

**Frjalsi
Investment Bank hf.**

**Annual Accounts
31 December 2004**

Icelandic kronas

Frjalsi Investment Bank hf.
Armuli 13a
108 Reykjavik

Reg. no. 691282-0829

Contents

Endorsement and Signatures of the Board of Directors and the Managing Director	3	Balance Sheet	6
Auditors' Report	4	Statement of Cash Flows	8
Profit and Loss Account	5	Notes to the Annual Accounts	9

Endorsement and Signatures of the Board of Directors and the Managing Director

The Annual Accounts include the Consolidated Annual Accounts of Frjalsi Investment Bank hf. and its wholly owned subsidiary, Hlidar ehf. The Annual Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Preparation of Annual Accounts of Credit Institutions. The accounting principles applied in preparing the Annual Accounts of Frjalsi Investment Bank hf. are consistent with those of the Bank for the previous year.

According to the Profit and Loss Account net earnings for the year amounted to ISK 511 million. Equity, according to the Balance Sheet, amounted to ISK 3,441 million at year-end. The Board of Directors does not propose a payment of dividend for the year 2004. Changes in equity and allocation of profit are further explained in the notes to the Annual Accounts. The capital ratio of the Bank, calculated according to the Act on Financial Undertakings, was 33.4%. The ratio may not be lower than 8.0%.

During the year, the average number of the Bank's employees was 27. Total salaries amounted to ISK 162 million and salary-related expenses amounted to ISK 34 million.

Shareholders at year-end were 6. One shareholder held more than 10% of the Bank's share capital, SPRON, which held 99.9% of the shares in the Bank.

The Board of Directors and the Managing Director hereby confirm the Annual Accounts of Frjalsi Investment Bank hf. for the year 2004 by means of their signatures.

Reykjavik, 16 February 2005.

Board of Directors

Gudmundur Hauksson

Hildur Petersen

Kristjan Hardarson

Larus Sigurdsson

Olafur Haraldsson

Managing Director:

Kristinn Bjarnason

Auditors' Report

To the Board of Directors and Shareholders of Frjalsi Investment Bank hf.

We have audited the accompanying Balance Sheet and Consolidated Balance Sheet of Frjalsi Investment Bank hf. as of 31 December 2004 and the related Profit and Loss Account and Statement of Cash Flows for the year then ended. These Annual Accounts are the responsibility of the Bank's management. Our responsibility is to express an opinion on these Annual Accounts based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Annual Accounts are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Annual Accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Annual Accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the Annual Accounts give a true and fair view of the financial position of Frjalsi Investment Bank hf. as of 31 December 2004, and the results of its operations and its cash flows for the year then ended, in accordance with the law and generally accepted accounting principles in Iceland.

Reykjavik, 16 February 2005.

Sigurdur Jonsson

Reynir Stefan Gylfason

KPMG Endurskodun hf.

Profit and Loss Account for the Year 2004

	Notes	2004	2003
Financial Income:			
Interest from credit institutions		4,717	12,617
Interest on loans		1,935,753	1,525,534
Interest on bonds		0	185,728
	4	1,940,470	1,723,879
Financial Expenses:			
Interest to credit institutions		435,142	335,627
Interest on borrowings		623,605	664,225
	4	1,058,747	999,852
Net interest income		881,723	724,027
Other Operating Income:			
Dividends from shares and other holdings		0	24
Commission receivable		67,028	62,953
Trading losses	15	(394)	(2,553)
Other operating income	16	124,784	44,654
		191,418	105,078
Net operating income		1,073,141	829,105
Other Operating Expenses:			
Salaries and salary-related expenses	18	195,525	170,485
Other administrative expenses		82,233	59,288
Depreciation	9,32	7,058	5,997
		284,816	235,770
Provision for losses	28	(165,000)	(90,000)
Pre-tax profit		623,325	503,335
Income tax	37	(112,199)	36,102
Net Earnings	38	511,126	539,437
Earnings per Share:			
Earnings per share	21	0.47	0.49

