (2015 EUR nil million) and in The United Kingdom amounting to EUR 8 million (2015 EUR 8 million).
The Group's projected defined benefit plans and early retirement plan cost for 2017 amount to EUR 156 million. The Group's expected cash contributions for these plans amount to EUR 151 million.

Post-employment medical benefits cost comprise:

	2016	2015
Interest cost	-	2
Losses/(gains) arising from plan amendments	1	(8)
Total	1	(6)

Other long-term employee benefits comprise:

	2016	2015
Current service cost	5	5
Interest cost	1	2
Immediate recognition of (gains)/losses	-	-
Other	10	6
Total	16	13

Number of full-time equivalent employees:

	2016	2015
Average for year		
Flight deck crew	3,242	3,302
Cabin crew	7,847	7,838
Ground staff	18,913	19,275
Total	30,002	30,415

As at December 31,	2016	2015
Flight deck crew	3,212	3,258
Cabin crew	7,447	7,329
Ground staff	18,082	19,237
Total	28,741	29,824

25. Other income and expenses

	2016	2015
Capitalised production	205	256
Operating Currency hedging recycling	86	155
Other expenses	(109)	(113)
Other income and expenses	182	298

26. Amortisation, depreciation and movements in provision

	2016	2015
Intangible assets	42	34
Flight equipment	407	416
Other property and equipment	66	61
Movements in provision	(7)	16
Total amortisation, depreciation and movements in provision	508	527

27. Other non-current income and expenses

The 2016 expense showed a profit of EUR 3 million which mainly relates to profit from sale spare engines (EUR 10 million), profit on sale MD11 Freighters and Fokker 70 aircraft (EUR 8 million) and positive result on sale several items (EUR 9 million) offset by provision for severance payment KLM (EUR 13 million), increase provision onerous lease B747-400 BCF (EUR 7 million) and several other items (EUR 4 million).

The 2015 expense showed a profit of EUR 71 million which mainly relates to profit from sale of 3 slots at Heathrow Airport (EUR 125 million), positive pension plan settlement from defined benefit to defined contribution for Transavia Cockpit Crew (EUR 45 million), negative pension plan change related to a pension age increase from 56 to 58 years offset by an increased yearly accrual rate of KLM Cockpit Crew (EUR 25 million), release provision onerous lease B747-400 BCF (EUR 7 million), provision for severance payment cockpit crew at Martinair (EUR 40 million), provision for voluntary leave at KLM (EUR 31 million) and several other items (EUR 9 million).

28. Net cost of financial debt

	2016	2015
Gross cost of financial debt		
Loans from third parties	58	68
Finance leases	40	40
Other interest expenses	18	27
Total gross cost of financial debt	116	135
Income from cash and cash equivalents		
Loans to third parties	16	21
Total income from cash and cash equivalents	16	21
Net cost of financial debt	100	114

	2016	2015
Foreign currency exchange gains/(losses)	(9)	(5)
Fair value gains/(losses)	9	(203)
Other Financial income and expenses	1	-
Total other financial income and expenses	1	(208)

The fair value results recorded in the financial year mainly consist of the ineffective and time value portion of fuel, interest rate and foreign currency exchange derivatives for EUR 40 million positive (2015 EUR 68 million negative), the change in value of derivative instruments no more qualifying for hedge accounting for EUR 1 million positive (2015 EUR 8 million negative) as well as the unrealised revaluation of other balance sheet items for EUR 32 million negative (2015 EUR 127 million negative).

Other financial income and expenses includes a release of EUR 21 million accrued interest related as a consequence of the annulment of the fine on the allegations of anti-competitive agreements or concerted actions in the airfreight industry by the EU commission. Reference is made to note 21 Contingent assets and liabilities - guarantees and to note 18 Other provisions - Legal issues. This line also includes additions of EUR 20 million to maintenance provisions resulting from the discounting effect in provision calculations.

29. Income tax expense / benefit

	2016	2015
Deferred tax (income)/expense relating to the origination and reversal of temporary differences and tax losses	139	38
Benefit from previously unrecognised tax losses	(72)	-
Reduction of tax losses carried forward	2	4
Total tax (income)/expenses	69	42

The increase of benefit from previously unrecognised tax losses relates to the KLM fiscal unity (EUR 65 million) and pre-fiscal unity income tax losses of Martinair Holland N.V. (EUR 7 million). Reference is made to note 16.

The applicable average tax rate in The Netherlands for the financial year 2016 is 25% (2015: 25%).

The average effective tax rate is reconciled to the applicable tax rate in The Netherlands as follows:

in %	2016	2015
Applicable average tax rate in The Netherlands	25.0	25.0
Impact of:		
Profit free of tax/Non-deductible expenses	(1.2)	3.0
Derecognition / (recognition) of tax losses	(12.0)	3.2
Differences in foreign tax rate changes	-	0.1
Effective tax rate	11.8	31.3

30. Share-based payments

Phantom shares

The movement in the number of phantom performance shares granted is as follows:

	2016	2015
As at January 1	523,372	525,703
Granted	137,883	100,611
Forfeited	(2,102)	(32,990)
Exercised	(111,058)	(69,952)
As at December 31	548,095	523,372

The date of expiry of the phantom shares is as follows:

As at December 31,	2016	2015
Phantom shares expiry date		
July 1, 2016	-	80,082
April 1, 2017	58,833	77,253
April 1, 2018	97,043	113,304
April 1, 2019	117,234	119,715
April 1, 2020	136,454	133,018
April 1, 2021	138,531	-
Carrying number	548,095	523,372

The phantom shares generate an amount of cash, which is equal to the AIR FRANCE KLM share price at the moment of selling of the shares. The number of vested phantom shares depends on the following criteria: AIR FRANCE KLM total shareholders return (30%), KLM Group Return on Capital Employed (40%) and AIR FRANCE KLM position in the Dow Jones Sustainability Index (30%). The maximum number of phantom shares that may be granted to an individual employee in any year is related to their job grade.

Subject to restrictions relating to the prevention of insider-trading, phantom shares may be exercised at any time between the third and the fifth anniversary of the day of grant. Phantom shares are forfeited when employees leave the Company.

Under the Long Term Incentive plan 2012, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2012. The first tranche has vested for 36% in April 2012. The second tranche has vested for 108% in April 2013. The third tranche has vested for 76.4% in April 2014. The 2012 phantom shares are now, insofar vested, unconditionally awarded and can be exercised between April 1, 2015 and April 1, 2017. The 2012 plan has an intrinsic value of EUR 0.3 million as at December 31, 2016.

Under the Long Term Incentive plan 2013, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2013. The first tranche has vested for 108% in April 2013. The second tranche has vested for 76.4% in April 2014. The third tranche has vested for 70.2% in April 2015. The 2013 phantom shares are now, insofar vested, unconditionally awarded and can be exercised between April 1, 2016 and April 1, 2018. The 2013 plan has an intrinsic value of EUR 0.5 million as at December 31, 2016.

Under the Long Term Incentive plan 2014, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2014. The first tranche has vested for 76.4% in April 2014. The second tranche has vested for 70.2% in April 2015. The third tranche has vested for 108.6% in April 2016. The 2014 phantom shares are now, insofar vested, unconditionally awarded and can be exercised between April 1, 2017 and April 1, 2019. The 2014 plan has an intrinsic value of EUR 0.6 million as at December 31, 2016.

