

**Frjalsi  
Investment Bank hf.**

**Interim Accounts  
1 January - 30 June 2004**

Frjalsi Investment Bank hf.  
Armuli 13a  
108 Reykjavik

Reg. no. 691282-0829

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# Report by the Board of Directors and the Manager

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On 1 January 2004 Frjalsi Investment Bank hf. and Logfang ehf. merged. Prior to the merger Frjalsi Investment Bank hf. held all shares in Logfang ehf.

The Interim Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Financial Statements of Credit Institutions. The accounting principles applied in preparing Frjalsi Investment Bank hf. Interim Accounts are consistent with those of the Bank for the previous year.

Net profit, according to the Profit and Loss Account, amounted to ISK 221 million for the period 1 January to 30 June 2004. Equity, according to the Balance Sheet, amounted to ISK 3,152 million at the end of the period. The capital ratio of the Bank, calculated according to the Act on Financial Undertakings, was 26.7%. This ratio may not be lower than 8.0%.

Shareholders at June-end numbered 5. 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 Manager hereby confirm the Interim Accounts of Frjalsi Investment Bank hf. for the period 1 January to 30 June 2004 by means of their signatures.

Reykjavik, 25 August 2004.

## **Board of Directors:**

Gudmundur Hauksson

Oskar Magnusson

Olafur Haraldsson

Arni Thor Sigurdsson

## **Manager:**

Kristinn Bjarnason

# Auditors' Report

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

We have reviewed the Balance Sheet of Frjalsi Investment Bank hf. as of 30 June 2004 and the related Profit and Loss Account and Statement of Cash Flows for the six months then ended. All information included in these Interim Accounts is the representation of the management of Frjalsi Investment Bank hf.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data and ratios. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the Interim Accounts taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the Interim Accounts in order for them to be in conformity with generally accepted accounting principles in Iceland.

Reykjavik, 25 August 2004.

***KPMG Endurskodun hf.***

# Profit and Loss Account 1 January – 30 June 2004

|   | Notes | 2004<br>1.1-30.6 | 2003<br>1.1-30.6 |
|---|-------|------------------|------------------|
| <b>Financial Income:</b>                          |       |                  |                  |
| Interest from credit institutions .....           |       | 1,507            | 7,477            |
| Interest on loans .....                           |       | 950,904          | 764,923          |
| Interest on bonds .....                           |       | 0                | 122,013          |
|   | 4     | 952,411          | 894,413          |
| <b>Financial Expenses:</b>                        |       |                  |                  |
| Interest to credit institutions .....             |       | 169,546          | 178,948          |
| Interest on borrowings .....                      |       | 336,602          | 352,892          |
|   | 4     | 506,148          | 531,840          |
| Net interest income                               |       | 446,263          | 362,573          |
| <b>Other Operating Income:</b>                    |       |                  |                  |
| Dividends from shares and other holdings .....    |       | 0                | 23               |
| Fees, commissions and other service charges ..... | 5     | 30,048           | 27,994           |
| Trading gains .....                               |       | ( 311 )          | ( 2,781 )        |
| Other operating income .....                      |       | 18,044           | 18,504           |
|   |       | 47,781           | 43,740           |
| Net operating income                              |       | 494,044          | 406,313          |
| <b>Other Operating Expenses:</b>                  |       |                  |                  |
| Salaries and related expenses .....               |       | 85,079           | 71,022           |
| Other administrative expenses .....               |       | 35,610           | 30,309           |
| Depreciation of fixed assets .....                |       | 2,781            | 2,873            |
|   |       | 123,470          | 104,204          |
| Provision for losses .....                        | 16    | ( 100,000 )      | ( 30,000 )       |
| Pre-tax profit                                    |       | 270,574          | 272,109          |
| Income tax .....                                  |       | ( 48,703 )       | ( 48,980 )       |
| Net worth tax .....                               |       | ( 615 )          | ( 2,500 )        |
| <b>Net Earnings</b> .....                         | 19    | 221,256          | 220,629          |
| <b>Earnings Per Share:</b>                        |       |                  |                  |
| Earnings per share .....                          | 6     | 0.2              | 0.2              |

