

Annual Report 2017

Royal Dutch Airlines



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Letter from the President

For KLM, 2017 was marked by impressive progress. We achieved record revenues, made record-high investments in customers and staff, flew to more destinations, welcomed more passengers on board, and rolled out many digital initiatives for the benefit of our customers. This and much more embodies the strength of the transformation KLM initiated from 2014 onwards.

In 2014, we formulated a new ambition, which is to become Europe's most customer-centric, innovative and efficient network carrier. In 2015, we revisited the top strategic priorities for KLM and redefined our purpose. In 2016, we executed and finalised the first transformation projects and integrated cultural elements into our refined strategy in the form of the KLM Kompas. In 2017 we deepened our strategy to reach the next level in our transformation. In all years we vigorously executed our strategy with the help of our annual KLM Flight Plan.

I am proud to say that because of this, KLM has seen steady and evident improvements on all key parameters over the past three years. Although the fuel price and economic upswing should be kept in mind when looking at the results, we have made great progress in 2017. Our operating margin improved, bringing us more in line with that of our European peers, and we have been able to increase our investments, especially in the areas that matter most to our customers and staff. Furthermore, in line with the ambition to de-risk the balance sheet, KLM successfully de-risked the pension plan of both cockpit and cabin crew in 2017. As a consequence, a one-off loss was recognised, driving the net results to a negative.

In line with KLM's purpose *Moving Your World*, I see it as my job to create a culture in which our employees can be their best selves to create memorable experiences for our customers. In 2017, our customers benefited from our improved physical and digital products and the empowerment of our staff to truly take care of them. Our staff benefited from new digital solutions that make their work easier and from the highest-ever pay-out from our profit sharing scheme of EUR 93 million in 2017 (related to 2016). For the year 2017 an even higher profit sharing scheme of EUR 170 million is expected. Some 2,100 employees took part in team development sessions and 15,000 employees are now familiar with the KLM Kompas. Inspired by the motto *Change, Participate and Win* ("*Veranderen, Meedoen, Winnen*"), KLM staff once more engaged, participated and delivered in the transformation of KLM.

In 2017 we continued to reap the benefits of our combination with Air France in the AIR FRANCE KLM Group. Over the past years, we have worked hard to also contribute to the success of the Group. With our 2017 results, we have once again proven our value. In the years to come, we will seek and deliver new AIR FRANCE KLM Group opportunities in global alliances and partnerships, distribution and our joint loyalty program Flying Blue.

2017 was also a year in which we faced large operational disturbances, mostly due to the additional released summer slot capacity at Schiphol airport. These circumstances demanded a lot from our customers as well as our staff. Looking back on the turbulent yet successful year behind us, I feel proud of what our KLM staff have been capable of and I am deeply grateful for their support and contribution. In particular I would like to thank all those colleagues who stood their ground in the challenging and demanding operational circumstances.

Change naturally leads to tensions. After three years in which the complexity of change has become tangible, our employees are in need of increased stability and new energy. We continue to aim for dialogue to keep our employees engaged. While it is natural to want to take things slower, there is no room for complacency. The airline industry continues to consolidate and the fast-evolving world forces us to continuously adapt to a new reality, especially in the fields of digitisation and labour. However, I do not just want KLM to be able to cope with these changes, I want us to shape them, as we have done multiple times over the course of almost 100 years.

It is my ambition to ensure that KLM will be "*healthy and fit for the next 100 years*" when we celebrate our centenary in 2019. Not just in terms of our finances, but also regarding the health of our employees and social relations with unions.

Together, we will have to embrace disruptive innovations in addition to incremental change, leading to a faster and more entrepreneurial way of working. I believe these elements will define our future.

That is why in 2018 we need to keep the momentum. We will continue our focus on cost reduction. Our main financial goals are to keep profit margins high, maintain a positive free cash flow and lower unit costs by at least 1 per cent a year. This will enable our record-high investments of EUR 1.2 billion in 2018. As for our organisational goals, we will enter a new phase, in which we will continue with our motto "Change, Participate and Win." Together with our employees, we will define what winning means for us, and explore new forms of changing and participating. The change and the incredible energy flowing through our organisation is becoming more and more visible each year. We are going to use this energy in the next phase. Finally, we will maintain our continuous focus on safety and pursue our ambitions with respect to sustainability.

I firmly believe that we are on the right track. In 2018 we will create new momentum for change to reach our centenary in great health. I have full confidence in our people, our plan and the enduring KLM pioneering spirit to realise our KLM ambition of becoming Europe's most customer-centric, innovative and efficient network carrier.

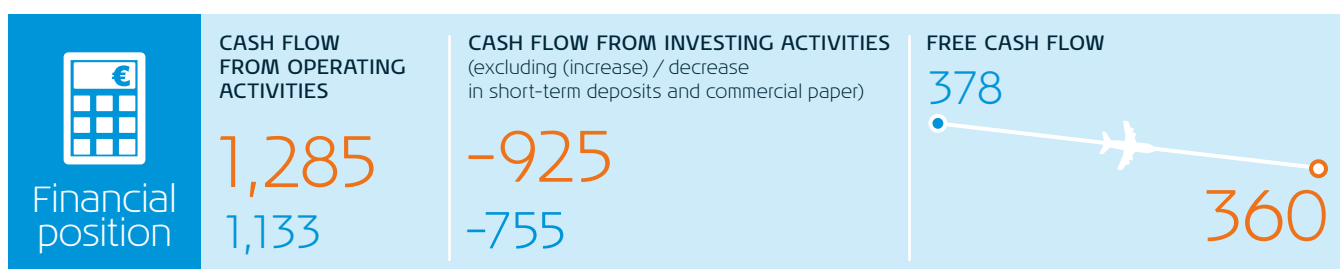
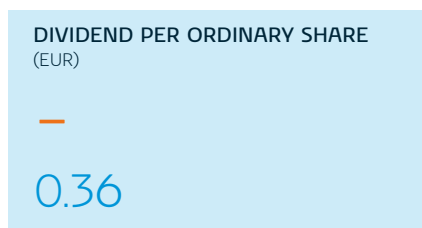
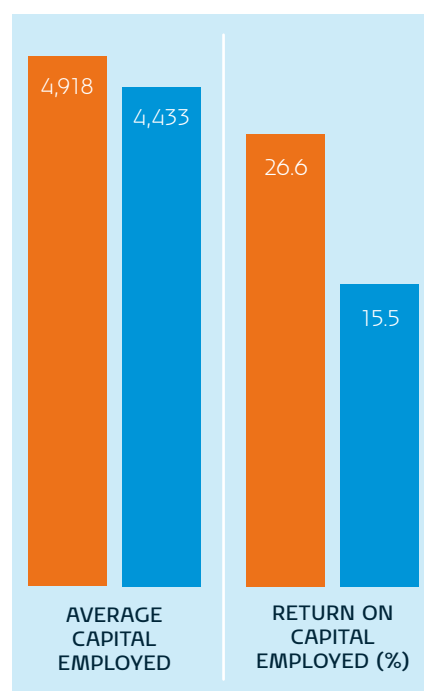
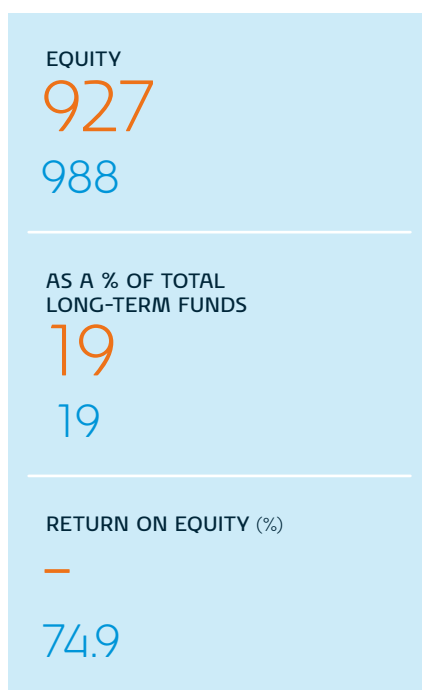
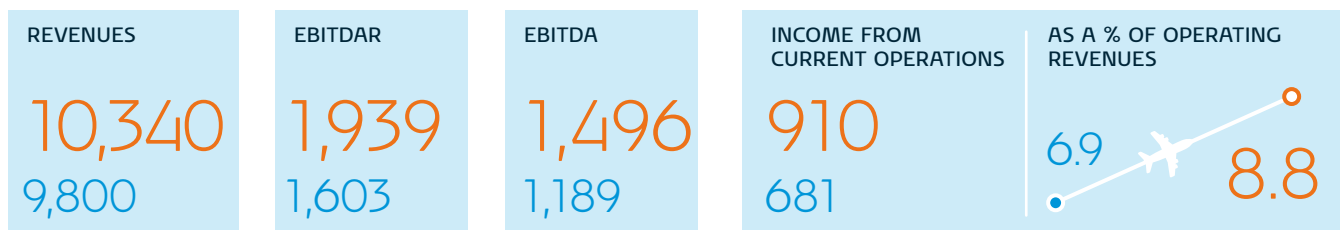


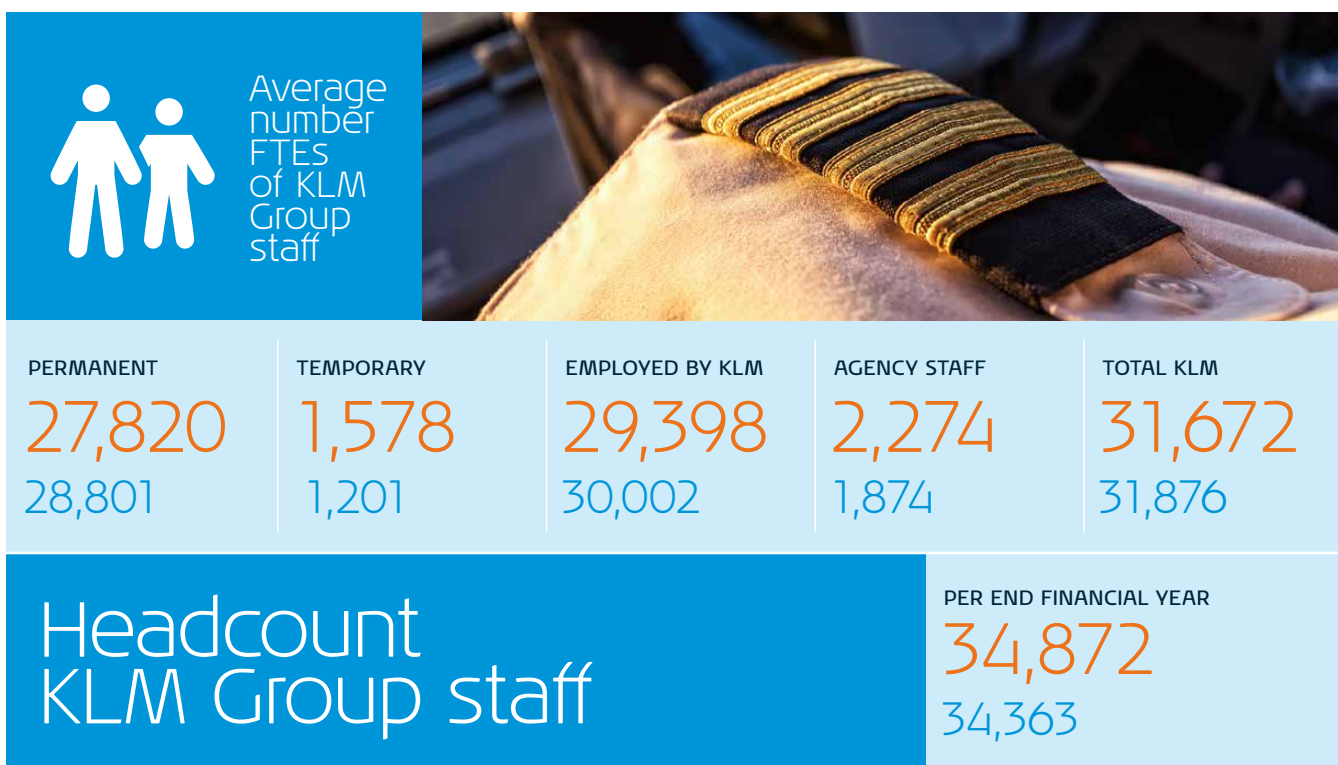
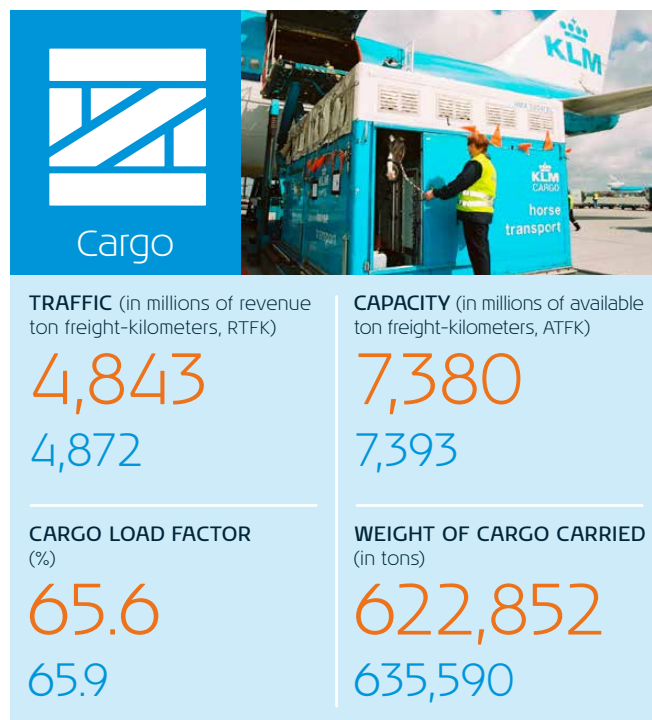
Pieter Elbers

President & Chief Executive Officer



Key figures







Review 2017: keep the momentum

Midway its five-year Perform 2020 program, KLM's mood, health, and outlook have improved. Here, the Board of Managing Directors discusses how a steady stream of investments and innovations were combined with organisational changes to create a winning momentum.

When KLM's new strategy was launched in 2015, the leadership team designed an ambitious program of change. Major investments in product and fleet were needed, costs had to decrease, productivity had to go up, and the organisation had to become more agile. Furthermore, a new purpose was defined, and employees were encouraged to change, participate and win in accordance with it.

Reflecting on three years of hard work and the achievements of 2017, President & Chief Executive Officer Pieter Elbers says these and other changes have improved KLM's position. "KLM is more robust, our financial shape is healthier, our product is improving and growth is picking up. We have been focussed on the execution of our strategy. Our people have a clear sense of direction and they are increasingly able to imagine and realise innovative ideas. Team development is strong. Although we are not yet fully where we want to be, we are increasingly in charge of our own destiny. We will need to keep the momentum in order to uphold or rather outpace competition."

Growth and profitability

The 2017 financial results echo confidence and even cautious optimism. Revenues reached EUR 10.3 billion, operating income rose from EUR 681 million to EUR 910 million, the operating margin increased from 6.9 to 8.8

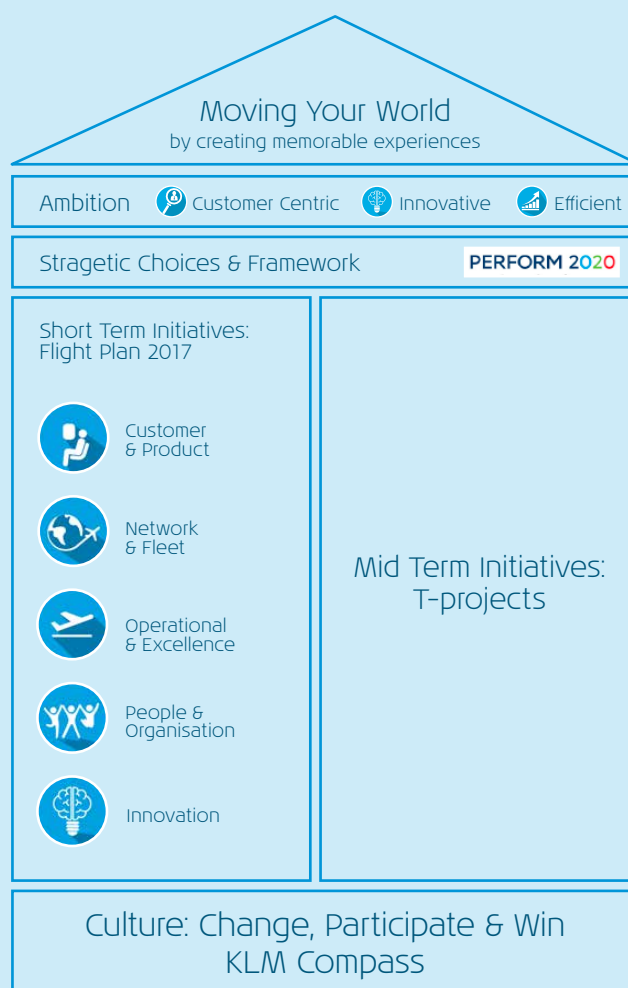


per cent, the cost per unit slightly increased by 0.1 per cent and decreased 1.0 per cent if increased profit sharing would be excluded, and productivity increased by 2.9 per cent.

Chief Financial Officer Erik Swelheim says KLM's results improved across all businesses. "Our network grew in all regions, particularly Asia and Central & South America. Europe continued the positive trend of 2016 and North America remained our strongest region. The Cargo activity showed strong performance, partly because of new partnerships and investments in equipment and digital services. Transavia transported 11 per cent more passengers and increased revenues by 13.3 per cent. Engineering & Maintenance, meanwhile, grew its turnover to EUR 1.6 billion, mainly through work for third parties."

Upgraded product

KLM's improved results meant that it could invest EUR 925 million in its ability to give customers a memorable experience. KLM added two more comfortable, efficient and maintenance-friendly Boeing 787-9 Dreamliners and two Boeing 777-300 aircraft to its fleet and continued the introduction of flat beds in its World Business Class. Within the regional fleet the replacement of Fokkers with Embraers was completed. KLM also initiated the Anytime for You meal service on certain routes and made progress



on the construction of the new KLM Crown Lounge at Schiphol. Furthermore, KLM extended its leadership in social media by becoming the world's first airline to enable two-way communication with customers using WhatsApp.

"In 2017, we maintained focus on executing our strategy to become the most customer-centric, innovative and efficient European network carrier. Our integral decision-making has further improved, and we became faster and more agile. Despite the physical constraints at Schiphol, which put pressure on our operations in the air and on the ground, we worked very hard and did our utmost to serve our customers," Chief Operating Officer René de Groot says.

As a result of these and other efforts, the Net Promotor Score (NPS), which captures which passengers are or are not likely to recommend KLM, ended at 39. This result is below the 2017 objective of 42 and below last year's score of 40. Operational disturbances, which occurred more often in 2017, were the most important reason for this. However, on more than 160 days of the year a NPS score of 42 or more was reached, which feeds our ambition for the future.

KLM clustered all operational analyses in a new Operations Decision Support organisation. Integrated decision support is, part of last year's embrace of Operational Excellence as a guiding philosophy to deliver on KLM's customer promise safely, effectively and at the lowest integral cost. In addition, 2017 marked the first year of the Integrated Safety Services Organisation, which bundles all safety activities and knowledge.

Innovation

According to Elbers, innovation made a difference in 2017 and will continue to do so in the years ahead. "Every company with a growth ambition will need to innovate both continuously and disruptively. Our challenge is to implement breakthrough innovations in our processes and procedures. This can only be done in close cooperation with our staff. The culture as well as the structure are increasingly in place to allow our staff to experiment, learn and implement winning ideas."

Guided by the agile-inspired X-way of Working, KLM built apps that help staff service passengers at Schiphol, limit aircraft turnaround times and delays and empower cabin crew to connect with passengers. In addition, KLM experimented with cutting-edge technologies such as artificial intelligence, virtual reality and blockchain.

De Groot adds that "by innovating, we can work more efficiently, improve our operations and deeply touch the lives of our customers at all points of their journey.

Having provided iPads to 15,000 ground, cabin and cockpit employees and modernising the underlying IT architecture in 2016, KLM in 2017 accelerated the pace at which it rolled out new digital services."

Agility

KLM's increased agility is also the result of the High Performance Organisation, whose implementation was almost completed in 2017. "By removing management layers, centralising support functions, empowering staff with digital services and increasing mobility, we are facilitating our staff to change, participate and win," says Swelheim.

Other important achievements

In 2017, the shift of two of the company's three pension funds from a defined benefit to a collective defined contribution scheme was achieved. "This has once and for all mitigated the risk of additional unplanned payments to these funds," Swelheim explains. At year-end, KLM was able to conclude an agreement with the cabin crew union VNC on a new collective labour agreement. KLM aims at implementing the new collective labour agreement for the cabin crew early 2018.

Network growth

To remain globally relevant in an industry impacted by consolidation and strong competition, KLM together with AIR FRANCE KLM concluded a number of new alliances. This included an enhanced cooperation agreement between Air France and KLM with India-based Jet Airways and a deal between AIR FRANCE KLM with Delta Air Lines and China Eastern Airlines through which each acquired a 10 per cent equity stake in AIR FRANCE KLM.

In addition, Delta Air Lines, AIR FRANCE KLM and Virgin Atlantic decided to launch a long-term joint venture, supported by an intended 31 per cent investment by AIR FRANCE KLM in Virgin Atlantic, to offer customers the most comprehensive transatlantic network.

KLM's growth was further supported by an expansion of its network. Fourteen new destinations were added and three were removed, largely as a result of a more entrepreneurial approach towards network development. "We used to be more conservative about when and how often we flew, but now we are quickly testing destinations and adapting our schedule according to real-time feedback. We have also begun to operationalise flight schedules on a monthly basis rather than doing it four times a year. The growth of our network reflects both a new mindset and a more streamlined organisation," De Groot comments.



René de Groot
COO

Pieter Elbers
CEO

Erik Swelheim
CFO

Long-term value creation

In 2017, KLM conducted a review of its strategy, in order to check its fit with a changing world, retain the winning momentum and create long-term value. Sharing its results with the top of the organisation and the Works Council, the leadership team further sharpened the current strategy and set new strategic priorities. KLM's Passenger activity will continue its current trajectory. The Cargo activity will increasingly focus on the value it adds to KLM by targeting small and medium-sized enterprises, e-commerce and the pharma industry. As part of the review of KLM's strategy, the Cargo activity is considered complimentary to the Passenger activity and in 2017 these two activities began to constitute an unique larger activity, called "Network". Engineering & Maintenance will work with its Air France counterpart to stay one of the world's leading maintenance, repair and overhaul organisations.

2018 and beyond

In 2018, KLM will continue to look for new opportunities for growing its network and alliances, and work hard to create a stable operation, particularly at Schiphol. KLM will further invest in fleet renewal, innovation and maintenance, with new Boeing 787 Dreamliners, and Embraers expected to join the fleet. KLM will also finalise the upgrade of its World Business Class to full flat, further continue with the roll-out of on-board connectivity, inaugurate the first part of its new

World Business Class lounge at Schiphol and step up digitisation efforts in effort to empower staff to create memorable experiences for customers.

"The world increasingly changes in sudden and radical ways, and KLM will need to achieve disruptive innovation in addition to incremental improvements. To this end we will partner more, innovate in line with our business goals, and learn to more quickly scale up our experiments," De Groot says.

KLM will continue to invest in its people, in order to be able to optimally change, participate and win. "To this end, we will improve staff engagement, further implement the KLM Kompas and introduce the Winning Way of Working, which connects people's behaviours with KLM's IT infrastructure and real estate to create an inspiring work environment," Swelheim adds.

Two years away from completing the Perform 2020 program and KLM's centenary, KLM is in a better shape. "We are further building upon KLM's strong foundation, we have been doing that successfully in the past and will continue to do so even more in the years to come in order to be fit and healthy for our next centenary. The KLM spirit that defines our history will now shape our future," Elbers concludes.



The world we operate in

In 2017, the economic upswing was reflected by growth. The outlook for advanced economies has improved, notably for the euro area, but in many countries inflation remains weak and prospects for growth in GDP per capita are held back. Prospects for many emerging markets and developing economies in Africa, the Middle East, and Latin America are not favourable, with several experiencing stagnant per capita incomes.

The economy

In 2017, there have been challenges and uncertainties regarding developments in the EU, the continued threat of terrorist attacks, the evolution of international trade, the growth of China and emerging markets as well as monetary policies. Nevertheless, the European economy has performed significantly better than expected in 2017, propelled by strong private consumption, stronger global growth and falling unemployment. Investment picked up amid favourable financing conditions and considerably brightened economic sentiment. By the end of 2017, all economic indicators of the Dutch economy were positive.



The airline industry

Enlarged accessibility of air transport, strong consumer and business confidence, and global GDP growth increased consumer spending and air travel. Classic changes in the industry, such as consolidation and ongoing growth of low-cost carriers remain. Following consolidation in the global aviation industry, in 2017 consolidation of European airlines further materialised. New challenges in the field of digitisation and artificial intelligence become visible. Air Cargo, meanwhile, benefited from growing trade and re-stocking of inventories. Yields performed better than expected, but jet fuel prices increased moderately due to production cuts. The average Earnings Before Interest and Tax (EBIT) margin of the airline industry as a whole was 8.3 per cent, but regional differences exist, with North America and Asia-Pacific being top-performing regions, Europe and Latin America in the middle, and the Middle East and Africa at the bottom.

Europe

Brexit negotiations have made some progress, but the impact on aviation remains unclear. Clarity is needed on air traffic rights between the United Kingdom and the European Union (EU) for air traffic to continue after the Brexit. A non-agreement between the United Kingdom and the EU could heavily restrict services.

KLM actively supports the European Commission's 2015 Aviation Strategy and is looking forward to the implementation thereof as this will 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. KLM supports the European Commission's efforts to promote a level playing field for aviation within and outside the EU. KLM also looks forward to the realisation of a Single European Sky, which could lower CO₂ emissions by 10 per cent and reduce costs by EUR 8 billion per year through more efficient routes.

KLM supports regulations that protect passenger rights. Customers are at the heart of KLM's business. Safety, punctuality and reliability are important to the company. In case of unforeseen events, KLM takes all measures necessary to minimise the inconvenience for passengers and in 2017 KLM spent around EUR 87 million on this, an increase of 40 million compared to 2014. Obviously, there is a strong relation between the operational disruption and the service recovery cost but these are also triggered by factors, such as changing customer claim behaviour and changes in regulations. KLM is concerned that the existing EU regulation 261/2004 burdens the airline industry with unreasonably high costs. Uniform enforcement and interpretation of the revised regulation across Europe is essential.

the Netherlands

KLM is proud of the significant role it plays in the Dutch economy. In 2017, the Dutch airline industry contributed around EUR 30 billion to the Dutch economy, and this industry was responsible for more than 300,000 jobs. KLM's world-wide network is the key reason that Schiphol is Europe's second-largest airport in terms of connectivity, contributing to the Netherlands' position of Gateway to Europe for global trade and air travel. KLM increased the competitive position of the Mainport area by growing its worldwide network, investments and cargo activities. With 34,900 employees KLM is the third-largest private employer in the Netherlands.

KLM is committed to reducing its impact on the environment, but believes a national aviation tax is not effective. Such a tax could push airlines to surrounding countries, which negatively impacts jobs and GDP, and would end up in the government's overall budget rather than be used directly for sustainability measures. KLM believes the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) provides a global approach that is more suitable to the global nature of the aviation industry.



Schiphol

KLM is proud to call Schiphol its home and to be the airport's flagship carrier. KLM and Schiphol have significantly contributed to each other's past successes and are key to each other's future. The strong partnership is a major part of the engine that keeps the Dutch economy running.

In 2017, KLM experienced several operational issues at Schiphol. Under the Alders Agreement, the number of flight movements cannot exceed 500,000 per year until the end of 2020. In 2017, Schiphol unexpectedly released all remaining capacity, causing the number of flights to sharply increase from 479,000 in 2016 to 497,000 in 2017. The number of passengers increased from 63.5 million in 2016 to 68.4 million in 2017, making Schiphol the third-busiest airport in Europe and the first airport in Europe in terms of flight movements. At the same time, Schiphol experienced insufficient numbers of security and border personnel, as well as gates and security lanes. As a result, passengers experienced long delays and missed flights during the spring and summer holidays.

The ceiling in the maximum number of flight movements has been reached some three years earlier than was foreseen. Without further initiatives, growth at Schiphol will no longer be possible for the period 2018 up to and including 2020.

Therefore, it is important that Lelystad Airport will be opened in 2019 to move leisure traffic away from Schiphol, through Traffic Distribution Rules, in order to enable continued growth at Schiphol until 2020 for intercontinental traffic and feeder flights. Next to the creation of flight movements at Lelystad Airport as relieve for Schiphol, we can also expect autonomous growth at Schiphol, according to what has been agreed upon in the Alders Agreement of 2008. KLM is working with the Ministry Infrastructure & Water Management and the parties involved in the Alders Agreement to make extra flight movements available at Schiphol making use of all aspects of the Agreement and the results of the environmental studies (MER) performed upon request of the Ministry. Next to this, for further improvement of Safety in and around Schiphol and for making sure that further growth will be safe, KLM together with Schiphol and Dutch Air Traffic Control organisation (LVNL) created the first of its kind Dutch aviation sector Integrated Safety Management System.

KLM is satisfied with the Coalition Agreement 2017-2021 in which the Dutch government recognises a successful home-carrier as a backbone of the Dutch economy. It supports the discussion on further growth at Schiphol until and beyond the year 2020.



With the sudden growth in 2017 and further growth ahead, the development of infrastructure is vital. One important solution to solve the present capacity shortage is the construction of Schiphol's A-pier, of which the first phase is scheduled for opening by the end of 2019. The pier's five gates for narrow-body aircraft and three for wide-body aircraft will ease some of the congestion. However, in spite of two additional gates that will be added in later years, Schiphol will still not have sufficient capacity for KLM's wide-body aircraft. Furthermore, as part of the ongoing renewal of its fleet, KLM will increasingly rely on larger aircraft, which means gates need to be renovated.

A measure taken to release pressure on the security filter was the finalisation of a new temporary terminal for Schengen passengers in April 2017. KLM contributed its expertise to this terminal, which gave it new check-in counters that can also be used in the summer of 2018. In addition, KLM conducted a joint study with Schiphol into the renovation of Departure Hall 1. The hall is scheduled for completion in 2020. This renovation will take place in coming years at the heart of KLM's passenger operation process at Schiphol.

Looking ahead, KLM believes that the opening of Lelystad Airport in 2019 and the implementation of the traffic distribution rule system should ease pressure on Schiphol, especially in the busy peak hours. If either measure is blocked or postponed, KLM expects that all parties involved will work together to realise autonomous growth for Schiphol in the upcoming period (2019-2020).

As a social responsibility and to help acceptance of further growth, KLM will continue its efforts to reduce noise pollution. Fleet renewal and adapted departure and arrival routes and procedures already delivered huge improvements. KLM also puts a lot of effort in to the reduction of CO₂ emissions.

Security is of the utmost importance to KLM and security measures have increased year on year after 9/11. KLM is concerned about their impact on the free flow of passengers and the ever-increasing cost of security. Currently, KLM and other airlines bear the full burden of these costs and in order to keep the industry competitive, a structural reduction in security costs is needed.



Finance

KLM achieved most of its financial targets in 2017, which included record-high revenues, a higher operating margin, good control of unit costs, increased investments, and lowered debt levels. While the results show the strategy is working, continued vigilance is needed.

For the first time in its 98-year history, KLM revenues exceeded the EUR 10 billion mark to reach EUR 10.3 billion. Operating margin rose from 6.9 per cent to 8.8 per cent and operating income was boosted from EUR 681 million in 2016 to EUR 910 million in 2017. Net debt was lowered from EUR 1.7 billion to EUR 1.4 billion. While this means the company has achieved its main financial targets, KLM's financial performance is still lagging behind some of its peers.

These overall positive results are due to the effective execution of KLM's strategy, higher utilisation of the company's fleet, purchasing initiatives and a 2.9 per cent increase in productivity. The cost per unit slightly increased 0.1 per cent and decreased 1.0 per cent if increased profit sharing for KLM staff would be excluded.

KLM reinvested profits into the continuous fleet renewal program, airport equipment and innovation, with a record high investment of EUR 925 million. By replacing the ageing Fokker fleet and Boeing 747 aircraft with more fuel-efficient successors, KLM lowered maintenance and fuel costs, despite fuel prices rising slightly.

KLM's results improved across all businesses. Network results (Passenger and Cargo) did well in all regions, particularly Central & South America and Asia. North America remains KLM's strongest region and Europe showed increased profitability. Engineering & Maintenance attracted more



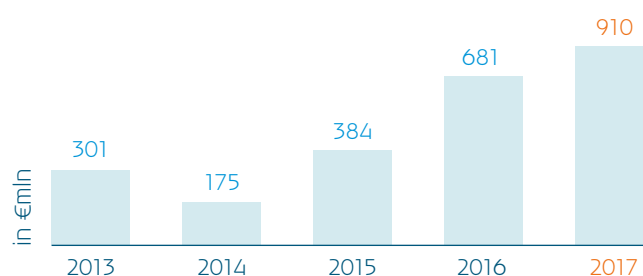
third-party work, which accounts for almost half of its business. Transavia had an excellent year with an operating margin of 6.0 per cent.