Under the Long Term Incentive plan 2015, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2015. The first tranche has vested for 70.2% in April 2015. The second tranche has vested for 108.6% in April 2016. The third tranche is still conditionally awarded.

Under the Long Term Incentive plan 2016, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2016. The first tranche has vested for 108.6% in April 2016. The second and third tranche are still conditionally awarded.

31. Supervisory Board remuneration

	2016			2015		
(Amounts in EUR)	As Supervisory Board member	As Committee member	Total	As Supervisory Board member	As Committee member	Total
H.N.J. Smits	42,500	1,000	43,500	42,500	3,000	45,500
I.P. Asscher-Vonk	26,500	1,000	27,500	26,500	3,000	29,500
P.C. Calavia	26,500	-	26,500	26,500	-	26,500
A. Dautry	26,500	-	26,500	26,500	-	26,500
H. Guillaume (until April 26, 2016)	8,465	1,000	9,465	26,500	2,000	28,500
C.C. 't Hart	26,500	4,000	30,500	26,500	2,000	28,500
R.J. Laan (until April 26, 2016)	8,465	1,500	9,965	26,500	4,500	31,000
J. Peyrelevade	26,500	8,000	34,500	26,500	4,000	30,500
A.J.M. Roobeek	26,500	4,000	30,500	26,500	2,000	28,500
F. Enaud (as from April 26, 2016)	18,035	-	18,035	-	-	-
P.F. Riolacci	-	-	-			
Total	236,465	20,500	256,965	254,500	20,500	275,000

For further information on the remuneration policy relating to Supervisory Board members, see the Remuneration Policy and Report in the Board and Governance section. The remuneration paid to the Supervisory Board is not linked to the Company's results.

Other transactions with Supervisory Board members

Apart from the transactions described above there were no other transactions such as loans or advances to or from or guarantees given on behalf of members of the Supervisory Board.

32. Board of Managing Directors remuneration

Base salary

(amounts in EUR)	2016	2015
P.J.Th. Elbers	450.000	450.000
R.M. de Groot (as from April 23, 2015)	310.000	206.667
E.R. Swelheim	300.000	300.000
E.F. Varwijk (until July 1, 2015) *	–	205.000
Total	1,060,000	1,161,667

* Mr. Varwijk stepped down as Managing Director per March 2015. His contract ended June 30, 2015. Based on his contract he received a redundancy package of two year base salary, which amounted to EUR 820,000

Total base salaries for the Board of Managing Directors amounted to EUR 1,060,000, which was 9% below 2015 and 31% below 2014. Since July 1, 2015 the Board of Managing Directors has been brought down to three members. Base salaries of the current Board of Managing Directors remained unchanged in 2016.

Short-term incentive plan

	2016		2015	
(amounts in EUR)	Short term incentive plan	Targets achieved	Short term incentive plan	Targets achieved
P.J.Th. Elbers	405,000	Partially	373,500	Partially
R.M. de Groot (as from April 23, 2015)	165,540	Partially	106,433	Partially
E.R. Swelheim	153,000	Partially	154,500	Partially
E.F. Varwijk (until July 1, 2015) *	-	-	-	-
Total	723,540		634,433	

* Mr. Varwijk did not receive a short term incentive over 2015

Total payment of the short-term incentive plan amounted to EUR 723,540. This is EUR 89,107 above 2015 and mainly relates to the appointment of Mr. de Groot as from April 23, 2015.

For 2016, the Board of Managing Directors did not receive any payments under the company-wide profit sharing scheme.

For a description of the short-term incentive plan, we refer to the Remuneration Policy and Report in the Board and Governance Section.

Other allowances and benefits in kind

In addition to the base salary, the members of the Board of Managing Directors were entitled to other allowances and benefits including a company car and customary plans such as disability insurance, telephone cost and a fixed monthly allowance of EUR 440 for business expenses not otherwise reimbursed.

Pensions

Pension cost (post-employment benefit)

(amounts in EUR)	2016	2015
P.J.Th. Elbers	29,042	29,743
R.M. de Groot (as from April 23, 2015)	25,233	14,684
E.R. Swelheim	18,862	19,178
E.F. Varwijk (until July 1, 2015)	-	4,447
Total	73,137	68,052

Given the new Dutch fiscal rules, amongst others, a maximum pensionable salary of EUR 100,000 and lower future accrual rate are applicable as from 2015. Therefore the pension cost, being the pension premium paid to the pension fund (defined benefit plan), are lower than previous years.

Pension allowance (short-term benefit)

(amounts in EUR)	2016	2015
P.J.Th. Elbers	77,882	75,831
R.M. de Groot (as from April 23, 2015)	48,759	28,049
E.R. Swelheim	52,813	51,578
E.F. Varwijk (until July 1, 2015)	-	39,706
Total	179,454	195,164

Given the new Dutch fiscal rules, as described above, the Board of Managing Directors receive a pension allowance for the pensionable salary above EUR 100,000. This gross pension allowance can, after wage tax, either be used to participate in the KLM net pension savings scheme (defined contribution plan) or paid out as net allowance.

External supervisory board memberships

According to the remuneration policy the Board of Managing Directors may retain payments they receive from other remunerated positions with a maximum number of 2 positions per Managing Director. The amount ceded to the Company amounts to EUR 34,461 (December 31, 2015 EUR 30,556), and amongst others includes remunerated positions in connection with directorships in Transavia and Kenya Airways.

Other transactions with members of the Board of Managing Directors

Apart from the transactions described above there were no other transactions such as loans or advances to or from or guarantees given on behalf of members of the Board of Managing Directors.

Long-term incentive plan

As an incentive to make a longer-term commitment to the Company, phantom shares are granted to members of the Board of Managing Directors on the basis of their reaching agreed personal performance targets.
Subject to restrictions relating to the prevention of insider-trading, phantom shares may be exercised at any time between the third and the fifth anniversary of the day of grant. After five years the outstanding phantom shares are forfeited.

The maximum number of phantom shares granted to the Chief Executive Officer is 10,000 and to the Managing Director 6,000. For further information see note 30.

The current and former members of the Board of Managing Directors have the following positions with respect to the phantom shares granted under the KLM long-term incentive plan at December 31, 2016:

(Amounts in EUR)	Number of phantom shares granted	Expiry date	Number of phantom shares forfeited	Number of phantom shares exercised	Average share price at exercise	Number of phantom shares conditional	Number of phantom shares vested	Total outstanding as at December 31, 2016
P.J.Th. Elbers								
July, 2011	4,500	July 1, 2016	(640)	3,860	7.41	-	3,860	-
April, 2012	4,500	April 1, 2017	(1,195)	-		-	3,305	3,305
April, 2013	6,000	April 1, 2018	(910)	-		-	5,090	5,090
April, 2014	7,500	April 1, 2019	(1,120)	-		-	6,380	6,380
April, 2015	10,000	April 1, 2020	(707)	-		3,333	5,960	9,293
April, 2016	10,000	April 1, 2021	-	-		6,666	3,621	10,000
	42,500		(4,572)	3,860		9,999	28,216	34,068
R.M. de Groot (as from April 23, 2015)								
April, 2012	1,500	April 1, 2017	(398)	-		-	1,102	1,102
April, 2013	1,500	April 1, 2018	(227)	-		-	1,273	1,273
April, 2014	1,500	April 1, 2019	(224)	-		-	1,276	1,276
April, 2015	4,500	April 1, 2020	(318)	-		1,500	2,682	4,182
April, 2016	6,000	April 1, 2021	-	-		4,000	2,172	6,000
	15,000		(1,167)	-		5,500	8,505	13,833
E.R. Swelheim (as from April 23, 2014)								
July, 2011	1,500	July 1, 2016	(213)	1,287	6.57	-	1,287	-
April, 2012	4,500	April 1, 2017	(1,195)	-		-	3,305	3,305
April, 2013	4,500	April 1, 2018	(682)	-		-	3,818	3,818
April, 2014	4,500	April 1, 2019	(672)	-		-	3,828	3,828
April, 2015	6,000	April 1, 2020	(424)	-		2,000	3,576	5,576
April, 2016	6,000	April 1, 2021	-	-		4,000	2,172	6,000
	27,000		(3,186)	1,287		6,000	17,986	22,527
P.F. Hartman (until July 1, 2013)								
July, 2011	10,000	July 1, 2016	(1,423)	8,577	7.49	-	8,577	-
April, 2012	10,000	April 1, 2017	(2,658)	7,342	8.54	-	7,342	-
April, 2013	10,000	April 1, 2018	(1,517)	-		-	8,483	8,483
	30,000		(5,598)	15,919		-	24,402	8,483
F.N.P.P. Gagey (until April 1, 2012)								
July, 2011	7,500	July 1, 2016	(1,067)	6,433	7.21	-	6,433	-
	7,500		(1,067)	6,433		-	6,433	-
Total	122,000		(15,590)	27,499		21,499	85,542	78,911

The 2016 phantom shares cost for the current Board of Managing Directors members is EUR 13,237 for Mr. Elbers (2015: EUR 30,135), EUR 9,426 for Mr. de Groot (2015: EUR 7,383) and EUR 2,600 for Mr. Swelheim (2015: EUR 16,731).

As at December 31, 2016 Mr. Hartman held 12,960 shares AIR FRANCE KLM S.A. Mr. Elbers, Mr. de Groot, and Mr. Swelheim had no interest in AIR FRANCE KLM S.A.

Total remuneration

The 2016 total remuneration of the Board of Managing Directors is EUR 980,441 for Mr. Elbers (2015: EUR 964,489), EUR 564,238 for Mr. de Groot (2015: EUR 366,736) and EUR 532,555 for Mr. Swelheim (2015: EUR 547,267).

33. Related party transactions

The Group has interests in various associates in which it has either significant influence in but not control or joint control over operating and financial policy. Transactions with these parties, some of which are significant, are negotiated at commercial conditions and prices, which are not more favourable than those which would have been negotiated with third parties on an arm's length basis. In addition dividends have been received from those interests (see note 3).
The following transactions were carried out with related parties:

	2016	2015
Sales of goods and services		
AIR FRANCE KLM Group companies	144	138
Associates	9	12
Other related parties	-	-
Purchases of goods and services		
AIR FRANCE KLM Group companies	242	196
Associates	-	3
Other related parties	21	20

For details of the year-end balances of amounts due to and from related parties see notes 7 and 19. For the AIR FRANCE KLM loans see note 11. Other than AIR FRANCE KLM S.A., no loans were granted to or received from related parties during 2016 and 2015.
For information relating to transactions with members of the Supervisory Board and Board of Managing Directors see note 30 to 32. For information relating to transactions with pension funds for the Group's employees see note 17.

34. Primary segment reporting

2016	Passenger	Cargo	Maintenance	Leisure	Other	Eliminations	Total
Revenues							
Revenues External	7,114	1,123	759	773	31		9,800
Revenues Internal	637	2	768	-	197	(1,604)	-
Total revenue	7,751	1,125	1,527	773	228	(1,604)	9,800
EBITDAR	1,442	(77)	102	123	13	-	1,603
EBITDA	1,107	(82)	102	51	11	-	1,189
Income from current operations	692	(88)	40	29	8	-	681
Share of results of equity shareholdings							3
Financial income and expenses							(99)
Gain/(loss) on disposal of assets							27
Other non current income and expenses							(24)
Income tax expenses							(69)
Profit for the year							519
Amortisation, depreciation and movements in provision	(415)	(6)	(63)	(21)	(3)		(508)
Other financial income and expenses	13	(1)	4	(12)	(3)		1
Assets							
Intangible assets	160	3	58	24	98		343
Flight equipment	2,494	195	371	335	(156)		3,239
Other property, plant and equipment	92	12	83	5	352		544
Trade receivables	337	151	16	17	-		521
Other assets	684	(282)	523	199	3,257		4,381
Total assets	**3,767**	**79**	**1,051**	**580**	**3,551**		**9,028**
Liabilities							
Deferred revenues on sales	1,122	8	72	91	-		1,293
Other liabilities	3,245	247	266	378	2,611		6,747
Total liabilities	**4,367**	**255**	**338**	**469**	**2,611**		**8,040**

2015	Passenger	Cargo	Maintenance	Leisure	Other	Eliminations	Total
Revenues							
Revenues External	7,143	1,376	625	727	34	-	9,905
Revenues Internal	737	3	851	-	194	(1,785)	-
Total revenue	7,880	1,379	1,476	727	228	(1,785)	9,905
EBITDAR	1,154	(81)	108	78	6	-	1,265
EBITDA	867	(88)	108	18	6	-	911
Income from current operations	448	(110)	46	(4)	4	-	384
Share of results of equity shareholdings							(37)
Financial income and expenses							(322)
Gain/(loss) on disposal of assets							127
Other non current income and expenses							(56)
Income tax expenses							(42)
Profit for the year							54
Amortisation, depreciation and movements in provision	(419)	(22)	(62)	(22)	(2)		(527)
Other financial income and expenses	(160)	(10)	16	(6)	(48)		(208)
ASSETS							
Intangible assets	181	4	62	18	43		308
Flight equipment	2,263	254	359	258	(140)		2,994
Other property, plant and equipment	103	8	72	6	343		532
Trade receivables	283	175	16	14	(14)		474
Other assets	737	(277)	319	228	3,410		4,417
Total assets	**3,567**	**164**	**828**	**524**	**3,642**		**8,725**
LIABILITIES							
Deferred revenues on sales	1,000	13	52	70	-		1,135
Other liabilities	3,628	343	157	366	2,700		7,194
Total liabilities	**4,628**	**356**	**209**	**436**	**2,700**		**8,329**

35. Secondary segment reporting

Revenues by destination 2016	Europe, North Africa	Caribbean, Indian Ocean	Africa, Middle East	Americas Polynesia	Asia, New Caledonia	Total
Scheduled passenger	2,143	336	933	2,046	1,385	6,843
Other passenger revenues	75	16	43	83	54	271
Total passenger revenues	2,218	352	976	2,129	1,439	7,114
Scheduled cargo	16	18	217	493	307	1,051
Other cargo revenues	1	1	15	34	21	72
Total cargo revenues	17	19	232	527	328	1,123
Maintenance	759	-	-	-	-	759
Other revenues	804	-	-	-	-	804
Total maintenance and other	1,563	-	-	-	-	1,563
Total revenues by destination	3,798	371	1,208	2,656	1,767	9,800