# Balance Sheet

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## Assets

|  | Notes         | 30.6.2004  | 31.12.2003 |
|--|---------------|------------|------------|
| <b>Amounts due from Credit Institutions:</b>     |               |            |            |
| Required deposits with the Central Bank .....    |               | 2,287      | 2,248      |
| Amounts due from other credit institutions ..... |               | 62,173     | 74,776     |
|  |               | 64,460     | 77,024     |
| <b>Loans:</b>                                    |               |            |            |
|  | 7-9,<br>15-16 |            |            |
| Loans to customers .....                         |               | 15,629,334 | 13,457,202 |
| Mortgages foreclosed .....                       |               | 42,428     | 67,653     |
|  |               | 15,671,762 | 13,524,855 |
| <b>Bonds and Shares in Companies:</b>            |               |            |            |
|  | 10,17         |            |            |
| Shares and other variable-yield securities ..... |               | 32,160     | 32,160     |
| Shares in associated companies .....             |               | 552        | 552        |
|  |               | 32,712     | 32,712     |
| <b>Other Assets:</b>                             |               |            |            |
| Fixed assets .....                               | 11            | 45,671     | 40,738     |
| Other assets .....                               |               | 12,793     | 27,112     |
|  |               | 58,464     | 67,850     |
| <b>Total Assets</b>                              |               | 15,827,398 | 13,702,441 |

## 30 June 2004

### Liabilities and Capital

|  | Notes        | 30.6.2004  | 31.12.2003 |
|--|--------------|------------|------------|
| <b>Amounts Owed to Credit Institutions</b> .....         |              | 6,353,269  | 4,213,502  |
| <b>Borrowings</b> .....                                  |              | 6,113,413  | 6,501,864  |
| <b>Other Liabilities</b> .....                           |              | 208,133    | 55,748     |
| <b>Provision for Deferred Income Tax Liability</b> ..... | 12           | 1,062      | 1,062      |
| <b>Equity:</b>   |              |            |            |
| Share capital .....                                      |              | 1,096,702  | 1,096,702  |
| Share premium .....                                      |              | 142,445    | 142,445    |
| Statutory reserve .....                                  |              | 131,731    | 131,731    |
| Retained earnings .....                                  |              | 1,780,643  | 1,559,387  |
|  | Equity 19-20 | 3,151,521  | 2,930,265  |
| <b>Total Liabilities and Equity</b>                      |              | 15,827,398 | 13,702,441 |
| <b>Off-Balance Sheet Items:</b>                          |              |            |            |
| Obligations .....  | 14,21        |            |            |

# Statement of Cash Flows 1 January – 30 June 2004

|   | Notes | 2004<br>1.1.-30.6 | 2003<br>1.1.-30.6 |
|---|-------|-------------------|-------------------|
| <b>Cash Flows from Operations:</b>                                  |       |                   |                   |
| Net earnings .....  | 19    | 221,256           | 220,629           |
| Difference between net earnings and cash from operations:           |       |                   |                   |
| Provision for losses .....  | 16    | 100,000           | 30,000            |
| Depreciation of fixed assets .....                                  |       | 2,781             | 2,873             |
| Other items .....   |       | ( 626)            | 33                |
| Changes in operating assets and liabilities.....                    |       | ( 21,758)         | 22,883            |
| Net cash provided by operating activities                           |       | 301,653           | 276,418           |
| <b>Cash Flows to Investing Activities:</b>                          |       |                   |                   |
| Time deposits with the Central Bank, changes .....                  |       | ( 39)             | 107,608           |
| Other time deposits with credit institutions, changes .....         |       | 26,968            | 111,263           |
| Loans to customers, changes .....                                   |       | ( 2,246,907)      | ( 616,677)        |
| Investment bonds, changes .....                                     |       | 0                 | ( 3,736)          |
| Trading shares, changes .....                                       |       | 0                 | 18,054            |
| Investment in shares in associated companies, changes .....         |       | 0                 | ( 552)            |
| Investment in fixed assets .....                                    |       | ( 10,238)         | ( 4,727)          |
| Proceeds from the sale of fixed assets .....                        |       | 3,150             | 0                 |
| Net cash used in investing activities                               |       | ( 2,227,066)      | ( 388,767)        |
| <b>Cash Flows from Financing Activities:</b>                        |       |                   |                   |
| Amounts owed to credit institutions, changes .....                  |       | 2,328,228         | 748,058           |
| Borrowings, changes .....   |       | ( 388,451)        | ( 613,604)        |
| Net cash provided by financing activities                           |       | 1,939,777         | 134,454           |
| <b>Increase in cash</b> .....                                       |       | 14,364            | 22,105            |
| <b>Cash and cash equivalents at the beginning of the year</b> ..... |       | 47,809            | 21,209            |
| <b>Cash and cash equivalents at the end of the period</b> .....     | 13    | 62,173            | 43,314            |

