

# **FL GROUP hf.**

## **Consolidated Financial Statements for the year 2007**

**ISK**

FL GROUP hf.

Síðumúli 24

108 Reykjavík

Iceland

Reg. no. 601273-0129

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# Endorsement and Statement by the Board of Directors and the CEO

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## **Operations in the year 2007**

The financial statements comprise the consolidated financial statements of FL GROUP hf. ("the Company") and its subsidiaries together referred to as the "Group".

FL GROUP hf. is an international investment company with core investments in financials and insurance along with private equity investments with special focus on property companies as well as proprietary trading. The Company operates offices in Reykjavík and London.

In January 2007 the Company sold all its shares in the fully owned subsidiary Kynnisferdir hf. The Company generated profit before taxes of ISK 486 million on this transaction in the first quarter.

During the year FL GROUP hf. acquired the majority of the shares in Tryggingamiðstöðin hf. (TM hf.) and at year-end it owned 99.9% of outstanding shares in the Company. TM hf. became a part of the consolidated financial statements in the beginning of October 2007. In relation to the acquisition of TM hf. the share capital was increased in September and October 2007 by ISK 1,300 million at the price of ISK 24.3 per share.

The share capital was further increased in two stages in December 2007. First by ISK 680 million which was sold for ISK 10,000 million in a share offering and then by ISK 3,659 million sold for ISK 53,791 million in relation to the investment in Landic Properties hf. and other real-estate companies and funds.

According to the consolidated income statement, loss for the year amounted to ISK 67,238 million. According to the consolidated balance sheet, equity at the end of the year amounted to ISK 155,844 million, including share capital in the amount of ISK 13,494 million. Reference is made to the notes to the consolidated financial statements regarding information on changes in equity.

The Board of Directors proposes that no dividends will be paid to shareholders in 2008.

## **Share capital and Articles of Association**

The share capital amounted to ISK 13,584 million at the end of the year, from which the Company held own shares in the amount of ISK 90 million. The share capital is divided into shares of ISK 1, each with equal rights within a single class of shares listed on the Icelandic Stock Exchange (OMX Iceland). The Board of Directors has the right to increase the share capital until 25 September 2012 by up to ISK 1,320 million with sale of new shares. Thereof are up to ISK 500 million subject to the pre-emptive purchase provisions of the Articles of Association. The Board of Directors decides the rules of sale each time, i.e. price, payments, subscription period etc. Additionally the Board of Directors can increase the share capital up to ISK 17 million for the purpose of financing the purchase of TM hf. The Board of Directors has the right to purchase up to 10% of the nominal value of the shares of the Company until 22 August 2008. The shares' purchase price may be up to 20% above the average sales price of shares on the Icelandic Stock Exchange.

Share-option agreements have been made with employees of the Group, which enables them to purchase shares in the Company at the average exercise price of ISK 14.7 per share after a vesting period of 12 to 36 months. Further information on the share option agreements is disclosed in note 39.

## **Endorsement and statement by the Board of Directors and the CEO, contd.:**

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The Company's Board of Directors comprises seven members and two reserve members elected on the annual general meeting for a term of one year. Those persons willing to stand for election must give formal notice thereof to the Board of Directors at least five days before the annual general meeting. The Company's Articles of Association may only be amended at a legitimate shareholders' meeting, provided that amendments and their main aspects are clearly stated in the invitation to the meeting. A resolution will only be valid if it is approved by at least 2/3 of votes cast and is approved by shareholders controlling at least 2/3 of the share capital represented at the shareholders' meeting.

Shareholders at the end of the year 2007 were 4,319, but were 4,622 at the beginning of the year, a decrease of 303 during the year. When forward agreements are taken into account, two shareholders held more than 10% of outstanding shares each at year end 2007. They are Baugur Group hf. and related Companies with 36.2% share, Oddaflug B.V. with 10.9% share and Gnúpur fjárfestingafélag hf. with 10.9% share.

Further information on matters related to share capital is disclosed in note 30.

### **Statement by the Board of Directors and the CEO**

The annual consolidated financial statements for the year ended 31 December 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the financial year 2007, its assets, liabilities and consolidated financial position as at 31 December 2007 and its consolidated cash flows for the financial year 2007.

Further, in our opinion the consolidated financial statements and the endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the annual consolidated financial statements of FL GROUP hf. for the year 2007 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements will be approved at the annual general meeting of FL GROUP hf.

Reykjavik, 13 February 2008.

The Board of Directors:



CEO:



# Independent Auditors' Report

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To the Board of Directors and Shareholders of FL GROUP hf.

We have audited the accompanying consolidated financial statements of FL GROUP hf. and its subsidiaries, (the "Group"), which comprise the consolidated balance sheet as at December 31, 2007, and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of FL GROUP hf. as at 31 December 2007, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted the EU.

Reykjavík, 13 February 2008.