Revenues by destination 2015	Europe, North Africa	Caribbean, Indian Ocean	Africa, Middle East	Americas Polynesia	Asia, New Caledonia	Total
Scheduled passenger	2,127	315	913	2,064	1,461	6,880
Other passenger revenues	76	14	37	77	59	263
Total passenger revenues	2,203	329	950	2,141	1,520	7,143
Scheduled cargo	16	17	258	588	421	1,300
Other cargo revenues	1	1	15	34	25	76
Total cargo revenues	17	18	273	622	446	1,376
Maintenance	625	-	-	-	-	625
Other revenues	761	-	-	-	-	761
Total maintenance and other	1,386	-	-	-	-	1,386
Total revenues by destination	3,606	347	1,223	2,763	1,966	9,905

Geographical analysis of assets: the major revenue-earning asset of the Group is the fleet, the majority of which are registered in The Netherlands. Since the Group's fleet is employed flexibly across its worldwide route network, there is no suitable basis of allocating such assets and related liabilities to geographical segments

36. Subsidiaries

The following is a list of the Company's significant subsidiaries as at December 31, 2016:

Name	Country of incorporation	Ownership interest in %	Proportion of voting power held in %
Transavia Airlines C.V.	The Netherlands	100	100
Martinair Holland N.V.	The Netherlands	100	100
KLM Cityhopper B.V.	The Netherlands	100	100
KLM Cityhopper UK Ltd.	United Kingdom	100	100
KLM UK Engineering Ltd.	United Kingdom	100	100
European Pneumatic Component Overhaul & Repair B.V.	The Netherlands	100	100
KLM Catering Services Schiphol B.V.	The Netherlands	100	100
KLM Flight Academy B.V.	The Netherlands	100	100
KLM Health Services B.V.	The Netherlands	100	100
KLM Equipment Services B.V.	The Netherlands	100	100
Cygnific B.V.	The Netherlands	100	100

KLM Royal Dutch Airlines company balance sheet

In millions of Euros	Note	December 31, 2016	December 31, 2015
Before proposed appropriation of the result for the year			
ASSETS			
Non-current assets			
Property, plant and equipment	37	3,061	2,922
Intangible assets		314	285
Investments accounted for using the equity method	38	307	260
Other non-current assets	4	317	280
Other financial assets	39	364	293
Deferred income tax assets	48	-	75
Pension assets	17	1,462	1,773
		5,825	5,888
Current assets			
Other current assets	4	224	281
Other financial assets	39	26	139
Inventories		154	134
Trade and other receivables	40	1,372	1,393
Cash and cash equivalents	41	720	368
		2,496	2,315
TOTAL ASSETS		8,321	8,203
EQUITY			
Capital and reserves			
Share capital	42	94	94
Share premium		474	474
Other reserves	42	(2,191)	(2,305)
Retained earnings		2,610	2,129
Total attributable to Company's equity holders		987	392
LIABILITIES			
Non-current liabilities			
Loans from parent company	43	288	288
Loans from subsidiaries	44	62	88
Finance lease obligations	45	988	1,180
Other non-current liabilities	4	176	254
Other financial liabilities	46	1,124	1,179
Deferred income	47	196	151
Deferred income tax liabilities	48	6	-
Provisions	49	618	546
		3,458	3,686
Current liabilities			
Trade and other payables	50	2,241	2,120
Loans from parent company	43	-	105
Loans from subsidiaries	44	33	33
Finance lease obligations	45	356	176
Other current liabilities	4	95	585
Other financial liabilities	46	84	71
Deferred income	47	929	856
Provisions	49	138	179
		3,876	4,125
Total liabilities		7,334	7,811
TOTAL EQUITY AND LIABILITIES		8,321	8,203

The accompanying notes are an integral part of these Company financial statements

KLM Royal Dutch Airlines company statement of profit or loss

In millions of Euros	2016	2015
Profit / (loss) from investments accounted for using equity method after taxation	90	4
Profit / (loss) of KLM N.V. after taxation	427	49
Income / (loss) for the year after taxation	517	53

The accompanying notes are an integral part of these Company financial statements

Notes to the Company financial statements

General

The Company financial statements are part of the 2016 financial statements of KLM Royal Dutch Airlines (the "Company").

Significant accounting policies

The principal accounting policies applied in the preparation of the Company financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Principles for the measurement of assets and liabilities and the determination of the result

In determining the principles to be used for the recognition and measurement of assets and liabilities and the determination of the result for its separate financial statements, the Company makes use of the option provided in Section 362 (8) of Book 2 of the Dutch Civil Code. This section permits companies to apply the same principles for the recognition and measurement of assets and liabilities and determination of the result (hereinafter referred to as principles for recognition and measurement) of the Company financial statements as those applied for the consolidated EU-IFRS financial statements.

Subsidiaries are accounted for using the equity method and investments accounted for using the equity method, over which significant influence is exercised, are stated on that basis. The share in the result of these investments comprises the share of the Company in the result of these investments. Results on transactions, where the transfer of assets and liabilities between the Company and its investments and mutually between these investments themselves, are not incorporated insofar as they can be deemed to be unrealised.

All amounts (unless specified otherwise) are stated in millions of Euros (EUR million).
For notes and/or details, which are not explained in the notes to the Company financial statements reference is made to the notes and/or details of the Consolidated financial statements.

37. Property, plant and equipment

	Flight equipment				Other property and equipment					
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total	Pre-payments	Total
Historical cost										
As at Jan. 1, 2016	1,286	2,244	1,531	5,061	567	356	160	1,083	46	6,190
Additions	81	61	289	431	-	-	17	17	147	595
Disposals	(268)	-	(329)	(597)	(4)	(22)	(19)	(45)	-	(642)
Other movements	4	(82)	163	85	13	32	(8)	37	(46)	76
As at Dec. 31, 2016	1,103	2,223	1,654	4,980	576	366	150	1,092	147	6,219
Accumulated depreciation and impairment										
As at Jan. 1, 2016	920	892	807	2,619	245	289	115	649	-	3,268
Depreciation	74	113	162	349	29	23	5	57	-	406
Disposals	(266)	-	(280)	(546)	(3)	(23)	(14)	(40)	-	(586)
Other movements	3	(58)	125	70	-	(5)	5	-	-	70
As at Dec. 31, 2016	731	947	814	2,492	271	284	111	666	-	3,158
Net carrying amount										
As at Jan. 1, 2016	366	1,352	724	2,442	322	67	45	434	46	2,922
As at Dec. 31, 2016	372	1,276	840	2,488	305	82	39	426	147	3,061

	Flight equipment				Other property and equipment					
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total	Pre-payments	Total
Historical cost										
As at Jan. 1, 2015	759	2,537	1,409	4,705	553	457	59	1,069	203	5,977
Additions	18	44	-	62	-	-	-	-	290	352
Disposals	(70)	-	(175)	(245)	(11)	(28)	(17)	(56)	(5)	(306)
Other movements	579	(337)	297	539	25	(73)	118	70	(442)	167
As at Dec. 31, 2015	1,286	2,244	1,531	5,061	567	356	160	1,083	46	6,190
Accumulated depreciation and impairment										
As at Jan. 1, 2015	603	987	745	2,335	212	376	38	626	-	2,961
Depreciation	70	115	170	355	29	16	7	52	-	407
Disposals	(74)	-	(153)	(227)	(11)	(27)	(14)	(52)	-	(279)
Other movements	321	(210)	45	156	15	(76)	84	23	-	179
As at Dec. 31, 2015	920	892	807	2,619	245	289	115	649	-	3,268
Net carrying amount										
As at Jan. 1, 2015	156	1,550	664	2,370	341	81	21	443	203	3,016
As at Dec. 31, 2015	366	1,352	724	2,442	322	67	45	434	46	2,922

Other movements mainly relates to the reclassification of finance leased aircraft to owned aircraft at the end of the lease.

