

**Frjalsi
Investment Bank hf.**

**Annual Accounts
31 December 2003**

Icelandic kronas

Frjalsi Investment Bank hf.
Armuli 13a
108 Reykjavik

Reg. no. 691282-0829

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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, Logfang 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 539 million. Equity, according to the Balance Sheet, amounted to ISK 2,930 million at year-end. The Board of Directors does not propose a payment of dividend for the year 2003. 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 26.3%. The ratio may not be lower than 8.0%.

During the year, the average number of the Bank's employees was 23. Total salaries amounted to ISK 143 million and salary-related expenses amounted to ISK 28 million.

Shareholders at year-end numbered 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 Manager hereby confirm the Annual Accounts of Frjalsi Investment Bank hf. for the year 2003 by means of their signatures.

Reykjavik, 12 February 2004.

Board of Directors

Gudmundur Hauksson

Jon G. Tomasson

Olafur Haraldsson

Arnar Bjarnason

Arni Thor Sigurdsson

Manager:

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 as of 31 December 2003 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 2003, 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, 12 February 2004.

Sigurður Jonsson

Reynir Stefan Gylfason

KPMG Endurskodun hf.

Profit and Loss Account for the Year 2003

	Notes	2003	2002
Financial Income:			
Interest from credit institutions		12,617	49,005
Interest on loans		1,525,534	1,463,615
Interest on bonds		185,728	241,412
	4	1,723,879	1,754,032
Financial Expenses:			
Interest to credit institutions		335,627	439,888
Interest on borrowings		664,225	615,363
	4	999,852	1,055,251
Net interest income		724,027	698,781
Other Operating Income:			
Dividends from shares and other holdings	15	24	2,122
Commission receivable		62,953	38,283
Trading (loss) gains	16	(2,553)	7,374
Other operating income	17	44,654	116,004
		105,079	163,783
Net operating income		829,105	862,564
Other Operating Expenses:			
Salaries and salary-related expenses	19	170,485	123,488
Other general operating expenses		58,198	60,225
Depreciation	9,32	5,997	25,501
		234,680	209,214
Provision for losses	29	(90,000)	(70,000)
Pre-tax profit		504,425	583,350
Income tax	37	36,102	(90,657)
Net worth tax		(1,090)	(9,708)
Net Earnings	38	539,437	482,985
Earnings per Share:			
Earnings per share	22	0.49	0.44

Balance Sheet

Assets

	Notes	2003	2002
Amounts Due from Credit Institutions:			
Cash and demand deposits with the Central Bank		2,248	341,558
Amounts due from other credit institutions		74,776	132,472
	23	77,024	474,030
Loans:			
Loans to customers		13,457,202	11,633,591
Mortgages foreclosed		67,653	13,895
	5-7, 24-29	13,524,855	11,647,486
Bonds and Shares in Other Companies:			
Bonds and other fixed-income securities		0	4,598,512
Shares and other variable-yield securities	30	32,160	0
Shares in associated companies	31	552	0
	8	32,712	4,598,512
Other Assets:			
Fixed assets	9,32	40,738	40,004
Other assets		27,112	13,877
		67,850	53,881
Total Assets		13,702,441	16,773,909

31 December 2003

Liabilities and Equity

	Notes	2003	2002
Amounts Owed to Credit Institutions	35	4,213,502	6,485,807
Borrowings	36	6,501,864	7,491,914
Other Liabilities		55,748	179,734
Provision for Deferred Income-Tax Liability	10,37	1,062	225,625
Equity:			
Share capital		1,096,702	1,096,702
Share premium		142,445	142,445
Statutory reserve		131,731	131,731
Retained earnings		1,559,387	1,019,950
Equity	38-39	2,930,265	2,390,828
Total Liabilities and Equity		13,702,441	16,773,909

Off-Balance Sheet Items:

Obligations	12,40
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Statement of Cash Flows for the Year 2003