**KPMG hf.**

## Consolidated Income Statement for the year 2007

	Notes	2007	2006
<b>Net investment (expense) income:</b>			
Net (expense) income from investment securities and derivatives .....	8	( 63,682)	23,956
Interest income .....	9	4,982	854
Interest expense .....	9	( 17,566)	( 4,948)
Net foreign exchange gain (loss) .....		2,476	( 2,371)
		<u>( 73,790)</u>	<u>17,491</u>
<b>Net insurance income:</b>			
Insurance premium .....	10	2,769	0
		<u>2,769</u>	<u>0</u>
<b>Operating expenses:</b>			
Insurance claims .....	11	( 2,598)	0
Other operating expenses .....	12	( 6,153)	( 2,771)
		<u>( 8,751)</u>	<u>( 2,771)</u>
<b>(Loss) profit before income tax .....</b>		<b>( 79,772)</b>	<b>14,720</b>
Income tax .....	15,16	12,534	2,631
<b>(Loss) profit from continuing operations .....</b>		<b>( 67,238)</b>	<b>17,351</b>
Profit from discontinued operations, net of income tax .....		0	27,208
<b>(Loss) profit for the year .....</b>		<b><u>( 67,238)</u></b>	<b><u>44,559</u></b>
<b>Attributable to:</b>			
Equity holders of the Company .....		( 67,247)	44,560
Minority interest .....		9	( 1)
<b>(Loss) profit for the year .....</b>		<b><u>( 67,238)</u></b>	<b><u>44,559</u></b>
<b>(Loss) earnings per share:</b>			
Basic (loss) earnings per share (ISK) .....	18	( 8.18)	6.65
Diluted (loss) earnings per share (ISK) .....	18	( 7.96)	6.60

The notes on pages 11 to 51 are an integral part of these consolidated financial statements.

## Consolidated Balance Sheet as at 31 December 2007

	Notes	2007	2006
<b>Assets:</b>			
Cash and cash equivalents .....	20	21,125	47,022
Unpaid share capital .....		7,500	0
Equity investments .....	21	218,998	181,037
Bonds and debt investments .....	22	16,021	124
Derivatives .....	24	6,604	4,309
Restricted cash .....	25	53,060	9,572
Assets classified as held for sale .....		0	904
Loans and receivables, including insurance receivables .....	26,27	42,348	19,478
Reinsurance assets .....	32	13,937	0
Deferred tax asset .....	35	8,623	0
Operating assets .....	28	2,167	425
Intangible assets .....	29	31,937	0
<b>Total assets</b>		<u>422,320</u>	<u>262,871</u>
<b>Equity:</b>			
Share capital .....	30	13,494	7,763
Share premium .....		160,965	70,530
Other reserves .....		1,626	948
(Accumulated deficit) retained earnings .....		( 20,559)	63,425
Total equity attributable to equity holders of the Company		155,526	142,666
Minority interest .....		318	10
Total equity		<u>155,844</u>	<u>142,676</u>
<b>Liabilities:</b>			
Derivatives .....	24	13,488	7,021
Short positions .....		3,350	0
Trade and other payables .....	31	14,469	5,908
Liabilities classified as held for sale .....		0	634
Insurance liabilities .....	32	29,626	0
Borrowings .....	34,35	204,979	104,955
Income tax liability .....	36	564	1,677
Total liabilities		<u>266,476</u>	<u>120,195</u>
<b>Total equity and liabilities</b>		<u>422,320</u>	<u>262,871</u>

The notes on pages 11 to 51 are an integral part of these consolidated financial statements.

## Consolidated Statement of Changes in Equity for the year 2007

	Notes	Other reserves						(Accumulated deficit)	Equity holders of the Company	Minority interest	Total equity
		Share capital	Share premium	Share option reserve	Hedging reserve	Translation reserve	retained earnings				
<b>2006</b>											
Equity 1.1.2006 .....		5,802	43,169	68	187	179	25,027		74,432	11	74,443
Translation difference .....						3,519			3,519		3,519
Effective portion of changes in fair value of cash flow hedges .....											
Hedging and translation reserves transferred to profit and loss .....					54				54		54
Net income recognised directly in equity .....					( 241 )	( 2,910 )			( 3,151 )		( 3,151 )
Profit for the year .....					( 187 )	609		422			422
Total profit for the year .....					( 187 )	609	44,560	44,560	( 422 )	( 1 )	44,559
Dividends (ISK 1.04 per share) .....							( 6,341 )	( 6,341 )			( 6,341 )
Issued share capital .....		2,100	30,244					32,344			32,344
Own shares, change .....		( 139 )	( 2,980 )					( 3,119 )			( 3,119 )
Translation reserve 1.1.2006 transferred .....					( 179 )		179	0			0
Stock options .....			97	271				368			368
Equity 31.12.2006 .....		7,763	70,530	339	0	609	63,425	142,666		10	142,676
<b>2007</b>											
Equity 1.1.2007 .....		7,763	70,530	339		609	63,425	142,666		10	142,676
Translation difference .....						258		258			258
Loss for the year .....							( 67,247 )	( 67,247 )		9	( 67,238 )
Total loss for the year .....						258	( 67,247 )	( 66,989 )		9	( 66,980 )
Dividends (ISK 1.93 per share) .....							( 14,984 )	( 14,984 )			( 14,984 )
Issued share capital .....	30	5,639	89,069					94,708			94,708
Own shares, acquired .....		( 22 )	( 600 )					( 622 )			( 622 )
Own shares, sold .....		114	2,480					2,594			2,594
Restatement of initial investment in TM hf. due to step acquisition .....	7						( 1,753 )	( 1,753 )			( 1,753 )
Sale of subsidiary .....	6						0	0		( 10 )	( 10 )
Minority interest arising on business combination .....	7							0		309	309
Stock options .....	36		( 514 )	420				( 94 )			( 94 )
Equity 31.12.2007 .....		13,494	160,965	759	0	867	( 20,559 )	155,526		318	155,844

The notes on pages 11 to 51 are an integral part of these consolidated financial statements.