The assets include assets which are held as security for mortgages and loans as follows:

As at December 31,	2016	2015
Aircraft	57	82
Land and buildings	122	126
Other property and equipment	23	27
Carrying amount	202	235

Borrowing cost capitalised during the year amounted to EUR 3 million (2015 EUR 4 million). The interest rate used to determine the amount of borrowing cost to be capitalised was 2.8 % (2015: 3.2%).

Land and buildings include buildings located on land which has been leased on a long-term basis. The book value of these buildings as at December 31, 2016 was EUR 200 million (December 31, 2015 EUR 213 million).

38. Investments accounted for using the equity method

As at December 31,	2016	2015
Subsidiaries	285	236
Associates	-	(1)
Jointly controlled entities	22	25
Carrying amount	307	260

	2016	2015
Subsidiaries		
Carrying amount as at January 1	236	359
Movements		
Investments	-	-
Share of profit/(loss) after taxation	106	57
OCI movement	(37)	(13)
Dividends received	(6)	(8)
Foreign currency translation differences	7	1
Other movements	(21)	(160)
Net movement	49	(123)
Carrying amount as at December 31	285	236

For details of the Group's investments in subsidiaries see note 36 to the consolidated financial statements. For details of the Group's investments in associates and jointly controlled entities see note 3 to the consolidated financial statements.

39. Other financial assets

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
Held-to-maturity investments				
Triple A bonds and long-term deposits	19	206	-	138
Loans and receivables				
Other loans and receivables	3	129	2	107
At fair value through profit or loss				
Other restricted deposits	1	-	-	-
Other deposits	-	-	135	-
Deposits on operating leased aircraft	3	23	2	40
AIR FRANCE KLM S.A. shares	-	6	-	8
Total at fair value	4	29	137	48
Carrying amount	26	364	139	293

40. Trade and other receivables

As at December 31,	2016	2015
Trade receivables	497	455
Provision trade receivables	(30)	(32)
Trade receivables - net	467	423
Amounts due from:		
- subsidiaries	524	655
- AIR FRANCE KLM group companies	46	61
- associates and jointly controlled entities	2	2
- maintenance contract customers	201	149
Taxes and social security premiums	32	28
Other receivables	46	49
Prepaid expenses	54	26
Total	1,372	1,393

Maintenance contract cost incurred to date for contracts in progress at December 31, 2016 amounted to EUR 173 million (December 31, 2015 EUR 173 million). Advances received for maintenance contracts in progress at December 31, 2016 amounted to EUR 28 million (December 31, 2015 EUR 11 million). The maturity of trade and other receivables is within one year.

41. Cash and cash equivalents

As at December 31,	2016	2015
Cash at bank and in hand	33	38
Short-term deposits	687	330
Total	720	368

The effective interest rates on short-term deposits are in the range from 0% to 1.14% (2015 range 0% to 5.26%). The short-term deposits are invested in money market instruments or in liquid funds with daily access to cash.

42. Share capital and other reserves

For details of the Company's share capital and movements on other reserves see note 9 and 10 to the consolidated financial statements. For details of the Company's equity see the consolidated statement of changes in equity.

The Company has other reserves relating to hedging, remeasurement of defined benefit plans, translation and other legal reserves. Reference is made to note 10.

43. Loans from parent company

As at December 31,	2016	2015
Non-current portion	288	288
Current portion	-	105
Carrying amount	288	393

For the loans with AIR FRANCE KLM reference is made to note 11. For the guarantees from KLM to AIR FRANCE KLM reference is made to note 21.

44. Loans from subsidiaries

As at December 31,	2016	2015
Non-current portion	62	88
Current portion	33	33
Carrying amount	95	121

45. Finance lease obligations

As at December 31,	2016	2015
Non-current portion	988	1,180
Current portion	356	176
Carrying amount	1,344	1,356

46. Other financial liabilities

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
A Cumulative preference shares	-	18	-	18
B Cumulative preference shares	-	14	-	14
Subordinated perpetual loans	-	600	-	584
Other loans (secured/unsecured)	84	492	71	563
Total	84	1,124	71	1,179

47. Deferred income

	December 31, 2016		December 31, 2015	
	Current	Non-current	Current	Non-current
Advance ticket sales	821	-	746	-
Sale and leaseback transactions	1	4	1	(3)
Flying Blue frequent flyer program	95	188	94	149
Others	12	4	15	5
Total	929	196	856	151

48. Deferred income tax

The gross movement on the deferred income tax account is as follows:

	2016	2015
Carrying amount as at January 1	(75)	(210)
Movements:		
Income statement (credit) /charge	47	22
Tax (credited)/charged to equity	30	115
Other movements	4	(2)
Net movement	81	135
Carrying amount as at December 31	6	(75)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The offset amounts are as follows:

As at December 31,	2016	2015
Deferred tax assets:		
Deferred tax assets to be settled in 12 months or less	90	77
Deferred tax assets to be settled after 12 months	144	323
	234	400
Deferred tax liabilities		
Deferred tax liabilities to be settled in 12 months or less	2	2
Deferred tax liabilities to be settled after 12 months	238	323
	240	325
Carrying amount	6	(75)

The movements in deferred tax assets and liabilities, without taking into consideration the offsetting of balances within the same tax jurisdiction, are as follows:

	Carrying amount as at January 1	Income statement (charge) /credit	Tax charged/ (credited) to equity	Other movements	Carrying amount as at December 31
Deferred tax assets					
2016					
Tax losses	230	(34)	-	(4)	192
Fleet related assets (maintenance)	1	(1)	-	-	-
Provisions for employee benefits	14	-	-	-	14
Financial lease obligations	1	-	-	-	1
Derivative financial instruments	119	-	(128)	-	(9)
Other	35	1	-	-	36
Total	400	(34)	(128)	(4)	234

	Carrying amount as at January 1	Income statement (charge) / credit	Tax charged/ (credited) to equity	Other movements	Carrying amount as at December 31
Deferred tax assets					
2015					
Tax losses	431	(203)	-	2	230
Fleet related assets (maintenance)	1	-	-	-	1
Provisions for employee benefits	14	-	-	-	14
Financial lease obligations	1	-	-	-	1
Derivative financial instruments	149	-	(30)	-	119
Other	37	(2)	-	-	35
Total	633	(205)	(30)	2	400

	Carrying amount as at January 1	Income statement (charge) / credit	Tax charged/ (credited) to equity	Other movements	Carrying amount as at December 31
Deferred tax liabilities					
2016					
Other tangible fixed assets	(4)	(2)	-	-	(6)
Pensions & benefits (asset)	475	15	(98)	-	392
Maintenance provision	(131)	-	-	-	(131)
Other	(15)	-	-	-	(15)
Total	325	13	(98)	-	240

	Carrying amount as at January 1	Income statement (charge) / credit	Tax charged/ (credited) to equity	Other movements	Carrying amount as at December 31
Deferred tax liabilities					
2015					
Other tangible fixed assets	(2)	(2)	-	-	(4)
Pensions & benefits (asset)	388	2	85	-	475
Maintenance provision	-	(131)	-	-	(131)
Other	37	(52)	-	-	(15)
Total	423	(183)	85	-	325

Tax fiscal unity

The Company, together with other subsidiaries in The Netherlands, has entered into a fiscal unity for the purpose of filing consolidated corporation tax and VAT returns. As a result, every legal entity in this tax group is jointly and severally liable for the tax debts of all the legal entities forming the group.