KLM's financial position was further derisked by the conclusion of a deal with two of the company's three pension funds. The cabin and cockpit crew pension funds switched from a defined benefit to a collective defined contribution, lowering the risk of unplanned heavy additional payments and equity volatility.

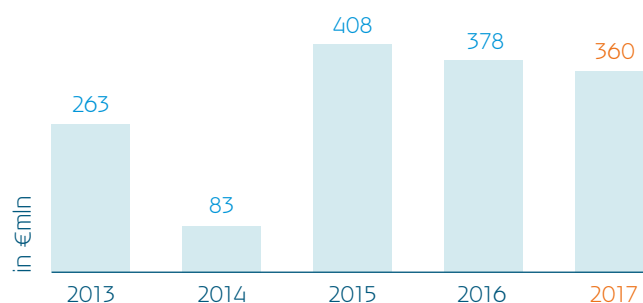
As part of our financial risk management framework, KLM in 2017 also conducted going concern analyses including scenario and sensitivity analyses. These analyses reconfirmed the insights into the most important risks and led to the conclusion of the Board of Managing Directors that – based on the information 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.

Looking ahead to 2018, KLM's main financial goals are to keep profit margins high, maintain a positive free cash flow and lower unit cost by at least 1 per cent a year. KLM seeks to invest at least EUR 1 billion a year over the next three years in fleet renewal, innovation and maintenance, in order to realise KLM's ambition to become the most customer-centric, innovative and efficient European network carrier.

Positive trend of current operating income



Positive free cash flow



Consolidated statement of profit or loss

In millions of Euros	2017	2016	Variance %
Revenues	10,340	9,800	6
External expenses	(5,523)	(5,519)	0
Employee compensation and benefit expenses	(2,955)	(2,860)	3
Other income and expenses	77	182	(58)
Total expenses	(8,401)	(8,197)	2
EBITDAR	1,939	1,603	21
Aircraft operating lease costs	(443)	(414)	7
EBITDA	1,496	1,189	26
Amortisation, depreciation and movement in provisions	(586)	(508)	15
Income from current operations	910	681	34

Revenues

Revenues were 5.5 per cent higher whereas traffic (passenger seat kilometers) went up almost 6 per cent and cargo traffic remained almost stable. Capacity (in equivalent available seat kilometers) was 4.4 per cent higher than last year. Unit revenue increased by 1.7 per cent (2.5 per cent at constant exchange rates). Yield increased by 0.4 per cent (1.1 per cent at constant exchange rates), while the load factor increased to 85.6 per cent (+1.1 per cent compared to 2016).

Expenses

Total expenses (excluding aircraft operating lease cost and amortisation, depreciation and the movement in provisions) amounted to EUR 8,401 million, an increase of EUR 204 million compared to 2016. Unit cost were 0.1 per cent above 2016, and decreased 1.0 per cent excluding the profit share for KLM staff.

Fuel prices

Overall fuel cost decreased EUR 83 million compared to 2016, with a 4 per cent lower jet fuel price after hedge and a 1.3 per cent stronger USD. The hedge portfolio contributed with a positive payout of EUR 11 million in 2017. Fuel volume was 1.1 per cent higher than last year.

Income from current operations

In millions of Euros	2017	2016
Income from current operations	910	681
Other non-current income and expenses	(1,849)	3
Net cost of financial debt	(91)	(100)
Other financial income and expenses	78	1
Pre-tax income	(952)	585
Income tax (expenses) / benefit	239	(69)
Share of results of equity shareholdings	10	3
(Loss) / profit for the period	(703)	519
Adjusted profit for the period	579	519

The net loss in financial year 2017 amounted to EUR 703 million. Excluding the 2017 one-off, non-cash settlement expenses for the cockpit crew pension plan of EUR 1,049 million after tax (EUR 1,399 million before tax as elucidated in the next paragraph) and the non-cash settlement for the cabin crew pension plan of EUR 233 million after tax (EUR 311 million before tax as elucidated in the next paragraph), the net result would have been a net profit of EUR 579 million in 2017.

Other non-current income and expenses

The other non-current income and expenses show a negative amount of EUR 1,849 million. This includes, among others, EUR 1,399 million non-cash settlement expenses following the modification to a collective defined contribution pension plan for cockpit crew and subsequent derecognition of the cockpit crew pension asset and the same modification related to cabin crew for a non-cash settlement expense of EUR 311 million, following the derecognition of the cabin crew pension asset. In addition a non-current expense related to a dowry payment amounting to EUR 194 million was agreed with the cockpit crew union, of which EUR 120 million was paid in 2017.

Other non-current expenses mainly relate to positive results of the sale of assets amounting to EUR 25 million (mainly Boeing 747 engines and Fokker 70 aircraft) and increase in the fair value of Kenya Airways amounting to EUR 50 million following the financial restructuring of that financial fixed asset in 2017.

The 2016 other non-current income and expenses show a positive amount of EUR 3 million. This includes, among others, EUR 13 million for voluntary leave plans at KLM, and a 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, including the sale of the 60% stake (and 40% by Air France) in Cobalt Ground Solutions Ltd.

Net cost of financial debt

The net cost of financial debt was reduced from EUR 100 million to EUR 91 million, mainly as a result of the reduction of net debt and lower interest rates.

Other financial income and expenses

The profit of EUR 78 million in other financial income and expenses in 2017, mainly relates to the positive revaluation of KLM's debt in foreign currencies and positive 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 EUR 4 million related to Martinair pre-fiscal unity losses.

Equity shareholdings

This mainly reflects the KLM share in the results of Schiphol Logistics Park and Transavia France.

Cash flow statement

In millions of Euros	2017	2016
Cash flow from operating activities	1,285	1,133
Cash flow used in investing activities (excluding (increase)/decrease in short-term deposits and commercial paper)	(925)	(755)
Free cash flow	360	378

Operational cash flow reached EUR 1,285 million, composed of a cash flow from operating activities before working capital of EUR 1,230 million, and a positive working capital movement of EUR 55 million. The continuous focus on cash resulted in a positive free cash flow of EUR 360 million (EUR 378 million in 2016) with investments EUR 169 million higher than 2016.

The investing cash flow included EUR 476 million for fleet renewal and modifications (EUR 534 million in 2016) and fleet related investments amounted to EUR 308 million, including EUR 129 million for capitalised fleet maintenance. Other capital expenditure amounted to EUR 212 million, including EUR 118 million for capitalised software. Disposal of aircraft and other assets led to an income of EUR 64 million and mainly relates to sales of Boeing 747 engines and Fokker 70 aircraft.

The financing cash flow was EUR 439 million negative. New financing included new external loans of EUR 425 million. Redemption of finance leases amounted to EUR 397 million, redemption on existing loans to EUR 188 million, redemption on AIR FRANCE KLM loans of

EUR 180 million and lower near cash of EUR 81 million.

EUR 17 million dividend 2016 was paid to KLM shareholders and EUR 1 million to a minority interest shareholder of a KLM subsidiary.

Equity

Equity slightly decreased to EUR 927 million at December 31, 2017, and includes the negative net result for the financial year 2017 amounting to EUR 703 million. It also includes the net positive movements in the remeasurement of defined benefit pension plans amounting to EUR 625 million, the positive net variance of the value of fuel derivatives amounting to EUR 84 million and the net negative variance of the value of interest and currency derivatives of EUR 67 million, all reported in "Other Comprehensive Income" in equity.

Including the subordinated perpetual loans and the preference shares, the near equity amounts to EUR 1,503 million at December 31, 2017 (EUR 1,620 million at December 31, 2016).

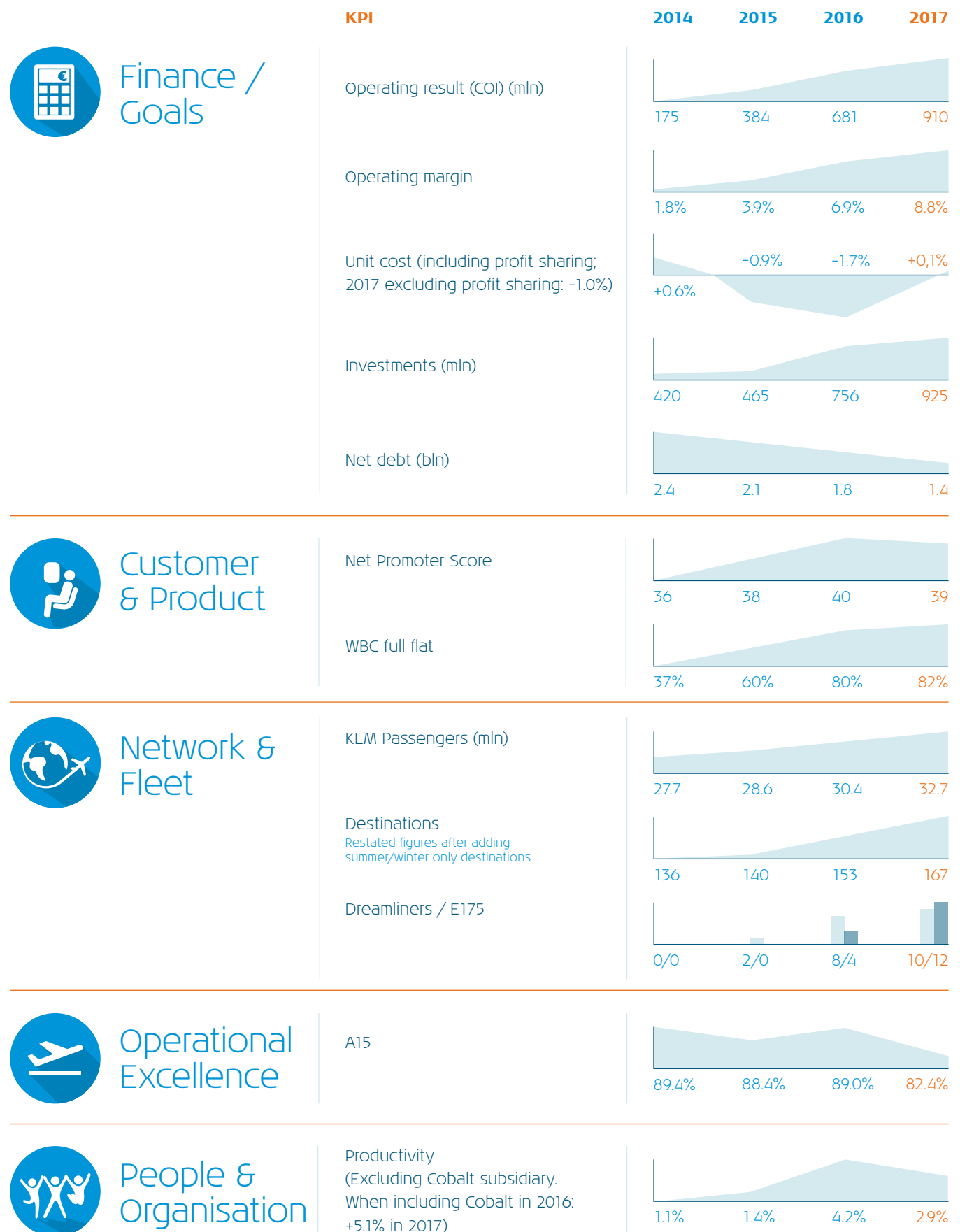
The equity level slightly decreased in 2017 but KLM's financial position was further derisked following the agreement with the cockpit crew and cabin crew to move from defined benefit to collective defined contribution pension plans, which substantially lowers the risk of unplanned heavy additional payments and equity volatility going forward. However the volatility in the value of fuel derivatives and the remeasurement of the current defined benefit pension plans remains for the ground staff pension plan and other smaller 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 do not directly affect the statement of profit or loss.

Despite the de-risking of the cockpit and cabin crew pension plans the equity is still low per end 2017. Going forward the balance sheet and thus the equity need to be strengthened.



KLM Flight Plan KPI's realisation

2017: The highest operational result in KLM's 98 years history



Flight Plan 2017

Each year, KLM translates its overall strategy and long-term goals into an annual Flight Plan. The Flight Plan consists of five pillars, being Customer & Product, Network & Fleet, Operations, People & Organisation and Innovation. For each of these pillars the objectives and achievements are described including a case study, which tells the story behind one of KLM's achievements.



Customer & Product



Network & Fleet



Operations

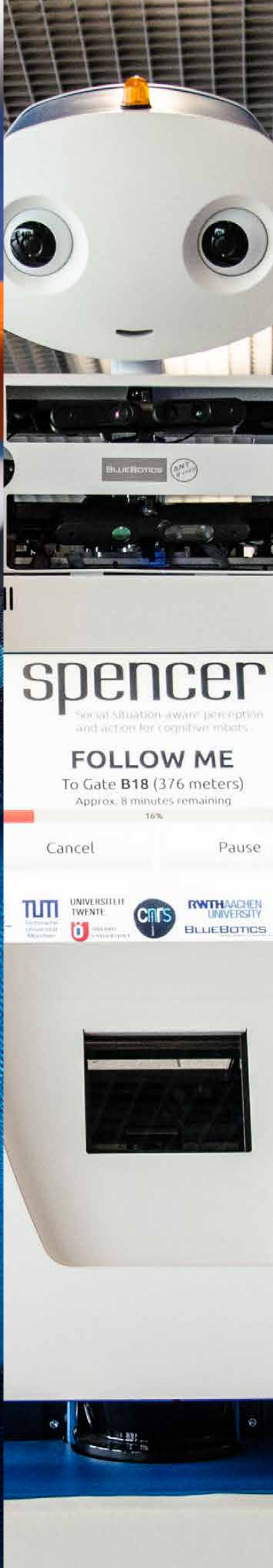


People & Organisation



Innovation





*"Moving Your World
by Creating
Memorable
Experiences."*

—

The purpose of KLM

Customer & Product



Customers in 2017 enjoyed an improved product because of investments in fleet, better cabin and seat comfort, further rollout of connectivity, staff training and tooling, digital innovation and an expansion of KLM's social media capabilities.



KLM has over 25 million fans, of which 17 million on Facebook, and followers on various social media platforms.





Personal attention

In light of KLM's purpose, Moving Your World by creating memorable experiences, KLM worked hard to further improve its services. In 2015, KLM launched its purpose and customer intimacy strategy. In 2017, KLM further built on this with substantial investments in products, services, and staff empowerment. This was supported by detailed monitoring of customer feedback on all points of their journey. Based on advanced customer journey analytics KLM was able to quickly implement decisions that add value to passengers or remove elements of discomfort.

Highlights of 2017 include upgrades of KLM's cabins and inflight services through improved seating, catering, and connectivity. Customers could also enjoy an upgraded in-flight entertainment system featuring larger touch screens and more content and applications. All passengers were given access to a new media app containing a large variety of newspapers and magazines. In addition to the Wi-Fi that was already offered on the Boeing 787 fleet, KLM began preparations for the rollout of Wi-Fi connectivity on its Boeing 777 aircraft and Airbus 330 aircraft, which will commence early 2018. KLM started the roll out of full flat beds on the last aircraft type of its fleet, the Airbus 330, so that by the end of 2018 the entire long-haul fleet will offer full flat seats in World Business Class.

With respect to catering, World Business Class customers were treated to the new 'Anytime for You' service on flights to Johannesburg and Bangkok. After a three-course meal that is served at a fixed time, customers can individually order dishes whenever it suits them, which meets the needs of those traveling from different time zones and better fits the personal schedule of our customers. Furthermore, KLM invested in the catering product offered on our European flights.

Construction of the KLM Crown Lounge at Schiphol reached its highest point. Featuring the best of Dutch design, the new lounge will become an eye-catching part of Schiphol once it fully opens in 2019. It will have high-tech features such as biometric access, a world-class restaurant and entertainment facilities. The first phase of the lounge will be delivered at the end of summer 2018.

Digital services and social media leadership

KLM invested heavily in digitisation and training of frontline staff to offer more personalised services. Building on the rollout of iPads for all ground and cabin staff that was completed in 2016, in 2017 KLM delivered new apps that empower staff at all points of the customer journey. Staff can, for example, sell upgrades or provide compensation with the click of a button, or know whether customers are celebrating special events that require a personal touch. This meets the expectations of customers who are increasingly connected and more demanding.

Social media presence

Since 2009, KLM has gained a reputation as pioneer in the field of social media services and campaigns. KLM has over 25 million fans, of which 17 million on Facebook, and followers on various social media platforms. Through these channels, KLM receives over 130,000 mentions every week, 30,000 of which are questions or remarks. These are personally answered by more than 300 service agents, who form the world's largest, dedicated social media team. On WhatsApp, Facebook, Messenger, Twitter, WeChat and KakaoTalk, KLM offers customers 24/7 service in nine different languages: Dutch, English, German, Spanish, Portuguese, French, Chinese, Japanese and Korean. During office hours, 7 days per week, KLM also offers services in Italian.

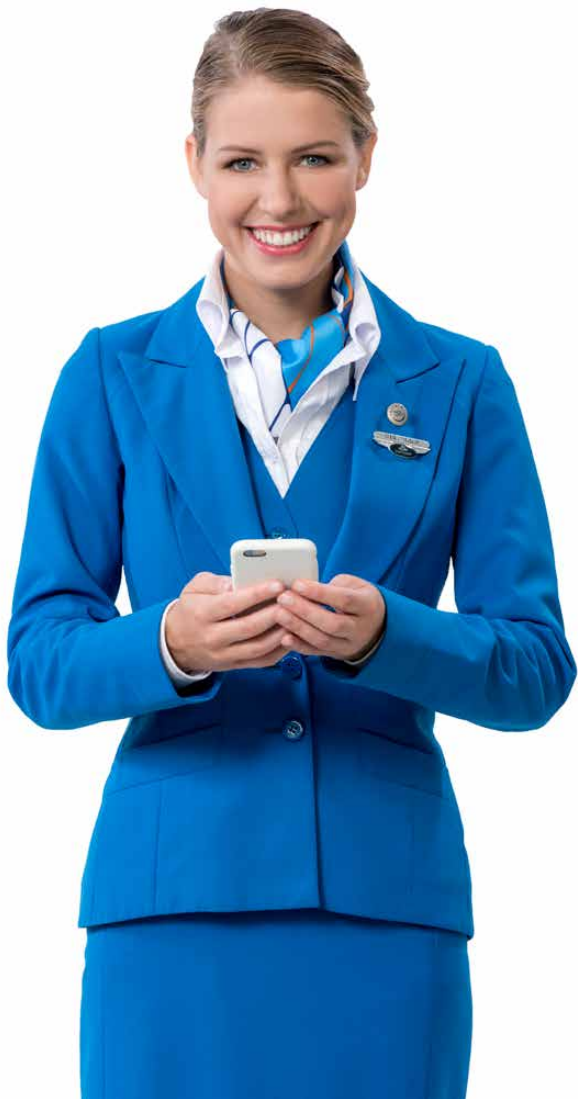
Be where our customers are

In 2017, KLM added the one major channel that customers kept asking for: WhatsApp, which has more than 1 billion users worldwide (see story *Be where the customer is*). KLM believes it should be where its customers are and therefore expects social media - and chat apps in particular - to become the third major "entry point" for customers, alongside klm.com and the KLM app. Consequently, the volume of consumer interaction will grow. KLM needs to keep up with this, without losing the personal KLM style of engagement and communication. KLM is therefore continuously implementing cutting-edge technologies such as artificial intelligence and chatbots.

KLM launched its interactive voice-driven pack assistant on Google Assistant. Here, KLM service bot Blue bot helps passengers to pack their bags.



In 2017, KLM added the one major channel that customers kept asking for: WhatsApp, which has more than 1 billion users worldwide.



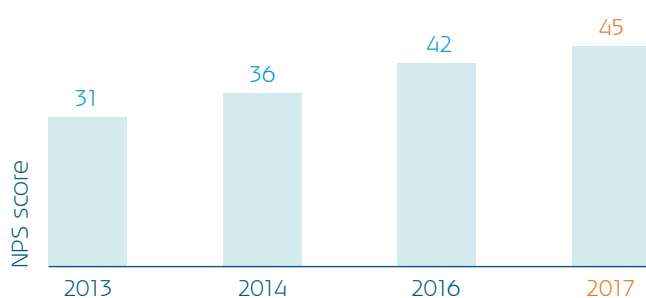
Furthermore, KLM introduced new ticket options in Economy class to Europe and the US, giving customers the opportunity to gain experience with different service elements. This new fare structure is a first step within KLM's personalised offer strategy, enabling customers to create a customized offer at the best price. Also, the Flight Bundle was introduced for customers travelling frequently to the same destinations. In order to meet customers' expectations KLM decided, in a joint approach with Air France, to upgrade the Flying Blue loyalty program which will feature more simplicity and flexibility, a clearer reward scale and more choice.

Net Promoter Score

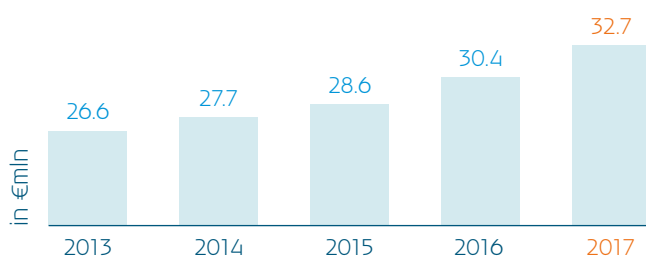
Through diligent investments in and improvements of products, KLM increased the Net Promoter Score from 35 at the beginning of 2015 to 39 for the overall year. Customer appreciation of the World Business Class reached the highest annual score of 44, while appreciation for European Business Class was also good. The overall NPS ended at 39, which was below target, mainly due to the pressure on operations caused by extreme weather and unforeseen capacity growth. KLM did, however, improve its response to disruptions by introducing self-service rebooking at all channels, Happy to Help trolleys that offer extra attention and refreshments to waiting passengers and collective e-recovery for groups of passengers facing on-board service disruptions.



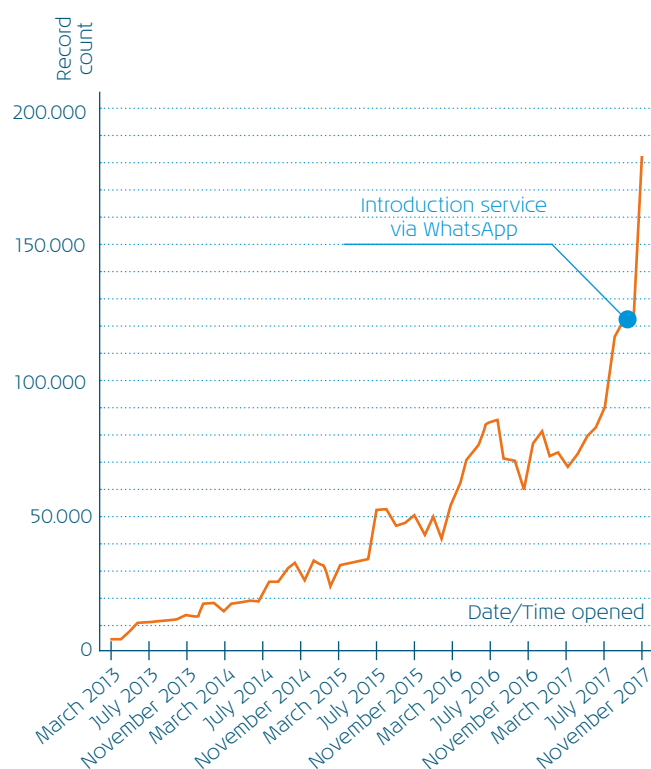
Positive trend of World Business Class NPS development (KLM entire network)



Increasing Number of Passengers (KLM Company)



Incoming social media questions or remarks March 2013 - December 2017





Be where the customer is

By introducing servicing via WhatsApp, KLM as a launching airline can service customers where they are and generate new sales.

KLM introduced WhatsApp because customers had been asking for it, but according to Martine van der Lee, Director Social Media, that was easier said than done. WhatsApp is critical about who can use its services and start partnerships.

“Due to our social media track record and because our vision of being where the customer is matched the vision of WhatsApp, they chose KLM as a launch customer in the aviation industry.”

In 2017, KLM integrated its servicing into WhatsApp's technology platform. “This was not just a matter of solving technical issues such as how to add our services in WhatsApp's encrypted environment, but also about learning to understand each other. In the aviation industry, for example, a secure code is needed to be able to board a flight, so sending them requires careful planning.”

Behind the scenes, KLM prepared for a massive influx of questions and comments from passengers and has connected WhatsApp to its sales systems, so it can sell flights, upgrades and ancillary services. “We want to be where our customer is. Therefore we are very proud to be the first airline that is able to service our customers via WhatsApp.”

By the end of 2017, KLM sent 220,000 boarding passes, 110,000 booking confirmations and 350,000 flight status updates via WhatsApp.

A portrait of Martine van der Lee, Director Social Media at KLM. She is a woman with long brown hair, wearing a grey turtleneck and a blue lanyard, sitting on a blue couch. The background is a blurred office or airport setting.

Martine van der Lee
Director Social Media

"All you need
is the plan,
the roadmap,
and the courage
to press on to
your destination."

—

Earl Nightingale

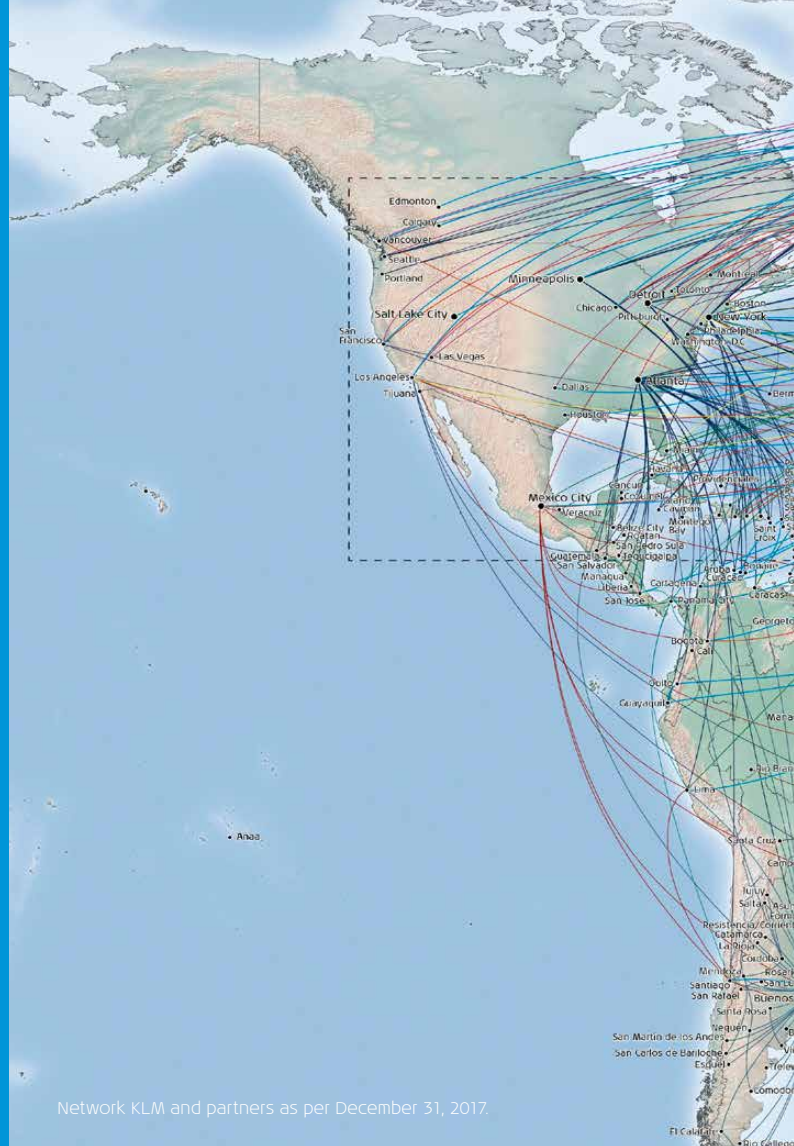
Network & Fleet



KLM aims to deliver a memorable experience to its passengers across the world. To this end, KLM expanded its network and made its schedule more flexible for more profitable growth and higher utilisation. KLM also continued to rejuvenate its fleet, for a better customer experience at a lower cost.

Network

In 2017, KLM achieved a large expansion of its network portfolio by opening fourteen new destinations. In Europe these were Porto, Malaga, Catania, Cagliari, Split, Gdansk and, Graz, while the intercontinental destinations were Minneapolis, Cartagena, Freetown, Monrovia, Mauritius, San Jose and Mumbai. In Milan KLM started operating on a second airport (Malpensa). Three destinations – Cali, Cairo and Doha – were closed. In 2017 KLM welcomed more than 32 million passengers to 167 destinations.



Network KLM and partners as per December 31, 2017.

The increased network created more opportunities for profitable growth. This boost reflects two important changes at KLM. First, the ongoing introduction of modern aircraft that require less maintenance, which means more of the winter months can be spent flying to long-haul destinations. As a result, this year saw the opening of counter-seasonal destinations such as Mauritius, Mumbai and San Jose (see story *Flying to gorgeous Costa Rica*).

The second change underpinning the growth of KLM's network is the more entrepreneurial approach taken to the selection and testing of destinations. This enables KLM to quickly capitalise on shifts in market demand. As a result, the KLM network has become more differentiated in 2017. More destinations also means more possible combinations across the entire network, which is beneficial to customers.

To complement this increased commercial flexibility, KLM took a more agile approach to developing and executing its schedule. This enables KLM to more efficiently use resources and deal with seasonal challenges.

Alliances

KLM uses partnerships to strengthen its network and to reach new markets. The company's strategy has two main building blocks. Firstly, KLM's participation in the transatlantic joint venture with Air France, Delta Air Lines and Alitalia. Secondly, joint ventures with Kenya Airways, Ukraine International Airlines, China Southern Airlines / Xiamen Airlines and China Eastern Airlines. Particularly due to the hub-to-hub and US West Coast operations, the transatlantic joint venture continues to achieve positive financial results, despite fierce competition and the expansion of new and existing low-cost entrants.

In July 2017 Delta Air Lines and China Eastern Airlines announced they would take a 10 per cent share each in AIR FRANCE KLM, solidifying their common interests in the world's largest aviation markets. This transaction was executed by year-end. At the same time, AIR FRANCE KLM announced it would take a 31 per cent stake in Virgin Atlantic. The combination of the existing joint ventures between firstly AIR FRANCE KLM, Delta Air Lines and Alitalia and secondly between Delta Air Lines and Virgin Atlantic, within a single joint-venture marks the expansion and reinforcement of one of the most advanced partnership models in the airline industry.



The partnership with China Southern Airlines and its subsidiary Xiamen Airlines performs well. This encompasses a joint venture on six routes and about 40 codeshare destinations beyond KLM's gateways in China, supporting KLM's operations in Greater China, including Hong Kong and Taiwan. In addition, KLM is further developing a joint venture with China Eastern Airlines, operating from its Shanghai base, complementing the partnerships in mainland China on the prime gateways. Together with China Southern Airlines / Xiamen Airlines, China Eastern Airlines and China Airlines from Taiwan, Amsterdam remains the leading gateway from Europe to China and from China to Europe with eight destinations served non-stop from Amsterdam.

In November 2017, KLM and Air France together with India's Jet Airways announced the launch of an enhanced cooperation agreement to develop their networks and commercial activities between Europe and India. This agreement builds on the extensive code sharing agreement between KLM, Delta Air Lines and Jet Airways, which began when Jet Airways transferred its European hub from Brussels to Schiphol in March 2016. Every day, hundreds of passengers on Jet Airways aircraft from India transfer to the KLM network in Amsterdam. Having started with just one flight per day two years ago, the joint venture

in 2017 operated five flights per day to three different destinations in India. KLM expects will grow the number of passengers between the Netherlands and India will grow to 1 million per year in 2018.

The partnership with GOL showed good results. Some 25 percent of the passengers who travel to Brazil makes an onward connection with GOL and are offered 35 code share destinations. This partnership will be enhanced in both the commercial and customer experience fields, in order to be the first choice for customers traveling between Brazil and Europe. In 2018 KLM and Air France together with GOL will launch a third hub in Brazil with flights to Fortaleza. Kenya Airways has experienced a challenging year, and in its role as shareholder and joint venture partner, KLM fully supports the successful restructuring efforts that took place this year.

Fleet

In line with the strategy, KLM committed itself to massive investments in its fleet over several years to phase out older aircraft, introduce more modern aircraft and upgrade the on-board experience. In 2017 KLM continued with rejuvenation on all fronts.