# Consolidated Statement of Cash Flows for the year 2007

	Notes	2007	2006
<b>Cash flows from operating activities:</b>			
(Loss) profit for the year .....	( 67,238 )		44,559
Adjustments for:			
Depreciation .....	113		23
Other operating items .....	21,355		784
Discontinued operations .....	0		1,982
Working capital (to) from operations	( 45,770 )		47,348
Net change in operating assets and liabilities .....	( 12,067 )		( 1,099 )
Net cash (used in) provided by operating activities	( 57,837 )		46,249
<b>Cash flows from investing activities:</b>			
Investment securities, change .....	48,083	( 92,518 )	
Acquisition of subsidiary, net of cash acquired .....	( 36,510 )	( 9,399 )	
Disposals of subsidiaries, net of cash sold .....	544		29,304
Derivatives, change .....	4,143		8,776
Restricted cash, change .....	( 37,514 )	( 9,572 )	
Trade receivables and bonds .....	( 1,839 )		8,274
Acquisition of operating assets .....	( 706 )	( 448 )	
Proceeds from the sale of operating assets .....	555		0
Acquisition of intangible assets .....	( 123 )		0
Discontinued operations .....	0		2,822
Net cash used in investing activities	( 23,367 )	( 62,761 )	
<b>Cash flows from financing activities:</b>			
Proceeds from the issue of share capital .....	2,500		0
Own shares, change .....	1,902	( 3,119 )	
Dividend paid .....	( 15,745 )	( 6,341 )	
Proceeds from borrowings .....	92,666		133,271
Repayment of borrowings .....	( 25,905 )	( 72,566 )	
Discontinued operations .....	0	( 584 )	
Net cash provided by financing activities	55,418		50,661
<b>Net (decrease) increase in cash and cash equivalents .....</b>	<b>( 25,786 )</b>		<b>34,149</b>
<b>Cash and cash equivalents at 1 January .....</b>	<b>47,022</b>		<b>10,350</b>
<b>Effect of exchange rate fluctuations on cash held .....</b>	<b>( 111 )</b>		<b>2,523</b>
<b>Cash and cash equivalents at 31 December .....</b>	<b>21,125</b>		<b>47,022</b>

The notes on pages 11 to 51 are an integral part of these consolidated financial statements.

## Consolidated Statement of Cash Flows for the year 2007, contd.:

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	Notes	2007	2006
<b>Investing and financing transactions without cash flow effect:</b>			
Acquisition of investment securities .....	(	53,791 )	( 28,322 )
Acquisition of subsidiary .....	(	31,584 )	( 4,022 )
Unpaid share capital .....	(	7,500 )	0
Issued share capital .....		92,875	32,344
<b>Other information:</b>			
Interest income received .....		2,439	818
Interest expense paid .....		11,552	2,663
Income taxes paid .....		782	0
Dividends received .....		4,297	806

The notes on pages 11 to 51 are an integral part of these consolidated financial statements.

# Notes

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## 1. Reporting Entity

FL GROUP hf.'s registered office is at Síðumúli 24 in Reykjavík, Iceland. The consolidated financial statements of FL GROUP hf. ("the Company") as at and for the year ended 31 December 2007 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities".

FL GROUP hf. is an international investment company with core investments in financials and insurance along with private equity investments with special focus on property companies as well as proprietary trading. The company operates offices in Reykjavík and London.

## 2. Basis of preparation

### a. *Statement of compliance*

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

The financial statements were approved by the Board of Directors of FL GROUP hf. on 13 February 2008.

### b. *Basis of measurement*

The consolidated financial statements are prepared on the historical cost basis except for the following:

- \* financial assets and liabilities held for trading are measured at fair value;
- \* financial assets designated at fair value through profit or loss are measured at fair value, including investments in associates.

### c. *Functional and presentation currency*

The consolidated financial statements are prepared in Icelandic Krona (ISK), which is the Company's functional currency. All financial information has been rounded to the nearest million, unless otherwise stated.

### d. *Use of estimates and judgements*

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is described in note 4m.

### 3. Accounting policies related to financial instruments

#### a. *Financial assets and liabilities*

##### (i) *Non-derivative financial assets and liabilities*

Non-derivative financial assets and liabilities in the Group's balance sheet comprise equity and debt investments, loans and receivables, cash and cash equivalents, restricted cash, short positions, trade and other payables and borrowings.

Non-derivative financial assets and liabilities are recognised initially at fair value plus, for assets and liabilities not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial assets and liabilities are measured as described below.

A financial instrument is recognised when the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e. the date that the Group commits itself to purchase or sell the asset. Loans and receivables are recognised on the date that they are originated. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

##### *Financial assets designated at fair value through profit and loss*

Financial assets are designated at fair value through profit or loss if the Group manages such investments with a view to profiting from their total return in the form of fair value changes, interest and dividend and makes purchase and sale decisions based on their fair value. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred.

##### *Financial assets and liabilities held for trading*

Financial assets and liabilities are classified as held for trading if acquired or incurred principally for the purpose of selling or repurchasing in the short term and if they are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of short-term profit-taking. Non-derivative financial liabilities held for trading consist of short positions in equity instruments. Financial assets and liabilities classified as held for trading are measured at fair value, and changes therein are recognised in profit or loss. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred.