49. Provisions

	Phasing-out costs of operating lease aircraft	Aircraft maintenance provision	Employee Benefit	Legal Issues	Other	Total
As at January 1, 2016	79	248	206	151	41	725
Additional provisions and increases in existing provisions	30	57	65	1	44	197
Unused amounts reversed	-	(2)	-	(17)	(5)	(24)
Used during year	(33)	(62)	(58)	-	(34)	(187)
Foreign currency translation differences	4	5	(2)	-	-	7
Other changes	(8)	40	4	-	2	38
As at December 31, 2016	72	286	215	135	48	756
Current/non-current portion						
Non-current portion	72	220	187	135	4	618
Current portion	-	66	28	-	44	138
As at December 31, 2016	72	286	215	135	48	756

50. Trade and other payables

As at December 31,	2016	2015
Trade payables	860	845
Amounts due to subsidiaries	511	611
Amounts due to AIR FRANCE KLM Group companies	92	76
Taxes and social security premiums	247	217
Employee related liabilities	401	209
Accrued liabilities	95	41
Other payables	35	121
Total	2,241	2,120

Other notes

For information relating to contingency assets and liabilities, including guarantees, see note 21.

For information relating to share-based payments, Supervisory Board and Board of Managing Directors remuneration see note 30 to 32.

Amstelveen, March 21, 2017

The Board of Managing Directors

Pieter J.Th. Elbers
René M. de Groot
Erik R. Swelheim

The Supervisory Board

Hans N.J. Smits
Irene P. Asscher-Vonk
Philippe C. Calavia
Alice Dautry
François Enaud
Cees C. 't Hart
Jean Peyrelevade
Pierre-François Riolacci
Annemieke J.M. Roobeek

Other information

Independent Auditors' Report

To the Shareholders and the Supervisory Board of KLM Royal Dutch Airlines (Koninklijke Luchtvaart Maatschappij N.V.)

Report on the accompanying financial statements

Our opinion

We have audited the financial statements 2016 of KLM Royal Dutch Airlines, based in Amstelveen. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:

» The accompanying consolidated financial statements give a true and fair view of the financial position of KLM Royal Dutch Airlines as at December 31, 2016 and of its result and its cash flows for 2016 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code;

» The accompanying company financial statements give a true and fair view of the financial position of KLM Royal Dutch Airlines as at December 31, 2016 and of its result for 2016 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:

1. The consolidated balance sheet as at December 31, 2016;
2. The following consolidated statements for 2016: the statement of profit or loss, the statement of profit or loss and other comprehensive income, statement of changes in equity and cash flow statement; and
3. The notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:

1. The company balance sheet as at December 31, 2016;
2. The company statement of profit or loss for 2016; and
3. The notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the 'Our responsibilities for the audit of the financial statements' section of our report.

We are independent of KLM Royal Dutch Airlines in accordance with the Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore, we have complied with the Verordening gedrags- en beroepsregels accountants (VGBA, Dutch Code of Ethics).
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Report on the other information included in the annual report

In addition to the financial statements and our auditors' report thereon, the annual report contains other information that consists of:

» Report of the Board of Managing Directors on page 4 - 53;

» Board and Governance on page 54 - 69;

» Other information as required by Part 9 of Book 2 of the Dutch Civil Code;

» Miscellaneous.

Based on the following procedures performed, we conclude that the other information:

» Is consistent with the financial statements and does not contain material misstatements;

» Contains the information as required by Part 9 of Book 2 of the Netherlands Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements.
By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.
Management is responsible for the preparation of the other information, including the Report of the Board of Managing Directors in accordance with Part 9 of Book 2 of the Dutch Civil Code, and other information as required by Part 9 of Book 2 of the Dutch Civil Code.

Description of the responsibilities for the financial statements

Responsibilities of Management and the Supervisory Board for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, Management is responsible for such internal control as Management determine is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to errors or fraud.
As part of the preparation of the financial statements, Management is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, Management should prepare the financial statements using the going concern basis of accounting unless Management either intend to liquidate the company or to cease operations, or has no realistic alternative but to do so.
Management should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.
The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.
Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud during our audit.
Misstatements can arise from fraud or errors and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included e.g.:

» Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
» Obtaining an understanding of internal control relevant to the audit 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 company's internal control;
» Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management;
» Concluding on the appropriateness of Management's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the company to cease to continue as a going concern;
» Evaluating the overall presentation, structure and content of the financial statements, including the disclosures;
» Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items. We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit.

Amstelveen/ Amsterdam, March 21, 2017

KPMG Accountants N.V.
E.H.W. Weusten RA

Deloitte Accountants B.V.
M.J. van der Vegte RA

Provisions of the articles of association on the distribution of profit Unofficial translation of article 32 of the articles of association of KLM Royal Dutch Airlines

1. Out of the profit established in the adopted financial statements, an amount may first be set aside by the meeting of priority shareholders in order to establish or increase reserves. The meeting of priority shareholders shall only do so after consultation of the Board of Managing Directors and the Supervisory Board.

2. So far as possible and permitted by applicable statute, the remainder of the profit shall be distributed as follows:
   a. the holders of priority shares shall receive first the statutory interest percentage prevailing on the last day of financial year concerned, with a maximum of 5% of the paid up amount per priority share; if and to the extent that the profit is not sufficient to make the full aforementioned distribution on the priority shares, in subsequent years a distribution to the holders of priority shares shall first be made to recompense this shortfall entirely before the following paragraph may be given effect;
   b. next the holders of cumulative preference shares-A shall receive 6% of the par value of their cumulative preference shares-A or - in the case of not fully paid-up shares - of the obligatory amount paid thereon; in the event and to the extent the profit is not sufficient to fully make the aforementioned distribution on the cumulative preference shares-A, the deficiency shall, to the extent possible and permitted by applicable statute, be distributed out of the freely distributable reserves with the exception of the share premium reserves; in the event and to the extent that the aforementioned distribution on the cumulative preference shares-A can also not be made out of such reserves, there shall in the following years first be made a distribution to the holders of cumulative preference shares-A to the effect that such shortfall is fully recovered before effect is given to what is provided hereinafter in this paragraph 2;
   c. next the holders of preference shares-B shall receive 5% of the par value of their preference shares-B or - in the case of not fully paid-up shares - of the amount obligatorily paid thereon;
   d. next the holders of preference shares-B shall receive ½% of the par value of their shares or - in the case of not fully paid-up shares - of the amount obligatorily paid thereon for each percent of the ratio (expressed as a percentage) of the profit to the operating revenues mentioned in the adopted consolidated profit and loss account, with the understanding that this dividend percentage shall not be in excess of 5% of the nominal amount of the issued common shares;
   e. subsequently, on each cumulative preference share-C of a series a dividend shall be paid which is equal to a percentage of the amount which has been paid up on the share, calculated by taking the arithmetic average of the effective yield on the government loans to be described below under letter (f), as published in the Officiële Prijscourant of Euronext Amsterdam N.V. for the last five (5) stock exchange days prior to the day on which a cumulative preference share-C of the series in question was issued for the first time, possibly increased by a supplement established by the Board of Managing Directors and approved by the Supervisory Board and the meeting of priority shareholders in the amount of a maximum of one hundred and thirty-five (135) basic points, depending on the market circumstances which shall prevail at that time, which supplement may be different for each series;
   f. government loans mentioned under the letter (e) of this paragraph shall be deemed to mean the government loans to the debit of the State of The Netherlands with a (remaining) life of seven to eight years. If the effective yield on these government loans has not been published in the Officiële Prijscourant of Euronext Amsterdam N.V., as the time of the calculation of the dividend percentage, then the government loans referred to under the letter (e) shall be deemed to be the government loans to the debit of the State of The Netherlands with a (remaining) life which is as close as possible to a (remaining) life of seven to eight years, the effective yield of which has been published in the Officiële Prijscourant of Euronext Amsterdam N.V. at the time of the calculation of the dividend percentage as stated above, on the proviso that the maximum (remaining) life is eight years;
   g. on the date on which the cumulative preference shares-C of the series in question have been outstanding for eight years, for the first time, and thereafter every subsequent eight years, the dividend percentage of cumulative preference shares-C of the series in question will be adjusted to the effective yield of the government loans referred to in the preceding subparagraphs which is valid at that time, calculated in the manner as described in the foregoing, but on the proviso that the average referred to shall be calculated over the last five (5) exchange days prior to the day as of which the dividend percentage shall be adjusted, possibly increased by a supplement established by the Board of Managing Directors and approved by the Supervisory Board and the meeting of priority shareholders in the amount of a maximum of one hundred and thirty-five (135) basic points, depending on the market circumstances which shall prevail at that time, which supplement may be different for each series. If the dividend percentage is adjusted in the course of a financial year, then for