	Notes	2003	2002
Cash Flows from Operations:			
Net earnings	38	539,437	482,985
Difference between net earnings and cash from operations:			
Gain on the sale of assets		0 (	78,802)
Provision for losses	29	90,000	70,000
Income tax, changes	38	(224,564)	(3,292)
Other items		5,692	23,185
Changes in assets and liabilities		51,032	174,550
Net cash provided by operating activities		<u>461,597</u>	<u>668,626</u>
Cash Flows to Investing Activities:			
Time deposits with the Central Bank, changes		339,310 (	97,437)
Other time deposits with credit institutions, changes		84,295	819,755
Loans to customers, changes .....	(	1,967,369)	(556,833)
Investment bonds, changes		4,598,512 (	1,217,398)
Trading shares, changes		0	3,427
Investment shares, changes	30	(32,160)	0
Investment in shares in associated companies, changes	31	(552)	73,085
Investment in fixed assets	32	(9,306)	(36,028)
Proceeds from the sale of fixed assets		3,090	63,898
Disposal of fixed assets		0	328,898
Net cash (used in) provided by investing activities		<u>3,015,820</u>	(<u>618,633</u>)
Cash Flows from Financing Activities:			
Amounts owed to credit institutions, changes .....	(	2,460,767)	(478,933)
Borrowings, changes .....	(	990,050)	706,252
Dividend paid		0 (	329,011)
Net cash provided by (used in) financing activities		<u>(3,450,817)</u>	<u>(101,692)</u>
Increase in cash		26,600 (	51,699)
Cash and cash equivalents at the beginning of the year		<u>21,209</u>	<u>72,908</u>
Cash and cash equivalents at the end of the year	11	<u><u>47,809</u></u>	<u><u>21,209</u></u>
Other Information:			
Taxes paid		103,269	19,410
Dividends received		24	120

Notes to the Annual Accounts

Summary of Accounting Principles

Basis of Preparation

1. The Annual Accounts of Frjalsi Investment Bank hf. contain the Consolidated Annual Accounts of the Bank and its wholly owned subsidiary, Logfang ehf. The Annual Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Preparation 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 subsidiary are included in the Consolidated Annual Accounts of the Bank from the acquisition of majority interest 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 currency are converted to Icelandic currency at the 31 December 2003 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 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 interest income is no longer recognized. Revenue and expenses equivalent to interest, such as borrowing charges, are included with interest income and expenses as they accrue.

Loans

5. Loans are capitalised with accrued interest, indexation and exchange rate difference at the end of the year. Indexed loans are entered based on indices effective at the beginning of 2004 and loans in foreign currency based on the exchange rate of the relevant currencies at 31 December 2003.
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 loans, the collection of which is uncertain, is not entered as income. The provision has been deducted from the appropriate Balance Sheet items, less the provision for issued guarantees that is posted among sundry liabilities in the Balance Sheet.
7. The Bank has redeemed assets on foreclosed mortgages. Foreclosed mortgages are entered at estimated market prices in the Bank's 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 or 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 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 Annual Accounts on the other. This difference is due to the fact that tax assessment is based on rules 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 48 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, 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, securities and interest rate are entered in the Bank's Annual Accounts at their year-end market value.

Notes, contd.:

International Accounting 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 accounting standards (IAS). 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 upon. 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:	2003	2002
Bonds issued	653,524	582,129
Bills of exchange	5,617	29,331
Other borrowings	5,084	3,903
Total	<u>664,225</u>	<u>615,363</u>

Other Operating Income

15. Dividends from shares and other holdings are specified as follows:

Dividend on trading shares and investment shares	24	120
Profit share in net earnings of associated companies	0	2,002
Total	<u>24</u>	<u>2,122</u>

16. Trading (loss) gains are specified as follows:

Trading shares	340	0
Asset and liabilities denominated in foreign currencies	(2,893)	7,374
Total	<u>(2,553)</u>	<u>7,374</u>