##### *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 recognised initially at fair value and subsequently measured at amortised cost using effective interest method. A provision for impairment of loans and receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to their original terms. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables.

## Notes, contd.:

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### 3. contd.:

#### *Held to maturity investments*

If the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

#### *Financial liabilities measured at amortised cost*

Other non-derivative financial liabilities are measured at amortised cost using the effective interest method.

#### (ii) *Derivative financial assets and liabilities*

The Group holds derivative financial instruments for investment purposes but also to hedge its interest rate and currency risk. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for through profit or loss. Derivatives with positive fair value at the reporting date are recognised as assets in the balance sheet while derivatives with negative fair value are recognised as liabilities. Because the Group does not apply hedge accounting, all derivative assets and liabilities are classified as held for trading.

### b. ***Investment income***

#### (i) *Net (expense) income from investment securities and derivatives*

Net (expense) income from investments in securities and derivatives comprise gain on the sale of shares, changes in the fair value of the investments and derivatives, other than foreign exchange hedges, and dividend income. Dividend income is recognised in the income statement on the date the Group's right to receive payments is established.

#### (ii) *Interest income and expense*

Interest income and expense is recognised in the income statement using the effective interest method.

#### (iii) *Net foreign exchange gain (loss)*

Net foreign exchange gain (loss) comprises foreign exchange changes arising from assets and liabilities denominated in foreign currencies, other than equity derivatives, and gains and losses arising from derivatives hedging the foreign currency risk.

## Notes, contd.:

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3. contd.:

c. ***Impairment of financial assets measured at amortised cost***

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in profit or loss.

d. ***Fair value measurement principles for financial instruments***

(i) ***Investment securities***

The fair value of investment securities is based on their quoted market bid prices at the reporting date without any deduction for estimated future selling costs.

If a quoted market price is not available on a stock exchange or from a broker / dealer for non-exchange-traded financial instruments, the fair value of the investment is estimated using valuation techniques, including use of recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the reporting date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the reporting date. Fair values for unquoted equity investments are estimated, if possible, using applicable price / earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

(ii) ***Derivatives***

The fair value of forward exchange contracts and equity derivatives are based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate based on government bonds.

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

## Notes, contd.:

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3. contd.:

(iii) *Loans and receivables including insurance receivables*

The fair value of loans and receivables, which is determined for disclosure purposes, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

(iv) *Non-derivative financial liabilities*

The fair value of non-derivative financial liabilities, which is determined for disclosure purposes, is based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

e. ***Insurance contracts***

As part of its insurance operations the Group's entities issue contracts that transfer both financial and insurance risk from the customers to the Group.

(i) *Insurance contracts - definition*

Insurance contracts are contracts under which the insurer accepts significant insurance risk from policyholders by agreeing to compensate the policyholders if a specified uncertain future event would occur.

Insurance risk is all risk, other than financial risk, that is transferred from the policyholder to the insurer such as accident, death or damage.

(ii) *Insurance contracts - classification*

The Group's insurance contracts are categorized in two groups according to how long the insurance risk lasts and whether the contract are fixed or changeable.

Property and casualty insurance:

Insurance contracts that are categorized as in this section are liability insurance, casualty insurance and property insurance.

Liability and casualty insurance contracts protect the customers against the risk of causing harm to third parties as a result of their legitimate activities and compensates the policyholders own damage in accordance with the terms of the insurance contracts.

Property insurance contracts mainly compensate the customers for damage suffered to their properties or for the value of property lost. Customers in business could also receive compensation for the loss of earnings caused by the inability to use the insured properties in their business.

Life insurance:

These contracts insure events associated with human life, for example death or survival over a long duration. Premiums are entered as income in the period they are issued and claims paid are entered as expense in the period that the insured event incurs.

## Notes, contd.:

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### 3. contd.:

#### (iii) *Investments with investments risk of the life assurance policyholders*

Investments with the investment risk of life assurance policyholders are financial assets owned by the Group that the policyholders have selected and carry the investment risk in accordance with the life assurance policy. Technical provision for life assurance policies where the investment risk is borne by the policyholders is the Group's liability towards these policyholders in the same amount.

#### (iv) *Technical provisions*

The Group assesses, at the end of the fiscal year, whether the recorded insurance liability can carry out the Group's estimated obligations by assessing future cash flows of the insurance liability. All changes in the insurance liability are recognized in the income statement. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used.

#### (v) *Reinsurance contracts*

Reinsurance contracts are made in order to reduce the Group's risks. Reinsurance contracts can be either proportional or carry the entire risk in the case of a damage exceeding a fixed damage cost.

Claims on reinsurers due to premiums and claims are recognized as reinsurance assets. The claims concern the reinsurers share in damages according to reinsured insurance contracts and share in premium liability. Obligations due to reinsurance are the reinsurers share in premiums for reinsurance contracts which are recognized in the income statement at the time of the renewal of the reinsurance contracts.

#### (vi) *Insurance operations*

Premiums recognised as income comprise the premiums contracted during the period including premiums transferred from last years but excluding next periods premiums, which are recognised as premium reserve. Premium reserve in the balance sheet forms the part of premiums due to insurance risk during the period which belongs to the next fiscal year.

Claims recognised in the income statements are the period's claims including increases due to claims of previous fiscal year. Claims reserved in the balance sheet are the total amount of reported but unpaid claims as well as actuarial provision for claims occurred but unreported.