Balance Sheet

Assets

	Notes	2004	2003
Cash and Amounts Due from Credit Institutions:			
Cash and demand deposits with the Central Bank		2,360	2,248
Amounts due from other credit institutions		310,587	74,776
	22	312,947	77,024
Loans:			
Loans to customers		17,031,471	13,457,202
Mortgages foreclosed		50,319	67,653
	5-7 23-28	17,081,790	13,524,855
Bonds and Shares in Other Companies:			
Shares and other variable-yield securities	29-30	171,232	32,160
Shares in associated companies	31	552	552
	8	171,784	32,712
Other Assets:			
Fixed assets	9,32	36,816	40,738
Other assets		178,298	27,112
		215,114	67,850
Total Assets		17,781,635	13,702,441

December 31, 2004

Liabilities and Equity

	Notes	2004	2003
Amounts Owed to Credit Institutions	35	2,143,178	4,213,502
Borrowings	36	12,039,314	6,501,864
Other Liabilities		155,176	55,748
Provision for Deferred Income-Tax Liability	10,37	2,575	1,062
Equity:			
Share capital		1,096,702	1,096,702
Share premium		142,445	142,445
Statutory reserve		131,731	131,731
Retained earnings		2,070,514	1,559,387
Total equity	38-39	3,441,392	2,930,265
Total Liabilities and Equity		17,781,635	13,702,441

Off-Balance Sheet Items:

Obligations 12,40

Statement of Cash Flows for the Year 2004

	Notes	2004	2003
Cash Flows from Operating Activities:			
Net earnings	38	511,126	539,437
Difference between net earnings and cash from operations:			
Provision for losses	28	165,000	90,000
Income tax, changes	37	1,513 (224,564)
Other items		374	5,692
Changes in assets and liabilities		(240,219)	51,032
Net cash provided by operating activities		<u>437,794</u>	<u>461,597</u>
Cash Flows to Investing Activities:			
Time deposits with the Central Bank, changes		(112)	339,310
Amounts due from other credit institutions, changes		(14,169)	84,295
Loans to customers, changes		(3,721,936)	(1,967,369)
Investment bonds, changes		0	4,598,512
Investment shares, changes	29-30	(139,072)	(32,160)
Investment in shares in associated companies	31	0 (552)
Investment in fixed assets	32	(14,603)	(9,306)
Proceeds from the sale of fixed assets		18,150	3,090
Net cash (used in) provided by investing activities		<u>(3,871,742)</u>	<u>3,015,820</u>
Cash Flows from Financing Activities:			
Amounts owed to credit institutions, changes		(1,881,862)	(2,460,767)
Borrowings, changes		5,537,450	(990,050)
Net cash provided by (used in) financing activities		<u>3,655,588</u>	<u>(3,450,817)</u>
Increase in cash		221,640	26,600
Cash and cash equivalents at the beginning of the year		<u>47,809</u>	<u>21,209</u>
Cash and cash equivalents at the end of the year	11	<u><u>269,449</u></u>	<u><u>47,809</u></u>
Other Information:			
Taxes paid		0	103,269
Dividends received		0	24

Notes to the Annual Accounts

Summary of Accounting Principles

Basis of Preparation

1. The Annual Accounts of Frjalsi Investment Bank hf. contains the Consolidated Annual Accounts of the Bank and its wholly owned subsidiary, Hlidar ehf. The Annual Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Presentation and Contents of the Annual Accounts of Credit Institutions. They are based on cost accounting and are prepared according to the same accounting principles as for the previous year. The Annual Accounts are prepared in Icelandic currency and amounts are presented in thousands of Icelandic kronas.
2. Subsidiaries are companies in which the Bank holds controlling interest. The Annual Accounts of the subsidiaries are included in the Consolidated Annual Accounts of the Bank from the time of acquisition of majority interest and until the interest is no longer held. Balances between group companies, transactions and profits created in intra-group transactions are eliminated in the Annual Accounts.

Foreign Currency

3. Assets and liabilities denominated in foreign currencies are converted to Icelandic kronas at the exchange rate at year-end 2004. Operational revenue and expenses denominated in foreign currencies are converted at the exchange rate of the date of transaction.

Interest Income and Expenses

4. Interest income and interest expenses are entered into the Profit and Loss Account as they accrue based on actual interest rates. Interest income is calculated on amounts due from other financial institutions and loans. Interest expenses are calculated on amounts owed to financial institutions, borrowings and subordinated loans. If loans have been in default for more than three months or are considered to be of particular risk, interest income is no longer recognized. Revenue and expenses equivalent to interest, such as borrowing charges, are included in interest income and interest expenses as they accrue.