KLM finalised changes to its European fleet, by phasing out the last Fokker aircraft. The KLM Cityhopper fleet now fully consists of two types of Embraers, with respectively 88 and 100 seats, which makes scheduling and resource planning more efficient. Four Boeing 747 aircraft left the intercontinental fleet and were replaced by two new Boeing 787-9 Dreamliners and two Boeing 777-300 aircraft, which offer higher comfort for passengers, reduced maintenance costs, and lower fuel consumption and CO₂ emissions.

KLM continued its fleet densification process that removed 12 seats from the World Business Class in order to add 37 seats to the economy class sections of the Airbus 330-200 and four seats to the Boeing 777-200, contributing to lower cost per unit. In 2018, KLM will continue the installation of Wi-Fi on Airbus 330-200 and Boeing 777-200 aircraft.

		Included in balance sheet			Operating leases	Total
		Average age in years *	Owned **	Finance leases		
Consolidated fleet as at December 31, 2017						
Boeing 787-9	wide body	1.7	-	1	9	10
Boeing 747-400 PAX	wide body	25.1	6	-	-	6
Boeing 747-400 Combi	wide body	21.8	7	-	-	7
Boeing 747-400ER Freighter	wide body	14.5	3	-	-	3
Boeing 747-400BC Freighter	wide body	27.6	1	-	-	1
Boeing 777-300ER	wide body	6.2	1	9	4	14
Boeing 777-200ER	wide body	13.1	3	5	7	15
Airbus A330-300	wide body	-	-	-	5	5
Airbus A330-200	wide body	11.8	5	1	2	8
Total wide body		14.6	26	16	27	69
Boeing 737-900	narrow body	14.9	1	1	3	5
Boeing 737-800	narrow body	10.5	15	7	36	58
Boeing 737-700	narrow body	9.8	3	8	15	26
Total narrow body		10.5	19	16	54	89
Embraer 190	regional	7.3	2	13	15	30
Embraer 175	regional	0.8	1	11	-	12
Total regional		6.1	3	24	15	42
Training aircraft		-	4	-	-	4
Total consolidated fleet		10.6	52	56	96	204

* Excluding operating leases and training aircraft. The average age including operating leases is 9.4 years

** Excluding 1 B747-400 Combi not in operation as per December 31, 2017

Fleet composition



Boeing 777-300ER/200ER

Number of aircraft	14/15
Cruising speed (km/h)	920/900
Range (km)	12,000/11,800
Max. take-off weight (kg)	351,543/297,500

Maximum passengers	408/320
Total length (m)	73.86/63.80
Wingspan (m)	64.80/60.90
Personal inflight entertainment	



Boeing 747-400 Passenger/Combi

Number of aircraft	6/7
Cruising speed (km/h)	920
Range (km)	11,500
Max. take-off weight (kg)	390,100/396,900
Max. freight (kg)	35,000

Maximum passengers	408/268
Total length (m)	70.67
Wingspan (m)	64.44
Personal inflight entertainment	



Boeing 747-400ER Freighter

Number of aircraft	3
Cruising speed (km/h)	920
Range (km)	11,500
Max. take-off weight (kg)	412,800

Maximum freight (kg)	112,000
Total length (m)	70.67
Wingspan (m)	64.44



Airbus A330-300/200

Number of aircraft	5/8
Cruising speed (km/h)	880/880
Range (km)	8,200/8,800
Max. take-off weight (kg)	233,000/230,000

Maximum passengers	292/268
Total length (m)	63.69/58.37
Wingspan (m)	60.30/60.30
Personal inflight entertainment	



Boeing 787-9 Dreamliner

Number of aircraft	10
Cruising speed (km/h)	920
Range (km)	11,500
Max. take-off weight (kg)	252,650

Maximum passengers	294
Total length (m)	62.80
Wingspan (m)	60.10
Personal inflight entertainment/Wi-Fi on board	



Boeing 737-900

Number of aircraft	5
Cruising speed (km/h)	850
Range (km)	4,300
Max. take-off weight (kg)	76,900

Maximum passengers	188
Total length (m)	42.12
Wingspan (m)	35.80



Boeing 737-800/700

Number of aircraft KLM	27/18
Number of aircraft Transavia	31/8
Cruising speed (km/h)	850/850
Range (km)	4,200/3,500

Max. take-off weight (kg)	73,700/65,317
Maximum passengers	186/142
Total length (m)	39.47/33.62
Wingspan (m)	35.80/35.80



Embraer 190/175

Number of aircraft	30/12
Cruising speed (km/h)	850/850
Range (km)	3,300/3,180
Max. take-off weight (kg)	45,000/36,500

Maximum passengers	100/88
Total length (m)	36.25/31.68
Wingspan (m)	28.72/28.65



Flying to gorgeous Costa Rica

KLM added Costa Rica to its growing list of destinations in Latin America. Doing so required careful preparations and dealing with an extinct volcano.



Steven van Wijk
Senior Network Planner

Because KLM's Boeing 787-9 Dreamliner requires less maintenance, traditionally scheduled for the winter months, the company began to explore new winter destinations. Costa Rica, fabled for its gorgeous nature, quickly emerged as a contender.

Senior Network Planner Steven van Wijk worked on a business case that looked at financial and operational matters. Using predictive modelling and data from partners, Cargo and the regional offices, it quickly became clear that Costa Rica could be a profitable connection.

Operationally however, an unusual challenge emerged in the form of Irazu, the extinct volcano close to the airport.

"It turned out that in 5% of flights, the wind would come from a certain direction and the aircraft would have to carry less fuel in order to clear the volcano. That would necessitate an extra refuelling stop that inconveniences passengers and leaves less turnaround time at Schiphol before the aircraft heads elsewhere."

All these kinds of elements were integrated into the business case and when Costa Rica was given the green light, the schedule was loaded into the booking system and KLM began to promote the destination.

The inaugural flight was held on October 31, 2017 and was fully booked. As part of the commitment to sustainability, the Costa Rican government and KLM also announced plans to look for ways to fly from San Jose using environmentally friendly bio-based fuel.

Steven concludes that "we are proud that thanks to the entrepreneurial approach of network development KLM has added Costa Rica to its Latin American route network."

*"The secret
of success?
Stop wishing,
start doing."*

—

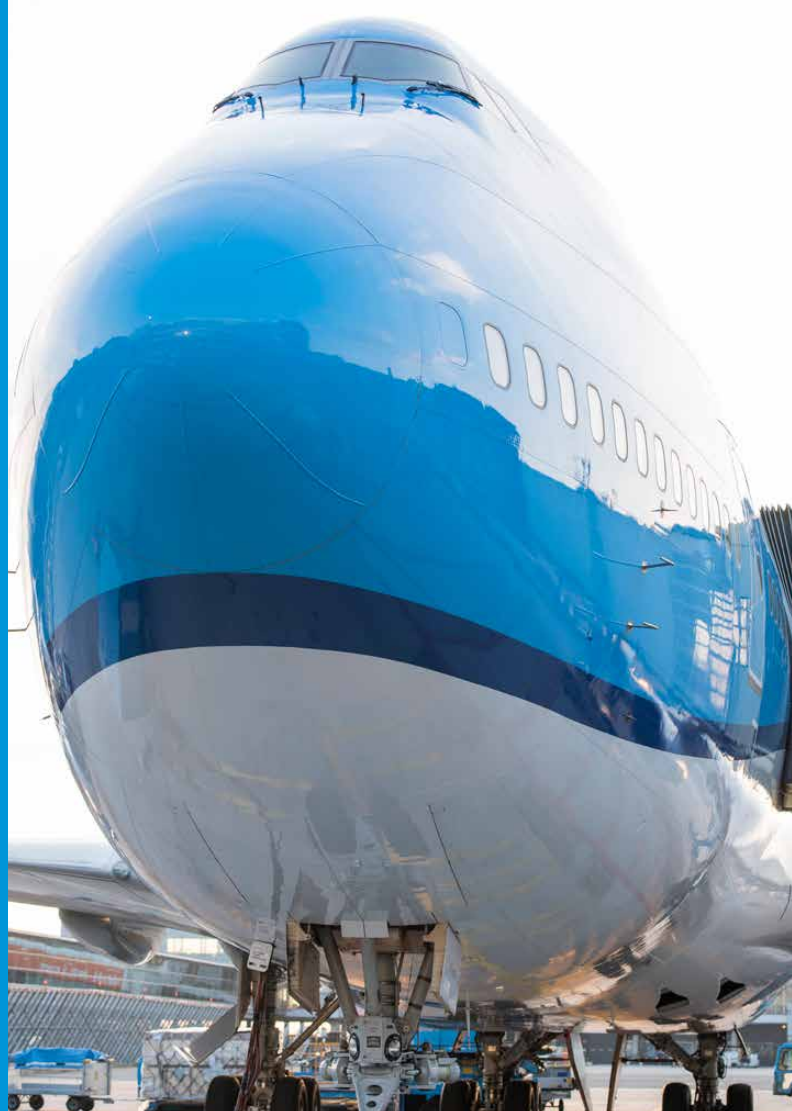
Author Unknown

Operations



A more integrated approach to operational analyses and safety, a broad range of innovations and highly committed staff meant KLM's operations proved their resilience in the face of strong network growth and operational constraints at Schiphol.

To become Europe's most customer-centric, innovative and efficient network carrier, KLM in 2015 adopted the Operational Excellence philosophy. This entails delivering on its customer promise safely, effectively and at the lowest overall cost by integrally reshaping all products, processes, control, organisation and information. After the many operational changes that were implemented in 2016, the goal for 2017 was to have a robust and stable operation with limited growth and as little complexity and variation as possible.



Operational challenges at Schiphol

The unexpected release in 2017 of the remaining capacity of Schiphol Airport changed the operating environment. The unforeseen capacity growth put pressure on KLM's resources and a strained infrastructure at Schiphol Airport. This changed the initial capacity and resource planning for 2017. Furthermore, 2017 was characterised by a significant higher number of disrupted days, with restricted Schiphol runway capacity due to bad weather conditions, compared to previous year.

In response KLM took severe operational measures. KLM is proud of the way staff handled this extreme situation. Engineering & Maintenance made ground teams available 24/7 and Flight Operations found a way to give certain critical flights priority at air traffic control. Ground staff meanwhile, did their utmost to help affected passengers, handle aircraft at the buffer and enable passengers to leave aircraft using the rear stairs and experiment with faster boarding methods. KLM also improved support for customers facing disruptions, including the Happy to Help trolley with refreshments and an app that allows passengers to rebook themselves.

Many other solutions were found and sacrifices made, and collectively they ensured operations stayed safe and stable. In fact, some of these operational measures have proven to be so effective, KLM has adopted them permanently. Despite these structural operational improvements, KLM was not able to realise the planned operational ambitions.

Innovation and digitisation were important themes in KLM's operations. In 2017 the company launched a number of apps and other tools that increase customer service and operational efficiency. Results include Bax@Risk, which predicts which passengers are likely to miss their flight (see story *The power of predictions*) and Optimiser, a tool for optimising the network schedule in the 14 days preceding a flight. PLUG, which provides real-time information needed to optimise turnarounds, was tested and will be launched in 2018.

Operational excellence

In 2017 KLM achieved a number of other changes. First, KLM began co-operating with the Delft University of Technology on the X-way of Working. The X-way of Working is a bottom-up approach to innovation through which employees imagine, test and learn from their own ideas, allowing KLM to balance rapid testing of promising concepts with operational safety. Second, the company launched

the new Operations Decision Support organisation, which is a key element of Operational Excellence. As a result, all operational analyses functions have been clustered in a single department to enable a single source of truth and more integrated operational decision support based on operational data and facts.

Safety

KLM continues to have a strong safety record. In 2017 KLM was recognised as the safest European full network airline with a 4th position in the yearly JACDEC Top 100 Safety Ranking and was awarded the highest safety ranking by the Airline Rating agency.

Also, the safety organisation and governance structure was re-organised in 2016 to enable further growth in this area. Acting on the four safety domains (Operational, Occupational, Environmental safety and Operational security) in an integrated way enhanced our knowledge on the risks that are at stake. It enables the organisation to develop and introduce appropriate mitigating actions. A large number of company-wide risk assessments and combined audits gave insight for further improvements.

To maintain the strong safety record, many initiatives are deployed each year. In 2017 the IT support tools were renewed by the introduction of the Qpulse system and innovation within the KLM's Safety-Data Warehouse, introducing new analytic tools. Elaborate training on many important safety issues, such as Just Culture and Reporting Culture, again raised the expertise level of KLM staff who work on continuous improvement in their daily work. KLM witnessed a decline in the number and severity of safety incidents both in the air and on the ground.

In 2017 a program started to improve Occupational Safety. This program included the development of KLM wide occupational safety policies and continuous Risk Inventory and Evaluation (RI&E) enhancements, the occupational requirements integrated with audits and the introduction of improvement programs per division.

A new layout of the Safety & Security Policy appeals to many colleagues throughout the company as is demonstrated by the fact that it was signed by thousands during an extensive road show. An unorthodox way of communicating around safety, using the format of a mini documentary, shows the pride of staff members throughout the company on KLM's safety ambition and records.

An internal safety culture survey conducted worldwide shows many improvements in consciousness, behaviour and attitude on working safely.

Variant flying

KLM operates part of its intercontinental flights with Boeing 777s and Boeing 787s. Because technically these two aircraft are different, pilots are normally qualified for only one type, making scheduling complex and inflexible. KLM is proud that in 2017 the majority of its Boeing 777 pilots were qualified for both variants, Boeing 777 and Boeing 787. KLM is the world's first airline to achieve variant flying and incorporated this into its daily operation. Working closely with Dutch regulators and the pilots union, KLM adapted its pilot training programs and safety processes. In 2017, on 120 occasions KLM was able to decide close to or on the day of departure which type of aircraft to use, resulting in more efficiency and higher utilisation of its fleet.

Cargo activity

After a long period dominated by economic turmoil and overcapacity, the cargo industry in general and KLM's business in particular bounced in 2017. Supply and demand became more balanced and yields increased. KLM was able to capitalise on this upturn because in recent years it had diligently restructured, lowered costs and dropped from 11 to four full freighters. In 2017, Cargo invested in partnerships, growth and digitisation and was able to contribute substantially to the Network business results of 2017.

2017 was a year of partnerships. KLM founded the Holland Flower Alliance, which gives growers a more reliable cool chain for their precious flowers, resulting in a higher quality product for consumers. KLM also signed agreements with China Southern Airlines and Jet Airways that will extend KLM's network to the Chinese and Indian markets. Furthermore, KLM joined forces with the Dutch government, Swiss Port, Kuehne + Nagel, and Jan de Rijk to form the European Green Fast Lane project. These partners will develop a digital trucking scheme that will reduce congestion at Schiphol and make KLM's workforce planning more flexible. Lastly, KLM worked with several non-airline stakeholders on a same-day delivery product to explore new commercial opportunities created by strong e-commerce growth.

Cargo has adjusted to the decrease in the number of freighters and resulting drop in main deck capacity, by positioning its combi capacity more towards forwarders and expeditors. That is why in 2017 KLM focused more on Small and Medium sized Enterprises (SME), which tend to operate in niche markets that offer higher yields. By investing in digital services for them through KLM's What Counts program, KLM increased its SME market share in its home market. Another major achievement in 2017 was the inauguration of the new sorter system, which automates various mail, express and pharma processes. This allows us



to capitalise on growth in the e-commerce and the pharma industry. Cargo was proud to welcome the giant panda's Xing Ya and Wen Wu as very special guests.

KLM's 2017 investments in digitisation make it a leader in the cargo industry. KLM integrated its reservation and booking system, which also uses big data technology to make predictions about how orders will evolve. KLM also launched the digital myCargo platform, which in the first nine months attracted a massive 15 per cent of business that previously would be conducted by phone. Clients can benefit from an intuitive system that quickly shows pricing across multiple days, creating a more dynamic process.

Engineering & Maintenance

Engineering & Maintenance provides KLM and other airlines with competitive aircraft, engine and component maintenance and engineering support. Engineering & Maintenance contributed to KLM's financial result through revenues from a growing number of third party contracts. In 2017, Engineering & Maintenance reduced the A-check turnaround time, prepared for Component Services 2.0 including business process redesign, increased the number of engine shop visits at Schiphol, performed the first third-party Boeing 787 G-check and developed capabilities for new products. Furthermore, Engineering & Maintenance finalised the cabin midlife upgrade for the Boeing 777-300 and commenced the seat densification project for the Airbus 330.

Innovation plays an important role at Engineering & Maintenance. It started experimenting with Virtual Reality training for staff, predictive maintenance using big data, robots for laser cladding and the digital Hangar of the Future. In addition, Engineering & Maintenance significantly reduced the number of managers as part of the High Performance Organisation and introduced teaming, resulting in more employee ownership and entrepreneurship.

Transavia

In 2017 KLM's low-cost subsidiary further improved business performance, posting a clearly improved operating result. Passenger numbers increased by 11 per cent, the load factor was 90.5 per cent (up 1.3 per cent from 2016), unit costs were reduced by 1.8 per cent and unit revenues increased by 3.8 per cent. In addition, Transavia added two Boeing 737-800 aircraft to its fleet. The network was rationalised, with the operational base in Munich closed according to plan in order to focus on the Dutch market to European destinations.

Next steps toward an agile organisation were taken through restructuring of the entire commercial organisation, outsourcing of IT support functions and reduction of overhead. The company continued its investment in memorable customer experiences through the development of the Transavia Interaction Platform, as well as experiments using chatbots and voice driven technology, from search to booking.

The power of predictions

KLM found an ingenious way to predict which passengers are likely to fail to board, preventing delays and unnecessary work.

Loading luggage into the belly of a narrow-body aircraft requires staff to haul heavy suitcases in cramped spaces. For security reasons, however, the luggage of a passenger who fails to board has to be unloaded. This is frustrating for staff and can lead to delays of up to 10 minutes or more.

Which made Shift Leader Ali Ergül wonder:

“What if KLM could somehow predict which passengers would fail to board?”

KLM listened to Ali and three months later tested the first version of Bax@Risk, a tool that by the end of the year could predict with up to 80% accuracy which passenger would fail to board.

Ali's light bulb moment was developed into an actual tool. “The amazing speed and surprising accuracy were the result of two factors. The first was using machine-learning technology to build a predictive model using historical and anonymous passenger data. The second factor was the X-way of Working, which allowed us to quickly test the tool in the live environment of Schiphol.”

Working at the gate with data scientists and other staff, Bax@Risk began to make predictions 145, 75 en 45 minutes prior to departure. After every prediction the accuracy would be checked and the results fed back into the model. “In the future we hope to make the model more accurate by incorporating live data from Schiphol's halls and security filters.”

Bax@Risk was tested in the summer of 2017 and went live on European flights at year-end. Due to this new tool delays and unnecessary work for our staff have been reduced.

Ali Ergül
Shift Leader

Traffic and capacity

Passenger	Passenger kilometers			Seat kilometers			Load factor	
In millions	2017	2016	% Change	2017	2016	% Change	2017 %	2016 %
Route areas								
Europe & North Africa	18,796	17,219	9.2	21,904	20,428	7.2	85.8	84.3
North America	21,388	20,344	5.1	24,012	22,888	4.9	89.1	88.9
Central and South America	14,302	13,632	4.9	15,963	15,500	3.0	89.6	87.9
Asia	27,445	26,607	3.1	30,356	29,973	1.3	90.4	88.8
Africa	11,239	10,648	5.6	12,859	12,407	3.6	87.4	85.8
Middle East	3,853	3,618	6.5	4,716	4,540	3.9	81.7	79.7
Caribbean and Indian Ocean	6,464	5,669	14.0	7,256	6,328	14.7	89.1	89.6
Total	103,487	97,737	5.9	117,066	112,065	4.5	88.4	87.2

Cargo	Traffic			Capacity			Load factor	
In million cargo ton-km	2017	2016	% Change	2017	2016	% Change	2017 %	2016 %
Route areas								
Europe & North Africa	17	22	(22.7)	364	337	8.0	4.7	6.5
North America	1,065	1,058	0.7	1,741	1,707	2.0	61.2	62.0
Central and South America	1,199	1,136	5.5	1,776	1,724	3.0	67.5	65.9
Asia	1,580	1,645	(4.0)	1,841	1,965	(6.3)	85.8	83.7
Africa	755	790	(4.4)	1,127	1,175	(4.1)	67.0	67.2
Middle East	142	150	(5.3)	244	250	(2.4)	58.2	60.0
Caribbean and Indian Ocean	85	71	19.7	287	236	21.6	29.6	30.1
Total	4,843	4,872	(0.6)	7,380	7,393	(0.2)	65.6	65.9

Transavia	Passenger kilometers			Seat kilometers			Load factor	
In millions	2017	2016	% Change	2017	2016	% Change	2017 %	2016 %
Route areas								
Europe & North Africa	16,386	14,740	11.2	18,107	16,528	9.6	90.5	89.2
Total	16,386	14,740	11.2	18,107	16,528	9.6	90.5	89.2

Overview of significant KLM participating interests

As at December 31, 2017

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)
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Associate

Transavia France S.A.S.	4
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Financial asset

Kenya Airways Ltd.	8
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*"The most
effective way
to cope with
change, is to
help create it."*

—

Author Unknown

People & organisation



The High Performance Organisation (HPO) was largely finalised, new staff were hired, KLM's Kompas and the Winning Way of Working was further integrated into the company's day-to-day work and two pension funds were derisked. These and other achievements contributed to KLM's improved results and renewed energy.

As part of its Perform 2020 plans, KLM in 2015 introduced the first plans for the HPO. 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 and empowered staff. In 2017, implementation of HPO was completed in all parts of the organisation, except for the Finance and Control organisation, which will be largely finalised in 2018.

The results of HPO became more visible in 2017. KLM delivered on its promise of increasing productivity, reducing unit costs and increasing the number of innovations. As a result of HPO, around 500 people have become redundant, 340 of whom have found a new position inside or outside of KLM with the help of the Transition Centre.

KLM's good control of unit cost was partly related due to new collective labour agreements concluded with pilots and cabin crew in 2015 and ground staff in 2015 and 2016, which stipulate productivity enhancements and profit sharing. KLM had been unable to negotiate a new deal with the cabin crew union in 2016. KLM therefore decided to reduce one cabin attendant on 40 per cent of intercontinental flights in order to realise productivity targets. This measure was maintained in 2017. At the end of 2017 KLM agreed on a new collective labour agreement with cabin crew union VNC. KLM aims at implementing the new collective labour agreement for cabin crew early 2018.

One major achievement in 2017 was that, after years of negotiation, the pilots and cabin crew unions agreed to shift pension funds from a defined benefit scheme to a collective defined contribution scheme.

Empowering staff

The KLM Kompas aims to increase staff engagement throughout the company. The KLM Kompas aligns ambitions for the desired customer experience with ambitions for the desired employee experience. In 2017, some 15,000 people were trained to work with the KLM Kompas, giving them a shared purpose, way of working and language. In addition team development sessions support staff in the transformation of KLM.

KLM staff benefited from new digital tools that made their work easier, as well as from profit sharing. In 2017 an amount of EUR 93 million was paid over financial year 2016 with an even higher payment of EUR 170 million to follow over financial year 2017. In addition, employee mobility improved. KLM hired some 1,300 new employees, which equals the number for the years 2013, 2014 and 2015 in total. The number of hires was the largest at Inflight Services, with over 500 new cabin crew hired and 700 cabin crew promoted to new positions. Recruiting and training these new colleagues to keep up with the growth of KLM's network was quite a challenge.

In 2017 the Human Resource (HR) organisation itself was further developed. As part of its HPO efforts, HR digitised hundreds of forms, introduced digital insight in leave days, created a centralised Learning and Development department, and launched a HR Shared Service Centre that treats staff more and more like internal customers. In addition, HR began to genuinely embrace strategic workforce planning, which enables KLM to take a structured approach to defining and realising the workforce needed over the coming five years. Furthermore, HR began to use HR analytics to enable data-driven decision-making.

As part of the 2016 collective labour agreement with ground staff, KLM launched a EUR 7 million Development and Training Fund for ground staff. In a digital environment staff can sign up for a variety of training programs, online tests and (financial) online advice. The Fund was extensively promoted in the operational divisions and is already frequently being used.

In line with the Net Promoter Score that was introduced in 2015, KLM began to experiment with an Employee Promoter Score, or EPS. In 15 departments, the EPS tool collected anonymous feedback from employees about their team, which was used to start a team development dialogue. KLM intends to increase the usage of this tool and extend it by creating an organisation-wide measurement tool.

Empowering ground staff to touch passengers' experiences

KLM's accelerated embrace of digital services is transforming the way ground staff support passengers that pass through Schiphol airport. Key to this is Appy2Help.



Francis Abidi
Ticketing Agent

When KLM in 2016 introduced iPads for all ground staff, it included an app called Appy2Help. Ticketing Agent Francis Abidi, who is part of a team of testers, helped the app become a digital hub for ground staff helping passengers at all points during their journey.

"The app is just great. For example, staff can check in passengers, scan their passport or boarding pass, and assign seats. But they can also pull up a full customer profile and make them a member of KLM's Flying Blue loyalty program," Francis explains.

Appy2Help is also proving helpful to passengers who are facing disruptions. "In the past, delays would lead to long lines of frustrated passengers waiting to be rebooked. Now my colleagues and I walk up to them and instantly rebook them with the click of a button."

Another advantage is that ground staff themselves have become more flexible.

"Everybody can rebook and send a final boarding alert via SMS to passengers. We can perform each other's tasks."

While passengers feel more recognised and touched, ground staff are happy they can go the extra mile. The bottom-up development process was key. "I feel like KLM is listening to me and my colleagues on the ground. The app is built exactly the way we want it and every feature we add serves a crystal clear purpose."

*"The future
depends on what
you do today."*

—

Mahatma Gandhi

Innovation



2017 brought a refreshing wave of innovation across the whole of KLM, through disruptive experiments in cutting-edge technologies, partnerships, and the development of digital apps. This marks the strengthened emphasis on innovation that leads to more satisfied customers and better results.



Incremental and disruptive innovation

In 2017, KLM pursued two types of innovations: those that lead to incremental improvements of day-to-day processes and disruptive experiments that can pave the way for radical changes.

The first type saw substantial achievements throughout the year, and built on investments done in earlier years. Using this foundation, KLM launched a broad range of apps that empower customers and staff with quick decision-making and timely information.

Proactive and timely care

Ground staff, for example, began working with the APPron app (see story *Saving precious time: APPron*), which allows for the efficient loading of aircraft and consequently quicker departure of flights, and the Appy2Help app (see story *Empowering ground staff to touch passengers' experiences*), which empowers staff across Schiphol to provide customers with more proactive and timely care. In addition, KLM began testing PLUG, which creates a coherent view of an aircraft's turnaround process in order to reduce the number of small delays.

Cabin crew saw their My Flight app receive new functionalities, while Cargo launched myCargo, a digital portal for customers that results in increased efficiency and more customer satisfaction. For pilots, KLM has developed Flight Deck, which gives pilots useful information about departure times and their roster. Engineering & Maintenance staff are also being supported by digital innovations, for example an app that provides a 3D look at the cabin for a quicker identification of broken chairs, which reduces valuable time needed for seat inspections.

Disruptive innovation

KLM is also investing in cutting-edge technologies, such as blockchain, drones, artificial intelligence in customer interaction and virtual reality training. These experiments are led by KLM's own Digital Studio, which was launched late 2016 and has become a true catalyst for change. The studio brings together some 200 people from across KLM in project teams focused on passengers, cargo, maintenance, human resources and finance. Acting from the belief that KLM's employees can be the biggest innovators, the Digital Studio broadly involves KLM staff in the conception and development of new ideas.

The Digital Studio supports digital innovation with designs for truly user-centric solutions, state-of-the-art engineering and Agile way of working. Product teams in the Digital Studio deliver products within short timeframes and experiment with new technologies. In 2017 the Digital Studio experimented with new technologies for equipment and baggage tracking, applied chatbots for commercial and internal purposes and tested augmented reality to improve throughput times of maintenance processes. Experiments that are successfully tested at X-gates, were scaled up for operations.

Partnerships

In addition to committing to experiments with emerging technologies, KLM is boosting its innovation efforts through partnerships with start-ups, academic institutions and research & development facilities. This allows KLM to acquire technologies rather than develop them in-house, and keep a close watch on promising developments worldwide. The artificial intelligence incorporated into Facebook Messenger, for example, was developed in co-operation with a Silicon Valley start-up.

Saving precious time: APPron

In 2017, KLM launched APPron, a new app to help ground staff load luggage and cargo into the aircraft and get the total ground process ready for take-off. This shaves vital minutes off the process and results in happier staff and customers.

While passengers are boarding, ground staff are busy loading luggage and cargo into the belly of the plane. This is done according to a predetermined load plan, which accounts for weight differences and technical restrictions. In the past, a paper version of the plan would be taken to the plane and any changes would be called through to the pilot using a walkie-talkie. KLM decided to launch APPron, a new app for loading luggage and cargo.

Patrick van Exel, Shift Leader was involved.

“We began with a clean slate and imagined an app that would perfectly fit the customer journey and the way we work on the ground.”

Later, Patrick and some colleagues locked themselves up with IBM and Apple staff for three days of pressure cooker brainstorming. “In January 2017 the app, which we named APPron, got the green light at KLM. The first results were very encouraging and we quickly expanded the user group and included more features.”

“APPron has a better work flow, improved connectivity and is user-friendly. Already in the first version we can better monitor the total ground process. We are able to identify which luggage is missing, which passenger still need to board and which containers could be loaded. With the click of the button the load sheet can be sent to the pilot’s iPad for final check-up. Our work has become easier and we already shaved several minutes off the whole process. This is precious time!”



Patrick van Exel
Shift Leader



Sustainability

In 2017 KLM took a next step in transforming its Corporate Social Responsibility (CSR) approach to a sustainability strategy with the primary goal of long-term value creation for both KLM and society. AIR FRANCE KLM was ranked second in the Dow Jones Sustainability Index, which is a respectful confirmation of our efforts on Corporate Social Responsibility.

By capitalising on the value of its network and operations, and by reducing its environmental footprint, KLM contributes to the position of the Mainport Schiphol and the United Nations Sustainable Development Goals (SDG). In particular, KLM focuses on SDG 7 (Affordable and Clean Energy), 8 (Decent Work and Economic Growth), 9 (Industry Innovation and Infrastructure) and 13 (Climate Action). This focus is in line with the feedback from our materiality assessment and the stakeholder dialogue that was organised in the spring of 2017. During this event customers, government representatives and other stakeholders emphasised that KLM should focus on climate change, sustainable mobility and economic growth. KLM remains committed to reducing its CO₂ emissions per passenger by 20 per cent in 2020 compared to 2011 levels.

In 2017, KLM reduced emissions by 4.1 per cent compared to 2016 in part because of the delivery of more fuel-efficient aircraft. The Boeing 787-9 Dreamliners and Embraers that joined the fleet emit around 35 per cent less CO₂ than the aircraft they replaced. KLM compensated over 830,000 tonnes of CO₂ through the EU Emission Trading Scheme.

A total of 60,000 passengers reduced their flight footprint by offsetting over 29,000 tonnes of emissions through KLM's CO₂ZERO compensation service. KLM is committed to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) that provides a global approach towards CO₂ neutral growth, congruent with the global nature of climate change and the aviation industry.

In line with KLM's strategy to develop a market for sustainable biofuels, KLM operated a daily flight from Los Angeles to Amsterdam with sustainable biofuels made from used cooking oil. Sustainable biofuel offers an 80 per cent reduction of CO₂ emissions compared to regular jet fuel. By welcoming Delft University of Technology and Air Traffic Control the Netherlands to the Corporate BioFuel Program, KLM continues to promote the use of sustainable biofuels. In addition, KLM signed a Letter of



In 2017 KLM took a next step in transforming its Corporate Social Responsibility (CSR) approach to a sustainability strategy with the primary goal of long-term value creation for both KLM and society.

Intent with the government of Costa Rica to investigate the feasibility of local sustainable biofuel production.

KLM is also committed to reducing the CO₂ emissions of its ground operations by 20 per cent in 2020 compared to 2011. In 2017, a total reduction of 17 per cent compared to 2011 was achieved. This is the result of continuous energy efficiency measures that realised a 5 per cent reduction of electricity use in 2017, and of stabilising emissions of engine testing, ground equipment and gas use despite KLM's growth. Similarly, the total waste volume stabilised despite a strong growth of passenger volume.

KLM has adopted a zero tolerance policy regarding illegal wildlife trade. KLM has signed the Declaration of the United for Wildlife (UFW) Buckingham Palace Declaration on the illegal trade in wildlife. In 2017, KLM began to collaborate with Wings of Support, a private initiative by KLM staff aimed at helping children at KLM destinations by means of facilitating education, shelter and medical care. Through KLM's communication channels colleagues are invited to support this initiative.



Risk management and control



The KLM In Control Statement is the KLM approach to comply with the Dutch Corporate Governance Code 2016. The purpose of the Code is to facilitate - with or in relation to other laws and regulations - a sound and transparent system of checks and balances and, to that end, to regulate relations between the Management Board Council, the Supervisory Board and the Shareholders (including the General Meeting of Shareholders).