17. Other operating income is specified as follows:

Capital gains on the sale of shares in subsidiaries	0	65,126
Capital gains on the sale of real estate	339	13,677
Other income	44,315	37,201
Total	<u>44,654</u>	<u>116,004</u>

Other Operating Expenses

18. The total number of employees is as follows:

Average number of employees during the year measured as full time equivalent positions	23	22
Full time equivalent positions at year-end	24	21

Notes, contd.:

19.	Salaries and salary-related expenses are specified as follows:	2003	2002
	Salaries	142,777	106,893
	Salary-related expenses	27,707	16,594
	Total	<u>170,484</u>	<u>123,487</u>
20.	Salaries and remunerations to the Board of Directors and the Managing Director are specified as follows:		
	Managing Director	17,300	20,663
	Chairman	1,532	1,253
	Other Directors	2,732	2,713
	Total	<u>21,564</u>	<u>24,629</u>
21.	Fee to the Bank's auditors is specified as follows:		
	Audit of the Annual Accounts	2,280	2,170
	Interim Accounts review	928	953
	Other services	476	841
	Total	<u>3,684</u>	<u>3,964</u>

Earnings per Share

22.	Earnings per share is the ratio between profit and weighted share capital at year-end:		
	Net earnings	539,437	482,985
	Weighted average share capital	1,096,702	1,096,702
	Earnings per share	0.49	0.44

Cash and Amounts due from Credit Institutions

23.	Amounts due from credit institutions:		
	On demand	47,809	21,209
	Up to 3 months	26,967	111,263
	Required deposits with Central Bank according to regulation	2,248	341,558
	Total	<u>77,024</u>	<u>474,030</u>

Loans

24.	Loans to customers specified by types of loans:		
	Bonds	9,259,386	6,993,160
	Other loans	4,197,816	4,617,449
	Other	0	22,982
	Total	<u>13,457,202</u>	<u>11,633,591</u>

Notes, contd.:

25.	Loans to customers specified by sectors:		2003	2002
	Sectors:			
	Commerce and service		14.6%	17.0%
	Fishing industry and agriculture		0.9%	5.6%
	Industry and contractors		25.6%	22.7%
	Other		0.5%	0.9%
	Individuals		58.4%	53.8%
	Total		<u>100.0%</u>	<u>100.0%</u>
26.	Loans to customers and lease contracts specified by maturity:			
	On demand		136,455	161,405
	Up to 3 months		610,328	847,118
	Over 3 months and up to a year		3,924,306	3,853,126
	Over 1 year and up to 5 years		2,528,339	3,073,790
	Over 5 years		6,257,774	3,698,152
	Total		<u>13,457,202</u>	<u>11,633,591</u>
27.	Mortgages foreclosed are specified as follows:			
	Buildings		64,056	5,890
	Current assets		3,597	8,005
	Total		<u>67,653</u>	<u>13,895</u>
28.	Non-performing loans are specified as follows:			
	Loans with a specific provision for losses		120,879	98,993
	Specific provision for losses .....	(	51,835)	(66,208)
	Non-performing loans less specific provision for losses		69,044	32,785
	Other non-performing loans		724,223	201,050
	Non-performing loans, total		<u>793,267</u>	<u>233,835</u>
29.	Changes in the provision for losses are specified as follows:			
		Provision for losses	2003	2002
		Specific	Total	Total
	Balance at the beginning of the year	66,208	197,883	264,091
	Provision for losses during the year	28,473	61,527	90,000
	Actual losses during the year	(42,846)	(42,846)	(65,376)
	Balance at the end of the year	<u>51,835</u>	<u>259,410</u>	<u>311,245</u>
	Provision for losses on the loan portfolio as a percentage of loans and issued guarantees	0.4%	1.9%	2.3%
			2.3%	2.3%

Notes, contd.:

Bonds and Shares in Other Companies

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

	Nominal value	Book value
Investment shares:		
Unlisted shares	32,160	<u>32,160</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 1.1.2003	9,068	34,639	43,707
Additions during the year	0	9,307	9,307
Disposals during the year	0	(3,552)	(3,552)
Total value 31.12.2003	<u>9,068</u>	<u>40,394</u>	<u>49,462</u>
Previously depreciated	45	3,659	3,704
Depreciation during the year	181	5,816	5,997
Disposals during the year	0	(977)	(977)
Total depreciation 31.12.2003	<u>226</u>	<u>8,498</u>	<u>8,724</u>
Book value 31.12.2003	<u>8,842</u>	<u>31,896</u>	<u>40,738</u>
Depreciation ratios	2%	0-20%	

On 31 December 2003 the official value of buildings was ISK 4.3 million and ISK 1.1 million for land or a total of ISK 5.4 million. The fire insurance value of the buildings amounted to ISK 6.8 million at the end of 2003. Insurance value of machinery and equipment amounted to ISK 53.2 million at the same time.

Assets and Liabilities Index Linked or in Foreign Currency

33. The total amount of indexed assets was ISK 8,855 million and the total amount of indexed liabilities was ISK 5,396 million at year-end.

34. The total amount of assets in foreign currencies was ISK 1,208 million at year-end and the total amount of liabilities was ISK 1,207 million at the same time. Included in assets and liabilities are currency contracts, see note 40.

Notes, contd.:

Amounts owed to Credit Institutions

35. Liabilities owed to credit institutions mature as follows:	2003	2002
Up to 3 months	1,611,644	5,575,313
Over 3 months and up to a year	1,218,534	193,965
Over 1 year and up to 5 years	1,383,324	716,529
Total	<u>4,213,502</u>	<u>6,485,807</u>

Borrowings

36. Borrowings are specified as follows:

Bonds issued	6,411,099	7,366,103
Bills of exchange issued	90,765	125,811
Total	<u>6,501,864</u>	<u>7,491,914</u>

Borrowings that mature within a year amount to ISK 869 million.

Deferred Income-Tax Liability

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

Deferred income-tax liability at the beginning of 2003	225,625
Calculated income tax for 2003	(36,102)
Joint taxation effects	(188,461)
Deferred income-tax liability at year-end	<u>1,062</u>

Deferred income-tax liability is specified as follows:

Fixed assets	<u>1,062</u>
Deferred income-tax liability at year-end	<u>1,062</u>

The applicable corporate income tax rate is 18%, however the Bank's effective tax rate is negative.

The difference is specified as follows:

Tax calculated according to the applicable corporate income tax rate of 18%	90,796
Tax exempt dividends on shares	(4)
Deferred capital gains by decreasing the purchase value of shares in associated companies	(135,822)
Amortization of goodwill	8,928
Total	<u>(36,102)</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 1.1.2003	1,096,702	142,445	131,731	1,019,950	2,390,828
Net earnings				539,437	539,437
Equity 31.12.2003	<u>1,096,702</u>	<u>142,445</u>	<u>131,731</u>	<u>1,559,387</u>	<u>2,930,265</u>

39. Equity at year-end amounts to ISK 2.930 million, equivalent to 21,4% of total assets according to the Balance Sheet. The capital ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 26.3%. According to the law the ratio may not be below 8.0%. The ratio is calculated as follows:

	Book value	Weighted value	
		2003	2002
Risk base:			
Assets recorded in the Annual Accounts	13,702,441	11,126,052	9,925,900
Guarantees and other off Balance Sheet items		8,557	25,145
Risk base, total		<u>11,134,609</u>	<u>9,951,045</u>
Capital:			
Recorded equity		2,930,265	2,390,828
Total capital		<u>2,930,265</u>	<u>2,390,828</u>
Capital ratio		26.3%	24.0%

Off-Balance Sheet Items

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

	2003	2002
Currency and interest rate contracts:		
Assets in foreign currencies		409,046
Assets in ISK	1,083,141	6,763,648
Liabilities in foreign currencies	1,056,173	2,141,971
Liabilities in ISK		5,201,704

41. 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 43 million at year-end when calculating the capital ratio of the Bank according to current rules.