the calculation of the dividend over that financial year, the percentage which applied before the adjustment shall apply up to the day of adjustment, and as from that day, the adjusted percentage;

h. if and to the extent that profits are not sufficient to make full payment of the dividend on the cumulative preference shares-C referred to in this paragraph, the shortfall will be paid and charged to the reserves, to the extent that such action is not contrary to the provisions of Article 105, paragraph 2 of Book 2 of the Dutch Civil Code. If and to the extent that the payment referred to in this paragraph cannot be charged to the reserves, then a payment will be made from the profits to the holders of cumulative preference shares-C such that the shortfall is fully paid up before the provisions stated in the following letters of the paragraph are applied. For the application of the provisions stated under this present letter (h), the holders of the various series of cumulative preference shares-C shall receive equal treatment. No further payment shall be made on the cumulative preference shares-C than those determined in this Article, in Article 11 paragraph 6 and in Article 42; interim payments made in accordance with the provisions of paragraph 4 of this Article for a financial year will be deducted from the payments made pursuant to this paragraph;

i. if, in the financial year for which the payment referred to above takes place, the amount paid in on the cumulative preference shares-C of a certain series has been reduced, the payment will be reduced by an amount equal to the aforementioned percentage of the amount of the reduction calculated from the time of the reduction;

j. if the profits over a financial year have been established and in that financial year one or more cumulative preference shares-C have been withdrawn with repayment, then those who were listed in the registry referred to in Article 9 as holders of those cumulative preference shares-C at the time of such withdrawal shall have an inalienable right to payment of profits as described hereinafter. The profits which are to be paid (if possible) to such a holder of cumulative preference shares-C shall be equal to the amount of the payment to which such a holder would be entitled to the grounds of the provisions of this paragraph if, at the time at which profits were determined, he were still a holder of the aforementioned cumulative preference shares-C calculated in proportion to the duration of the period during which he was a holder of those cumulative preference shares-C in said financial year, from which payment shall be deducted the amount of the payment which was made pursuant to the provisions of Article 32;

k. if, in the course of a given financial year, issuance of cumulative preference shares-C has taken place, then for that financial year the dividend on the shares in questions will be decreased in proportion to the time passed until the first day of issuance;

l. the remainder will be received by the holders of common shares in proportion to the par value of their common shares to the extent the general meeting of shareholders does not make further appropriations for reserves in addition to any reserves established pursuant to paragraph 1 of this Article.

3. On the recommendation of the Board of Managing Directors and after approval of such recommendation by the Supervisory Board and the meeting of priority shareholders, the general meeting of shareholders may decide that payments to shareholders shall be wholly or partly effected by issuing shares of the same type of capital stock of the company as the type of the shares to which these payments relate.

4. As far as possible and subject to the approval of the Supervisory Board, the meeting of priority shareholders may resolve to distribute one or more interim dividends against the expected dividend, provided that an interim statement of assets and liabilities demonstrates that the company meets the requirements of Article 105, paragraph 2 Book 2 of the Dutch Civil Code. This interim statement of assets and liabilities shall be drawn up, signed and made public according to the specifications contained in paragraph 4 of the statutory provision mentioned above.

5. Subject to the approval of the Supervisory Board, the meeting of priority shareholders may, to the extent possible and permitted by law, resolve to make a distribution to the holders of common shares out of one or more of the freely distributable reserves with the exception of the share premium reserves.

6. Subject to the approval of the Supervisory Board, the meeting of priority shareholders may, to the extent possible and permitted by applicable statute, decide to make, as an advance payment on the distribution referred to in paragraph 2 of this Article, distributions out of the freely distributable reserves, with the exception of the share premium reserves.

7. No other distributions than the distributions provided for in this Article and in Article 42 are made on the priority shares and preference shares.

Appropriation of profit and distribution to shareholders

It is proposed that the net profit for 2016 amounting to EUR 516,535,000 be appropriated as follows:

Transfer to reserves	
Retained earnings	EUR 499,682,714
Dividend distributions	
Priority shareholders 2016	794
Ordinary shareholders 2016	16,851,492
Total dividend distributions	EUR 16,852,286
Total transfer to reserves/ dividends	EUR 516,535,000
Interest expenses	
A cumulative preference shareholder 2016 (6%)	1,057,500
C cumulative preference shareholder 2016 (0.82%)	115,465
Total interest expenses	EUR 1,172,965

Miscellaneous

Five-Year Review

(in millions of EUR, unless stated otherwise)	2016	2015	2014	2013	2012 * restated
Consolidated income statement					
Passenger	7,114	7,143	6,847	6,869	6,631
Cargo	1,123	1,376	1,505	1,537	1,664
Other revenues	1,563	1,386	1,291	1,282	1,178
Revenues	9,800	9,905	9,643	9,688	9,473
Expenses	(8,197)	(8,640)	(8,629)	(8,536)	(8,534)
EBITDAR	1,603	1,265	1,014	1,152	939
Aircraft operating lease costs	(414)	(354)	(283)	(301)	(310)
EBITDA	1,189	911	731	851	629
Amortisation, depreciation and movement in provisions	(508)	(527)	(556)	(550)	(548)
Income from current operations	681	384	175	301	81
Financial income and expenses	(99)	(322)	(208)	(59)	(104)
Other non-current income and expenses	3	71	676	(51)	(95)
Pre-tax income	585	133	643	191	(118)
Income tax expenses	(69)	(42)	(253)	(48)	31
Net result after taxation of consolidated companies	516	91	390	143	(87)
Share of results of equity shareholdings	3	(37)	(49)	(10)	(11)
Profit / (loss) for the year	519	54	341	133	(98)
Consolidated balance sheet					
Current assets	2,617	2,321	2,314	2,418	2,484
Non-current assets	6,411	6,404	6,185	7,191	7,354
Total assets	9,028	8,725	8,499	9,609	9,838
Current liabilities	3,737	4,001	4,218	3,443	3,274
Non-current liabilities	4,303	4,328	4,272	4,555	5,063
Group equity	988	396	9	1,611	1,501
Total liabilities	9,028	8,725	8,499	9,609	9,838