# Notes

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## Summary of Accounting Principles

### *Basis of Preparation*

1. The Interim Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Financial Statements of Credit Institutions. They are based on cost accounting and are prepared according to the same accounting principles as for the previous year. The Interim Accounts are prepared in Icelandic currency and amounts are presented in thousands of Icelandic kronas.
2. Associated companies are companies where Frjalsi Investment Bank hf. has significant influence over the financial and operational policies but not controlling interest. The Interim Accounts contain the Bank's share in the performance of associated companies from the beginning of influence until the influence no longer exists. Should Frjalsi Investment Bank hf.'s part of loss be higher than the book value of an associated company the book value is recorded as zero and further entries of loss are ceased unless the Bank has granted guarantees for the associated company or financed it.

### *Foreign Currency*

3. Assets and liabilities in foreign currency are converted to Icelandic currency at the 30 June 2004 exchange rate. Operational revenue and expenses in foreign currency 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 rate. Interest income is calculated on amounts due from other financial institutions, loans and market securities. Interest expenses are calculated on amounts owed to financial institutions and borrowings. Interest on loans, the collection of which is uncertain, is not entered as income. Revenue and expenses equivalent to interest, such as borrowing charges, are included with interest income and expenses as they accrue.

### *Fees and Commission Income*

5. The Bank provides various services to its clients and derives income therefrom. Commission income includes income from lending activities. Commission income is entered into the Bank's Profit and Loss Account when it is derived.

### *Earnings per Share*

6. Earnings per share is the ratio between profit and weighted average number of outstanding shares during the period and shows the profit per share. The profit for the period amounted to ISK 221 million and the weighted average number of shares was 1,097 million.

## Notes, contd.:

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### *Loans*

7. Loans are capitalized with accrued interest, indexation and exchange rate difference at the end of the period. Indexed loans are entered based on indices effective at the beginning of July 2004 and loans in foreign currency based on the exchange rate of the relevant currencies at 30 June 2004.
8. 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 loans, the collection of which is uncertain, is not entered as income. The provision has been deducted from the appropriate Balance Sheet items.
9. The Bank has redeemed assets on foreclosed mortgages. Foreclosed mortgages are entered at estimated market price in the Balance Sheet.

### *Bonds and Shares in Companies*

10. 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 or market price, whichever is lower.

### *Property and Equipment*

11. 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 .....               | 5 years   |
| Machinery and equipment ..... | 3-5 years |
| Vehicles .....                | 7 years   |

### *Deferred Income Tax Liability*

12. The deferred income tax liability has been calculated and entered in the Balance Sheet. 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 Interim Accounts on the other. This difference is due to the fact that tax assessment is based on rules that differ from those governing the Interim Accounts, mostly because expenses, especially depreciation, are entered earlier in the tax return than in the Interim Accounts. The Bank uses an authorization in the tax law for joint taxation with SPRON as of the year 2004.

### *Cash and Cash Equivalents*

13. 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 62 million at June-end.

## Notes, contd.:

### Derivatives

14. 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, commodity, bond or equity products.

The Bank's derivatives are mainly intended to reduce the price, 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 could not fulfil its part of the contract.