Compliance with the Code contributes to confidence in good and responsible management of companies and their contribution into society. Building blocks of the In Control Statement are the next two paragraphs on Risks and Risk Management and on Control and Monitoring. The In Control Statement can be found in the Board and Governance paragraph.

Risks and risk management

KLM is exposed to the general risks associated with the air transport industry and with airline operations, and consequently has a system to identify, analyse, monitor, manage and control risks. A distinction is made between strategic, operational, compliance and financial risks. Strategic risks are related to KLM's strategic choices, operational risks are related to operational activities, compliance risks are related to applicable laws and regulations, and financial risks are related to financial and market developments. The financial risks are also elaborated upon in the Financial Risk Management section 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 risks can also have an impact on KLM's brand, reputation, profitability, liquidity and access to capital markets.

Risk profile

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. Especially increased attention for environment can have impact on KLM. KLM is fully aware of this risk profile and has a risk management process and internal control monitoring in place to manage this profile.

Risk appetite

The risk appetite of KLM differs per type of risks:

- » Strategic: with a mission 'to become Europe's most customer-centric, innovative and efficient network carrier' taking and accepting strategic risks are inevitable;
- » Operational: KLM operations are diverse. KLM accepts zero risks in the field of flight safety and operational safety, other operational risk are considered in view of the (daily) business;
- » Compliance: KLM is averse to risks that could jeopardize compliance with applicable external and internal laws and regulations; and
- » Financial: KLM is averse to risks that could endanger the integrity of finance and reporting.

Risk management process

KLM has implemented a system to identify, analyse, monitor, manage and control 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 KLM-wide risks takes place.

Every three months, KLM divisions, departments and Group entities update its decentralised operational risks sheet that contains an outline of risks, the probability these risks will occur, the potential financial impact and mitigating actions taken or proposed. Risks are discussed within the management teams owning the risks. Both specific decentralised 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 outlines the strategic risks as well as the related action plans within the context of establishing the AIR FRANCE KLM Group's strategy. These risks and action plans are discussed by the AIR FRANCE KLM Group Executive Committee.

Strategic risks – 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, such as the high-speed rail network in Europe. In addition, KLM faces competition from low-cost airlines for European point-to-point traffic. To increase revenues per seat, some of the low-cost airlines adopt a more hybrid model by also focusing more on the business travel market. KLM expects downward pressure on airfares in Europe to continue.

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 global 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 and Turkish 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.

Mitigating action(s): 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 and 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 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 larger cargo capacities than the types they replace. As a result, cargo unit revenues are under pressure.

Mitigating action(s): KLM addresses the risk by structurally lowering unit cost and has reduced the number of full freighters.

Risks linked to the cyclical nature of the air transport industry

Local, regional and international economic conditions can have an impact on KLM's activities and financial results. Periods of economic crisis 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.

Mitigating action(s): KLM monitors demand closely to be able to adjust capacity while reinforcing the flexibility of the fleet via operational leases.

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 higher cost base in the winter.

Mitigating action(s): To reduce seasonality cost KLM uses flexible networking planning, temporary personnel during peaks and projects and seasonal maintenance.

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 a material impact on the profitability. Furthermore, any change in the US dollar relative to the Euro also results in a deviating fuel bill.

Mitigating action(s): 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.

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

Any terrorist attack or threat, or a military action may have a negative effect on KLM's 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.

Mitigating action(s): KLM has an Integrated Safety Management System, contingency plans and procedures that enables the company adapt quickly to changing environments and to 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 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 EU Council of Ministers Regulation 95/93. Pursuant to this regulation, at least 80 per cent 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 negative impact in terms of market share, results or even future development.

Mitigating action(s): 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 Schiphol almost reached its maximum capacity, therefore access to new airport slots will be limited.

Risks linked to the passenger 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.

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. Another issue is the emergence of claim agents who assist passengers in claiming compensation from airlines. Due to the spectacular growth of the number of claim agencies, the number of claims for compensation ending up in court has grown substantially.

Outside the Europe Union, air passenger rights apply, but sometimes conflict with other passenger rights. This can lead to regulatory conflicts.

Mitigating action(s): KLM supports a global standardisation of passenger rights, also in light of a level playing field and the competitive position of EU carriers.

Risks linked to competition from aircraft, engine and component manufacturers in maintenance

Aircraft, engine manufacturers and aircraft component manufacturers are rapidly expanding its after-sales departments to offer customers increasingly integrated aircraft maintenance solutions. This positioning corresponds to a long-term strategy based on leveraging intellectual property by selling licenses to maintenance providers seeking to exercise its business activity on certain products. Ultimately, if it were to result in reduced competition in the aviation maintenance market, this trend could have a material adverse impact on airline maintenance costs. This trend is escalating, especially with the arrival of new aircraft such as the Embraer 190/175 or Boeing 787. The ability to maintain balanced competitive conditions is a priority objective for commercial activity in maintenance and to contain the Group's maintenance costs.

Mitigating action(s): KLM discusses OEM license agreements, and is actively developing scenarios for further discussions with manufacturers.

Risks linked to the environment

The air transport industry has to manage its impact on the environment and is subject to numerous environmental laws and regulations, 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 its operations.

Mitigating action(s): KLM is best in class in fuel efficiency and reducing CO₂ emissions and has the ambition to go beyond the target, set by the International Civil Aviation Organisation (ICAO). In order to reduce our CO₂ emission by 20 per cent in 2020 compared to 2011 levels, the KLM Group is acting to reduce its fuel consumption and carbon emissions by:

- » Fleet renewal, improved fuel management, 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; and
- » Cooperation with the relevant National, European and International authorities, e.g. on optimisation of traffic control and by creating effective market-based solutions to manage climate impact in the aviation industry.

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 minimising noise pollution is supported with an active dialogue in the Omgevingsraad Schiphol. Due to growth at Schiphol over the last years, dialogues intensified to minimise noise pollution and safeguarding connectivity in KLM's network within the agreed operational restrictions.

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

In 2010, the global aviation industry agreed to stabilise emissions from 2020. In 2016, ICAO concluded the global climate agreement for international aviation, in which 72 countries will participate in the first stage, covering more than 80 per cent of the global routes from international aviation.

The European Commission implemented the Emissions Trading Scheme (EU ETS)¹ covering global emissions from flights within, to and from Europe. In November 2017 the EU decided to extend the current intra EU scope of EU ETS until 2023. It is still uncertain how EU ETS will be aligned with the proposed global ICAO measure.

Mitigating action(s): Besides mandatory offsetting, KLM also offers a voluntary offsetting program to its passengers to fly CO₂ neutral by means of high-quality offsets with Gold Standard certification. KLM hedges the EU ETS price two years forward to limit the price volatility.

¹ The principle of the European Emissions Trading Scheme is that each Member State is allocated an annual allotment of CO₂ 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 CO₂ 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).



Operational risks – risks related to the operations of KLM

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.

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

Mitigating action(s): KLM has taken a number of operational initiatives to safeguard its operational integrity, in order to deliver a high-quality service to its customers. The Operations Control Center, where all network-related decisions on the day of operations are taken, is central to ensuring operational integrity.

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.

As accident risk is inherent to air transport, each AOC holder is required to adopt a predictive and pro-active approach that 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 2017 for KLM without any findings. Martinair and KLM Cityhopper also passed the renewal audit.

Due to the decision to also codeshare with Delta Air Lines, Transavia renewed the IOSA certificate in June 2017.

Mitigating action(s): KLM continuously aims to 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.

Safety and security

Safety and security are fundamental elements of KLM operations and a prerequisite for customer satisfaction. KLM is committed to continuously improving the safety of its operations, its personnel, its customers and passengers.

Mitigating action(s): KLM builds 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 and operational security.

IT risks and cybercrime

The IT and telecommunications systems are of vital importance to day-to-day operations. They comprise the IT applications in the operating centers that are used through the networking of tens of thousands of different devices.

IT systems and the information they contain may be exposed to risks concerning continuity of functioning, data security and regulatory compliance. These risks have diverse origins from both inside and outside of the company. The materialisation of one of these risks could have an impact on KLM's activity, reputation, revenues and costs, and thus its results.

Mitigating action(s): The secure functioning of the IT systems is monitored on a permanent basis. Dedicated help centers and redundant networks guarantee the availability and accessibility of data and IT processing in the event of major incidents.

The AIR FRANCE KLM Group's IT division implements security rules aimed at reducing the risks linked to new technologies, particularly mobile data terminals. The access controls to IT applications and to the computer files at each workstation together with the control over the data exchanged outside the company all comply with rules in line with international standards.

Mitigating action(s): Campaigns to raise the awareness of all staff to the potential threats to encourage best practices are regularly carried out. Specialised companies, external auditors and Internal Audit, comprising IT experts, regularly evaluate the effectiveness of the solutions in place.

Data security is a priority, especially the protection of data of a personal nature pursuant to the laws and regulations requiring its strict confidentiality. New EU legislation, the General Data Protection Regulation (GDPR), will become effective in May 2018. This legislation calls for pro-active control over all personal data processing, embedding accountability, transparency and data subjects rights into the organisation. Non-compliance may lead to severe enforcement with penalties at a maximum of 4 per cent of the yearly turn-over.

Mitigating action(s): KLM has launched a project pertaining to the critical elements of GDPR, preparing the business to take responsibility. The project is led by the Data Protection Officers (DPO), together with business and IT and is on schedule to comply to GDPR by May 2018.

The risk of damage to IT facilities is covered by an insurance policy but the risk of the operating losses that such damage might entail isn't. As with any business making extensive use of modern communication and IT data processing technologies KLM is exposed to threats of cyber criminality.

Mitigating action(s): To protect itself against this risk, the AIR FRANCE KLM Group deploys substantial resources aimed at ensuring business continuity, data protection, the security of personal information pursuant to the law, and the safeguarding of at-risk tangible and intangible assets.

The Cybercrime program, approved by the AIR FRANCE KLM Group Executive Committee, covers the prevention and detection procedures such as cyber threat surveillance, evaluations of Information System security and tests to pinpoint any Information System incursions via the internet. There are regular awareness-raising campaigns on IT security for staff across the company.

Risks linked to labour disruptions

Labour costs 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.

Mitigating action(s): KLM fosters social dialogue and employee agreements among others in order to prevent the emergence of a conflict.

Risks linked to the reduction of labour cost

The cabin crew Collective Labour Agreement (CLA) expired in April 2016. In 2017 CLA negotiations have been conducted with the cabin crew unions. The identified risk regarding the willingness to achieve further productivity improvement materialised as cabin crew organised limited industrial action. An agreement was made with the largest of the two cabin crew unions (VNC), which significantly reduced the chance of industrial action.

At the end of 2017, and the beginning of 2018, CLA negotiations with both cockpit crew and ground staff started. These may cause a risk of industrial action, which could potentially harm KLM's activities and financial results.

Mitigating action(s): KLM fosters social dialogue and employee agreements among others in order to prevent the emergence of a conflict.

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 the Group's activity and financial results.

Mitigating action(s): 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 the Group's different operating entities to ensure the long-term viability of all commercial and operational activities.

KLM has implemented specific policies to ensure compliance with anti-bribery and corruption for sales representatives that are used by the maintenance business. KLM monitors compliance with such policies and will implement further control enhancements to reduce the risk of non-compliance with these policies.

Compliance risks – risks related to non-compliance to applicable laws and regulation

Risks linked to changes in International, National or regional laws and regulations

Air transport activities are highly regulated, particularly with regard to the allocation of traffic rights, time slots and conditions relating to operations like safety standards and security, aircraft noise, CO₂ 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. Brexit will influence EU decision-making in the near future.

Implementation of a Single European Sky is still 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. 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, meaning that further growth at Schiphol is possible after 2020. Till then growth will be facilitated at Lelystad Airport. The government policy has been complemented with an Action Agenda Aviation, drafted in 2016.

Mitigating action(s): For KLM it is important to monitor that the implementation of 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. 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.

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 Union in December 2015. The new fine for KLM and Martinair, as announced on March 17, 2017, amounts to EUR 142.6 million. On 29 May 2017, KLM submitted its appeal to the General Court of the EU. While the decision is under appeal, there is no obligation to pay the imposed fines. Reference is made to note 21 "Contingent assets and liabilities" of the consolidated financial statements.

Mitigating action(s): To KLM, compliance (in general) has top priority. Various programs and procedures aimed at preventing a breach of antitrust legislation, such as online training modules and on-site and tailor-made training sessions have been implemented and staff appointed. KLM will further expand 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.

Mitigating action(s): The joint venture is fully approved for 10 years. The joint venture was granted antitrust immunity from the US Department of Transport in 2008. In 2018, the existing joint venture between AIR FRANCE KLM, Delta Air Lines and Alitalia and the existing joint venture between Delta Air Lines and Virgin Atlantic will be further combined within a single global joint venture between AIR FRANCE KLM, Delta Air Lines and Virgin Atlantic as announced in July 2017. This joint venture will enable the AIR FRANCE KLM to extend the partnership over a 15-year period.

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.

Mitigating action(s): The honouring of the commitments is closely monitored and the related (information) dialogue with the European Commission is ongoing.

Legal risks and arbitration proceedings

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. Where applicable provisions are included in the consolidated financial statements and/or information is 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.

Mitigating action(s): Any and all proceedings and investigations are duly addressed and claims defended. External counsel is appointed. Where applicable, provisions are included in the consolidated financial statements and/or information is being included in the notes to the consolidated financial statements as to contingent liabilities.



Financial risks – risks related to integrity of finance and reporting

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 AIR FRANCE KLM holding. 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.

Mitigating action(s): AIR FRANCE KLM has set up a Risk Management Committee to manage the financial risk and keep them within predetermined budgeted margins, as described in the part Financial Risk Management.

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.

Mitigating action(s): 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. Following positive taxable profits in the last couple of years a substantial part of the tax losses carried forward have been utilised. If 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.

Mitigating action(s): 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 as per December 31, 2017 is the KLM ground staff pension plan 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. On the one hand this has resulted in, among 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 statement of profit or loss 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 KLM ground staff pension plan 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.

Mitigating action(s): In 2016 KLM began to modernise the three KLM pension plans. Pensions will remain a key employment benefit, but the current pension schemes must be redesigned.

In 2017 KLM concluded new defined contribution (Collective Defined Contribution) pension contracts for the KLM cabin and cockpit crew pension plan based in the Netherlands, and consequently derecognised related pension assets. The KLM ground staff pension plan can create an accounting volatility in KLM's equity. The cash risk on recovery premiums for the ground staff pension plan is limited based on the funding agreement between the pension fund and KLM. The regular premium level is fixed. Given the longer allowed recovery time and recovery strength of the fund itself this clearly also limits cash risks.

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.

Mitigating action(s): 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. Following the new defined contribution pension contracts for KLM cabin and cockpit crew concluded in 2017, the non-cash remeasurements in "Other Comprehensive Income" lowered significantly, but is still applicable to the KLM ground staff plan. 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.

Insurance coverage

KLM and Air France have pooled its airline risks in the insurance market in order to capitalise on its 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) 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 to them 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 these analyses are:

- » In general, KLM's financial risk profile has improved due to a combination of developments and achievements;
- » Equity volatility risk has reduced considerably compared to last year as a result of a successful de-risking of two of the company's three pension schemes. Both the cockpit crew pension scheme and the cabin crew pension scheme have migrated from a Defined Benefit to a Defined Contribution scheme;
- » Equity is still positive thanks to strong profitability in 2017 and despite the negative impact on the Equity level due to the de-risking of both pension schemes;
- » Another relevant risk has been mitigated: the potential equity volatility due to the introduction of IFRS16 on January 1, 2018, as a result of USD volatility (influencing the related off-balance sheet obligations that will be brought on-balance and are denominated in USD and reported in EUR). This potential volatility has been substantially mitigated due to a natural hedge provided by future USD revenue streams;
- » Net Debt and Adjusted Net Debt were lowered in 2017, enabled by the net effect of a positive free cash flow exceeding the limited growth of (capitalised) operating leases;
- » The current macro-economic situation developed favourably, boosting demand that was reflected by a robust unit revenue development throughout 2017;
- » 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 is 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; and
- » KLM has ensured that the scenario and financial sensitivity analyses were based on an up-to-date business plan that has been built up from realistic business and financial parameters, taking into consideration the trends in the current business environment as well as the continued implementation of internal reform programs.

KLM will retain to apply its low appetite for financial risks programs 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 carefully managing 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.

Control and monitoring

The foundations of KLM's Internal Control System are the regularly performed processes in the areas of Risk Management, Safety Management, (Internal) Control Management, Compliance and Fraud and the Management Control cycle.

KLM uses the COSO (Committee of Sponsoring Organisation of the Treadway Commission) 2013 standards for internal control. According to these standards, internal control is a process, defined and implemented by the executives, businesses and employees to provide a reasonable level of comfort regarding:

- » The reliability of the financial information;
- » The compliance with the laws and regulations in force; and
- » The performance and optimisation of operations.

KLM has organised its operations in such a manner as to anticipate risks and minimise exposure. For that purpose KLM has dedicated departments or functions to manage and control the risks in daily activities, in line with the risk groups, as defined in the chapter on Risk and Risk Management.

Next to the control organisation, additional comfort and/or mitigation is given by the departments of Internal Audit, Legal and Insurances.

As with any control system, it is not possible to provide an absolute guarantee that risks will be totally eliminated.

Risk management

The Risk Management process is described in the chapter Risk and Risk Management.

Safety management

KLM has set up a Safety and Security Organisation to ensure compliance with the principle of secure, safe and effective operations.

Safety review board

The Safety Review Board (SRB) is a strategic meeting chaired by the Accountable Manager (Chief Operating Officer) that deals with high-level issues.

The SRB sets the safety policy and provides the platform to:

- » Monitor the safety and compliance performance against safety policy and objectives; and
- » Ensure appropriate resources are allocated to achieve the desired safety and compliance performance.

The SRB sets strategic safety directives, including the company's safety goals. The Management Team Operations (MTO) as the corporate Safety Action Group monitors if these goals are being met, safety risks are identified and any necessary corrective action is taken in a timely manner.

Operational responsibility for safety and compliance, including the implementation of mitigations, resides with the Nominated Person or Head of Division and ultimately, the Accountable Manager. The corporate safety services organisation ensures that the measures applied by all the Company's entities are consistent.

The main objectives of the SRB are the execution, communication and promotion of KLM's Safety Policy and the review of the Integrated Safety Management. The SRB allocates the appropriate resources to ensure the proper execution of safety and compliance.

Integrated safety management system board

The Integrated Safety Management System Board (ISMS Board) is a strategic meeting and is chaired by the Accountable Manager Air Operator Certificate. The ISMS Board sets policies, procedures and methods with respect to the delivery of safety services. Its objective is the continuous development of the ISMS for KLM, KLM Engineering & Maintenance and KLM Cityhopper and to ensure the effectiveness of KLM's ISMS processes, procedures and methods with respect to safety and compliance monitoring. The ISMS board allocates the

appropriate resources to ensure the proper execution of safety and compliance monitoring.

Safety & compliance execution

It is the responsibility of the divisions and business units within KLM to work safely and in accordance with legislation and agreements (KLM policy).

Advice and support for this responsibility is organised both decentrally and centrally. The Integrated Safety & Compliance Manager (ISCM) within the (decentral) line organisation is responsible for the implementation of KLM's safety policy and related culture. Each ISCM has a direct line and access to the highest responsible manager in the division or business unit.

Safety & compliance monitoring

The Integrated Safety Services Organisation (ISSO) is a centralised independent support department, which is responsible for monitoring, measuring, policy and advice.

Legal & business ethics compliance organisation

KLM has set up and implemented a legal and business ethics Compliance Framework, which was adopted by the Board of Managing Directors and the Supervisory Board in December 2016. The Framework ensures staff are capable of adhering rules of conduct, internal procedures and relevant laws and regulations.

The KLM Compliance Charter is released by the Board of Managing Directors and subsequently adopted by the Supervisory Board. Its target audience are all employees and regular temporary workforce. Its purpose is to inform the target audience regarding the principles, roles, tasks and responsibilities of the compliance function within the company.

The corporate compliance monitor provides an overview of the compliance status of KLM. The compliance monitor is discussed with the Supervisory Board.

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 the identification and prevention of fraud. 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.

Control management

KLM has set up an Internal Control organisation and a system of internal controls in order to provide reasonable comfort regarding reliability of accounting and financial information and to comply with the applicable laws and regulations.

The Internal Control Office (embedded in the Corporate Control department) supports and guides all activities in relation to internal controls. Principles are laid down in the Internal Control Charter.

Within the businesses and at corporate level Internal Control Coordinators are appointed to monitor the Internal Control activities. An important part of the Internal Control Coordinator's activities is to oversee the yearly testing of the entity level controls, the testing of the operational effectiveness of the transaction level controls in the financial disclosure processes and the testing of the IT general controls that are relevant for the financial disclosure processes. The results of the testing are also one of the cornerstones for signing the Document of Representation (DoR) by the business executives and business controllers. The Internal Control Office is responsible for the governance and principles of internal control as well as the communication towards Internal Control Coordinators. Next, the Internal Control Office reports on the result of the internal control testing to Financial Management and performs quality reviews to monitor the application of internal control principles by the business.

Business management and their Internal Control Coordinators are responsible for executing an annual risk assessment to determine e.g. changes in their scoped processes, additional or changed (IT) systems, the impact of open issues from testing and/or the Management Letter issued by the external auditors. The appropriate execution of controls as well as the validation of this execution is also the responsibility of business management.

On pre-defined dates during the year the Internal Control Coordinators have to report the progress of testing and detected issues to the Internal Control Office. Based on these business reports, an overall KLM Group Internal Control Monitor is maintained, published and shared with Financial Management.

The use of a DoR is incorporated in the internal reporting procedures. It requires the business executives and business controllers in the KLM Group to confirm at the end of the financial year the reliability of the figures they submit and their control procedures and to report detected issues that could not be repaired before year

end. It also underlines their responsibility for transparent accounting procedures, adequate risk management and the establishment and operating of an adequate internal control framework.

Based on received information from the businesses in the DoR and the Internal Control reporting during the year, at year end an Internal Control memo is prepared which is shared with the Board of Managing Directors. This memo contains a summary of the performed controls, detected issues (solved issues and open) and an indication regarding the materiality level of the open issues.

Management control cycle

KLM's organisation is based on the Network Business, in which both Passenger and Cargo activities are combined, Engineering and Maintenance Business, Leisure Business and Central Staff functions and the Subsidiaries controlled by KLM.

The AIR FRANCE KLM Group budget and three-year plan process is fully aligned. This alignment not only relates to common key assumptions but also to timing and review meetings. KLM's part of this aligned budget and three-year plan process is managed by KLM's Corporate Control Department and implemented in the three business segments and ten of KLM's most significant subsidiaries, thus covering almost the entire business of KLM.

A management report is sent every month by each of the businesses analysing the monthly development of the financial results in relation to the forecast, budget and previous year. Furthermore these management reports built up to the operational performance of the Company. The management reports are discussed with responsible managers of the businesses and the Board of Managing Directors in Monthly Review Meetings. KLM's most significant subsidiaries are monitored through KLM's Corporate Strategy Department and Corporate Control Department on a monthly basis. KLM Board members are represented in the management of the most significant subsidiaries.

Planning & control process

This process is based on the following three structural procedures:

- » Group Strategic Framework which is updated annually in close cooperation with Air France and AIR FRANCE KLM;
- » Corporate three-year plan which determines which growth and investment is needed to realise the Company's vision. The corporate budget for the next financial year is fully embedded in the first year of the corporate three-year plan. The budget is drawn up on an entity level and consolidated at Company level. As mentioned before, this

process is fully aligned in AIR FRANCE KLM Group. The corporate three-year plan, including the budget for 2018, has been prepared and approved before the start of the financial year 2018 (December 2017); and

- » Tactical Planning Meetings held quarterly on a business level, which evaluate (and update) the performance of the businesses in the context of the budget.

Accounting process and establishment of accounts

The Corporate Control Department prepares monthly group financial information on the basis of information submitted by the businesses and subsidiaries. The AIR FRANCE KLM accounting manual meets the compliance objectives for accounting records. The accounting information feedback from the subsidiaries is required to follow the Group's accounting rules, methods and frames of reference laid down by the Company and presentation of financial statements must be in the format circulated by the Group. The consolidated and company financial statements are submitted twice a year (at the middle and end of the year) for review by the Vice President Reporting & Control to the external auditors prior to their closure at a summary meeting, and are then forwarded for discussion to the Audit Committee.

Management reporting process

The Corporate Control Department co-ordinates the Company's reporting process. At the beginning of the month, a forecast is prepared in a bottom-up process by the businesses and most significant subsidiaries based on the planned network activity information available of the previous month. Once the accounting result is known, the Corporate Control Department then produces a monthly management report listing the main activity data, staff numbers and accounting and financial data. Also each month, the Corporate Control Department examines and analyses with the Company's businesses and main subsidiaries the economic performances for the month just passed and evaluates the results for the coming months up to the end of the current financial year.

The Corporate Controller presents the management report monthly in the Management Board Council and KLM Executive Team meeting and in the Audit Committee on a biannual basis, focusing on the variances between actual year and budget/forecast and explaining incidental results recorded during the month. Attention is also given to the variances in the full-year forecast.

Support functions

Internal audit

KLM has set up an independent Internal Audit Function (IAF) to strengthen the internal controls. The presence and activities of an IAF provides a powerful element in contributing to assure proper risk management, governance and internal control.

The IAF is subject to a regular external quality assessment by the Dutch and French affiliates of the worldwide Institute of Internal Auditors. The overall opinion is positive.

The IAF is an independent function designed to provide added value to the KLM Group and improve its operations. It helps to accomplish the KLM Group's objectives by bringing a systematic, disciplined approach to evaluating and strengthening the effectiveness of decision making, risk management, internal control and governance processes. The IAF objectively reviews the accuracy and reliability of the KLM Group's internal controls in general and related processes in particular. Management will be pro-actively advised on required improvements.

The IAF conducts audits on request of the Audit Committee, the Board of Managing Directors or the Executive Team. An annual audit plan is drawn up and presented to the Board and Executive Team and approved by the Audit Committee.

The Internal Audit Function performs different types of engagements like operational audits, information and communication technologies or electronic data processing audits, compliance audits, post audits, fraud investigations and consulting engagements.

Engagements that have been carried out are summarised in a report that describes the conclusions, highlighting findings, risks and related recommendations. For audits a four-point grading scale is used to express the impact of the findings and the level of action required from either local management or the Board of Managing Directors. The follow up by business management is required and monitored within a desired timeframe depending on the issue and reasonable corrective action period.

The KLM Internal Audit department provides management with audit reports, which four times a year are recapitulated for the Board of Managing Directors and twice a year for the Audit Committee of the KLM Supervisory Board.



Insurance department

The KLM business activities and related processes involve myriad major and minor risks. Many of these risks are mitigated by a variety of measures, such as contingency plans, hedging and back-up facilities or mandatory insurance. The remaining risks can be either accepted or insured against, the latter if risks are perceived unacceptable, for instance because they may threaten the continuity of KLM. KLM has insured risks such as damage to its owned and leased aircraft and liability to its customers and others in case of an aircraft incident, war risks, damage to property and business interruption. If ever such a risk becomes manifest, the damage can be claimed on the insurance company up to the insured amount taking deductibles and standard market exclusions into account.

Legal department

The Legal department is responsible for legal practices within KLM and monitors the "legal integrity" of activities performed by KLM. The Legal department supports both KLM's Board of Managing Directors and the businesses. The department is centralised, exist of qualified legal professionals and functions as a single point of contact for external lawyers.

Reference standards

Charters and manuals

Integrated safety management manual

The Integrated Safety Management Manual (ISMM) describes the Integrated Safety Management System (ISMS). The ISMS is an integrated system that is used in the following KLM domains: operational safety, occupational safety, environmental safety and operational security.

The ISMS assures the safe performance of all processes within these domains through the effective management of safety risk.

The ISMS complies with relevant national and international legislation. The ISMS is also based on the requirements of other regulatory systems: IOSA, ISAGO, ISO 14001 etc. The ISMS encompasses all safety management system components and elements as stated in ICAO document 9859.

ISMS allows risks to be predictively indicated and proactively eliminated or mitigated before accidents and

incidents occur. ISMS also allows safety to be continuously improved by collecting and analysing data, identifying hazards, threats and safety issues, and assessing safety risks to ensure the optimal allocation of company resources. KLM's ISMS is based on the following main internal and external frames of reference:

External frames of reference:

- » Statutory: European and Dutch regulations (including European and Dutch regulations for operational security) and general implementing regulations;
- » Industry: IATA Operational Safety Audit (IOSA), a standard that ensures a transparent level of operational safety to enable code share operations without further audits on KLM and ICAO document 9859, for the Safety Management Manual; and
- » Environment: ISO 14001: a standard for monitoring environmental control and impact.

Internal frames of reference:

These are variations of external frames of reference adjusted to the Company's own processes:

- » Statutory: statutory manuals (operating manuals, maintenance manuals, quality manual) and associated general procedures, which are usually formally validated by the supervisory authorities that issue approval certificates (CAA-NL, FAA, etc.);
- » Quality manuals for environmental control; and
- » Management system: the company's Integrated Safety Management Manual and associated general procedures.

Social rights and ethics charter

The KLM Group has published a Social Rights and Ethics Charter to enshrine individual commitment to Corporate Social Responsibility by orienting its corporate and ethical policy towards respect for individuals at the professional, social and citizenship levels.

Code of conduct

The KLM Group has published a Code of Conduct addressing the following principal matters: compliance with laws and regulations, conflicts of interest, confidentiality, the safeguarding of assets, environmental protection, Corporate Social Responsibility and intellectual property. KLM has also implemented a code of ethics intended principally for employees in finance positions.

Manual to prevent the risks of corruption

This manual affirms the commitment to exercising its activities fairly, equitably, honestly and with integrity, and in the strict respect of anti-corruption laws wherever its companies or subsidiaries exercise their activities.

It establishes the guidelines for preventing corruption, and for identifying and handling at-risk situations with regard to the anti-corruption legislation.

The e-learning module "competition law compliance" and "anti-bribery and corruption" have been available online to all employees since 2014. In 2017 a new e-learning module has been rolled out.

Internal control charter

The AIR FRANCE KLM Internal Control Charter sets out the components of the internal control framework and outlines the methodology adopted to guarantee its effective implementation and functioning. It also reaffirms the involvement in the prevention and control of the risks associated with the KLM Group's activities.

Internal audit charter

To provide the internal auditors with an adequate base, a KLM Group Internal Audit Charter is in place. The charter is revised and tailored to changing needs and has been signed in 2017 by the President and Chief Executive Officer of KLM, the Chairman of the KLM Audit Committee and the Vice President Internal Audit. It is in line with the Dutch Corporate Governance Code.

The KLM Group Internal Audit Charter establishes the framework of the Internal Audit Function and contains the guidelines to which it adheres regarding:

- » Internal Audit mission and objective, scope of work and types of work;
- » Accountability, independence and relationship to other assurance functions;
- » Authority and ethics; and
- » Applicable standards.

The KLM Group Internal Audit Charter is in line with the governance structure regarding the Internal Control Function, and is in line with the AIR FRANCE KLM Group Internal Audit Charter.



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 2016.

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 2016.

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; and
- » The depositary receipts issued by Stichting Administratiekantoor Cumulatief Preferente Aandelen C (SAK II) on the cumulative preference shares C.

On December 31, 2017, 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 19 members. The Board has five 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. In 2017, the fifth Dutch member joined the Board as Director representing employees. 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.