### f. ***Share capital***

#### *Ordinary shares*

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of shares and share options are recognised as a deduction from equity, net of any tax effects.

#### *Repurchase of share capital*

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs net of tax, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to/from share premium/retained earnings.



## Notes, contd.:

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### 3. contd.:

#### *Dividends*

Dividends are recognised as a decrease in equity in the period in which they are declared.

### 4. **Other accounting policies**

#### a. ***Basis of consolidation***

##### (i) *Subsidiaries*

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

When an acquisition is completed by a series of successive transactions, each significant transaction is considered individually for the purpose of the determination of the identifiable assets, liabilities and contingent liabilities acquired and hence for the goodwill associated with the acquisition.

##### (ii) *Minority interests*

Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the income statement and within equity in the consolidated balance sheet, separately from the equity attributable to equity holders of the Company. The Group accounts for transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Company that is recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised immediately as income in the income statement.

##### (iii) *Associates*

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Investments in associates are designated at fair value through profit or loss on initial recognition and are included within equity investments in the balance sheet. The Group defines its operations partly as venture capital organisation and that part of the business is clearly and objectively distinct from other operations.

##### (iv) *Transactions eliminated on consolidation*

Intra-group balances and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

## Notes, contd.:

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4 contd.:

(v) *Discontinued operations*

A discontinued operation is a component of the Group's business that represents a separate major line of business that has been disposed of or is classified held for sale. Subsidiaries acquired exclusively with a view to resale are also defined as discontinued operations. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the comparative period.

b. ***Foreign currency***

(i) *Foreign currency transactions*

Transactions in foreign currencies are translated to the respective functional currency of Group entities at exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Acquisition of operating assets in foreign currencies is translated at the foreign exchange rate ruling at the date of the transaction. Operating expenses and sales in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction.

(ii) *Foreign operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to the functional currency at exchange rates at the reporting date. The income and expenses of foreign operations are translated to the functional currency at the average exchange rate.

Foreign currency translation differences are recognised directly in equity in the translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount in the translation reserve is transferred to profit or loss.

c. ***Operating assets***

(i) *Measurement*

Operating assets are stated at cost less accumulated depreciation and accumulated impairment losses.

(ii) *Subsequent costs*

The cost of replacing part of an item of operating asset is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other costs are recognised in the income statement as an expense as incurred.

(iii) *Depreciation*

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each item of operating assets. The estimated useful lives are as follows:

Buildings .....	33 years
Other operating assets .....	3-10 years

## Notes, contd.:

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4 contd.:

The depreciation method, useful lives and residual values are reassessed at the reporting date.

d. ***Intangible assets***

(i) *Goodwill and intangible assets with indefinite useful lives*

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill and trademarks with indefinite useful lives are stated at cost less accumulated impairment losses.

(ii) *Other intangible assets*

Other intangible assets are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of the relevant asset. The estimated useful lives are specified as follows:

Software .....	3 years
Customer relations .....	6 years
Other intangible assets .....	6-10 years

(iii) *Subsequent expenditure*

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

e. ***Impairment of non-financial assets***

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the 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 the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

## Notes, contd.:

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### 4. contd.:

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's 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.

### f. *Share-based payment transactions*

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

The fair value of employee stock options is measured using a Black-Scholes model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility based on weighted average historic volatility adjusted for changes expected due to publicly available information, weighted average expected life of the instruments based on historical experience and general option holder behaviour, expected dividends, and the risk-free interest rate based on government bonds. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

### g. *Lease payments*

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense 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. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

### h. *Income tax*

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

## Notes, contd.:

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### 4. contd.:

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### i. **Earnings per share**

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprises share options granted to employees.

### j. **Segment reporting**

A segment is a distinguishable component of the Group that is engaged in providing products or services and which is subject to risks and rewards that are different from those of other segments. The Group's primary format for segment reporting at year-end is based on one hand on the investment activities and the other hand the insurance activities that consist of TM hf. and its subsidiaries acquired during the year.

### k. **New standards and interpretations effective in 2007**

*IFRS 7 Financial Instruments: Disclosures* and the Amendment to *IAS 1 Presentation of Financial Statements: Capital Disclosures* became mandatory for the Group's 2007 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group. In accordance with the transitional requirements of the standards, the Group has provided full comparative information.

IFRIC 7 – 10 became mandatory for the Group's 2007 financial statements but their adoption had no impact on the Group's 2007 financial statements.

## Notes, contd.:

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### 1. *New standards and interpretations not yet adopted*

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these consolidated financial statements:

*IFRS 8 Operating Segments* introduces the “management approach” to segment reporting. IFRS 8, which becomes mandatory for the Group’s 2009 financial statements, will require the disclosure of segment information based on the internal reports. The Group has not yet determined the potential effect of IFRS 8 on the consolidated financial statements.

*IAS 1 Presentation of Financial Statements (revised in 2007)* replaces IAS 1 Presentation of Financial Statements (revised in 2003) as amended in 2005. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either in a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the statement of changes in equity. IAS 1 (revised in 2007), which becomes mandatory for the Group’s 2009 financial statements if endorsed by the EU, is expected to impact the presentation of the Group’s income statement and statement of changes in equity.