Loans

5. Loans are capitalised with accrued interest, indexation and exchange rate difference at year-end. Indexed loans are entered based on indices effective at the beginning of 2005 and loans in foreign currency based on the exchange rate of the relevant currencies at year-end 2004.
6. Provision for losses on the loan portfolio is made to meet the risk attached to lending operations. The loss provision is based on estimation and does not represent a final write-off. In addition to the required contribution, certain risk factors are evaluated to determine the total contribution for this purpose. Firstly, there are specific provisions to adjust for obligations of creditors that have received a poor risk evaluation, and secondly there is a general provision to meet the general risk of lending operations. Interest on doubtful loans is not entered as income. The provision has been deducted from the appropriate Balance Sheet items, less the provision for issued guarantees, which is posted among various liabilities in the Balance Sheet.
7. The Bank has redeemed assets on foreclosed mortgages. Foreclosed mortgages are valued at estimated market prices in the Annual Accounts.

Notes, contd.:

Bonds and Shares in Other Companies

8. The Bank's securities are entirely investment shares. Investment shares are those that by a formal decision are expected to be held for more than one year. Investment shares are capitalized at cost price or estimated market price, whichever is lower.

Property and Equipment

9. Property and equipment are capitalized at cost price less depreciation. Depreciation is calculated as a fixed annual percentage based on the estimated useful life of the property and equipment until a scrap value is reached. Estimated useful life is specified as follows:

Buildings	50 years
Fixtures	5 years
Machinery and equipment	3 - 5 years

Deferred Income-Tax Liability

10. The deferred income-tax liability is calculated and entered in the Annual Accounts. The calculation is based on the temporary difference between Balance Sheet items as presented in the tax return on the one hand, and in the Annual Accounts on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Annual Accounts, mostly because expenses, especially depreciation, are entered earlier in the tax return than in the Annual Accounts.

Cash and Cash Equivalents

11. Cash and cash equivalents in the Statement of Cash Flows consist of cash and demand deposits with credit institutions. Cash and cash equivalents amount to ISK 269 million at year-end.

Derivatives

12. Derivatives are financial instruments, the contracted or notional amounts of which are not included in the Bank's Balance Sheet, either because rights and obligations arise out of one and the same contract, the contracts perform after the Balance Sheet date or because the notional amounts serve merely as variables for calculating purposes. The notional amounts of derivatives do not necessarily give any indication of the size of the cash flows and the market and credit risk attached to derivatives transactions. Examples of derivatives are forward exchange contracts, options, swaps, futures and forward rate agreements. The underlying value may involve interest rate, currency, goods, bonds or shares.

The Bank's derivatives are mainly intended to reduce the exchange rate risk and interest rate risk assumed by the Bank or its customers. Derivatives performance is entered in the Profit and Loss Account and in the Balance Sheet. Net assets are capitalized among amounts due from credit institutions and other assets whereas net obligations are entered among sundry liabilities and amounts owed to credit institutions.

The market risk attached to derivatives is created by changes in the price of the factors on which the contracts are based, such as interest rate changes or exchange rate changes in currency and listed securities. Risk attached to borrowings reflects the loss incurred by the Bank if the counter party in a derivative contract were unable to fulfil its part of the contract.

Forward rate agreements and futures relating to currency, securities and interest rate are entered in the Bank's Annual Accounts at their year-end market value.

Notes, contd.:

International Financial Reporting Standards

13. According to rules on the presentation of the annual accounts of companies listed on the Iceland Stock Exchange the Bank will adjust the preparation of its Consolidated Annual Accounts in accordance with international financial reporting standards (IFRS). The due date for the implementation of these changes for companies whose bonds are listed on the Iceland Stock Exchange has not yet been decided. However, according to an EC Directive, these companies may postpone the implementation of the international accounting standards until the year 2007. The Bank is currently preparing the necessary adjustments.