* after the impact of revised IAS19 as per January 1, 2013

(in millions of EUR, unless stated otherwise)		2016	2015	2014	2013	2012 ** restated
Key financial figures (KLM Group)						
Return on equity (%)		74.9	26.8	42.1	8.5	(6.0)
Result for the year as percentage of revenues		5.3	0.5	3.5	1.4	(1.0)
Earnings per ordinary share (EUR)		11.03	1.14	7.26	2.82	(2.14)
Result for the year plus depreciation		1,034	565	880	640	(98)
Capital expenditures (net)		(755)	(340)	(420)	(363)	(353)
Adjusted net debt/EBITDAR ratio		2.9	3.6	4.3	4.0	5.2
Dividend per ordinary share (EUR)		0.36	-	-	0.15	-
Average number of staff (KLM Group)						
(in FTE)						
The Netherlands		26,073	26,460	26,657	26,505	26,915
Outside The Netherlands		3,929	3,955	4,054	4,130	4,274
Employed by KLM		**30,002**	**30,415**	**30,711**	**30,635**	**31,189**
Total agency staff		1,874	1,928	1,983	1,870	1,661
Total KLM Group		31,876	32,343	32,694	32,505	32,850
Traffic (KLM Company)						
Passenger kilometers	*	97,737	93,228	91,477	89,039	86,281
Revenue ton freight-kilometers	*	3,722	3,730	3,764	3,688	3,651
Passenger load factor (%)		87.2	86.4	86.5	85.8	85.7
Cargo load factor (%)		64.5	65.1	66.4	66.1	66.4
Number of passengers (x 1,000)		30,399	28,562	27,740	26,581	25,775
Weight of cargo carried (kilograms)	*	479	483	491	480	474
Average distance flown per passenger (in kilometers)		3,215	3,264	3,298	3,350	3,347
Capacity (KLM Company)						
Available seat-kilometers	*	112,065	107,851	105,755	103,793	100,727
Available ton freight-kilometers	*	5,772	5,734	5,671	5,576	5,497
Kilometers flown	*	433	422	419	409	403
Blockhours (x 1,000)		644	630	625	612	607
Yield (KLM Company)						
Yield (in cents):						
Passenger (per RPK)		7.0	7.4	7.2	7.4	7.4
Cargo (per RTK)		21.6	23.9	24.2	24.7	26.0
Average number of staff (KLM Company)						
(in FTE)						
The Netherlands		20,476	20,898	20,979	20,944	21,190
Outside The Netherlands		2,444	2,619	2,744	2,719	2,745
Employed by KLM		22,920	23,517	23,723	23,663	23,935

* in millions
** after the impact of revised IAS19 as per January 1, 2013

Glossary of terms and definitions

Adjusted net debt
The sum of net debt and 7x the annual aircraft operating lease cost.

Available Ton Freight Kilometer (ATFK)
One metric ton (1,000 kilograms) cargo capacity flown a distance of one kilometer.

Available Seat Kilometer (ASK)
One aircraft seat flown a distance of one kilometer.

Cargo load factor
Total Revenue Ton Freight Kilometers (RTFK) expressed as a percentage of the total Available Ton Freight Kilometers (ATFK).

Capital employed
The sum of property, plant and equipment, intangible assets, equity method investments, inventories and trade and other receivables less trade and other payables.

Code sharing
Service offered by KLM and another airline using the KL code and the code of the other airline.

Earnings per ordinary share
The profit or loss attributable to ordinary equity holders divided by the weighted average number of ordinary shares outstanding.

EBITDA
The earnings before interests, taxes, depreciation, amortization and movements in provisions. EBITDA provides a simple indicator of the cash generation during the year.

EBITDAR
The earnings before interests, taxes, depreciation, amortization, movements in provisions and operational lease cost. This aggregate is adapted to sectors like the air transport industry which can finance a significant proportion of their assets using operating leases. It is obtained by subtracting aircraft operating lease cost from EBITDA.

Free cash flow
This corresponds to the cash available after investments in (prepayments in) aircraft, other tangible fixed assets, intangible fixed assets less the proceeds of disposals.

Net debt
The sum of current and non-current financial liabilities, current and non-current finance lease obligations, less cash and cash equivalents, short-term deposits and commercial paper and held-to-maturity financial assets.

Passenger load factor
Total Revenue Passenger-Kilometers (RPK) expressed as a percentage of the total Available Seat-Kilometers (ASK).

Revenue Ton Freight Kilometer (RTFK)
One metric ton (1,000 kilograms) of cargo flown a distance of one kilometer.

Revenue Passenger Kilometer (RPK)
One passenger flown a distance of one kilometer.

Return on capital employed
The sum of income from operating activities, adjusted for the gain/ (loss) on disposal of assets and the results of equity shareholdings after taxation divided by average capital employed.

Return on equity
Net result after taxation divided by the average equity after deduction of the priority shares.

Warning about forward-looking statements

This Annual Report contains, and KLM and its representatives may make, forward-looking statements, either orally or in writing, about KLM and its business. Forward-looking statements generally can be identified by the use of terms such as 'ambition', 'may', 'will', 'expect', 'intend', 'estimate', 'anticipate', 'believe', 'plan', 'seek', 'continue' or similar terms. These forward-looking statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate management's beliefs, and assumptions made by management about future events. Any such statement is qualified by reference to the following cautionary statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors, many of which are outside of our control and are difficult to predict, that may cause actual results to differ materially from any future results expressed or implied from the forward-looking statements. These statements are not guarantees of future performance and involve risks and uncertainties including:

- The airline pricing environment;
- Competitive pressure among companies in our industry;
- Current economic downturn;
- Political unrest throughout the world;
- Changes in the cost of fuel or the exchange rate of the Euro to the U.S. dollar and other currencies;
- Governmental and regulatory actions and political conditions, including actions or decisions by courts and regulators or changes in applicable laws or regulations (or their interpretations), including laws and regulations governing the structure of the combination, the right to service current and future markets and laws and regulations pertaining to the formation and operation of airline alliances;
- Developments affecting labour relations;
- The outcome of any material litigation;
- The future level of air travel demand;
- Future load factors and yields;
- Industrial actions or strikes by KLM employees, Air France employees or employees of our suppliers or airports;
- Developments affecting our airline partners;
- The effects of terrorist attacks, the possibility or fear of such attacks and the threat or outbreak of epidemics, hostilities or war, including the adverse impact on general economic conditions, demand for travel, the cost of security and the cost and availability of aviation insurance coverage and war risk coverage;
- The effects of natural disasters and extreme weather conditions;
- Changing relationships with customers, suppliers and strategic partners;
- Developments in any of these areas, as well as other risks and uncertainties detailed from time to time in the documents we file with or furnish to relevant agencies, could cause actual outcomes and results to differ materially from those that have been or may be projected by or on behalf of us. We caution that the foregoing list of important factors is not exhaustive. Additional information regarding the factors and events that could cause differences between forward-looking statements and actual results in the future is contained our filings.

We do not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.