Revised *IAS 23 Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If endorsed by the EU, the revised IAS 23 will become mandatory for the Group’s 2009 financial statements and will have no effect on the Group’s accounting policies.

The amendments to *IFRS 2 Share Based Payment – Vesting Conditions and Cancellations* (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Group’s 2009 financial statements, with retrospective application required. The amendments are not expected to have any effect on the consolidated financial statements of the Group.

*IFRS 3 Business Combinations (revised in 2008)* and amended *IAS 27 Consolidated and Separate Financial Statements* introduce changes to the accounting for business combinations and for non-controlling (minority) interest. The most significant changes from IFRS 3 (2004) and IAS 27 (2003) are the following:

- IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations achieved by contract alone;
- The definition of a business combination has been revised to focus on control;
- The definition of a business has been amended;
- Transaction costs incurred by the acquirer in connection with the business combination do not form part of the business combination transaction;
- Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
- Disposals of equity interests while retaining control are accounted for as equity transactions;
- New disclosures are required.

## Notes, contd.:

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### 4. contd.:

*IFRS 3 (revised in 2008)* and amended *IAS 27* will become mandatory for the Group's 2010 Financial Statements, if endorsed by the EU. The carrying amounts of any assets and liabilities that arose under business combinations prior to the application of IFRS 3 (revised in 2008) are not adjusted while most of the amendments to IAS 27 must be applied retrospectively. The Group has not yet determined the potential effect of IFRS 3 (revised in 2008) and amended IAS 27 on the consolidated financial statements.

*IFRIC 11 IFRS 2 – Group and Treasury Share Transactions* requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Group's 2008 financial statements, with retrospective application required. IFRIC 11 is not expected to have any impact on the consolidated financial statements.

*IFRIC 12 Service Concession Arrangements* provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Group's 2008 financial statements if endorsed by the EU, will have no effect on the consolidated financial statements.

*IFRIC 13 Customer Loyalty Programmes* addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13, which becomes mandatory for the Group's 2009 financial statements if endorsed by the EU, is not expected to have a material impact on the consolidated financial statements.

*IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Group's 2008 financial statements if endorsed by the EU, with retrospective application required. The Group has not yet determined the potential effect of the interpretation on the consolidated financial statements.

### m. **Accounting estimates and judgements**

#### **Key sources of estimation uncertainty**

##### *Determination of fair values of financial instruments*

As indicated in note 3a the Group's securities, derivatives and investments in associates are measured at fair value. For the majority of these financial instruments, quoted market prices are readily available. However, certain financial instruments, for example, over-the-counter derivatives or unquoted securities are fair valued using valuation techniques, including reference to the current fair values of other instruments that are substantially the same, subject to the appropriate adjustments.

Fair value estimates are made at a specific point in time, based on market conditions and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement (e.g. interest rates, volatility, estimated cash flows etc.) and therefore, cannot be determined with precision.

## Notes, contd.:

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### 4. contd.:

#### *Determination of impairment of financial assets*

Financial assets accounted for at amortised cost are evaluated for impairment on the basis described in accounting policy 3c. The assessment for impairment is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying collateral.

#### *Determination of impairment of non-financial assets*

Non-financial assets, such as goodwill and intangible assets, are reviewed at each reporting date for impairment. The assessment for impairment is based upon management's estimates of future cash flows and discount rates.

#### *Determination of fair value of share-based payment transactions*

The fair value of options at grant date is determined as disclosed in accounting policy 4f. For share options granted to employees, in many cases market prices are not available, because the options granted are subject to terms and conditions that do not apply to traded options. If traded options with similar terms and conditions do not exist, the fair value of the options granted are estimated by applying an option pricing model. In estimating the fair value of options at grant date, the management considers factors that knowledgeable, willing market participants would consider in selecting the option pricing model to be used for this purpose.

### **Critical accounting judgements in applying the Group's accounting policies**

Critical accounting judgements made in applying the Group's accounting policies include:

#### *Financial assets and liability classification*

The Group's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances:

In classifying financial assets or liabilities as "trading", the Group has determined that it meets the description of trading assets and liabilities set out in accounting policy 3a.

In designating financial assets or liabilities at fair value through profit or loss, the Group has determined that it has met the criteria for this designation set out in accounting policy 3a.

In classifying financial assets as held-to-maturity, the Group has determined that it has both the positive intention and ability to hold the assets until their maturity date as required by accounting policy 3a.

#### *Deferred tax assets*

Deferred tax assets are recognised for most deductible temporary differences and for tax losses carried forward to the extent that it is probable that taxable profit will be available against which they can be utilized. Significant management judgement is required to determine the amount of deferred tax assets that can be recognized, based on the likely timing and level of future taxable profits together with future tax planning strategies.



## Notes, contd.:

### Segment reporting

5. Segment information is presented in the consolidated financial statements to reflect the Group's management and internal reporting structure for the year 2007 and is divided into two segments, investment and insurance. The investment segment consists of FL Group's operations excluding TM and its subsidiaries, which represent the insurance operations of the Group.

Inter-segment pricing is determined on an arm's length basis.