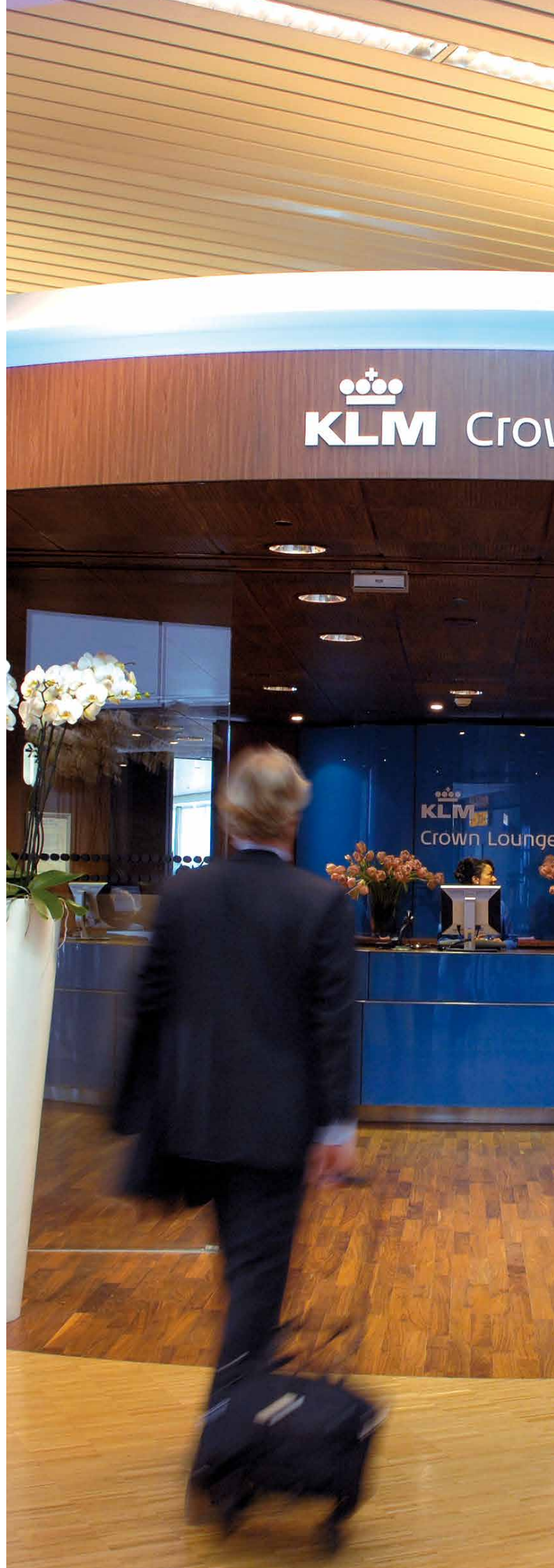
Supervisory Board

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, among others things, the committees' tasks.

Board of Managing Directors

On December 31, 2017, 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 organ with collective responsibility. The Board of Managing Directors has final responsibility for the overall management of the company and monitors all corporate governance activities. 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.

General Meeting of Shareholders

KLM's yearly Annual General Meeting of Shareholders will be held on April 26, 2018. 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. The KLM Works Council met representatives of the Board of Managing Directors on ten occasions in financial year 2017.

At AIR FRANCE KLM level a 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 held two plenary meetings in financial year 2017. The Management Board met on seven occasions.

Diversity

KLM aims for balanced gender diversity in the Management Board and Supervisory Board.

On December 31, 2017, one third of the directors of the Supervisory Board is female. The Supervisory Board profile deals with the aspects of diversity in the composition of the Supervisory Board that are relevant to the company. Within the framework of the Supervisory Board profile diversity aspects, such as age, nationality, gender and education and working background are addressed. The Supervisory Board consists of five French board members and four Dutch board members.

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.

Culture

The KLM Legal & Business Ethics Compliance Framework supports leadership and staff to do business with loyalty, fairness, transparency, honesty and integrity. It requires KLM staff to reach out, take ownership and be competent and leadership to connect, to guide, to challenge and to inspire their teams in a joint effort to secure the integrity of the KLM organisation internally and vis-à-vis the third parties that KLM deals with in its day-to-day business.

The KLM Code of Conduct serves as a framework that reflects the basic principles of business integrity and shall be taken into account by KLM staff, management and contracted third parties. The Code of Conduct clarifies rules and standards that are to be complied with as well as sets out expected behaviour. Designated individuals are required to complete additional training on antitrust and competition laws, anti-bribery and corruption law and data protection. KLM has published relevant codes and regulations on its intranet.

The KLM Legal & Business Ethics Compliance Framework supports leadership and staff to do business with loyalty, fairness, transparency, honesty and integrity.

On behalf of the Board of Managing Directors KLM's Compliance Committee's monitors the effectiveness of the KLM Legal & Business Ethics Compliance Program and frequently reports on the compliance status of KLM. The KLM Kompas fosters staff engagement throughout the company. The KLM Kompas aligns ambitions for the desired customer experience with ambitions for the desired employee experience.

Dutch corporate governance code

KLM's corporate governance is, generally in line with generally accepted principles of good governance, such as laid down in the Dutch Corporate Governance Code (Code). Although KLM as a non-listed company is not formally obliged to comply with the Code, it has committed itself to following the Code voluntarily where possible. In 2017, KLM took a deep dive into the amended Dutch Corporate Governance Code. An assessment was made to consider compliance with the new principles and best practices. On several occasions the Board of Managing Directors together with the Supervisory Board discussed the impact of the Code on KLM's corporate governance.

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;
- » The composition of the Supervisory Board does not meet the Best Practice Provision 2.1.7 sub i. that relates to the Independence of the Supervisory Board; and
- » The severance pay of newly appointed members of the Board of Managing Directors, from within KLM, in the event of dismissal is set at a maximum of two years base salary, and consequently does not comply with Best Practice Provision 3.2.3.

Conflict of interest

The handling of conflicts of interest between the company and members of the Board of Managing Directors or the Supervisory Board is governed by Dutch law, the relevant provisions of the Dutch Corporate Governance Code and the Regulations of the respective Board. A Board member is required to report any conflict of interest or potential conflict of interest that is of material significance to the company and/or to the member concerned, to the Chairman of the Supervisory Board. The relevant Board member shall not take part in any discussion or decision taking on a subject in which he or she has a conflict of interest. Decisions to enter into transactions in which there are conflicts of interest with members of either Board that are of material significance to the company or such member require the approval of the Supervisory Board.

During the financial year 2017, no conflicts of interest were reported.

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. In 2017, KLM reviewed the regulations from the perspective of the revised Corporate Governance Code. 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, in so far 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.

In control statement

In accordance with previous paragraphs on Risks and Risk Management and on Control and Monitoring, in addition to the Going Concern statement in Risks and Risk Management, all currently known circumstances taken into consideration, the Board of Managing Directors states to the best of its knowledge that:

- i. The Annual Report 2017 provides sufficient insights into potential material weaknesses in the effectiveness of the internal risk management and control systems;
- ii. The internal risk management and control systems of the company provide reasonable assurance that the financial reporting does not contain any material inaccuracies;
- iii. Based on the current state of affairs, it is justified that the financial reporting is prepared on a going concern basis; and
- iv. The Annual Report 2017 states those material risks and uncertainties that are relevant to the expectation of the company's continuity for the period of twelve months after the preparation of the report.





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

In 2017, the Supervisory Board held six meetings according to the pre-set schedule and one meeting via conference call. Four Supervisory Board meetings were held shortly after the quarterly close. The deliberations during the February, April, July and October meetings concentrated on KLM's (quarterly, semi-annual and annual) financial results. One meeting focused on KLM's strategy and the execution 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. The additional Supervisory Board meeting dealt with 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 Supervisory Board meetings were followed by an Executive Session – meetings of the Supervisory Board without the presence of members of the Board of Managing Directors. The Company Secretary attended both the Supervisory Board meetings as well as the Executive Sessions. Management Group members and the external accountants were frequently invited to present on specific topics. Average attendance of the Supervisory Board meetings was 87 percent. All but three members attended all meetings of the Supervisory Board.

Long-term value creation

In order to realise the ambition to become Europe's most customer-centric, innovative and efficient network carrier, in 2017 KLM continued on the course set. In 2015, KLM revisited its top strategic priorities, redefined strategic choices and updated strategic objectives. In 2016, KLM focused on execution. In 2017, KLM found itself on the verge of the next phase of the transformation, shifting focus from 'not losing' to carefully determining how to win from the competition. The financial performance has improved considerably and the company is well on track to achieve the Perform 2020 targets that allow further investment in the customer and staff. The 2015 strategy is paying off and KLM is well underway to realise its ambition.

During the annual strategy meeting the Supervisory Board assessed with the Board of Managing Directors KLM's initial strategic choices, objectives and initiatives. Required elements of the strategy were discussed to reach the next level of KLM's transformation. An additional set of strategic initiatives was discussed and added to the KLM transformation agenda. Concluding the strategy meeting, the topics of necessary innovation endeavors,

strategic workforce planning and the development of digital capabilities were addressed as important challenges for the second half of the Perform 2020 period.

The Supervisory Board feels well engaged in the Board of Managing Director's process of formulating and executing KLM's strategy for realising long-term value creation. During the quarterly meetings the Supervisory Board was informed on the progress of the execution of the strategy. Prior to the strategy meeting the Supervisory Board visited the Cargo Department to learn about the specifics of the Cargo activities and made a visit to the new cargo sorter.

Highlights 2017

The Supervisory Board closely monitored the negotiations towards a new collective labour agreement for cabin crew. Throughout financial year 2017, KLM has focused on finding solutions together with cabin crew that accommodate productivity increases and cost reductions on the one side and that coincide with the vision of parties on customer service and crew composition on the other side. By year-end, an agreement was reached with the largest of the two cabin crew unions (VNC). KLM aims at implementing the new collective labour agreement for the cabin crew early 2018.

On frequent occasions in financial year 2017, the Supervisory Board was informed about staff engagement during the execution of KLM's strategy. People are an important asset and they make the difference when it comes to delivering KLM's services to the customer. In 2017, the further implementation of the High Performance Organisation has led to a reduction in the number of management layers and of supporting staff. In part because of this, productivity increased. Thanks to the revised model for profit sharing, employees benefitted from KLM's improved results.

Throughout the year the Supervisory Board learned that culture, as described in the KLM Kompas and implemented from 2016 onwards and staff engagement remained important topics covered in the annual strategic priorities of the company. The KLM Kompas derived from the purpose of Moving your World, has generated energy throughout the company. Guided by the KLM Kompas, staff at all levels of the company worked on improving engagement and personalisation across the entire customer journey.

During the second half of 2017, the Supervisory Board discussed the background of the AIR FRANCE KLM strategic projects. In particular it spoke about the announced share that AIR FRANCE KLM will take in Virgin Atlantic, allowing Air France and KLM, together with Delta Air Lines and Virgin Atlantic to build a four-party transatlantic joint venture.

Furthermore it looked at the capital increase of AIR FRANCE KLM, whereby Delta Air Lines and China Eastern Airlines committed to taking a 10 per cent stake in AIR FRANCE KLM. Subsequently, the Supervisory Board discussed the rationale of these strategic projects, being the need to strengthen AIR FRANCE KLM's financial position and the partnership profile and KLM's position therein.

Within the framework of customer-centricity, the Supervisory Board together with the Board of Managing Directors focused on innovation and the digitisation of products and services. The airline industry in itself has a relatively low innovation rate due to restrictive regulations and long term fleet cycles. Consequently, the outside world is changing much faster than the airline industry. New (digital) business models offer opportunities, but do also threaten KLM's position. In order to realise KLM's ambition, KLM will need to innovate the company more fundamentally and accelerate innovation efforts. On multiple occasions the Supervisory Board discussed the need for external strategic partnerships in all business domains and the need to develop innovation competencies in order to increase the agility of KLM.

In October 2017, on the occasion of KLM's inaugural flight to Mumbai, the Supervisory Board together with the Board of Managing Directors held its October meeting in Mumbai. Formal and informal meetings were organised with KLM's joint venture partner Jet Airways, suppliers and the local commercial organisation.

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 Supervisory Board discussed with the Board of Managing Directors developments in the markets and the best way to respond to these developments. The annual update of the operational performance was discussed from the perspective of the KLM's ambition to grow, operational constraints at Amsterdam Airport Schiphol and the Operational Excellence program.

Other topics discussed during the financial year, some of which are recurring, were the safety and quality assurance program, the company's fleet development planning, developments within Engineering & Maintenance and Cargo and construction works at Amsterdam Airport Schiphol, including KLM's Crown Lounge and the A-pier.

The Supervisory Board was periodically informed about discussions with the Works Council. The Supervisory Board

is grateful to the Works Council for its contribution in the transformation process of KLM. In keeping with previous years, members of the Supervisory Board took turns to attend meetings of the Works Council.

Financial topics

The Supervisory Board discussed progress on the budget and the Perform 2020 program as well as the annual plan on a frequent basis. Quarterly reports and figures were discussed during the regular meetings. The Perform 2020 targets were assessed as part of the reviews of the strategy execution that focus on achievements in the domains of finance. Despite the positive results the Supervisory Board has been carefully discussing the outlook for 2018 and beyond. KLM remains exposed to external financial risks; unit revenues may come under pressure and the fuel price is expected to rise. In the strategy meeting various scenarios were discussed, including actions to be taken in case of less favorable scenarios. During the year, key areas of focus were measures to improve KLM's balance sheet and equity position as well as measures to mitigate financial risks. During the Supervisory Board's December meeting the company's financing plan for financial year 2018 was approved.

The Supervisory Board fully supports the Board of Managing Directors in the further execution of the strategy and the Perform 2020 program. Well on course to achieving KLM's objectives, the whole of KLM is aware that further and higher investments are needed in order to continuously improve the relative position of the company and with it the need for a positive and acceptable cashflow. The Supervisory Board intensely discussed with the Board of Managing Directors necessary investment levels predominantly in the renewal of aircraft but to a high degree also in its on-board product, digitisation and equipment.

On multiple occasions, the Supervisory Board discussed KLM's pension schemes, more specifically the situation regarding the pilot pension fund. In previous years, as a result of falling interest rates and various changes in regulations, the Board of Managing Directors has taken various initiatives to derisk the three KLM pension funds for cockpit, ground and cabin crew. Significant measures were implemented and regularly discussed with KLM's Supervisory Board. Still, the defined benefit schemes made KLM's cash position and the balance sheet too volatile. After a successful transition of the KLM cabin crew pension plan towards a collective defined contribution scheme in August 2017, KLM and the pilot union VNV came to an agreement to move KLM's pilot pension scheme to a collective defined contribution scheme in December 2017. The Supervisory Board is convinced that the agreements

with the cabin crew and the pilot unions are clearly reducing KLM's risk profile for pensions and is aligned with agreements recently concluded in other Dutch corporations.

The portfolio of KLM's subsidiaries was assessed during the strategy meeting. In 2017 the Supervisory Board was closely involved in decision taking with respect to KLM's participation in Kenya Airways. Kenya Airways results have been under pressure from a combination of high growth in an environment with increasing competition and reduced passenger numbers due to terrorist attacks and diseases. In its role as shareholder and joint venture partner, KLM takes responsibility for supporting the restructuring plan of Kenya Airways.

Risk management

The Supervisory Board paid close attention to the topic of risk management, as risk is inherent to the airline industry. KLM's Audit Committee takes responsibility for monitoring the adequacy of KLM's risk control system and prepares discussions in the Supervisory Board. During financial year 2017, the Supervisory Board was regularly updated on KLM's strategic, financial and operational risks and compliance risks and the design of the internal risk management and control system. During these updates, the Supervisory Board reviewed and discussed the assessments of the Board of Managing Directors of the adequacy and effectiveness of the risk management and control system. Other important topics were KLM's risk management and risk appetite. KLM's internal audit function is firmly positioned within the organisation and creates conditions for an effective interaction between the Board of Managing Directors, the Supervisory Board and the Audit Committee.

The Supervisory Board thoughtfully analysed and discussed cybersecurity risks, which are increasing. In 2017, the Supervisory Board reviewed the way in which KLM organises the prevention of cybercrime and consequently integrates the existing risks into its risk management and control system.

Corporate governance and compliance

Within the framework of the company's Legal & Business Ethics Compliance framework and the Compliance Charter, the Supervisory Board monitored KLM's compliance with rules and regulations. During the year, the Supervisory Board took a deep dive into the principles of the revised Corporate Governance Code 2016. KLM committed itself to follow the principles and best practice provisions where possible. The Supervisory Board together with the Board of Managing Directors concluded that the introduction of the revised Corporate Governance Code's most important principles, being long-term value creation and culture,

coincided with the implementation of KLM's new process for defining, executing and reviewing its strategy. To assure compliance with the revised Code the regulations of the Board were adjusted accordingly.

Composition of the Supervisory Board

At the end of the Annual General Meeting of 2017, Mrs. Asscher stepped down as Supervisory Board member. Mrs. Asscher served 13 consecutive years. The Supervisory Board wishes to express its gratitude for her valuable contribution to the company.

Mrs. De Gaay Fortman was appointed as Supervisory Director for a first term of four years, at the end of the Annual General Meeting of 2017. Mrs. De Gaay Fortman was carefully selected based on her knowledge in the field of corporate governance, her broad management experience, her extended social and cultural network as well as the complementarity of her experience and competences within the Supervisory Board team. The General Meeting of Shareholders was granted the opportunity to recommend candidates for the position but waived the possibility to propose a candidate. The KLM's Works Council has recommended the appointment of Mrs. de Gaay Fortman. After appointment to the Supervisory Board, Mrs. De Gaay Fortman received an introduction program that covered general financial topics, financial reporting by the company and several aspects that are unique to KLM, its business activities, the company culture and the relationship with the Works Council.

As announced in last year's annual report, Mrs. Dautry and Mr. 't Hart are due to retire by rotation. Mr. 't Hart has advised the company to be available for reappointment for a second term of four years. Mrs. Dautry has informed the company that she is not available for reappointment. The Supervisory Board will propose to the 2018 Annual Meeting of Shareholders the reappointment of Mr. 't Hart. AIR FRANCE KLM has the right to propose a candidate for the vacancy arising from the resignation of Mrs. Dautry.

The Supervisory Board hereby announces that Mr. Peyrelevade, Mrs. Roobeek and Mr. Smits are due to retire by rotation at the end of the closure of the Annual General meeting of Shareholders in 2019.

Shareholders are entitled to make recommendations for Supervisory Board vacancies. It should however be noted that for the position of Mr. Peyrelevade AIR FRANCE KLM may propose a candidate and that for the positions of Mrs. Roobeek and Mr. Smits KLM's Works Council has the right to recommend candidates.

Independence

The Supervisory Board considers all but two of its members to be independent pursuant to the revised Dutch Corporate Governance Code 2016. Both Mr. Calavia and Mr. Riolacci, in their capacity of former Chief Financial Officers of AIR FRANCE KLM, are not considered independent. Mr. Calavia resigned as Chief Financial Officer of AIR FRANCE KLM as per the end of January 2014. Mr. Riolacci resigned as Chief Financial Officer of AIR FRANCE KLM as per July 2016.

Composition of the Board of Managing Directors

The Board of Managing Directors consists of three members, Mr. Elbers, Chief Executive Officer, Mr. Swelheim, Chief Financial Officer, and Mr. de Groot, Chief Operating Officer. The composition of the Board of Managing Directors did not change in 2017. The term of Mr. Swelheim expires per the Annual General Meeting of Shareholders 2018. The Supervisory Board hereby announces that it will propose to the 2018 Annual General Meeting of Shareholders the reappointment of Mr. Swelheim, Chief Financial Officer, as Managing Director for a second term of four years.

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. Committee meetings are open to all members of the Board, regardless of membership of the Committees. The Audit Committee consists of three members, being Mr. Peyrelevade (Chairman), Mr. 't Hart and Mrs. Roobeek. The Audit Committee met on two occasions during the financial year. These meetings were scheduled in line with the regular schedule. The Audit Committee meetings were attended by all members of the Committee, with the exception of one member not being present at one meeting. The Audit Committee's meetings are regularly 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 Senior Vice President Corporate Controller.

In keeping with previous years, the Audit Committee met with the external auditors without the members of the Board of Managing Directors present, to discuss the closing procedures and the state of affairs during the financial year. In addition to the plenary Audit Committee meetings, the Chairman of the Audit Committee held separate sessions with the Chief Financial Officer and the Vice President Internal Audit.

In the Audit Committee meetings, the Audit Committee discussed among others things the yearly and bi-yearly financial results as well as the internal and external audit results, as reported under the authority of respectively the company's internal auditor and the external auditors KPMG and Deloitte. The Audit Committee discussed the main financial and non-financial risks deriving from management's risk assessments. The Audit Committee discussed financial reporting, the overall internal controls over financial reporting and the adherence of the company to laws and regulations governing financial and regularly reporting.

The Audit Committee considered the role, performance and reports of the external auditor, the management letters and the auditor's independence and fees. In its February 2018 meeting the Audit Committee discussed the report of the external auditor regarding financial year 2017.

The Chairman of the Audit Committee reported to the Supervisory Board about the deliberations and findings on the main topics during the meetings of the Supervisory Board.

Due to the retirement of Mrs. Asscher and the appointment of Mrs. De Gaay Fortman, the composition of the remuneration and the nomination committee was amended during financial year 2017. The Remuneration Committee and the Nomination Committee consist of Mr. Enaud and Mr. Smits and Mrs. De Gaay Fortman. The Remuneration Committee is chaired by Mrs. De Gaay Fortman. The Nomination Committee is chaired by Mr. Smits.

The Remuneration Committee met on three occasions during the financial year. All members attended the meetings. 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 the financial year. 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, and these targets have been endorsed by the Supervisory Board. Further information, can be found in the Remuneration Policy and Report section of this annual report.

The Nomination Committee met on one occasion during the financial year and all members attended. During the meeting, the composition of both the Supervisory Board and the Board of Managing Directors, including succession planning, was discussed.

The meetings of both the Remuneration Committee and the Nomination Committee were partly attended by the President & Chief Executive Officer and the Company Secretary.

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.

In the absence of a net profit, mainly as a result of the de-recognition of the cockpit and cabin crew pension asset in the financial year 2017, no distribution of dividend to any class of share shall be made.

The dividend claim of priority and preference shareholders related to financial year 2017 will be paid in one of the subsequent years (once conditions are met that would allow such payment).

Financial statements 2017

The Supervisory Board hereby presents the annual report and the financial statements for financial year 2017. 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 2017.

Closing remarks

KLM is well on its way to become Europe's most customer-centric, innovative and efficient network carrier. KLM's revised strategy is bearing fruit. The transformation of KLM is becoming visible and everyone in the company is convinced that this transformation is needed for a healthy and sustainable future. KLM's staff supports on the transformation and broadly participates in the pursuit of change. Tangible energy is running through the veins of the company. At the same time, we are aware that the transformation has demanded a lot from all employees. We are confident that we are on the right track but will remain cautious. The competition will continue to put pressure and KLM will remain exposed to internal and external risks. However, KLM is building further on its strong base towards its 100th anniversary.

In closing and on behalf of the entire Supervisory Board I wish to express our true appreciation for the work of the Board of Managing Directors and the Executive team in realising KLM's strategic and business objectives. A special thank you to all KLM employees as well for all their support, effort and engagement to KLM and its passengers and customers across the world.

Amstelveen, March 29, 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 policy, and within the framework of the policy the actual 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 external benchmark data regarding directors' remuneration (reference group is large Dutch companies) are also taken into account and (ii) inflation and developments in KLM's collective labour agreements. Any changes in individual remuneration resulting from 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 aims to encourage Managing Directors to improve the performance of KLM and to achieve KLM's long-term objectives within the context of AIR FRANCE KLM.

As a consequence, the remuneration package includes, in addition to a base salary, a short-term incentive in cash relating to the (financial and non-financial) performance in the financial year as reported 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; and
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 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 described 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 in case of an 'excellent' score is 100%;
- » In case of an 'at target' score for each of the three short-term incentive targets, this percentage is 70%; and
- » In case of a 'below a set limit' score (target less than 80% achieved), no payment is made.

For the Managing Director position:

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

The Remuneration Committee evaluates the agreed targets each year and proposes new targets. The CEO and other Board members are asked to provide input for their evaluation.

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's 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 encourages 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.

KLM's 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 in the 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 for the Chief Executive Officer, and 6,000 shares for 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; and
- » 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 2017

1. Base salary

The base salaries of the individual Managing Directors slightly increased in 2017, and now stand at EUR 475,000 (2016: EUR 450,000) for Pieter Elbers, EUR 315,000 (2016: EUR 300,000) for Erik Swelheim and EUR 325,000 (2016: EUR 315,000) for René de Groot.

Despite the increase compared to 2016, the base salary of the Managing Directors remains significantly below the median of the applicable market benchmark as well as below that of previous KLM CEOs in the case of Pieter Elbers.

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 2017 in accordance with the remuneration policy and its proposal has subsequently been endorsed by the Supervisory Board. The exceptional financial results are reflected in the short-term incentive payment for financial year 2017: 94% (out of 100% maximum) of the base salary for Pieter Elbers, 60% (out of 60% maximum) for Erik Swelheim and 60% (out of 60% maximum) for René de Groot.

For 2017, 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 plan and based on the performance evaluation of financial year 2017, phantom shares will be conditionally granted to each member of the Board of Managing Directors in April 2018. Pieter Elbers will receive 10,000 phantom shares and Erik Swelheim and René de Groot will receive 6,000 each. These are granted conditionally in accordance with the provisions of the long-term incentive plan.

At its January 2018 meeting, the Remuneration Committee has evaluated the results achieved against the targets set for the long-term incentive plan. In respect of financial year 2017, all targets were met in full.

Therefore the first (one-third) increment of the 2018 phantom shares series, the second (one-third) increment of the 2017 phantom shares series and the third (one-third) increment of the 2016 phantom shares series will vest for 114%. These phantom shares will be unconditionally awarded in April 2018 to the members of the Board of Managing Directors. Since the first and second increment of the 2016 phantom shares series have vested for 108.6% and 116% respectively, the 114% vesting of the third increment will be capped, so that the vesting in total will not exceed 100%.

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

Internal pay ratio

In line with the Dutch Corporate Governance code, internal pay ratios are an important input for assessing the Remuneration policy for the Board of Managing Directors. The ratio between the annual total compensation for the CEO and the average annual total compensation for an employee of KLM was 11.5 for the 2017 financial year. Annual total compensation for both include variable income and pension benefits. The development of this ratio will be monitored and disclosed going forward.

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 changed since 2008. The remuneration consists of a fixed annual fee and a fee for each meeting that is 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 2017

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 described in the travel regulations for KLM employees.

Details on the remuneration received by 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, 2017)

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 de Jong Group / Board member Odjell SE, Former Chairman Board of Managing Directors Havenbedrijf Rotterdam N.V., former Chairman and CEO Rabobank, former Chairman and CEO Amsterdam Airport Schiphol.
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) 2016 – 2020	President & CEO FE Development / Director Arkema, Board member of Aston Finance respectively Premium Peers, Board member of Linkbynet/ Chairman of Shadline and DejaMobile/ President ANSA / Senior advisor Oddo Finance.
Marry de Gaay Fortman **	1965	Dutch	2017 / (first) 2017 – 2021	Partner Houthoff Buruma / Member Supervisory Board De Nederlandsche Bank, Chair Stichting Topvrouwen, various board memberships in the cultural sector.
Cees C. 't Hart	1958	Dutch	2014 / (first) 2014 – 2018	CEO Carlsberg Group / director Supervisory Board Aids Fonds, Former CEO of Royal Friesland Campina.
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/ SNI Marocco.
Pierre François Riolacci ***	1966	French	2016 (first) 2016 – 2020	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 of 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, 2017 are shown here

** Appointed upon recommendation of KLM's Works Council

*** Appointed upon recommendation of AIR FRANCE KLM



Board of Managing Directors (situation as at december 31, 2017)

Name	Year of birth	Nationality	First appointment	Function
Pieter J.T.H. 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

2017 Financial Statements

KLM Royal Dutch Airlines Consolidated balance sheet

In millions of Euros	Note	December 31, 2017	December 31, 2016
Before proposed appropriation of the result for the year			
ASSETS			
Non-current assets			
Property, plant and equipment	1	4,319	3,783
Intangible assets	2	394	343
Investments accounted for using the equity method	3	24	22
Other non-current assets	4	186	317
Other financial assets	5	404	365
Deferred income tax assets	16	145	119
Pension assets	17	590	1,462
		6,062	6,411
Current assets			
Other current assets	4	229	224
Other financial assets	5	170	28
Inventories	6	177	193
Trade and other receivables	7	1,228	964
Cash and cash equivalents	8	1,058	1,208
		2,862	2,617
TOTAL ASSETS		8,924	9,028
EQUITY			
Capital and reserves			
Share capital	9	94	94
Share premium		474	474
Other reserves	10	(336)	(2,191)
Retained earnings		694	2,610
Total attributable to Company's equity holders		926	987
Non-controlling interests		1	1
Total equity		927	988
LIABILITIES			
Non-current liabilities			
Loans from parent company	11	198	288
Finance lease obligations	12	1,181	1,365
Other non-current liabilities	4	216	171
Other financial liabilities	13	1,113	1,208
Deferred income	15	207	204
Provisions for employee benefits	17	423	474
Other provisions	18	622	593
		3,960	4,303
Current liabilities			
Trade and other payables	19	2,167	1,983
Finance lease obligations	12	355	395
Other current liabilities	4	112	66
Other financial liabilities	13	33	85
Deferred income	15	1,133	1,017
Provisions for employee benefits	17	100	28
Other provisions	18	137	163
		4,037	3,737
Total liabilities		7,997	8,040
TOTAL EQUITY AND LIABILITIES		8,924	9,028

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	2017	2016
Revenues	22	10,340	9,800
Expenses			
External expenses	23	(5,523)	(5,519)
Employee compensation and benefit expenses	24	(2,955)	(2,860)
Other income and expenses	25	77	182
Total expenses		(8,401)	(8,197)
EBITDAR		1,939	1,603
Aircraft operating lease costs		(443)	(414)
EBITDA		1,496	1,189
Amortisation, depreciation and movements in provisions	26	(586)	(508)
Income from current operations		910	681
Other non-current income and expenses	27	(1,849)	3
Income from operating activities		(939)	684
Gross cost of financial debt	28	(102)	(116)
Income from cash and cash equivalents	28	11	16
Net cost of financial debt		(91)	(100)
Other financial income and expenses	28	78	1
Pre-tax income		(952)	585
Income tax benefit/(expense)	29	239	(69)
Net result after taxation of consolidated companies		(713)	516
Share of results of equity shareholdings		10	3
(Loss) / profit for the year		(703)	519
Attributable to:			
Equity holders of the Company		(704)	517
Non-controlling interests		1	2
		(703)	519
Net (loss) / profit attributable to equity holders of the Company		(704)	517
Dividend on priority shares		-	-
Net (loss) / profit available for holders of ordinary shares		(704)	517
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
(Loss)/profit per share (in EUR)		(15.04)	11.03
Diluted (loss)/profit per share (in EUR)		(15.04)	11.03

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	2017	2016
(Loss)/ profit for the year	(703)	519
Cash flow hedges		
Effective portion of changes in fair value of cash flow hedges recognised directly in equity	41	205
Change in fair value transferred to profit or loss	(13)	344
Exchange differences on translation foreign operations	12	8
Tax on items of comprehensive income that will be reclassified to profit or loss	(7)	(137)
Total of comprehensive income that will be reclassified to profit or loss	33	420
Remeasurement of defined benefit pension plans	831	(455)
Tax on items of comprehensive income that will not be reclassified to profit or loss	(206)	114
Total of comprehensive income that will not be reclassified to profit or loss	625	(341)
Total of other comprehensive after tax	658	79
Recognised income and expenses	(45)	598
- Equity holders of the company	(46)	596
- Non-controlling interests	1	2

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	Attributable to Company's equity holders						Non-controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total			
As at January 1, 2017	94	474	(2,191)	2,610	987		1	988
Net gain/(loss) from cash flow hedges	-	-	28	-	28		-	28
Exchange differences on translation foreign operations	-	-	12	-	12		-	12
Remeasurement of defined benefit pension plans	-	-	831	-	831		-	831
Transfer from retained earnings	-	-	1,197	(1,197)	-		-	-
Tax on items taken directly to or transferred from equity	-	-	(213)	-	(213)		-	(213)
Net income/(expense) recognised directly in equity	-	-	1,855	(1,197)	658		-	658
(Loss) for the year	-	-	-	(704)	(704)		1	(703)
Total recognised income/(expenses)	-	-	1,855	(1,901)	(46)		1	(45)
Dividends paid	-	-	-	(17)	(17)		(1)	(18)
Other movements	-	-	-	2	2		-	2
As at December 31, 2017	94	474	(336)	694	926		1	927

In millions of Euros	Attributable to Company's equity holders						Non-controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total			
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

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	2017	2016
(Loss)/profit for the year		(703)	519
Depreciation and amortisation	26	532	516
Changes in provisions	26	54	(7)
Results of equity shareholdings		(10)	(3)
Result on sale of equity shareholdings		(30)	(3)
Changes in pension assets		(33)	(23)
Changes in deferred income tax	29	(239)	69
Other changes *		1,659	(61)
Net cash flow from operating activities before changes in working capital		1,230	1,007
(Increase) / decrease in inventories		14	(43)
(Increase) / decrease in trade receivables		(160)	(98)
Increase / (decrease) in trade payables		43	49
(Increase) / decrease in other receivables and other payables		158	218
Change in working capital requirement		55	126
Net cash flow from operating activities		1,285	1,133
Capital expenditure on intangible fixed assets	2	(118)	(93)
Capital expenditure on aircraft	1	(784)	(734)
Disposal of aircraft		51	91
Capital expenditure on other tangible fixed assets	1	(94)	(54)
Disposal of other (in-)tangible fixed assets		7	15
Sale of equity shareholdings		6	14
Dividends received		7	5
(Increase) / decrease in short-term deposits and commercial paper		(60)	174
Net cash flow used in investing activities		(985)	(582)
Increase in long-term debt		425	318
Decrease in long-term debt		(765)	(412)
Increase in long-term receivables		(113)	(107)
Decrease in long-term receivables		32	24
Dividend paid		(18)	(1)
Net cash flow used in financing activities		(439)	(178)
Effect of exchange rates on cash and cash equivalents		(11)	(5)
Change in cash and cash equivalents		(150)	368
Cash and cash equivalents at beginning of period		1,208	840
Cash and cash equivalents at end of period **	8	1,058	1,208
Change in cash and cash equivalents		(150)	368

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

* 2017 Other changes mainly relate to the non-cash settlement expenses following modification of pension plans. See note 17 and 27

** Including unrestricted Triple A bonds, deposits and commercial paper the overall cash position and other highly liquid investments amount to EUR 1,508 million as at December 31, 2017 (December 31, 2016 EUR 1,541 million)

In millions of Euros	2017	2016
Cash flow from operating activities	1,285	1,133
Cash flow used in investing activities (excluding (increase)/decrease in short-term deposits and commercial paper)	(925)	(755)
Free cash flow	360	378

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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.