Interest Expenses

14. Interest on borrowings is specified as follows:	2004	2003
Bonds issued	613,323	653,524
Bills of exchange	5,082	5,617
Other borrowings	5,200	5,084
Total	<u>623,605</u>	<u>664,225</u>

Other Operating Income

15. Trading loss is specified as follows:		
Trading shares	0	340
Asset and liabilities denominated in foreign currencies	(394)	(2,893)
Total	<u>(394)</u>	<u>(2,553)</u>

16. Other operating income is specified as follows:		
Capital gains on the sale of fixed assets	6,684	339
Other income	118,100	44,315
Total	<u>124,784</u>	<u>44,654</u>

Other Operating Expenses

17. The total number of employees is as follows:		
Average number of employees during the year measured as full time equivalent positions	27	23
Full-time equivalent positions at year-end	28	24
18. Salaries and salary-related expenses are specified as follows:		
Salaries	161,974	142,777
Salary-related expenses	33,551	27,707
Total	<u>195,525</u>	<u>170,484</u>

Notes, contd.:

19. Salaries and remunerations to the Board of Directors and the Managing Director are specified as follows:

	2004
Managing Director:	
Kristinn Bjarnason	20,449
Board of Directors:	
Gudmundur Hauksson, chairman	1,662
Olafur Haraldsson	831
Arni Thor Sigurdsson	831
Oskar Magnusson	560
Arnar Bjarnason	411
Jon G. Tomasson	201
Total	<u>24,945</u>

20. Fee to the Bank's auditors is specified as follows:

	2004	2003
Audit of the Annual Accounts	2,421	2,280
Interim Accounts review	947	928
Other services	229	476
Total	<u>3,597</u>	<u>3,684</u>

Earnings per Share

21. Earnings per share is the ratio between profit and weighted share capital at year-end:

Net earnings	511,126	539,437
Weighted average share capital	1,096,706	1,096,702
Earnings per share	0.47	0.49

Cash and Amounts due From Credit Institutions

22. Amounts due from credit institutions:

On demand	269,449	47,809
Up to 3 months	41,138	26,967
Required deposits with Central Bank according to regulation	2,360	2,248
Total	<u>312,947</u>	<u>77,024</u>

Loans

23. Loans to customers specified by types of loans:

Bonds	14,283,992	9,259,386
Other loans	2,747,479	4,197,816
Total	<u>17,031,471</u>	<u>13,457,202</u>

Notes, contd.:

24.	Loans to customers specified by sectors:		2004	2003
	Sectors:			
	Commerce and service		15.4%	14.6%
	Fishing industry and agriculture		0.7%	0.9%
	Industry and contractors		21.6%	25.6%
	Other		0.3%	0.5%
	Individuals		62.0%	58.4%
	Total		<u>100.0%</u>	<u>100.0%</u>
25.	Loans to customers and lease contracts specified by maturity:			
	On demand		137,836	136,455
	Up to 3 months		552,233	610,328
	Over 3 months and up to a year		4,404,489	3,924,306
	Over 1 year and up to 5 years		5,581,810	2,528,339
	Over 5 years		6,355,103	6,257,774
	Total		<u>17,031,471</u>	<u>13,457,202</u>
26.	Mortgages foreclosed are specified as follows:			
	Buildings		48,282	64,056
	Current assets		2,037	3,597
	Total		<u>50,319</u>	<u>67,653</u>
27.	Non-performing loans are specified as follows:			
	Loans with a specific provision for losses		593,221	120,879
	Specific provision for losses	(182,143)	(51,835)
	Non-performing loans less specific provision for losses		411,078	69,044
	Other non-performing loans		663,419	724,223
	Non-performing loans, total		<u>1,074,497</u>	<u>793,267</u>
28.	Changes in the provision for losses are specified as follows:			
		Provision for losses	2004	2003
		Specific General	Total	Total
	Balance at the beginning of the year	51,835 259,409	311,244	264,091
	Provision for losses during the year	163,372 1,628	165,000	90,000
	Actual losses during the year	(33,064)	(33,064)	(42,846)
	Balance at the end of the year	<u>182,143</u> <u>261,037</u>	<u>443,180</u>	<u>311,245</u>
	Provision for losses on the loan portfolio as a percentage of loans and issued guarantees	1.1% 1.5%	2.6%	2.3%

Notes, contd.:

Bonds and Shares in Other Companies

29. Bonds and other fixed-income securities are specified as follows:

	Nominal value	Book value
Trading shares:		
Unlisted shares	48,250	<u>109,649</u>
Investment shares:		
Unlisted shares	61,583	<u>61,583</u>
Total		<u>171,232</u>

30. Investment shares are specified as follows:

	Ownership	Nominal value	Book value
Hotel Borg ehf.	41.1%	60,583	60,583
Rekstrarfelag Spron hf.	9.1%	1,000	<u>1,000</u>
Total			<u>61,583</u>

31. Shares in associated companies are specified as follows:

The Savings Banks' Data Center, Kopavogur	552	<u>552</u>
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Fixed Assets