Segment results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

	Investment activities	Insurance	Eliminations	Consolidated
<b>2007</b>				
<b>Net investment (loss) income</b> .....	<u>( 72,885)</u>	<u>( 905)</u>	<u>0</u>	<u>( 73,790)</u>
<b>Operating income:</b>				
Insurance premium .....	<u>0</u>	<u>2,769</u>	<u>0</u>	<u>2,769</u>
<b>Operating expenses:</b>				
Insurance claims .....	<u>0</u>	<u>( 2,598)</u>	<u>0</u>	<u>( 2,598)</u>
Other operating expenses .....	<u>( 5,227)</u>	<u>( 712)</u>	<u>0</u>	<u>( 5,939)</u>
Depreciation and amortisation .....	<u>( 85)</u>	<u>( 129)</u>	<u>0</u>	<u>( 214)</u>
Segment result before income tax .....	<u>( 78,197)</u>	<u>( 1,575)</u>	<u>0</u>	<u>( 79,772)</u>
Income tax .....	<u>8,510</u>	<u>4,024</u>	<u>0</u>	<u>12,534</u>
Profit for the year .....	<u>( 69,687)</u>	<u>2,449</u>	<u>0</u>	<u>( 67,238)</u>
Segment assets .....	377,221	70,431	( 25,332)	422,320
Segment liabilities .....	221,648	44,828		266,476
	Investment	Discontinued		
<b>2006</b>	activities	operations	Eliminations	Consolidated
<b>Net investment (loss) income</b> .....	<u>43,191</u>	<u>( 226)</u>	<u>0</u>	<u>42,965</u>
<b>Operating income</b> .....	<u>0</u>	<u>93,363</u>	<u>0</u>	<u>93,363</u>
<b>Operating expenses:</b>				
Operating expenses .....	<u>( 2,772)</u>	<u>( 88,860)</u>	<u>0</u>	<u>( 91,632)</u>
Depreciation and amortisation .....	<u>( 24)</u>	<u>( 2,744)</u>	<u>0</u>	<u>( 2,768)</u>
Segment result before income tax .....	<u>40,395</u>	<u>1,533</u>	<u>0</u>	<u>41,928</u>
Income tax .....	<u>2,633</u>	<u>( 2)</u>	<u>0</u>	<u>2,631</u>
Profit for the year .....	<u>43,028</u>	<u>1,531</u>	<u>0</u>	<u>44,559</u>
Segment assets .....	262,226	904	( 259)	262,871
Segment liabilities .....	119,562	633	0	120,195

## Notes, contd.:

### Disposal of Kynnisferðir ehf.

6. Kynnisferðir ehf., a subsidiary operating in the tourism industry, was presented as of 31 December 2006 as a disposal group held for sale, was sold in January 2007. Comparative amounts in the consolidated financial statements contain amounts from the financial statements of the aforementioned company. Total assets the company at year-end 2006 amounted to ISK 904 million and total liabilities amounted to ISK 634 million. The gain on the sale, ISK 486 million, is included as gain on shares in the line Net income from securities and derivatives in the income statement.

### Business combination

7. During the year the Company in stages acquired 99.9% of outstanding shares in Tryggingamiðstöðin hf. (TM hf.), an insurance company. The acquisition date was determined 1 October 2007. Until 1 October, 2007 TM hf. was accounted for at fair value but the fair value change was reversed on acquisition date through equity. Comparative amounts in the consolidated financial statements do not contain amounts from the financial statements of TM hf.

The acquisition, accounted for according to the purchase method, had the following effect on the Group's balance sheet:

	Pre-acquisition carrying amounts	Provisional fair value adjustments	Recognised values on acquisition
Cash and cash equivalents .....	5,073		5,073
Equity investments .....	28,274		28,274
Bonds and debt investments .....	2,494		2,494
Loans and receivables, including insurance receivables .....	16,412		16,412
Reinsurance assets .....	13,899		13,899
Deferred tax asset .....	565		565
Operating assets .....	544	549	1,093
Intangible assets .....	986	2,428	3,414
Trade and other payables .....	( 6,653 )		( 6,653 )
Insurance liabilities .....	( 30,567 )		( 30,567 )
Borrowings .....	( 8,438 )		( 8,438 )
Income tax liability .....	( 4,230 )	( 99 )	( 4,329 )
Net identifiable assets and liabilities .....	18,359	2,878	21,237
Minority interest .....			( 309 )
Goodwill on acquisition .....			28,446
Total purchase consideration .....			49,374
Consideration satisfied by shares issued at fair value .....			( 33,897 )
Consideration satisfied in cash .....			15,477
Net cash acquired .....			( 5,073 )
Cash outflow on acquisition .....			10,404

Included in the consideration satisfied by cash are acquisition related expenses, i.e. advisers fees and other fees amounting to ISK 290 million. Part of the consideration was satisfied with 1,390 million shares at the average price of ISK 24.4 per share in accordance with the market price at each time.

## Notes, contd.:

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### 7. contd.:

The goodwill recognised on the acquisition is attributable mainly to the work force and the synergies expected to be achieved from integrating the company into the Group's existing activities. If the acquisition had occurred on 1 January 2007, management estimates that consolidated revenues from insurance operation would have been ISK 10,543 million and consolidated loss for the year would have been ISK 65,420 million.

TM hf.'s operations since 1 October 2007 are part of the consolidated income statement and consolidated cash flow statement of FL GROUP hf. Profit resulting from TM hf. since acquisition date amounts to ISK 2,449 million.

The purchase price allocation has been determined provisionally. Accordingly, the allocation of goodwill to cash-generating units could not be completed before year-end.