Change in segment presentation

As part of the strategic repositioning of the cargo business, the Company together with its subsidiaries (the "Group") has implemented a new business model aimed at optimising the belly and combi capacity of the passenger aircraft and reduced the full freighter fleet to four aircraft in recent years.

Except for the full freighter fleet, the commercial interests of the passenger business are determining the utilisation of aircraft in the Group's network, particularly with regard to the choice of aircraft and the frequencies to destinations. In this context, cargo is considered to be an activity which is complementary to the passenger activities, contributing to the line profitability and performance of the routes. These two activities constituting a unique larger activity, called 'Network'. In line with IFRS 8 this activity is evaluated regularly by the Board of Managing Directors in deciding how to allocate resources and in assessing performance.

As from 2017 the Group has refined its principal businesses: network activities, which include air transport of passengers and cargo activities, maintenance, leisure and other activities linked to air transport. Note 34 and 35 have been changed accordingly.

These financial statements have been authorised for issue by the Board of Managing Directors on March 29, 2018 and will be submitted for approval to the Annual General Meeting (AGM) of shareholders on April 26, 2018.

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, 2017. 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 in these financial statements, unless stated otherwise.

Recent accounting pronouncements

The following IFRS standards, amendments and IFRIC interpretations, have been published by the IASB, which are applicable on a mandatory basis to the 2017 financial statements:

- » Amendment to IAS 7 "Disclosure initiative - Reconciliation of liabilities from financing activities", effective for the period beginning January 1, 2017; and
- » Amendment to IAS 12 "Income tax", effective for the period beginning January 1, 2017.

These amendments had no material impact on the Group's financial statements as of December 31, 2017.

IFRS standards which are applicable on a mandatory basis and for early adoption to the 2018 financial statements

The estimated impact of the adoption of these standards on the Group equity as of January 1, 2017 concerning IFRS 15 "Revenue Recognition from Contracts with Customers" and IFRS 16 "Leases" (opted for the early adoption) and as of January 1, 2018 concerning IFRS 9 "Financial Instruments", is supported by valuations made as of today. Impact of the adoption of these standards as of January 1, 2018 might change because of the following reasons:

- » Analysis and/or the detailed impact assessment will continue in 2018;
- » The Group has not finished the whole set of testing and valuations of controls relating to its new IT systems;
- » A different interpretation of the accounting methods can change until the Group will present its financial statements concerning the year of the first application; and
- » The Group being an early adopter of IFRS 16, the positions taken could change in the view of new and/or changed interpretations.

IFRS standards which are applicable on a mandatory basis to the 2018 financial statements

» Standard IFRS 9 "Financial Instruments"

This standard must be applied starting January 1, 2018. The group has chosen to apply IFRS 9 retrospectively to each previous period in which financial information is presented, according to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Dedicated working groups have been set up within the Air France and KLM head-accounting departments together with the Air France and KLM middle-office treasury departments.

This standard comprises new accounting principles for financial instruments (classification, impairment and hedge). Two main impacts are expected following the application of this standard.

The first impact concerns the recognition of a change in call-option time-value in "other comprehensive income" whereas it is currently recorded in "other financial income and expenses".

The second impact is linked to the valuation of capital instruments either in fair value through the statement of profit or loss or in fair value through other comprehensive income. The classification methodology for capital instruments will be defined as follows:

- » When the capital instrument is considered to be a cash investment, its revaluations will be recorded in "other financial income and expenses".
- » When the capital instrument is considered to be a business investment, its revaluations will be recorded in "other comprehensive income".

On the opening balance sheet (January 1, 2017), the impact of IFRS 9 will involve a decrease in "other comprehensive income" between EUR 10 and EUR 20 million and an increase of the same amount in "other reserves".

» Standard IFRS 15 "Revenue Recognition from Contracts with Customers"

This standard must be applied starting January 1, 2018. The Group has set up dedicated working groups within the relevant business segments and departments to establish an inventory of customer contract types across the Group and to analyse each contract type using the five-step approach outlined within IFRS 15.

In parallel, the Group has 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 harmonized accounting treatments for issues requiring clarity under the new standard.

The amendments to IFRS 15 "Clarifications to IFRS 15 Revenue Recognition from Contracts with Customers" has been taken into account.

The Group has chosen to apply IFRS 15 retrospectively to each previous period in which financial information is presented, according to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Within this framework, none of the simplification measures proposed by the standard should be used.

The estimated impact of IFRS 15 on the opening balance sheet as of January 1, 2017 would lead to:

- » An increase in the "other current assets" for an amount between EUR 10 and EUR 20 million;
- » A decrease in the "other provisions" for an amount between EUR 10 and EUR 20 million;
- » An increase in the "other liabilities" for an amount between EUR 10 and EUR 20 million;

- » An increase in the "deferred income on ticket sales" for an amount between EUR 25 and EUR 50 million;
- » An increase in the deferred tax asset for an amount between EUR 0 and EUR 10 million; and
- » A decrease in equity for an amount between EUR 10 and EUR 20 million.

The main estimated impacts are detailed hereafter:

Type of performance	Business segment	Current accounting treatment	IFRS 15 accounting treatment	Expected impacts
Revenue recognised concerning unused tickets	Network	Revenue recognition, based on a historical statistical rate, which is regularly updated on the date the ticket is issued	Revenue recognition, based on a historical statistical rate of the unused tickets which is regularly updated, at the theoretical date of the transport	Impact on the opening balance sheet (January 1, 2017) increasing the "deferred income on ticket sales", with an "equity" counterpart, translating the recording of revenues at the time of the transport.
Change fees	Network	Revenue recognition at the date of change fee issuance	Revenue recognition at the transport date, not involving a different service bringing a profit to the passenger in the absence of transport	No material impact on the yearly Group revenues if it remains constant, being a timing and recurring impact.
Issuing fees	Network	Revenue recognition at the date of issuance		
Commissions and other distribution costs linked to the airline-ticket sales	Network	Cost recognition when incurred, being at the ticket issuance	Capitalisation and recognition when transport is made. The Group did not opt for the simplified option in order to translate the seasonality of its activity and the gap leads between sales and transport	Impact on the opening balance sheet (January 1, 2017) increasing the "other current assets", with an "equity" counterpart, translating the recording of costs at the time of the transport. No material impact on "commercial and distribution costs" if they remain constant, being a timing and recurring impact.
Transport of goods on behalf of the Group, by another airline	Network	Analysis as principal on the transport realised by the Group with recognition of the revenue. Analysis as agent on the part operated by another airline with recognition of the commission in revenues	The airline acts for its own account when it sells the service (principal) because it controls the promised service (the transport of the goods). The revenue charged to the customer is entirely recognised and a cost corresponding to the chartering is recorded	No impact on the opening balance sheet (January 1, 2017) being a presentation impact of the statement of profit or loss. Concerning the statement of profit or loss presentation, based on the year 2016 figures, revenues and chartering costs would have increased by around EUR 90 million.
Power-by-the hour contracts (overhaul of aircraft equipment and engines)	Maintenance	Revenue recognition based on invoicing schedule, according to flight hours; booking of a provision for expected costs	Revenue recognition based on the costs incurred	Impacts on the opening balance sheet (January 1, 2017): decrease in provisions, increase in other liabilities which corresponds to services charged before the realisation of the service and decrease of the equity due to the margin postponed in the date of realisation of the service. No material impact on the Group revenues.

Concerning the treatment of clients compensation, the Group is currently working with the airline industry (through IATA) to determine the way to present it. The position is under progress of finalization. The accounting of the other revenue streams will not be significantly affected by the application of IFRS 15.

The accounting of the other revenue streams will not be significantly affected by the application of IFRS 15.

IFRS standard which is applicable for early adoption to the 2018 financial statements

» The Group has opted for the early adoption of IFRS 16 "Leases" starting January 1, 2018.

The Group has chosen to apply IFRS 16 using the retrospective restatement to each prior reporting period presented applying IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The Group has elected to use the two exemptions proposed by the standard on the following contracts:

- » Lease contracts with a duration of less than 12 months; and
- » Lease contracts for which the underlying asset has a value in new of below USD 5,000.

The estimated impact of IFRS 16 on the opening balance sheet as of January 1, 2017 would lead to:

- » The booking of a right-of-use asset for an amount between EUR 1.7 and EUR 2.1 billion;
- » The booking of a lease debt for an amount between EUR 2.1 and EUR 2.5 billion;
- » An increase in the deferred tax asset for an amount between EUR 0.1 and EUR 0.2 billion; and
- » A decrease in the equity for an amount between EUR 0.2 and EUR 0.4 billion.

These figures do not include the impacts concerning the maintenance of leased aircraft which are under finalisation.

Lease contracts adjustment has an impact of reclassification in the cash flow statements, the standard having no impact on the cash position of the Group:

- » Improvement in "Net cash flow from operating activities" due to the cancellation of lease costs partially compensated by the cash-out attributing to financial costs in lease debt; and
- » Integration of the reimbursement of the lease debt in "Net cash flow used in investing activities".

Impacts in the cash flow statements concerning the maintenance of leased aircraft are detailed hereafter.

The main aggregates used by the Group will present the following impacts:

- » Increase in EBITDA;
- » Cancellation of the EBITDAR;
- » Increase in the "income from current operations" partially compensated by the increase in the "net cost of financial debt";
- » Increase in the net debt; and
- » Increase in the "operating cash flow excluding discontinued activities".

The main expected impacts, including impacts in the statement of profit or loss, are detailed hereafter. The impact on the statement of profit or loss have not been calculated and disclosed.

Capitalisation of aircraft lease contracts

For the aircraft lease contracts fulfilling the capitalisation criteria defined by IFRS 16, the lease term will correspond to the duration of the contracts signed except in cases where the Group is reasonably certain of exercising renewal options contractually foreseen. For example, this may be the case if important cabin customisation has taken place whereas the residual lease term is significantly shorter than the useful life of cabins.

The discount rate used to calculate the right-of-use asset and the lease debt will correspond, for each aircraft, to the implicit rate involved by the contractual elements.

The impacts on the statement of profit or loss will be as follows:

- » Cancellation of lease cost in "aircraft operating lease costs" involving the cancellation of the EBITDAR;
- » Amortisation of the right-of-use asset; and
- » Financial costs of the lease debt.

Since most of the aircraft lease contracts are denominated in USDs, starting from January 1, 2018 the Group will put in place a natural hedge for its USD revenues by the lease debt in USD in order to limit the volatility of the foreign exchange result involved by the revaluation of its lease debt.

Accounting of the maintenance of leased aircraft

Within the framework of IFRS 16 deployment, the Group has reviewed the accounting of the maintenance costs and of the contractual maintenance obligations at redelivery of its leased aircraft. Maintenance operations on leased aircraft will therefore be recorded as follows:

- » Recognition of a provision on delivery of the aircraft when works are not dependent on aircraft use for maintenance costs to be incurred when the aircraft must be redelivered to the lessor. The counterpart of the provision is recorded in the book value of the right-of-use asset at the inception of the lease;

- » Recognition of a provision for redelivery costs corresponding to the potential of flight hours that leased aircraft must have at the date of their redelivery to the lessor according to the consumption of potentials. In addition, the probability of the aircraft redelivery at the end of the contract shall not be integrated in the calculation of this provision, as it is the case currently; and
- » Identification of components corresponding to potentials included in the right-of-use asset of each leased aircraft. These components are amortised over the period between the date of acquisition and the next major overhaul.

The main impacts on the statement of profit or loss will be as follows:

- » Decrease in operational costs due to the capitalisation of maintenance costs for the rebuilding of potential of flight hours; and
- » Increase in "Amortisation, depreciation and provisions".

Capitalisation of real-estate lease contracts

The Group has analysed all the real-estate contracts to ensure that they fulfill the criteria to qualify as leases according to IFRS 16. In particular, when the Group has taken into account that when it rents surfaces in airports other than its hub (Amsterdam), an effective substitution right in the hand of the lessor leads not to consider the existence of a lease contract.

Based on its analysis, the Group has identified lease contracts according to the standard concerning surfaces rented in its hubs, lease contracts on building devoted to the maintenance business, lounges customized in airports other than hubs and lease contracts on office buildings. The lease term will correspond to the not terminable period completed if necessary by options of renewal of which the use by the Group is reasonably certain. The discount rate used to calculate the right-of-use asset and the lease debt will be determined, for each asset, according to the incremental borrowing rate at the signature debt.

The impacts on the statement of profit or loss will be as follows:

- » Cancellation of the rents included in "external expenses" involving an increase in EBITDA;
- » Amortisation of the right-of-use asset; and
- » Financial costs on the lease debt.

Accounting of the other assets leases

The Group has made the analysis of all the lease contracts on other assets to ensure that they fulfill the criteria to qualify and to account a lease according to IFRS 16. After its analysis, the main lease contracts identified correspond to company car, pool of spare parts and engines.

The lease term will correspond to the not terminable period completed if necessary by options of renewal of which the use by the Group is reasonably certain. The discount rate used to calculate the right-of-use asset and the lease debt will be determined, for each asset, according to the incremental borrowing rate at the signature debt.

The impacts on the statement of profit or loss will be as follows:

- » Cancellation of the rents included in "external expenses" involving an increase in EBITDA;
- » Amortisation of the right-of-use asset; and
- » Financial costs on the lease debt.

The impacts on the cash flow statements are mainly a reclassification of flows linked to maintenance works. Currently, they are presented in "Net cash flow from operating activities". Under IFRS 16, being associated to a fixed asset (right-of-use assets), they will be presented in "Purchase of property plant and equipment and intangible assets".

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

- » Amendment to IFRS 2 "Classification and Measurement of Share-based Payment Transactions", effective for the period beginning January 1, 2018;
- » Amendment to IFRS 12 "Disclosure of Interests in Other Entities", effective for the period beginning January 1, 2017;
- » Amendment to IAS 28 "Long-term interests in associate or joint venture", effective for the period beginning January 1, 2019;
- » Interpretation IFRIC 22 "Foreign Currency Transactions and Advance Consideration", effective for the period beginning January 1, 2018;
- » Interpretation IFRIC 23 "Uncertainty over Income Tax Treatments", effective for the period beginning January 1, 2019;
- » Amendment to IFRS 9 "Prepayment Features with Negative Compensation", effective for the period beginning January 1, 2019;
- » Amendment to IAS 12 "Income Tax Consequences of Payments on Instruments classified as Equity", effective for the period beginning January 1, 2019;
- » Amendment to IFRS 3 and IFRS 11 "Previously Held Interests in Joint Operation", effective for the period beginning January 1, 2019;
- » Amendment to IAS 23 "Borrowing Costs Eligible for Capitalisation", effective for the period beginning January 1, 2019; and
- » IFRS 17 "Insurance Contracts", effective for the period beginning January 1, 2021.

The Group does not expect any material impacts relating to the application of the amendments to IFRS 2 and IFRIC 22, which are effective for the period beginning January 1, 2018.

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 or loss.

Intra-group operations

All intra-group balances and transactions, including income, expenses and dividends are fully eliminated. Profits or 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 joint 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 recognises 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.

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.

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

	Balance Sheet December 31, 2017 EUR	Average in Statement of profit or loss 2017 EUR	Balance Sheet December 31, 2016 EUR
1 US dollar (USD)	0.83	0.89	0.95
1 Pound sterling (GBP)	1.13	1.15	1.17
1 Swiss franc (CHF)	0.85	0.91	0.93
100 Japanese yen (JPY)	0.74	0.80	0.81
100 Kenya shilling (KES)	0.79	0.87	0.94

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.

As from 2017, the Group has as its principal businesses: network activities, which include air transport of passengers and cargo activities, aircraft maintenance, leisure and other activities linked to air transport. Note 34 and 35 have been restated accordingly.

Business segments

The activities of each segment are as follows:

» Network

Includes air transport of passengers and cargo activities:

- » Passenger 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; and
- » 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; and
- » 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 less 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; and
- » Significant and infrequent elements such as the recognition of goodwill in the statement of profit or 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 statement of profit or loss 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, property, plant and equipment 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, software 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 the relevant 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, which 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 offset 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; and
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 of 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 income 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:

- » The present value of the defined benefit obligations at the balance sheet date; and
- » 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.

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 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 allocated by 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

Network

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 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 minimise 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/losses disposal are netted.

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 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 or 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 2017, 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 programme (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, based on geographical and counterparty risk, 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, 2017, KLM identified the following exposure to counterparty risk:

LT Rating (Standard & Poor's)	Total exposure in EUR millions
AAA	518
AA+	76
AA-	142
A+	67
A	635
Total	1,438

At December 31, 2017, 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, among 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				Pre-payments	Total
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total		
Historical cost										
As at Jan. 1, 2017	1,342	2,576	2,006	5,924	626	459	187	1,272	238	7,434
Additions	169	169	457	795	28	36	11	75	6	876
Disposals	(506)	-	(310)	(816)	(4)	(52)	(2)	(58)	-	(874)
Other movements	816	(585)	32	263	10	-	(6)	4	219	486
As at Dec. 31, 2017	1,821	2,160	2,185	6,166	660	443	190	1,293	463	7,922
Accumulated depreciation										
As at Jan 1, 2017	863	1,041	954	2,858	299	355	139	793	-	3,651
Depreciation	90	123	202	415	33	25	8	66	-	481
Disposals	(503)	-	(284)	(787)	(4)	(52)	(3)	(59)	-	(846)
Other movements	594	(348)	66	312	10	(1)	(4)	5	-	317
As at Dec. 31, 2017	1,044	816	938	2,798	338	327	140	805	-	3,603
Net carrying amount										
As at Jan. 1, 2017	479	1,535	1,052	3,066	327	104	48	479	238	3,783
As at Dec. 31, 2017	777	1,344	1,247	3,368	322	116	50	488	463	4,319

	Flight equipment				Other property and equipment				Pre-payments	Total
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	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

Other movements mainly relate to the reclassification of finance leased aircraft to owned aircraft at the end of the lease and the impact of hedging on fleet prepayments.

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

	As at December 31,	2017	2016
Aircraft		49	57
Land and buildings		116	122
Other property and equipment		21	23
Carrying amount		186	202

Borrowing cost capitalised during the year amounts to EUR 6 million (2016 EUR 3 million). The interest rate used to determine the amount of borrowing cost to be capitalised was 3.0% (2016 2.8%).

Land and buildings include buildings located on land which has been leased on a long-term basis. The book value of these buildings at December 31, 2017 amounts to EUR 213 million (December 31, 2016 EUR 212 million).

2. Intangible assets

	Goodwill	Software	Software under development	Total
Historical cost				
As at January 1, 2017	39	438	92	569
Additions	-	10	108	118
Disposals	-	(55)	(15)	(70)
Other movements	-	42	(43)	(1)
As at December 31, 2017	39	435	142	616
Accumulated amortisation and impairment				
As at January 1, 2017	29	197	-	226
Amortisation	-	51	-	51
Disposals	-	(55)	-	(55)
Other movements	-	-	-	-
As at December 31, 2017	29	193	-	222
Net carrying amount				
As at January 1, 2017	10	241	92	343
As at December 31, 2017	10	242	142	394
Historical cost				
As at January 1, 2016	39	416	56	511
Additions	-	44	49	93
Disposals	-	(20)	(13)	(33)
Other movements	-	(2)	-	(2)
As at December 31, 2016	39	438	92	569
Accumulated amortisation and impairment				
As at January 1, 2016	29	174	-	203
Amortisation	-	42	-	42
Disposals	-	(20)	-	(20)
Other movements	-	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

As at December 31, 2017, 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,	2017	2016
Associates		5	-
Jointly controlled entities		19	22
Carrying amount		24	22

Investments in associates

	2017	2016
Carrying amount as at January 1	-	(1)
Movements		
Investments	5	-
Share of profit after taxation	4	-
Dividends received	(1)	-
Foreign currency translation differences	-	1
Other movements	(3)	-
Net movement	5	1
Carrying amount as at December 31	5	-

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 main associate Transavia France S.A.S. can be summarised as follows:

	As at December 31,	2017	2016
Country of incorporation		France	France
Percentage of interest held		4.49%	40%
Assets		523	277
Liabilities		443	349
Revenues		568	454
Profit/(loss) after taxation		46	(40)
Share of profit / (loss) after taxation		2	(16)

As per December 31, 2016 Transavia France S.A.S. (Transavia France) was an associate controlled by Air France (60%) and Transavia Airlines C.V. (40%) (Transavia). Transavia France had a negative equity and therefore both shareholders decided on a capital increase by Air France in November 2017. Transavia decided not to participate in this capital increase. As a result the Transavia interest in Transavia France decreased from 40% to 4.49%. Despite this Transavia concluded that the significant influence prior to the capital increase has not changed significantly after the transaction. As a result the Group continues equity accounting for its 4.49% interest in Transavia France.

The carrying amount of the 4.49% stake in Transavia France is EUR 4 million (2016 EUR nil million) as at December 31, 2017.

In addition in November 2017 both shareholders agreed a put option whereby Transavia was granted the right to sell to Air France its 4.49% shareholding in Transavia France in 2020 at a fixed price depending on the average actual net results in 2018-2019 of Transavia France. Based on an assessment and sensitivity tests Transavia concluded that this option is currently out of the money and therefore valued at nil as per December 31, 2017.

Former investments in associates

On November 16, 2017 Kenya Airways Ltd. announced that its debt and equity restructuring has been finalised. As a result, among others, the Group's interest in its associate with which it has a joint venture decreased from 26.73% to 7.76% and the Group lost its ability to exercise significant influence on Kenya Airways. Consequently, Kenya Airways is not an associate anymore and has become a financial asset at fair value through profit or loss. Reference is made to note 5.

Jointly controlled entities

	2017	2016
Carrying amount as at January 1	22	25
Movements		
Dividends received	(5)	(5)
Share of profit after taxation	5	4
Other movements	(3)	(2)
Net movement	(3)	(3)
Carrying amount as at December 31	19	22

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,	2017	2016
Country of incorporation	the Netherlands	the Netherlands
Percentage of interest held	53%	53%
Percentage of voting right	45%	45%
Non-current assets	29	43
Current assets	24	11
Profit after taxation	10	7
Share of profit after taxation	5	4

4. Other assets and liabilities

As at December 31, 2017	ASSETS		LIABILITIES	
	Current	Non-current	Current	Non-current
Exchange rate risk				
Fair value hedges	25	64	(44)	(72)
Cash flow hedges	17	2	(38)	(26)
Items not qualifying for hedge accounting	11	4	(11)	(4)
Total exchange rate risk hedges	53	70	(93)	(102)
Interest rate risk				
Fair value hedges	-	10	-	(6)
Cash flow hedges	-	2	(2)	(32)
Items not qualifying for hedge accounting	-	2	-	(3)
Total interest rate risk hedges	-	14	(2)	(41)
Commodity risk hedges				
Cash flow hedges	176	36	(17)	(1)
Total commodity risk hedges	176	36	(17)	(1)
Total derivative financial instruments	229	120	(112)	(144)
Others	-	66	-	(72)
Total as at December 31, 2017	229	186	(112)	(216)

As at December 31, 2016	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)

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, 2017 the types of derivatives used, their nominal amounts and fair values are as follows:

	In millions of Euros							Fair Value
	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	
Exchange rate risk hedges								
Fair value hedges								
Forward purchases								
USD	2,096	686	339	363	323	280	105	(59)
JPY	-	-	-	-	-	-	-	-
Forward sales								
USD	379	79	30	69	56	67	78	32
Total fair value hedges	2,475	765	369	432	379	347	183	(27)
Cash flow hedges								
Options								
GBP	34	34	-	-	-	-	-	1
JPY	15	15	-	-	-	-	-	-
Forward purchases								
USD	868	568	300	-	-	-	-	(61)
GBP	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-
Forward sales								
GBP	206	139	67	-	-	-	-	3
USD	56	56	-	-	-	-	-	3
JPY	19	19	-	-	-	-	-	4
CHF	11	11	-	-	-	-	-	1
KRW	26	26	-	-	-	-	-	(1)
NOK	71	71	-	-	-	-	-	4
SGD	12	12	-	-	-	-	-	-
SEK	19	19	-	-	-	-	-	1
Total cash flow hedges	1,337	970	367	-	-	-	-	(45)
Items not qualifying for hedge accounting								
Forward purchases								
USD	119	63	15	29	12	-	-	15
Forward sales								
USD	(119)	(63)	(15)	(29)	(12)	-	-	(15)
Other	-	-	-	-	-	-	-	-
Total items not qualifying for hedge accounting	-	-	-	-	-	-	-	-
Total exchange rate risk derivatives	3,812	1,735	736	432	379	347	183	(72)

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.

As at December 31, 2017	In local currency 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
Interest rate risk hedges								
Fair value hedges								
Swaps	179	-	-	-	26	-	153	4
Total fair value hedges	179	-	-	-	26	-	153	4
Cash flow hedges								
Swaps	642	87	45	39	190	78	203	(32)
Total cash flow hedges	642	87	45	39	190	78	203	(32)
Items not qualifying for hedge accounting								
Swaps	-	-	-	-	-	-	-	(1)
Total items not qualifying for hedge accounting	-	-	-	-	-	-	-	(1)
Total interest rate risk derivatives	821	87	45	39	216	78	356	(29)

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, 2017 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	398	347	51	-	-	-	-	69
Options	1,186	768	418	-	-	-	-	125
Total cash flow hedges	1,584	1,115	469	-	-	-	-	194
Total commodity risk derivatives	1,584	1,115	469	-	-	-	-	194

Valuation methods for financial assets and liabilities at their fair value

As at December 31, 2017, 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	68	-	68
Assets at fair value through profit or loss			
Marketable securities	315	673	988
Cash and cash equivalents	-	70	70
Derivatives instruments (asset and liability)			
Currency exchange derivatives	-	(72)	(72)
Interest rate derivatives	-	(29)	(29)
Commodity derivatives	-	194	194

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, 2017.

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, 2017		December 31, 2016	
	Increase of 10 USD	Decrease of 10 USD	Increase of 10 USD	Decrease of 10 USD
Pre-tax income	(27)	(22)	(19)	(36)
Other reserves	224	(161)	215	(157)

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, 2017	Dec. 31, 2016	Dec. 31, 2017	Dec. 31, 2016
USD	506	457	328	333
JPY	-	-	235	271
CHF	-	-	320	349

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, 2017	Dec. 31, 2016	Dec. 31, 2017	Dec. 31, 2016	Dec. 31, 2017	Dec. 31, 2016
Change in value of financial instruments	(16)	(11)	21	25	-	-
Other reserves	(89)	(76)	3	7	22	20

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); and
- » 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 2017 (EUR nil million for 2016).

5. Other financial assets

	Held-to-maturity investments		Loans and receivables		At fair value through profit or loss		Total	
	2017	2016	2017	2016	2017	2016	2017	2016
Carrying amount as at January 1	332	204	13	12	48	255	393	471
Movements								
Additions and loans granted	93	114	7	5	72	4	172	123
Loans and interest repaid	(18)	-	(7)	(4)	(7)	(210)	(32)	(214)
Change in scope of consolidation	-	-	-	-	61	-	61	-
Interest accretion	6	5	-	-	-	-	6	5
Foreign currency translation differences	(34)	9	(1)	-	6	(1)	(29)	8
Other movements	-	-	3	-	-	-	3	-
Net movement	47	128	2	1	132	(207)	181	(78)
Carrying amount as at December 31	379	332	15	13	180	48	574	393

	December 31, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
Held-to-maturity investments				
Triple A bonds and long-term deposits	93	286	19	313
Loans and receivables				
Other loans and receivables	5	10	5	8
At fair value through profit or loss				
Other restricted deposits	2	-	1	-
Deposits and commercial paper with original maturity 3-12 months	70	-	-	-
Deposits on operating leased aircraft	-	25	3	32
Kenya Airways Ltd. shares	-	61	-	-
AIR FRANCE KLM S.A. shares	-	15	-	6
Other financial assets	-	7	-	6
	72	108	4	44
Carrying amount	170	404	28	365

Following a debt and equity restructuring of Kenya Airways Ltd., the Group's stake decreased from 26.73% as at December 31, 2016 to 7.76% as at December 31, 2017 and the Group lost its ability to exercise significant influence on Kenya Airways in November 2017. Consequently, Kenya Airways is not an associate anymore and has become a financial asset. Reference is made to note 3.

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

	As at December 31,	2017	2016
USD		172	287
GBP		-	1
Kenyan shilling		61	-
Total		233	288

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

	in %	December 31, 2017		December 31, 2016	
		EUR	USD	EUR	USD
Held-to-maturity investments		-	2.2	-	3.0
Loans and receivables		-	-	0.1	0.6
At fair value through profit or loss		0.1	-	-	0.3

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 195 million (December 31, 2016 EUR 35 million) is restricted.

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

	As at December 31,	2017	2016
Held-to-maturity			
Less than 1 year		93	19
Between 1 and 2 years		-	93
Between 2 and 3 years		37	11
Between 3 and 4 years		55	-
Between 4 and 5 years		2	64
Over 5 years		192	145
Total		379	332

The maturities of loans and receivables are as follows:

	As at December 31,	2017	2016
Loans and receivables			
Less than 1 year		5	5
Between 1 and 2 years		-	5
Between 2 and 3 years		-	-
Between 3 and 4 years		-	-
Between 4 and 5 years		-	-
Over 5 years		10	3
Total		15	13

The fair values of the financial assets are as follows:

As at December 31,	2017	2016
Held-to-maturity		
Triple A bonds and long-term deposits	404	338
Loans and receivables		
Other loans and receivables	15	5
At fair value through profit or loss		
Restricted deposit EU Cargo claim	50	-
Restricted deposit other	20	1
Deposits on operating leased aircraft	25	35
Kenya Airways Ltd. shares	61	-
AIR FRANCE KLM S.A. shares	15	6
Other financial assets	7	6
	178	48
Total fair value	597	391

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;
- » Kenya Airways Ltd. shares: Quoted price as at close of business on December 31, 2017;
- » AIR FRANCE KLM S.A. shares: Quoted price as at close of business on December 31, 2017 and December 31, 2016; and
- » 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,	2017	2016
Less than 1 year	105	62
Between 1 and 2 years	4	99
Between 2 and 3 years	47	-
Between 3 and 4 years	55	-
Between 4 and 5 years	2	61
Over 5 years	253	125
Total interest bearing financial assets	466	347

6. Inventories

As at December 31,	2017	2016
Carrying amount		
Maintenance inventories	189	212
Allowance for obsolete inventories	(63)	(62)
Maintenance inventories - net	126	150
Other sundry inventories	51	43
Total	177	193

7. Trade and other receivables

As at December 31,	2017	2016
Trade receivables	636	553
Provision trade receivables	(15)	(32)
Trade receivables - net	621	521
Amounts due from:		
- AIR FRANCE KLM group companies	82	54
- associates and jointly controlled entities	3	2
- maintenance contract customers	267	208
Taxes and social security premiums	38	36
Other receivables	83	51
Prepaid expenses	134	92
Total	1,228	964

As at December 31,	2017	2016
< 90 days	595	503
90-180 days	9	3
180-360 days	15	14
> 360 days	2	1
Total trade receivables	621	521

In the financial year EUR 6 million (December 31, 2016 EUR nil million increase) decrease 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, 2017 amounted to EUR 210 million (December 31, 2016 EUR 173 million).

Advances received for maintenance contracts in progress at December 31, 2017 amounted to EUR 19 million (December 31, 2016 EUR 28 million).