32. Fixed assets are specified as follows:

	Buildings	Fixtures, equipment and vehicles	Total
Total value 1.1.2004	9,068	40,394	49,462
Additions during the year	0	14,602	14,602
Sold during the year	(9,068)	(4,853)	(13,921)
Total value 31.12.2004	<u>0</u>	<u>50,143</u>	<u>50,143</u>
Previously depreciated	226	8,498	8,724
Depreciation during the year	166	6,892	7,058
Disposals during the year	(392)	(2,063)	(2,455)
Total depreciation 31.12.2004	<u>0</u>	<u>13,327</u>	<u>13,327</u>
Book value 31.12.2004	<u>0</u>	<u>36,816</u>	<u>36,816</u>
Depreciation ratios	2%	0-20%	

On 31 December 2004, the Insurance value of machinery and equipment amounted to ISK 56.6 million.

Notes, contd.:

Assets and Liabilities, Index Linked or in Foreign Currency

33. The total amount of indexed assets was ISK 13,117 million and the total amount of indexed liabilities was ISK 10,774 million at year-end.
34. The total amount of assets in foreign currencies was ISK 1,122 million at year-end and the total amount of liabilities was ISK 1,084 million at the same time. Included in assets and liabilities are currency contracts, see note 40.

Amounts Owed to Credit Institutions

35. Liabilities owed to credit institutions mature as follows:	2004	2003
Up to 3 months	602,536	1,611,644
Over 3 months and up to a year	174,351	1,218,534
Over 1 year and up to 5 years	1,366,292	1,383,324
Total	<u>2,143,179</u>	<u>4,213,502</u>

Borrowings

36. Borrowings are specified as follows:

Bonds issued	9,232,830	6,501,864
Bills of exchange issued	2,806,484	0
Total	<u>12,039,314</u>	<u>6,501,864</u>

Borrowings that mature within a year amount to ISK 1,071 million.

Deferred Income-Tax Liability

37. Changes in the deferred income-tax liability are specified as follows:

Deferred income-tax liability at the beginning of 2004	1,062
Calculated income tax for 2004	112,199
Joint taxation effects	(110,686)
Deferred income-tax liability at the end of 2004	<u>2,575</u>

Deferred income-tax liability is specified as follows:

Fixed assets	2,575
Deferred income-tax liability at year-end	<u>2,575</u>

Notes, contd.:

Equity

38. According to the Bank's Articles of Association, total Share Capital amounts to ISK 1,215 million. At year-end own shares amounted to ISK 118 million and Share Capital, according to the Balance Sheet, amounted to ISK 1,097 million. Changes in equity are specified as follows:

	Share capital	Share premium	Statutory reserve	Retained earnings	Total
Equity 1.1.2004	1,096,702	142,445	131,731	1,559,388	2,930,266
Net earnings				511,126	511,126
Equity 31.12.2004	<u>1,096,702</u>	<u>142,445</u>	<u>131,731</u>	<u>2,070,514</u>	<u>3,441,392</u>

39. Equity at year-end amounts to ISK 3,441 million, equivalent to 19.4% of total assets according to the Balance Sheet. The capital ratio of the Group, calculated in accordance with Article 84 of the Act on Financial Undertakings, was 33.4%. According to the law, the minimum ratio is 8.0%.

The ratio is calculated as follows:

	Book value	Weighted value	
		2004	2003
Risk base:			
Assets recorded in the Annual Accounts	17,781,635	10,306,316	11,126,052
Guarantees and other items not included in the Balance Sheet..		8,134	8,557
Risk base, total		<u>10,314,450</u>	<u>11,134,609</u>
Capital:			
Recorded equity		3,441,392	2,930,265
Total capital		<u>3,441,392</u>	<u>2,930,265</u>
Capital ratio		33.4%	26.3%

Off-Balance Sheet Items

40. The Bank has entered into currency and interest rate contracts with its customers. These obligations are specified as follows:

	2004	2003
Currency and interest rate contracts:		
Assets in ISK	1,037,328	1,083,141
Liabilities in foreign currencies	988,597	1,056,173

The objective of the above mentioned agreements is to control the currency and interest rate risk of the Bank. The Bank's risk in relation to these agreements relates to currency and exchange rate differences and credit risk is valued at ISK 41 million when calculating the capital ratio of the Bank according to current rules.