Forward rate agreements and futures relating to currency are entered in the Bank's Interim Accounts at their June-end market value.

### Loans

|   |   |                                 |                  |                  |
|---|---|---------------------------------|------------------|------------------|
| 15. Non-performing loans are specified as follows:  |   |                                 | 30.6.2004        | 31.12.2003       |
| Loans with a specific provision for losses .....  |   |                                 | 821,838          | 120,879          |
| Specific provision for losses .....   | ( |                                 | 135,564)         | ( 51,835)        |
| Other non-performing loans .....  |   |                                 | 925,352          | 724,223          |
| Non-performing loans, total .....   |   |                                 | <u>1,611,626</u> | <u>793,267</u>   |
| 16. Changes in the provision for losses are specified as follows:                                 |   |                                 |                  |                  |
|   |   | Provision for losses            | 30.6.2004        | 31.12.2003       |
|   |   | Specific          General       | Total            | Total            |
| Balance at the beginning of the year .....  |   | 51,835          259,410         | 311,245          | 264,091          |
| Provision for losses during the period .....  |   | 100,000                         | 100,000          | 90,000           |
| Actual losses during the period .....   | ( | <u>16,271)</u>                  | <u>( 16,271)</u> | <u>( 42,846)</u> |
| Balance at the end of the period .....  |   | <u>135,564          259,410</u> | <u>394,974</u>   | <u>311,245</u>   |
| Provision for losses on the loan portfolio as a<br>percentage of loans and issued guarantees .... |   | 0.8%          1.6%              | 2.4%             | 2.3%             |

## Notes, contd.:

### Bonds and Shares in Companies

17. Shares and other variable-yield securities are specified as follows:

|                       | Nominal value | Book value    |
|-----------------------|---------------|---------------|
| Investment shares:    |               |               |
| Unlisted shares ..... | 32,160        | <u>32,160</u> |

### Assets and Liabilities in Foreign Currency

18. The total amount of assets in foreign currencies was ISK 1,174 million at June-end and the total amount of liabilities was ISK 1,081 million at the same time. Included in assets and liabilities are currency contracts and interest rate swaps, see note 21.

### Equity

19. According to the Bank's Articles of Association, total capital amounts to ISK 1,215 million. At June-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           | 1,559,387         | 2,930,265        |
| Net earnings .....      |                  |                |                   | 221,256           | 221,256          |
| Equity 30.06.2004 ..... | <u>1,096,702</u> | <u>142,445</u> | <u>131,731</u>    | <u>1,780,643</u>  | <u>3,151,521</u> |

20. Equity at June-end amounts to ISK 3,152 million. The capital ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 26.7%. According to the law the ratio may not be below 8.0%. The ratio is calculated as follows:

|  | Book value | Weighted value    |                   |
|--|------------|-------------------|-------------------|
|  |            | 30.6.2004         | 31.12.2003        |
| Risk base:   |            |                   |                   |
| Assets recorded in the Annual Accounts .....       | 15,827,398 | 11,791,048        | 11,126,052        |
| Guarantees and other off Balance Sheet items ..... |            | 7,451             | 8,557             |
| Risk base, total .....                             |            | <u>11,798,499</u> | <u>11,134,609</u> |
| Capital:   |            |                   |                   |
| Recorded equity .....                              |            | <u>3,151,521</u>  | <u>2,930,265</u>  |
| Total capital .....                                |            | <u>3,151,521</u>  | <u>2,930,265</u>  |
| Capital ratio .....                                |            | 26.7%             | 26.3%             |

## Notes, contd.:

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### Obligations

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

|   | 30.6.2004 | 31.12.2003 |
|---|-----------|------------|
| Currency and interest rate contracts:   |           |            |
| Assets in foreign currencies .....      | 129,439   | 0          |
| Assets in ISK .....                     | 929,897   | 1,083,141  |
| Liabilities in foreign currencies ..... | 929,919   | 1,056,173  |
| Liabilities in ISK .....                | 130,254   | 0          |

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 37 million at June-end when calculating the capital ratio of the Bank according to current rules.