8. Cash and cash equivalents

As at December 31,	2017	2016
Cash at bank and in hand	70	57
Short-term deposits	988	1,151
Total	1,058	1,208

The effective interest rates on short-term deposits are in the range from -0.45% to 1.65% (2016 range 0% to 1.14%). 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,	2017	2016
USD	35	29
GBP	-	-
Other currencies	12	5
Total	47	34

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, 2017		December 31, 2016	
	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:

- To set aside an amount of the profit established in order to establish or increase reserves (art. 32.1 Articles of Association (AoA));
- Distribution of interim dividends, subject to the approval of the Supervisory Board (art. 32.4 AoA);
- 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); and
- 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); and
- 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, 2017 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, 2017	45	(2,565)	-	329	(2,191)
Gains/(losses) from cash-flow hedges	28	-	-	-	28
Exchange differences on translating foreign operations	-	(1)	13	-	12
Remeasurement of defined benefit pension plans	-	831	-	-	831
Transfer from retained earnings	-	1,144	-	53	1,197
Tax on items taken directly to or transferred from equity	(7)	(206)	-	-	(213)
As at December 31, 2017	66	(797)	13	382	(336)
As at January 1, 2016	(367)	(2,221)	(11)	294	(2,305)
(Losses)/gains 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)

The equity level slightly decreased in 2017 but KLM's financial position was further de-risked following the agreement with the cockpit crew and cabin crew to move from defined benefit to collective defined contribution pension plans, which substantially lowers the risk of unplanned heavy additional payments and equity volatility going forward. However, the volatility for movements in the value of fuel derivatives and the remeasurement of the current defined benefit pension plans remains for the ground staff pension plan and other smaller 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) that need to be recognised in the Company's equity do not directly affect the statement of profit or loss.

Despite the de-risking of the cockpit and cabin crew pension plans the equity is still low per end 2017. Going forward the balance sheet and thus the equity need to be strengthened.

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 remaining 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, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
AIR FRANCE KLM S.A.	-	198	-	288
Total	-	198	-	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, 2017, KLM has no amounts drawn under this facility, which matures on January 18, 2018 in line with the maturity date of the bond.

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. This intercompany loan facility remains in place, despite the fact that the related bond has converted at AIR FRANCE KLM S.A. in November 2017. On December 31, 2017, 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, 2017			December 31, 2016		
	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	364	9	355	403	8	395
Total current	364	9	355	403	8	395
Between 1 and 2 years	240	19	221	368	16	352
Between 2 and 3 years	176	14	162	228	12	216
Between 3 and 4 years	231	12	219	166	10	156
Between 4 and 5 years	104	9	95	226	8	218
Over 5 years	507	23	484	442	19	423
Total non-current	1,258	77	1,181	1,430	65	1,365
Total	1,622	86	1,536	1,833	73	1,760

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 1.78% (average fixed rate 2.28%, average floating rate 1.32%). Taking into account the impact of hedging the average interest rate is 2.16% (average fixed rate 2.39%, average floating rate 1.29%). After hedging 82% of the outstanding lease liabilities have a fixed interest rate.

The fair value of finance lease liabilities amounts to EUR 1,165 million as at December 31, 2017 (December 31, 2016 EUR 1,414 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, 2017	2016	December 31, 2017	2016	December 31, 2017	2016	December 31, 2017	2016
Operating lease commitments								
Within 1 year	449	504	35	35	12	13	496	552
Total current	449	504	35	35	12	13	496	552
Between 1 and 2 years	408	482	31	32	10	12	449	526
Between 2 and 3 years	359	445	23	30	7	10	389	485
Between 3 and 4 years	302	399	19	22	3	6	324	427
Between 4 and 5 years	236	339	16	17	2	3	254	359
Over 5 years	262	561	154	152	4	6	420	719
Total non-current	1,567	2,226	243	253	26	37	1,836	2,516
Total	2,016	2,730	278	288	38	50	2,332	3,068

13. Other financial liabilities

	2017	2016
Carrying amount as at January 1	1,293	1,271
Additions and loans received	91	92
Loans repaid	(188)	(92)
Foreign currency translation differences	(56)	15
Other changes	6	7
Net movement	(147)	22
Carrying amount as at December 31	1,146	1,293

The financial liabilities comprise:

	December 31, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
A Cumulative preference shares	-	18	-	18
C Cumulative preference shares	-	14	-	14
Subordinated perpetual loans	-	544	-	600
Other loans (secured/unsecured)	33	537	85	576
Total	33	1,113	85	1,208

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 336 million as at December 31, 2017 (December 31, 2016 EUR 349 million) are listed on the SWX Swiss Exchange, Zurich.

The maturity of financial liabilities is as follows:

As at December 31,	2017	2016
Less than 1 year	33	85
Between 1 and 2 years	11	131
Between 2 and 3 years	148	134
Between 3 and 4 years	267	148
Between 4 and 5 years	105	152
Over 5 years	582	643
Total	1,146	1,293

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

As at December 31,	2017	2016
USD	4	5
CHF	320	349
JPY	224	251
Total	548	605

The fair values of financial liabilities are as follows:

As at December 31,	2017	2016
A Cumulative preference shares	18	18
C Cumulative preference shares	14	14
Subordinated perpetual loans	511	544
Other loans (secured/unsecured)	508	681
Fair value	1,051	1,257

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, 2017				
Total borrowings	578	-	568	1,146
Effect of interest rate swaps	(63)	-	63	-
	515	-	631	1,146
As at December 31, 2016				
Total borrowings	671	-	622	1,293
Effect of interest rate swaps	(64)	-	64	-
	607	-	686	1,293

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

in %	December 31, 2017		December 31, 2016	
	EUR	Other	EUR	Other
Cumulative preference shares	3.70	-	3.70	-
Subordinated perpetual loans	-	4.73	-	3.96
Other loans	1.58	-	1.60	-

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	-	544	-	4.73	4.73
Other loans	509	63	1.69	1.57	1.68

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 2017 or 2016.

The total financial liabilities are as follows:

	Note	As at December 31,	
		2017	2016
Finance lease obligations	12	355	395
Other financial liabilities	13	33	85
Total current		388	480
Loans from parent company	11	198	288
Finance lease obligations	12	1,181	1,365
Perpetual subordinated loan stock in YEN	13	208	251
Perpetual subordinated loan stock in Swiss francs	13	336	349
Cumulative preference shares	13	32	32
Other financial liabilities	13	537	576
Total non-current		2,492	2,861
Total		2,880	3,341

The total movements in financial liabilities are as follows:

	Note	As at January 1, 2017	New financial debt	Reimbursement of financial debt	Currency translation differences	Other	As at December 31, 2017
Loans from parent company	11	288	90	(180)	-	-	198
Finance lease obligations	12	1,760	261	(397)	(21)	(66)	1,537
Perpetual subordinated loan stock	13	600	-	-	(56)	-	544
Cumulative preference shares	13	32	-	-	-	-	32
Other financial liabilities	13	661	91	(188)	(1)	6	569
Total		3,341	442	(765)	(78)	(60)	2,880

14. Net debt

	As at December 31,	2017	2016
Current and non-current financial debt		2,882	3,343
Financial debt		2,882	3,343
Cash and cash equivalents		1,058	1,208
Restricted deposits		80	44
Cross currency element of CCIR swaps		5	40
Near cash		379	298
Financial assets		1,522	1,590
Total net debt		1,360	1,753
		2017	2016
Carrying amount as at January 1		1,753	2,078
Free cash flow		(360)	(378)
Other (including currency translation adjustment)		(33)	53
Net movement		(393)	(325)
Carrying amount as at December 31		1,360	1,753

15. Deferred income

	December 31, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
Advance ticket sales	1,028	-	907	-
Sale and leaseback transactions	1	14	2	13
Flying Blue frequent flyer program	88	191	95	188
Others	16	2	13	3
Total	1,133	207	1,017	204

16. Deferred income tax

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

	2017	2016
Carrying amount as at January 1	(119)	(214)
Income statement (credit) /charge	(239)	69
Tax (credited)/charged to equity	213	23
Other movements	-	3
Net movement	(26)	95
Carrying amount as at December 31	(145)	(119)

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 30 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 27 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,	2017	2016
Deferred tax asset other tax jurisdictions	(30)	(38)
Net deferred tax asset Dutch tax fiscal unity (offset)	(115)	(81)
	(145)	(119)

The net deferred tax liability is built up as follows:

As at December 31,	2017	2016
Deferred tax assets		
Deferred tax assets to be recovered in 12 months or less	168	90
Deferred tax assets to be recovered after more than 12 months	19	119
	187	209
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	70	126
	72	128
Net deferred tax asset KLM income tax fiscal unity (offset)	(115)	(81)

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					
2017					
Tax losses	223	(200)	-	190	213
Fleet assets	1	-	-	-	1
Provisions for employee benefits	45	-	(6)	-	39
Derivative financial instruments	(15)	-	(7)	-	(22)
Other	3	-	-	(7)	(4)
Total	257	(200)	(13)	183	227
	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					
2016					
Tax losses	280	(56)	-	(1)	223
Fleet assets	2	(1)	-	-	1
Provisions for employee benefits	35	-	10	-	45
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 liabilities					
2017					
Other tangible fixed assets	(8)	(2)	-	-	(10)
Pensions and benefits (asset)	329	(437)	200	-	92
Maintenance provision	(131)	-	-	131	-
Other	(52)	-	-	52	-
Total	138	(439)	200	183	82
	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					
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

The Group has tax loss carry forwards in the Netherlands amounting to EUR 0.8 billion (December 31, 2016 EUR 0.9 billion) and in The United Kingdom amounting to EUR 23 million (December 31, 2016 EUR 17 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.

In 2015, some accounting principles in the KLM income tax fiscal unity were changed as a result of which the result for tax purposes increased with EUR 730 million. This higher result was fully offset by tax losses carried forward. In 2017 these accounting principles have been fully reversed, by re-filing of the 2015 corporate income tax return.

In 2017 an amount of EUR 4 million of pre-fiscal unity income tax losses of Martinair Holland N.V. has been used. As per January 1, 2018 the maximum future period for utilising tax losses carried forward of nine years on these pre-fiscal unity income tax losses ended.

The Group has tax loss carry forwards in The United Kingdom in the amount of EUR 9 million (December 31, 2016 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 20 million (December 31, 2016 EUR 31 million).

17. Provisions for employee benefits

As at December 31,	2017	2016
Pension and early-retirement obligations	381	357
Post-employment medical benefits	32	37
Other long-term employment benefits	97	96
Termination benefits	13	12
Total liabilities	523	502
Less: Non-current portion		
Pension and early-retirement obligations	288	337
Post-employment medical benefits	30	35
Other long-term employment benefits	93	92
Termination benefits	12	10
Non-current portion	423	474
Current portion	100	28

As at December 31,	2017	2016
Assets		
Pension assets non current portion	590	1,462
Total assets	590	1,462

Pension plans

As already stipulated in the 2016 Annual Report the Company was in discussion with the KLM cabin crew unions and the KLM cockpit union on de-risking the pension plans, which could lead to derecognizing the related pension asset.

In August 2017, the Company and the KLM cabin crew unions agreed to modify the cabin crew plan. This modified plan qualifies as a defined contribution plan (collective defined contribution) and led to derecognition of the cabin pension asset. The pension asset, based on specific actuarial assumptions for the cabin crew plan as of August 1, 2017, amounted to EUR 311 million and has been recorded in "Other non-current income and expenses" in the Consolidated statement of profit or loss. See note 27.

In December 2017, the Company and the KLM cockpit crew union agreed to modify the cockpit crew plan. This modified plan qualifies as a defined contribution plan (collective defined contribution) and led to derecognition of the cockpit pension asset. The pension asset, based on specific actuarial assumptions for the cockpit crew plan as of December 15, 2017, amounted to EUR 1,399 million and has been recorded in "Other non-current income and expenses" in the Consolidated statement of profit or loss. See note 27.

In addition a dowry payment amounting to EUR 194 million was agreed with the cockpit crew union of which EUR 120 million was paid in 2017. The agreed dowry payment has been recorded in "Other non-current income and expenses" in the Consolidated statement of profit or loss. See note 27. The remaining dowry amount of EUR 74 million to be paid has been included in the current portion of the pension and early-retirement obligations as per December 31, 2017.

These modified pension plans for KLM cabin crew and KLM cockpit crew are a significant de-risking for the Group's risk profile and reduction of volatility in the balance sheet and avoid the Company to be potentially forced to make substantial additional pension payments.

The Company sponsors a number of pension plans for employees world-wide. As per December 31, 2017, the major defined benefit plans include KLM ground staff based in the Netherlands, the United Kingdom, Germany, Hong Kong, and Japan. These 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 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 increased from 67 years to 68 years as per January 1, 2018. The average 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.

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 among 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.

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. As a consequence, the existing recovery plan for the ground staff plan has been updated as per April 1, 2017.

If the threshold cannot be realised within 10 years 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 contribution basis. A reduction of contribution is possible if the indexation of pensions is fully funded. Besides Dutch Pension Law, this reduction is not limited and can be performed either by a reimbursement of contributions, or by a reduction in future contributions. Given the Dutch fiscal rules, among others, a maximum pensionable salary of EUR 100,000 (EUR 105,075 as per January 1, 2018) 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, a substantial part of the sensitivity to an interest rate shock on all maturities is covered by an interest hedge.

Investment strategy

The board of the aforementioned ground staff plan, consults independent advisors as necessary to assist them with determining investment strategies consistent with the objectives of the fund. 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 of the Company to the benefits provided. The fund uses 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 plan invests a large proportion of its assets in equities which is believed to 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 2017

The aforementioned settlement of the cabin crew plan and the cockpit crew plan resulted in a significant decrease of plan assets amounting to EUR 11,780 million and EUR 9,876 million of funded obligations. The balance of EUR 1,904 million is recorded as a non-current expense. Reference is made to further info in this note and to note 27.

In 2017 the financial markets were very positive and plan assets (excluding settlements) increased with EUR 1,189 million. The discount rate used to calculate the pension obligations remained at 1.90% and small adjustments were made to other assumptions. Consequently the defined benefit obligations (excluding settlements) only increased with EUR 180 million.

The funding ratio (based on the average 12 months rolling policy coverage), as set by the Dutch Central Bank, is as follows as at December 31, 2017 (and as at December 31, 2016):

» Ground staff pension fund 115.3% (December 31, 2016: 103.4%).

As per year-end 2017 the ground staff pension fund is below the required coverage ratio and therefore has to issue an updated recovery plan before April 1, 2018. As a result of the 10 year rolling recovery plan no additional recovery payments are needed for 2018.

Recognition of pension assets and liabilities in the balance sheet

The funds have together a surplus totalling EUR 210 million as at December 31, 2017 (December 31, 2016 a liability of EUR 213 million, excluding the cabin crew plan and the cockpit crew plan).

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 agreement between the ground staff pension fund 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 the ground staff pension fund and the Company can have a significant impact on the recoverability of the net pension assets (IFRIC 14).

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 %	2017	2016
Weighted average assumptions used to determine benefit obligations		
Discount rate for year ended	1.92	1.92
Rate of compensation increase	1.14	0.93
Rate of price inflation	1.88	1.80
Weighted average assumptions used to determine net cost		
Discount rate for year ended	1.92	2.39
Rate of compensation increase	0.93	1.32
Rate of price compensation	1.80	1.70

For the main ground staff pension plan, 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,	
	2017	2016
Present value of wholly or partly funded obligations	8,843	18,539
Fair value of plan assets	(9,053)	(19,644)
Net liability/(asset) relating pension and other post-retirement obligations	(210)	(1,105)

	Pension and early-retirement obligations	
	As at December 31,	
	2017	2016
Amounts in the balance sheet		
Liabilities	381	357
Assets	(590)	(1,462)

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

	Pension and early-retirement obligations	
	2017	2016
Carrying amount as at January 1	18,539	16,722
Current service cost	287	230
Interest expense	323	395
Past service cost	(6)	37
Curtailments/settlements	(9,876)	-
Actuarial losses/(gains) demographic assumptions	(11)	10
Actuarial losses/(gains) financial assumptions	171	1,657
Actuarial losses/(gains) experience adjustments	(162)	3
Benefits paid from plan/company	(401)	(431)
Exchange rate changes	(21)	(84)
Net movement	(9,696)	1,817
Carrying amount as at December 31	8,843	18,539

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

	2017	2016
Fair value as at January 1	19,644	18,216
Interest income	345	431
Return on plan assets excluding interest income	831	1,197
Employer contributions	259	181
Member contributions	163	100
Curtailments/settlements	(11,780)	-
Benefits paid from plan / company	(396)	(423)
Other	1	-
Exchange rate changes	(14)	(58)
Net movement	(10,591)	1,428
Fair value as at December 31	9,053	19,644

The balance of the settlements amounts to EUR 1,904 million. This includes EUR 1,399 million non-cash settlement expenses following the modification to a collective defined contribution pension plan for the cockpit crew plan and subsequent derecognition of the cockpit crew pension asset and the same modification related to the cabin crew pension plan for a non-cash settlement expense of EUR 311 million following the derecognition of the cabin crew pension asset. In addition, a non-current expense related to a dowry payment amounting to EUR 194 million was agreed for the cockpit crew pension plan. Reference is made to note 27.

The experience adjustments are as follows:

	2017	2016
Benefit obligation	(162)	3
Plan asset	831	1,197

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

In millions of Euros	Sensitivity of the assumptions for the year ended December 31,	
	2017	2016
0.25% increase in the discount rate		
Impact on service cost	(12)	(22)
Impact on defined benefit obligation	(412)	(878)
0.25% decrease in the discount rate		
Impact on service cost	13	25
Impact on defined benefit obligation	473	1,010

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

In millions of Euros	Sensitivity of the assumptions for the year ended December 31,	
	2017	2016
0.25% increase in the salary increase		
Impact on service cost	3	5
Impact on defined benefit obligation	29	73
0.25% decrease in the salary increase		
Impact on service cost	(2)	(4)
Impact on defined benefit obligation	(26)	(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:

In millions of Euros	Sensitivity of the assumptions for the year ended December 31,	
	2017	2016
0.25% increase in the pension increase rate		
Impact on service cost	11	20
Impact on defined benefit obligation	427	909
0.25% decrease in the pension increase rate		
Impact on service cost	(8)	(14)
Impact on defined benefit obligation	(332)	(715)

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

in %	As at December 31,	
	2017	2016
Debt securities	50	49
Real estate	10	12
Equity securities	40	39

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 is 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.

As at December 31,	Post-employment medical benefits	
	2017	2016
Present value of unfunded obligations	32	37
Net liability/(asset) relating pension and other post-retirement obligations	32	37

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

	Post-employment medical benefits	
	2017	2016
Carrying amount as at January 1	37	52
Interest expense	1	2
Actuarial losses/(gains) demographic assumptions	-	(1)
Actuarial losses/(gains) financial assumptions	(1)	(7)
Actuarial losses/(gains) experience adjustments	-	(7)
Past service cost	(1)	(1)
Benefits paid from plan/company	(2)	(2)
Exchange rate changes	(2)	1
Net movement	(5)	(15)
Carrying amount as at December 31	32	37

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 %	2017	2016
Weighted average assumptions used to determine benefit obligations			
Discount rate for year		3.65	3.60
Weighted average assumptions used to determine net cost			
Discount rate for year		3.60	4.15
Medical cost trend rate assumptions used to determine net cost *			
Immediate trend rate Pre 65		7.30	11.90
Immediate trend rate Post 65		7.30	11.90
Ultimate trend rate		3.90	4.00
Year that the rate reaches ultimate trend rate		2074	2079

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

Other long-term employee benefits

	2017	2016
Jubilee benefits	66	71
Other benefits	31	25
Total carrying amount	97	96
Less: Non-current portion		
Jubilee benefits	62	67
Other benefits	31	25
Non-current portion	93	92
Current portion	4	4

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

	2017	2016
Redundancy benefits		
Non-current portion	12	10
Current portion	1	2
Total carrying amount	13	12

Termination benefits relate to a provision for projected dismissal benefits (also called severance or termination indemnities) to current employees in case they voluntarily choose to leave the Company.

18. Other provisions

	Phasing-out costs of operating lease aircraft	Aircraft maintenance provision	Legal Issues	Other	Total
As at January 1, 2017	75	449	166	66	756
Additional provisions and increases in existing provisions	44	125	31	22	222
Unused amounts reversed	(5)	(1)	(14)	-	(20)
Used during year	(3)	(100)	(29)	(46)	(178)
Foreign currency translation differences	(17)	(35)	-	-	(52)
Other changes	23	13	-	(5)	31
As at December 31, 2017	117	451	154	37	759
Current/non-current portion					
Non-current portion	104	370	145	3	622
Current portion	13	81	9	34	137
Carrying amount as at December 31, 2017	117	451	154	37	759

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 2017 discounted at 4.6% (2016 5.2%).

Legal issues

The provision as at December 31, 2017 relates to the Cargo anti-trust investigations in Europe for KLM and Martinair, anti-trust investigations in Switzerland and other Cargo related claims. 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,	2017	2016
Trade payables	983	972
Amounts due to AIR FRANCE KLM Group companies	148	96
Taxes and social security premiums	291	261
Other payables	685	577
Accrued liabilities	60	77
Total	2,167	1,983

20. Commitments

As at December 31, 2017, KLM has commitments for previously placed orders amounting to EUR 2,434 million (December 31, 2016 EUR 3,177 million). EUR 2,334 million of this amount relates to aircraft (December 31, 2016 EUR 3,069 million) of which EUR 574 million is due in 2018. The balance of the commitments as at December 31, 2017 amounting to EUR 100 million (December 31, 2016 EUR 108 million) is related to Property, plant and equipment. As at December 31, 2017 prepayments on aircraft orders have been made, amounting to EUR 346 million (December 31, 2016 EUR 329 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. On 29 May 2017, KLM submitted its appeal to the General Court of the EU. While the decision is under appeal, there is no obligation to pay the imposed fines, but accrued interest is added as from June 2017.

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 0.8 million was recorded.

As of December 31, 2017, the total amount of provisions in connection with antitrust cases amounts to EUR 144 million (including accrued interest).

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.

c. Civil actions relating to the Passenger activity

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

In 2016, The Dutch Consumer and Market Authority (ACM) studied the contacts between KLM and Schiphol from 2010 as part of the mutually dependent relationship between the two parties and the consequences that this relationship could have for competition. The ACM concluded its investigation. ACM did not establish any violation of competition law. Both parties clarified to ACM how the relationship could be continued given its importance for the mainport.

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 an outstanding bond loan issued by AIR FRANCE KLM S.A. (see note 11), amount to EUR 238 million as at December 31, 2017 (December 31, 2016 EUR 216 million).

With the conversion of the March 28, 2013 AIR FRANCE KLM S.A. convertible bond in November 2017, the Company does not provide any longer a guarantee to the related former bondholders. The guarantees that the Company provides for the 2012 plain vanilla bond issued by AIR FRANCE KLM S.A. (see note 11) cover 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, the Company has irrevocably and unconditionally agreed to act as several but not as joint guarantors (the Company for 40%). For this bond the total guaranteed amount outstanding is reduced by the total amount drawn as at December 31, 2017 on the existing related intercompany loan facilities. The total net guarantee exposure for the Company, related to this bond, is EUR 201 million as at December 31, 2017 (December 31, 2016 EUR 173 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 654 million as at December 31, 2017 (December 31, 2016 EUR 551 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

	2017	2016
Services rendered		
Passenger transport	7,496	7,114
Cargo transport	1,121	1,123
Network	8,617	8,237
Maintenance contracts	820	759
Charter and low cost business	875	773
Other services	28	31
Total revenues	10,340	9,800

23. External expenses

	2017	2016
Aircraft fuel	1,911	1,994
Chartering costs	66	61
Landing fees and route charges	796	792
Catering	209	209
Handling charges and other operating costs	580	544
Aircraft maintenance costs	994	1,009
Commercial and distribution costs	357	319
Insurance	21	25
Rentals and maintenance of housing	201	198
Sub-contracting	164	168
Other external expenses	224	200
Total external expenses	5,523	5,519

In aircraft fuel expenses an amount of EUR 11 million positive (2016 EUR 411 million negative) is included which was transferred from OCI to the consolidated statement of profit or loss.

24. Employee compensation and benefit expenses

	2017	2016
Wages and salaries	2,374	2,326
Social security premiums other than for state pension plans	243	225
Share-based remuneration	3	-
Hired personnel	159	128
Pension and early-retirement plan costs	165	164
Post-employment medical benefit costs	1	1
Other long-term employee benefit costs	10	16
Total employee compensation and benefit expenses	2,955	2,860

Pension and early-retirement plan cost comprise:

	2017	2016
Defined benefit plans	112	131
Defined contribution plans	53	33
Total	165	164

Defined benefit plans and early-retirement plan cost comprise:

	2017	2016
Current service cost	120	153
Interest expense	324	395
Interest income	(345)	(431)
Administration cost	13	14
Total	112	131

In the financial year 2017 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 112 million (2016 EUR 131 million) and the total contributions paid by the Group amounted to EUR 139 million (2016 EUR 181 million). The contributions paid in the financial year 2017 include additional deficit funding for the Dutch KLM plans amounting to EUR nil million (2016 EUR nil million) and in The United Kingdom amounting to EUR 10 million (2016 EUR 8 million).

The Group's projected defined benefit plans and early retirement plan cost for 2018 amount to EUR 115 million. The Group's expected cash contributions for these plans amount to EUR 99 million.

Post-employment medical benefits cost comprise:

	2017	2016
Interest cost	1	-
Losses/(gains) arising from plan amendments	-	1
Total	1	1

Other long-term employee benefits comprise:

	2017	2016
Current service cost	5	5
Interest cost	1	1
Immediate recognition of (gains)/losses	(3)	-
Other	7	10
Total	10	16

Number of full-time equivalent employees:

	2017	2016
Average for year		
Flight deck crew	3,251	3,242
Cabin crew	8,161	7,847
Ground staff	17,986	18,913
Total	29,398	30,002

As at December 31,	2017	2016
Flight deck crew	3,236	3,212
Cabin crew	8,099	7,447
Ground staff	18,040	18,082
Total	29,375	28,741

25. Other income and expenses

	2017	2016
Capitalised production	169	205
Operating currency hedging recycling	16	86
Other expenses	(108)	(109)
Other income and expenses	77	182

26. Amortisation, depreciation and movements in provision

	2017	2016
Intangible assets	51	42
Flight equipment	415	407
Other property and equipment	66	66
Movements in provision	54	(7)
Total amortisation, depreciation and movements in provision	586	508

27. Other non-current income and expenses

The other non-current income and expenses show a negative amount of EUR 1,849 million. This includes, among others, EUR 1,399 million non-cash settlement expenses following the modification to a defined contribution pension plan for the cockpit crew plan and subsequent derecognition of the cockpit crew pension asset and the same modification related to the cabin crew plan for a non-cash settlement expense of EUR 311 million following the derecognition of the cabin crew pension asset. In addition a non-current expense related to a dowry payment amounting to EUR 194 million was agreed for the cockpit crew plan, of which EUR 120 million was paid in 2017. See note 17.

Other non-current expenses relate to, on balance, EUR 24 million provisions for Cargo related claims and lawyers' fees, new voluntary leave plans amounting to EUR 11 million, offset by positive pension plan amendments of EUR 15 million and positive results on sale of assets amounting to EUR 25 million (mainly Boeing 747 engines and sale of Fokker 70s) and an increase in the fair value of Kenya Airways amounting to EUR 50 million following the financial restructuring of that financial fixed asset in 2017.

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).

28. Net cost of financial debt

	2017	2016
Gross cost of financial debt		
Loans from third parties	56	58
Finance leases	39	40
Other interest expenses	7	18
Total gross cost of financial debt	102	116
Income from cash and cash equivalents		
Loans to third parties	11	16
Total income from cash and cash equivalents	11	16
Net cost of financial debt	91	100

	2017	2016
Foreign currency exchange gains/(losses)	-	(9)
Fair value gains/(losses)	100	9
Other financial income and expenses	(22)	1
Total other financial income and expenses	78	1

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 5 million negative (2016 EUR 40 million positive), the change in value of derivative instruments no more qualifying for hedge accounting for EUR nil million (2016 EUR 1 million positive), revaluation of AIR FRANCE KLM S.A. shares for EUR 9 million positive (2016 EUR 2 million negative) as well as the unrealised revaluation of other balance sheet items for EUR 96 million positive (2016 EUR 30 million negative).

Other financial income and expenses include additions of EUR 22 million (2016 EUR 20 million) to maintenance provisions resulting from the discounting effect in provision calculations.

In 2016 a release of EUR 21 million accrued interest related to the annulment of the fine on the allegations of anti-competitive agreements or concerted actions in the airfreight industry by the EU commission.

29. Income tax expense / benefit

	2017	2016
Deferred tax (income)/expense relating to the origination and reversal of temporary differences and tax losses	(239)	139
Benefit from previously unrecognised tax losses	-	(72)
Reduction of tax losses carried forward	-	2
Total tax (income)/expenses	(239)	69

The applicable average tax rate in the Netherlands for the financial year 2017 is 25% (2016: 25%).

The average effective tax rate is reconciled to the applicable tax rate in the Netherlands as follows:

	in %	2017	2016
Applicable average tax rate in the Netherlands		25.0	25.0
Impact of:			
Profit free of tax/Non-deductible expenses		0.1	(1.2)
Derecognition / (recognition) of tax losses		-	(12.0)
Differences in foreign tax rate changes		-	-
Effective tax rate		25.1	11.8

30. Share-based payments

Phantom shares

The movement in the number of phantom performance shares granted is as follows:

	2017	2016
As at January 1	548,095	523,372
Granted	135,814	137,883
Forfeited	(2,565)	(2,102)
Exercised	(154,071)	(111,058)
As at December 31	527,273	548,095

The date of expiry of the phantom shares is as follows:

	As at December 31,	2017	2016
Phantom shares expiry date			
April 1, 2017		-	58,833
April 1, 2018		43,362	97,043
April 1, 2019		65,621	117,234
April 1, 2020		136,130	136,454
April 1, 2021		142,723	138,531
April 1, 2022		139,437	-
Carrying number		527,273	548,095

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 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 0.6 million as at December 31, 2017.

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 plan has an intrinsic value of EUR 0.9 million as at December 31, 2017.

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 has vested for 116.0% in April 2017. The 2015 plan has an intrinsic value of EUR 1.8 million as at December 31, 2017.

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 tranche has vested for 116.0% in April 2017. The third tranche is still conditionally awarded.

Under the Long Term Incentive plan 2017, executive employees of KLM have received (conditional and unconditional) phantom shares per April 1, 2017. The first tranche has vested for 116.0% in April 2017. The second and third tranche are still conditionally awarded.

31. Supervisory Board remuneration

(Amounts in EUR)	2017			2016		
	As Supervisory Board member	As Committee member	Total	As Supervisory Board member	As Committee member	Total
H.N.J. Smits	42,500	3,000	45,500	42,500	1,000	43,500
I.P. Asscher-Vonk (until April 21, 2017)	8,172	1,000	9,172	26,500	1,000	27,500
P.C. Calavia	26,500	-	26,500	26,500	-	26,500
A. Dautry	26,500	-	26,500	26,500	-	26,500
F. Enaud (as from April 26, 2016)	26,500	-	26,500	18,035	-	18,035
M.T.H. de Gaay Fortman (as from April 21, 2017)	17,972	3,000	20,972	-	-	-
H. Guillaume (until April 26, 2016)	-	-	-	8,465	1,000	9,465
C.C. 't Hart	26,500	2,000	28,500	26,500	4,000	30,500
R.J. Laan (until April 26, 2016)	-	-	-	8,465	1,500	9,965
J. Peyrelevade	26,500	4,000	30,500	26,500	8,000	34,500
P.F. Riolacci	26,500	-	26,500	-	-	-
A.J.M. Roobeek	26,500	2,000	28,500	26,500	4,000	30,500
Total	254,144	15,000	269,144	236,465	20,500	256,965

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)	2017	2016
P.J.Th. Elbers		475,000	450,000
R.M. de Groot		325,000	310,000
E.R. Swelheim		315,000	300,000
Total		1,115,000	1,060,000

Following a Supervisory Board decision the base salary of the Board of Managing Directors has been increased as from 2017. Despite the increase versus 2016, the base salary of the Board of Managing Directors remains significantly below the median of the applicable market benchmark as well as below that of previous KLM CEOs in the case of Mr. Elbers.

Short-term incentive plan

	(amounts in EUR)	2017 Short-term incentive plan	2016 Short-term incentive plan
P.J.Th. Elbers		446,500	405,000
R.M. de Groot		195,000	165,540
E.R. Swelheim		189,000	153,000
Total		830,500	723,540

The Remuneration Committee has evaluated KLM's actual results against the collective and individual targets set for 2017 in accordance with the remuneration policy and its proposal has subsequently been endorsed by the Supervisory Board. The exceptional financial results are reflected in the short-term incentive payment for financial year 2017.

For 2017 and 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)	2017	2016
P.J.Th. Elbers		28,883	29,042
R.M. de Groot		25,281	25,233
E.R. Swelheim		18,486	18,862
Total		72,650	73,137

Given the Dutch fiscal rules, among others, a maximum pensionable salary of EUR 103,317 (2017) 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), is lower than previous years.

Pension allowance (short-term benefit)

	(amounts in EUR)	2017	2016
P.J.Th. Elbers		114,184	77,882
R.M. de Groot		73,615	48,759
E.R. Swelheim		80,361	52,813
Total		268,160	179,454

Given the Dutch fiscal rules, as described above, the members of the Board of Managing Directors receive a pension allowance for the pensionable salary above EUR 103,317 (2017). 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 32,713 (December 31, 2016 EUR 34,461) and 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.

Total remuneration (base salary, short term incentive plan and pensions)

	(amounts in EUR)	2017	2016
P.J.Th. Elbers		1,069,847	967,204
R.M. de Groot		624,176	554,812
E.R. Swelheim		608,127	529,955
Total		2,302,150	2,051,971

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, 2017:

(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, 2017
P.J.Th. Elbers								
April, 2012	4,500	April 1, 2017	(1,195)	3,305	6.48	-	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	(174)	-		-	9,826	9,826
April, 2016	10,000	April 1, 2021	-	-		2,514	7,486	10,000
April, 2017	10,000	April 1, 2022	-	-		6,133	3,867	10,000
	48,000		(3,399)	3,305		8,647	35,954	41,296
R.M. de Groot								
April, 2012	1,500	April 1, 2017	(398)	1,102	6.48	-	1,102	-
April, 2013	1,500	April 1, 2018	(227)	1,273	8.38	-	1,273	-
April, 2014	1,500	April 1, 2019	(224)	1,276	8.38	-	1,276	-
April, 2015	4,500	April 1, 2020	(78)	-		-	4,422	4,422
April, 2016	6,000	April 1, 2021	-	-		1,508	4,492	6,000
April, 2017	6,000	April 1, 2022	-	-		3,680	2,320	6,000
	21,000		(927)	3,651		5,188	14,885	16,422
E.R. Swelheim								
April, 2012	4,500	April 1, 2017	(1,195)	3,305	7.06	-	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	(104)	-		-	5,896	5,896
April, 2016	6,000	April 1, 2021	-	-		1,508	4,492	6,000
April, 2017	6,000	April 1, 2022	-	-		3,680	2,320	6,000
	31,500		(2,653)	3,305		5,188	23,659	25,542
P.F. Hartman (until July 1, 2013)								
April, 2013	10,000	April 1, 2018	(1,517)	8,483	7.52	-	8,483	-
	10,000		(1,517)	8,483		-	8,483	-
Total	110,500		(8,496)	18,744		19,023	82,981	83,260

Cost of the phantom shares are based on IFRS accounting standards and do not reflect the value of the phantom shares at the vesting date.

The 2017 phantom shares cost for the current Board of Managing Directors members is for Mr. Elbers EUR 325,825 (2016: EUR 13,237), of which EUR 180,928 relates to the technical revaluation of the phantom shares portfolio following the 2017 sharp increase of the AIR FRANCE KLM share price from 5.17 as per December 31, 2016 to EUR 13.58 per December 31, 2017. For Mr. de Groot EUR 128,680 (2016: EUR 9,426), of which EUR 49,893 relates to the technical revaluation of the portfolio and for Mr. Swelheim EUR 205,574 (2016: EUR 2,600), of which EUR 118,632 relates to the technical revaluation of the portfolio.

As at December 31, 2017 Mr. Elbers, Mr. de Groot, and Mr. Swelheim had no interest in AIR FRANCE KLM S.A.

The 2017 remuneration, including phantom shares cost, of the Board of Managing Directors amounts to EUR 2,962,229 (2016: EUR 2,077,234). For Mr. Elbers EUR 1,395,672 (2016: EUR 980,441), of which EUR 180,928 relates to the technical revaluation of the phantom shares portfolio following the 2017 sharp increase of the AIR FRANCE KLM share price. For Mr. de Groot EUR 752,856 (2016: EUR 564,238), of which EUR 49,893 relates to the technical revaluation of the portfolio and for Mr. Swelheim EUR 813,701 (2016: EUR 532,555), of which EUR 118,632 relates to the technical revaluation of the portfolio.

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:

	2017	2016
Sales of goods and services		
AIR FRANCE KLM Group companies	143	144
Associates	14	9
Other related parties	36	-
Purchases of goods and services		
AIR FRANCE KLM Group companies	262	242
Associates	6	-
Other related parties	31	21

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 2017 and 2016.

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

2017	Network	Maintenance	Leisure	Other	Eliminations	Total
Revenues						
Revenues External	8,617	820	875	28	-	10,340
Revenues Internal	126	754	2	208	(1,090)	-
Total revenue	8,743	1,574	877	236	(1,090)	10,340
EBITDAR	1,633	110	186	10	-	1,939
EBITDA	1,268	110	109	9	-	1,496
Income from current operations	810	42	52	6	-	910
Other non-current income and expenses						(1,849)
Financial income and expenses						(13)
Income tax benefit						239
Share of results of equity shareholdings						10
Loss for the year						(703)
Amortisation, depreciation and movements in provision	(458)	(68)	(57)	(3)	-	(586)
Other financial income and expenses	43	(17)	14	38	-	78
Assets						
Intangible assets	175	52	23	144	-	394
Flight equipment	2,878	440	395	38	-	3,751
Other property, plant and equipment	113	96	5	354	-	568
Trade receivables	611	18	18	(26)	-	621
Other assets	450	595	216	2,329	-	3,590
Total assets	4,227	1,201	657	2,839	-	8,924
Liabilities						
Deferred revenues on sales	1,232	56	108	-	-	1,396
Other liabilities	3,167	221	445	2,768	-	6,601
Total liabilities	4,399	277	553	2,768	-	7,997

2016	Network	Maintenance	Leisure	Other	Eliminations	Total
Revenues						
Revenues External	8,237	759	773	31	-	9,800
Revenues Internal	639	768	-	197	(1,604)	-
Total revenue	8,876	1,527	773	228	(1,604)	9,800
EBITDAR	1,365	102	123	13	-	1,603
EBITDA	1,025	102	51	11	-	1,189
Income from current operations	604	40	29	8	-	681
Other non-current income and expenses						3
Financial income and expenses						(99)
Income tax expenses						(69)
Share of results of equity shareholdings						3
Profit for the year						519
Amortisation, depreciation and movements in provision	(421)	(63)	(21)	(3)	-	(508)
Other financial income and expenses	12	4	(12)	(3)	-	1
Assets						
Intangible assets	163	58	24	98	-	343
Flight equipment	2,689	371	335	(156)	-	3,239
Other property, plant and equipment	104	83	5	352	-	544
Trade receivables	488	16	17	-	-	521
Other assets	402	523	199	3,257	-	4,381
Total assets	3,846	1,051	580	3,551	-	9,028
Liabilities						
Deferred revenues on sales	1,130	72	91	-	-	1,293
Other liabilities	3,492	266	378	2,611	-	6,747
Total liabilities	4,622	338	469	2,611	-	8,040

35. Secondary segment reporting

Revenues by destination 2017	Europe, North Africa	Caribbean, Indian Ocean	Africa, Middle East	Americas Polynesia	Asia, New Caledonia	Total
Scheduled passenger	2,321	371	950	2,167	1,464	7,273
Other passenger revenues	71	11	30	66	45	223
Total passenger revenues	2,392	382	980	2,233	1,509	7,496
Scheduled cargo	13	19	202	508	310	1,052
Other cargo revenues	1	1	14	33	20	69
Total cargo revenues	14	20	216	541	330	1,121
Total network revenues	2,406	402	1,196	2,774	1,839	8,617
Maintenance	820	-	-	-	-	820
Other revenues	903	-	-	-	-	903
Total maintenance and other	1,723	-	-	-	-	1,723
Total revenues by destination	4,129	402	1,196	2,774	1,839	10,340

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
Total network revenues	2,235	371	1,208	2,656	1,767	8,237
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

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, 2017:

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, 2017	December 31, 2016
Before proposed appropriation of the result for the year			
ASSETS			
Non-current assets			
Property, plant and equipment	37	3,362	3,061
Intangible assets		367	314
Investments accounted for using the equity method	38	408	307
Other non-current assets	4	203	317
Other financial assets	39	372	364
Deferred income tax assets	48	34	-
Pension assets	17	590	1,462
		5,336	5,825
Current assets			
Other current assets	4	252	224
Other financial assets	39	95	26
Inventories		140	154
Trade and other receivables	40	1,899	1,372
Cash and cash equivalents	41	383	720
		2,769	2,496
TOTAL ASSETS		8,105	8,321
EQUITY			
Capital and reserves			
Share capital	42	94	94
Share premium		474	474
Other reserves	42	(336)	(2,191)
Retained earnings		694	2,610
Total attributable to Company's equity holders		926	987
LIABILITIES			
Non-current liabilities			
Loans from parent company	43	198	288
Loans from subsidiaries	44	39	62
Finance lease obligations	45	675	988
Other non-current liabilities	4	214	176
Other financial liabilities	46	1,027	1,124
Deferred income	47	200	196
Deferred income tax liabilities	48	-	6
Provisions	49	642	618
		2,995	3,458
Current liabilities			
Trade and other payables	50	2,471	2,241
Loans from subsidiaries	44	33	33
Finance lease obligations	45	297	356
Other current liabilities	4	132	95
Other financial liabilities	46	30	84
Deferred income	47	1,028	929
Provisions	49	193	138
		4,184	3,876
Total liabilities		7,179	7,334
TOTAL EQUITY AND LIABILITIES		8,105	8,321

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	2017	2016
Profit / (loss) from investments accounted for using equity method after taxation	119	90
Profit / (loss) of KLM N.V. after taxation	(823)	427
(Loss) / income for the year after taxation	(704)	517

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 2017 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				Pre-payments	Total
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	Total		
Historical cost										
As at Jan. 1, 2017	1,103	2,223	1,654	4,980	576	366	150	1,092	147	6,219
Additions	105	-	259	364	27	33	9	69	72	505
Disposals	(431)	-	(243)	(674)	(4)	(50)	(2)	(56)	-	(730)
Other movements	795	(518)	92	369	6	-	-	6	176	551
As at Dec. 31, 2017	1,572	1,705	1,762	5,039	605	349	157	1,111	395	6,545
Accumulated depreciation and impairment										
As at Jan. 1, 2017	731	947	814	2,492	271	284	111	666	-	3,158
Depreciation	75	105	167	347	30	21	7	58	-	405
Disposals	(409)	-	(232)	(641)	(4)	(50)	(2)	(56)	-	(697)
Other movements	574	(336)	73	311	6	-	-	6	-	317
As at Dec. 31, 2017	971	716	822	2,509	303	255	116	674	-	3,183
Net carrying amount										
As at Jan. 1, 2017	372	1,276	840	2,488	305	82	39	426	147	3,061
As at Dec. 31, 2017	601	989	940	2,530	302	94	41	437	395	3,362

	Flight equipment				Other property and equipment				Pre-payments	Total
	Owned aircraft	Leased aircraft	Other flight equipment	Total	Land and buildings	Equipment and fittings	Other property and equipment	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

Other movements mainly relate 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,	2017	2016
Aircraft		49	57
Land and buildings		116	122
Other property and equipment		21	23
Carrying amount		186	202

Borrowing cost capitalised during the year amounted to EUR 6 million (2016 EUR 3 million). The interest rate used to determine the amount of borrowing cost to be capitalised was 3.0% (2016: 2.8%).

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, 2017 was EUR 202 million (December 31, 2016 EUR 200 million).

38. Investments accounted for using the equity method

	As at December 31,	2017	2016
Subsidiaries		384	285
Associates		5	-
Jointly controlled entities		19	22
Carrying amount		408	307

	2017	2016
Subsidiaries		
Carrying amount as at January 1	285	236
Movements		
Investments	-	-
Share of profit/(loss) after taxation	113	106
OCI movement	(4)	(37)
Dividends received	(11)	(6)
Foreign currency translation differences	1	7
Other movements	-	(21)
Net movement	99	49
Carrying amount as at December 31	384	285

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, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
Held-to-maturity investments				
Triple A bonds and long-term deposits	93	147	19	206
Loans and receivables				
Other loans and receivables	1	126	3	123
At fair value through profit or loss				
Other restricted deposits	1	-	1	-
Other financial assets	-	6	-	6
Deposits on operating leased aircraft	-	17	3	23
Kenya Airways Ltd. Shares	-	61	-	-
AIR FRANCE KLM S.A. shares	-	15	-	6
Total at fair value	1	99	4	35
Carrying amount	95	372	26	364

For Kenya Airways see note 5.

40. Trade and other receivables

As at December 31,	2017	2016
Trade receivables	576	497
Provision trade receivables	(13)	(30)
Trade receivables - net	563	467
Amounts due from:		
- subsidiaries	794	524
- AIR FRANCE KLM group companies	75	46
- associates and jointly controlled entities	4	2
- maintenance contract customers	260	201
Taxes and social security premiums	30	32
Other receivables	80	46
Prepaid expenses	93	54
Total	1,899	1,372

Maintenance contract cost incurred to date for contracts in progress at December 31, 2017 amounted to EUR 210 million (December 31, 2016 EUR 173 million). Advances received for maintenance contracts in progress at December 31, 2017 amounted to EUR 19 million (December 31, 2016 EUR 28 million). The maturity of trade and other receivables is within one year.

41. Cash and cash equivalents

As at December 31,	2017	2016
Cash at bank and in hand	49	33
Short-term deposits	334	687
Total	383	720

The effective interest rates on short-term deposits are in the range from -0.45% to 1.65% (2016 range 0% to 1.14%). 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,	2017	2016
Non-current portion	198	288
Carrying amount	198	288

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,	2017	2016
Non-current portion		39	62
Current portion		33	33
Carrying amount		72	95

45. Finance lease obligations

	As at December 31,	2017	2016
Non-current portion		675	988
Current portion		297	356
Carrying amount		972	1,344

46. Other financial liabilities

	December 31, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
A Cumulative preference shares	-	18	-	18
B Cumulative preference shares	-	14	-	14
Subordinated perpetual loans	-	544	-	600
Other loans (secured/unsecured)	30	451	84	492
Total	30	1,027	84	1,124

47. Deferred income

	December 31, 2017		December 31, 2016	
	Current	Non-current	Current	Non-current
Advance ticket sales	924	-	821	-
Sale and leaseback transactions	-	7	1	4
Flying Blue frequent flyer program	88	191	95	188
Others	16	2	12	4
Total	1,028	200	929	196

48. Deferred income tax

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

	2017	2016
Carrying amount as at January 1	6	(75)
Movements		
Income statement (credit) /charge	(264)	47
Tax (credited)/charged to equity	216	30
Other movements	8	4
Net movement	(40)	81
Carrying amount as at December 31	(34)	6

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,	2017	2016
Deferred tax assets		
Deferred tax assets to be settled in 12 months or less	168	90
Deferred tax assets to be settled after 12 months	49	144
	217	234
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	181	238
	183	240
Carrying amount	(34)	6

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					
2017					
Tax losses	192	(176)	-	182	198
Fleet related assets (maintenance)	-	-	-	-	-
Provisions for employee benefits	14	-	-	-	14
Financial lease obligations	1	-	-	-	1
Derivative financial instruments	(9)	-	(16)	-	(25)
Other	36	-	-	(7)	29
Total	234	(176)	(16)	175	217
	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 liabilities					
2017					
Other tangible fixed assets	(6)	(3)	-	-	(9)
Pensions & benefits (asset)	392	(437)	200	-	155
Maintenance provision	(131)	-	-	131	-
Other	(15)	-	-	52	37
Total	240	(440)	200	183	183
	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

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, 2017	72	286	215	135	48	756
Additional provisions and increases in existing provisions	43	79	208	19	18	367
Unused amounts reversed	(5)	-	-	-	-	(5)
Used during year	-	(71)	(138)	(19)	(30)	(258)
Foreign currency translation differences	(17)	(20)	(7)	-	-	(44)
Other changes	11	18	(7)	-	(3)	19
As at December 31, 2017	104	292	271	135	33	835
Current/non-current portion						
Non-current portion	103	236	171	129	3	642
Current portion	1	56	100	6	30	193
As at December 31, 2017	104	292	271	135	33	835
	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,	2017	2016
Trade payables		905	860
Amounts due to subsidiaries		538	511
Amounts due to AIR FRANCE KLM Group companies		143	92
Taxes and social security premiums		253	247
Employee related liabilities		519	401
Accrued liabilities		79	95
Other payables		34	35
Total		2,471	2,241

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 29, 2018

The Board of Managing Directors

Pieter J.Th. Elbers
René M. de Groot
Erik R. Swelheim

The Supervisory Board

Hans N.J. Smits
Philippe C. Calavia
Alice Dautry
François Enaud
Marry de Gaay Fortman
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 audit of the financial statements 2017 included in the annual report

Our opinion

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, 2017 and of its result and its cash flows for the year then ended, 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, 2017 and of its result for the year then ended in accordance with Part 9 of Book 2 of the Dutch Civil Code.

What we have audited

We have audited the financial statements 2017 of KLM Royal Dutch Airlines ("the Company") based in Amstelveen. The financial statements include the consolidated financial statements and the company financial statements.

The consolidated financial statements comprise:

1. the consolidated balance sheet as at December 31, 2017;
2. the following consolidated statements for 2017: 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 December 31, 2017;
2. the company statement of profit or loss for 2017; 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 Wet toezicht accountantsorganisaties (Wta, Audit firms supervision act), 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 the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Audit approach

Summary

Materiality

Materiality of EUR 50 million
- 0.5% of revenue

Group audit

- 97% of total assets
- 95% of revenue

Key audit matters

- Revenue recognition for issued but unused passenger tickets
- Pensions and early retirement obligations
- Provisions for litigation and contingent liabilities

Our opinion is unqualified

Materiality

Based on our professional judgement we determined the materiality for the financial statements as a whole at EUR 50 million (2016: EUR 50 million). The materiality is determined with reference to revenue, of which it represents 0.5% (2016: 0.5%). We consider revenue as the most appropriate benchmark because of the volatility of the profit before tax. We have also taken into account misstatements and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of EUR 2 million which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

Scope of the group audit

KLM Royal Dutch Airlines is at the head of a group of components. The financial information of this group is included in the consolidated financial statements of KLM Royal Dutch Airlines.

Our group audit mainly focused on significant group components that are (i) of individual financial significance to the group, or (ii) that, due to their specific nature or circumstances, are likely to include significant risks of material misstatement of the group financial statements. We have considered in this respect the Companies business volatility and its environment. Our group audit covered the company's Network (passenger transport and cargo transport), Maintenance, Leisure and other activities.

Because we are ultimately responsible for the auditors' report, 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 components reporting for group audit purposes. Decisive were the size and/or the risk profile of the components or operations.

On this basis, we selected 11 components (2016: 12 components) to perform audits for group reporting purposes on a complete set of financial information as well as 3 components (2016: 3 components) to perform audit procedures for group reporting purposes on account balances.

We performed audit procedures ourselves at group level in respect of areas such as the annual goodwill impairment tests, accounting for associates and joint ventures, valuation of deferred tax assets and litigations and claims.

The group audit team provided detailed instructions to all component auditors who were part of the group audit,

covering the significant audit areas, including the relevant risks of material misstatement, and set out the information required to be reported back to the group audit team. For all components in scope of the group audit, we held physical meetings with the auditors of the components. We visited the components included in the Network (passenger transport and cargo transport), Maintenance, Leisure and other activities (payroll including pensions, fuel and financing). During these visits the audit approach, the findings and observations reported to the group audit team were discussed in more detail. Also file reviews were performed for most of these components.

This resulted in an audit coverage of 95% (2016: 91%) of total revenues and 97% (2016: 95%) of total assets.

For the remaining components, we performed amongst others analytical procedures at (business) group level to validate our assessment that there are no significant risks of material misstatement within these components.

The company is adopting IFRS 9 "Financial Instruments", IFRS 15 "Revenue Recognition from Contracts with Customers" and IFRS 16 "Leases" as of January 1, 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with IAS 8 Changes in Accounting Estimates and Error as set out in the general note. We have performed audit procedures for the purpose of assessing the disclosure made in accordance with IAS 8.

By performing the procedures mentioned above at group components, together with additional procedures at group level, we have been able to obtain sufficient and appropriate audit evidence about the group's financial information to provide an opinion about the consolidated financial statements.

Our procedures as described above can be summarized as follows:

Total revenues

95%
Audit of the
complete
set of financial
information

0%
Audit of
account
balances

5%
Central
procedures
remaining
entities

Total assets

92%
Audit of the
complete
set of financial
information

5%
Audit of
account
balances

3%
Central
procedures
remaining
entities

Our key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revenue recognition for issued but unused passenger tickets

Description

Revenue from the network activities amounts to EUR 8,617 million and essentially corresponds to passenger transport services and to a lesser extent to cargo. The revenue related to passenger transport is recognized when the transportation service is provided. On issuance passenger tickets are recorded as "Deferred income on ticket sales", which balance as of December 31, 2017 is EUR 1,028 million. However, a portion of these sales, relate to tickets that have been issued and paid but which will never be used and, consequently, should be recognized as revenue. The revenue recognition is based on a statistical rate which is regularly updated. The rate is determined by the company based on historical data taken from the information systems and adjusted for non-recurring and specific events of the periods considered.

We considered revenue recognition for issued but unused passenger tickets to be a key audit matter due to the importance of management judgment in determining the recognition assumptions. There is a risk that revenue may be overstated due to fraud through manipulation of the estimated percentage of tickets which will never be used.

Our response

With the assistance of our own IT specialists, we tested the operating effectiveness of key controls implemented by the company that we considered the most relevant in determining the statistical rates for "Deferred income on ticket sales."

Our procedures primarily consisted of:

- » assessing the appropriateness and consistency of the methodology adopted by the company;
- » agreeing the statistical rate calculations, for the estimated percentage of tickets which will never be used, with the underlying data from the information systems;
- » comparing actual revenue from unused passenger tickets with prior year-end estimates;

- » analysing the age of deferred revenue on ticket sales presented on the consolidated balance sheet to assess the appropriateness of the revenue recognized in the period.

Our observation

Based on our procedures performed for revenue recognition for issued but unused passenger tickets we consider that management judgment is within the acceptable range and revenue recognition accounting in accordance with EU-IFRS.

Pensions and early retirement obligations

Description

The company has a large number of retirement and other long-term benefit plans for its employees with specific characteristics, most of which are in the Netherlands and in the UK. Several of these schemes are classified as defined benefit plans.

As of December 31, 2017, the actuarial value of cumulative benefits was EUR 8,843 million, covered by plan assets with a market value of EUR 9,053 million. As of this same date, plan assets and pensions obligations recognized on the balance sheet amounted to EUR 590 million and EUR 381 million, respectively.

The measurement of obligations and related plan assets, as well as the actuarial cost for the year requires the exercise of judgment to determine the key assumptions to adopt, particularly in relation to discount and long-term inflation rates, as well as salary and pension increase rates, staff turnover in the company, life expectancy, and retirement age assumptions. As indicated in Note 17, changes in certain of these assumptions may have a material impact on pension assets and obligations recorded and company's net result. Accordingly, the company engaged external actuaries to assist determine these assumptions.

In 2017 the accounting classification of the modified pension schemes for KLM Cabin Crew and KLM Cockpit Crew as collective defined contribution plans required significant management judgement.

We considered the measurement and the correct classification of retirement and other long-term benefits as either defined benefit plans or defined contribution plans to be a key audit matter due to the materiality of the amounts, the high degree of management's judgment, the technicality required for their measurement and the sensitivity of measurement results to the assumptions adopted.

Our response

We assessed the measurement process applied by the company for employee benefit obligations.

With the assistance of our own actuaries, we examined the measurement of the obligations, assets and liabilities of the main pension plans and the information presented in the actuarial valuation reports made available by the company, in particular by assessing:

Pension commitments

- » the appropriateness of discount and long-term inflation rates in relation to available market data;
- » the consistency of the assumptions relating to salary increase, turnover and mortality rates, and pension increases with the particulars of each plan and, where applicable, with the relevant national and sector benchmarks;
- » the calculations prepared by the external actuaries, and specifically those supporting the sensitivity of obligations to changes in the discount rate.

Measurement of plan assets

- » The reasonableness of the assumptions adopted by the company to measure these assets, which primarily concern the Netherlands and the justification of their treatment as plan assets based on the documentation provided (report of the external actuary hired by the company).

We also assessed with the assistance of our own actuaries, the appropriateness of the disclosures in Note 17 to the consolidated financial statements and specifically the information covering:

- » the implementation of the modified pension schemes for KLM Cabin Crew in August 2017 and KLM Cockpit Crew in December 2017, their assessment as collective defined contribution plans, whose main impact on the accounts are (i) the derecognition of the related net assets and (ii) a mainly non-cash and non-current expense of EUR 1,904 million;
- » the sensitivity of the measurement of these obligations to the assumptions adopted.

Our observation

We consider management's key assumptions and estimates, which resulted in the measurement of the retirement and other long-term benefits plans, to be within the acceptable range, concur with the classification as either defined contribution or defined benefit of the different pension plans, and determined that the company's disclosures (Note 17) are in accordance with EU-IFRS.

Provisions for litigation and contingent liabilities

Description

The company is involved in several governmental, judicial or arbitration procedures and litigations, particularly concerning anti-trust laws. The outcome of these procedures and litigations depends on future events. The company's estimates are inherently based on the use of company assumptions and assessments.

We considered the measurement of the litigation provisions and the related disclosure to be a key audit matter due to the uncertainty surrounding the outcome of current procedures, the high degree of company estimates and judgment and the potentially material nature of the impact of provision amounts on consolidated net income and equity should these estimates change.

Our response

Our audit procedures included, amongst others, the assessment of management's process for the identification, evaluation and disclosure of claims, proceedings and investigations and the recording and continuous re-assessment of the related (contingent) liabilities and provisions and disclosures, in accordance with EU-IFRS.

We also inquired with both legal and financial staff in respect of claims, proceedings and investigations, inspected relevant correspondence, inspected the minutes of the Audit Committee, the Supervisory Board and the Executive Committee and obtained legal confirmation letters from a selection of external legal counsel.

Furthermore, we challenged the estimates and assumptions applied by the company in determining the need to recognize a provision and, where applicable, its amount.

Based on these items, we conducted a critical review of the estimates and positions adopted by the company. We also assessed the appropriateness of the disclosures in Note 21 to the consolidated financial statements including for those claims for which a provision could not be reasonably estimated.

Our observation

We consider the estimates and management's judgment applied for the litigation provision and contingent liabilities to be within the acceptable range and determined that the related disclosure (Note 21) are in accordance with EU-IFRS.

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;
- » Board and governance;
- » Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code; and
- » Section "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 Dutch 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 substantially less than the scope of those performed in our audit of the financial statements.

The Board of Managing Directors is responsible for the preparation of the other information, including the information as required by Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

KLM Royal Dutch Airlines engaged us, KPMG Accountants N.V. and Deloitte Accountants B.V. to perform a joint audit. We were re-engaged by the General Meeting of Shareholders as auditors of KLM Royal Dutch Airlines on April, 21 2017 for the audit of the year 2017, and have operated as statutory auditors ever since financial year 2005/06.

Description of responsibilities regarding the financial statements

Responsibilities of the Board of Managing Directors and the Supervisory Board for the financial statements

The Board of Managing Directors 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, the Board of Managing Directors is responsible for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Board of Managing Directors is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Board of Managing Directors should prepare the financial statements using the going concern basis of accounting unless the Board of Managing Directors either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Board of Managing Directors 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 engagement 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 detect all material errors and fraud during our audit.

Misstatements can arise from fraud or error 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 these 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.

A further description of our responsibilities for the audit of the financial statements is included in the appendix of this auditors' report. This description forms part of our auditors' report.

Amstelveen/Amsterdam, March 29, 2018

KPMG Accountants N.V.
E.H.W. Weusten RA

Deloitte Accountants B.V.
M.J. van der Vegte RA

Appendix: Description of our responsibilities for the audit of the financial statements

Appendix to our auditors' report on the financial statements 2017 of KLM Royal Dutch Airlines

Description of our responsibilities for the audit of the financial statements

We have exercised professional judgement and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included among others:

- » 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 the risk 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 the Board of Managing Directors;
- » concluding on the appropriateness of the Board of Managing Directors' 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 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 a company to cease to continue as a going concern;
- » evaluating the overall presentation, structure and content of the financial statements, including the disclosures; and
- » 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 components. Decisive were the size and/or the risk profile of the group components or operations. On this basis, we selected group components 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.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine the key audit matters: those matters that were of most significance in the audit of the financial statements. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

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 1/2% 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

In the absence of a net profit for 2017, no distribution of dividends to any class of share shall be made. The net loss for 2017 amounting to EUR 703,875,000 will be transferred to retained earnings.

Miscellaneous

Five-Year Review

(in millions of EUR, unless stated otherwise)	2017	2016	2015	2014	2013
Consolidated statement of profit or loss					
Passenger	7,496	7,114	7,143	6,847	6,869
Cargo	1,121	1,123	1,376	1,505	1,537
Other revenues	1,723	1,563	1,386	1,291	1,282
Revenues	10,340	9,800	9,905	9,643	9,688
Expenses	(8,401)	(8,197)	(8,640)	(8,629)	(8,536)
EBITDAR	1,939	1,603	1,265	1,014	1,152
Aircraft operating lease costs	(443)	(414)	(354)	(283)	(301)
EBITDA	1,496	1,189	911	731	851
Amortisation, depreciation and movement in provisions	(586)	(508)	(527)	(556)	(550)
Income from current operations	910	681	384	175	301
Financial income and expenses	(13)	(99)	(322)	(208)	(59)
Other non-current income and expenses	(1,849)	3	71	676	(51)
Pre-tax income	(952)	585	133	643	191
Income tax expenses	239	(69)	(42)	(253)	(48)
Net result after taxation of consolidated companies	(713)	516	91	390	143
Share of results of equity shareholdings	10	3	(37)	(49)	(10)
Profit / (loss) for the year	(703)	519	54	341	133
Consolidated balance sheet					
Current assets	2,862	2,617	2,321	2,314	2,418
Non-current assets	6,062	6,411	6,404	6,185	7,191
Total assets	8,924	9,028	8,725	8,499	9,609
Current liabilities	4,037	3,737	4,001	4,218	3,443
Non-current liabilities	3,960	4,303	4,328	4,272	4,555
Group equity	927	988	396	9	1,611
Total liabilities	8,924	9,028	8,725	8,499	9,609

(in millions of EUR, unless stated otherwise)

		2017	2016	2015	2014	2013
Key financial figures (KLM Group)						
Return on equity (%)		-	74,9	26,8	42,1	8,5
Result for the year as percentage of revenues		(6.8)	5.3	0.5	3.5	1.4
Earnings per ordinary share (EUR)		(15.04)	11.03	1.14	7.26	2.82
Result for the year plus depreciation		(171)	1.034	565	880	640
Capital expenditures (net)		(925)	(755)	(340)	(420)	(363)
Adjusted net debt/EBITDAR ratio		2.3	2.9	3.6	4.3	4.0
Dividend per ordinary share (EUR)		-	0.36	-	-	0.15
Average number of staff (KLM Group)						
(in FTE)						
the Netherlands		26,179	26,073	26,460	26,657	26,505
Outside the Netherlands		3,219	3,929	3,955	4,054	4,130
Employed by KLM		29,398	30,002	30,415	30,711	30,635
Total agency staff		2,274	1,874	1,928	1,983	1,870
Total KLM Group		31,672	31,876	32,343	32,694	32,505
Traffic (KLM Company)						
Passenger kilometers	*	103,487	97,737	93,228	91,477	89,039
Revenue ton freight-kilometers	*	3,727	3,722	3,730	3,764	3,688
Passenger load factor (%)		88.4	87.2	86.4	86.5	85.8
Cargo load factor (%)		63.3	64.5	65.1	66.4	66.1
Number of passengers (x 1,000)		32,689	30,399	28,562	27,740	26,581
Weight of cargo carried (kilograms)	*	471	479	483	491	480
Average distance flown per passenger (in kilometers)		3,166	3,215	3,264	3,298	3,350
Capacity (KLM Company)						
Available seat-kilometers	*	117,066	112,065	107,851	105,755	103,793
Available ton freight-kilometers	*	5,883	5,772	5,734	5,671	5,576
Kilometers flown	*	451	433	422	419	409
Blockhours (x 1,000)		674	644	630	625	612
Yield (KLM Company)						
Yield (in cents):						
Passenger (per RPK)		7.0	7.0	7.4	7.2	7.4
Cargo (per RTK)		21.7	21.6	23.9	24.2	24.7
Average number of staff (KLM Company)						
(in FTE)						
the Netherlands		20,409	20,476	20,898	20,979	20,944
Outside the Netherlands		2,397	2,444	2,619	2,744	2,719
Employed by KLM		22,806	22,920	23,517	23,723	23,663

* in millions

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).

Average capital employed

The sum of property, plant and equipment, intangible assets, equity method investments, other financial assets, provisions (excluding for pensions, cargo litigation and restructuring) and working capital (excluding market value of derivatives). The capital employed for the year is obtained by taking the average of the capital employed on the opening and closing balance sheets plus the capital employed of aircraft under operating leases (seven times the amount of operating leases for the year).

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 and 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 current operations adjusted for the portion corresponding to financial charges in operating leases (34%), dividends received, the share of results in equity shareholdings and after taxation divided by the 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 USD 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.