### Investment income

#### 8. Net (expense) income from investment securities and derivatives is specified as follows:

	2007	2006
Net (loss) gain on financial assets designated at fair value through profit and loss .....	( 48,207)	25,589
Net loss on financial assets held for trading .....	( 15,475)	( 1,633)
Net (expense) income from investment securities and derivatives .....	<u>( 63,682)</u>	<u>23,956</u>

Dividend income included in net investment income amounts to ISK 4,297 million (2006: ISK 806 million).

### Interest income and expense

#### 9. Interest income and expense are specified as follows:

##### Interest income on:

Cash and cash equivalents and restricted cash .....	2,584	854
Loans and receivables .....	<u>2,398</u>	<u>0</u>
<b>Total</b> .....	<u>4,982</u>	<u>854</u>

##### Interest expense on:

Borrowings .....	17,520	4,947
Trade and other payables .....	<u>46</u>	<u>1</u>
<b>Total</b> .....	<u>17,566</u>	<u>4,948</u>

## Notes, contd.:

### Net insurance income

10. Insurance premium is specified as follows:	2007	2006
Premiums written .....	3,583	0
Reinsure's share .....	( 1,744)	0
Change in the gross provision for unearned premiums .....	1,688	0
Change in the provision for unearned premiums, reinsure's share .....	( 758)	0
Total insurance premium .....	<u>2,769</u>	<u>0</u>

### Operating expenses

11. Insurance claims are specified as follows:		
Claims paid .....	4,099	0
Claims paid, reinsure's share .....	( 1,553)	0
Change in the provision for claims .....	707	0
Change in the provision for claims, reinsures' share .....	( 655)	0
Total insurance claims .....	<u>2,598</u>	<u>0</u>
12. Other operating expenses are specified as follows:		
Salaries, salary-related expenses and other personnel expenses, see note 13 .....	2,543	1,652
Depreciation and amortisation .....	113	23
Other operating expenses .....	<u>3,497</u>	<u>1,096</u>
Total operating expenses .....	<u>6,153</u>	<u>2,771</u>

### Salaries and salary-related expenses

13. Salaries and salary-related expenses are specified as follows:		
Salaries and bonus payments .....	1,459	1,071
Equity-settled shared-based payment transactions .....	567	435
Salary-related expenses .....	<u>484</u>	<u>126</u>
Total salaries and salary-related expenses .....	<u>2,510</u>	<u>1,632</u>
Other personnel expenses .....	<u>33</u>	<u>20</u>
Salaries, salary-related expenses and other personnel expenses, total .....	<u>2,543</u>	<u>1,652</u>
Average number of employees during the year .....	78	20

### Auditors' fees

14. Remuneration to the Group's Auditors are specified as follows:		
Audit of Financial Statements .....	34	33
Review of Interim Financial Statements .....	6	8
Other services .....	<u>38</u>	<u>32</u>
Total auditors's fee .....	<u>78</u>	<u>73</u>

## Notes, contd.:

### 14. contd.:

The above mentioned figures include fees to the auditors of all companies within the Group during the year. Fees to other auditors than the auditors of the Parent Company amounted to ISK 44 million during the year 2007 (2006: ISK 17 million).

### Income tax

#### 15. Income tax recognised in the income statement is specified as follows:

	2007	2006
Current tax .....	6	782
Origination and reversal of temporary differences .....	( 12,540)	( 3,413)
Total income tax in income statement .....	( 12,534)	( 2,631)

#### 16. Reconciliation of effective tax rate:

	2007	2006
(Loss) profit before income tax .....	( 79,772)	41,928
Income tax using the Company's domestic tax rate .....	18.0% ( 14,359)	18.0% 7,547
Tax exempt revenue .....	0.2% ( 132)	( 0.9%) ( 390)
Effect of tax rates in foreign jurisdictions .....	( 4.5%) 3,621	( 0.1%) ( 33)
Tax incentives .....	5.0% ( 3,997)	( 22.6%) ( 9,485)
Non-deductible expenses .....	( 3.2%) 2,534	0.0% 2
Other items .....	( 0.9%) ( 201)	( 0.9%) ( 272)
Effective tax rate .....	15.7% ( 12,534)	( 6.3%) ( 2,631)

#### 17. Income tax recognised directly in equity is specified as follows:

	2007	2006
Income tax on cost of issuing shares .....	92	34

### (Loss) earnings per share

#### 18. (Loss) profit attributable to ordinary equity holders of the Company:

Continuing operations .....	( 67,247)	17,351
Discontinued operations .....	0	27,209
Total .....	( 67,247)	44,560

## Notes, contd.:

18. contd.:

### Weighted average number of ordinary shares

*in million shares*

	2007	2006
Issued ordinary shares at 1 January .....	7,763	5,802
Effect of bought and sold own shares .....	( 64)	( 133)
Effect of the increase of share capital in January 2006 .....	0	284
Effect of the increase of share capital in July 2006 .....	0	752
Effect of the increase of share capital in April 2007 .....	2	0
Effect of the increase of share capital in September 2007 .....	266	0
Effect of the increase of share capital in October 2007 .....	68	0
Effect of the increase of share capital in December 2007 .....	181	0
Weighted average number of ordinary shares at 31 December .....	8,216	6,705

### Weighted average number of ordinary shares (diluted)

*in million shares*

Weighted average number of ordinary shares (basic) .....	8,216	6,705
Effect of share options .....	228	49
Weighted average number of ordinary shares (diluted) at 31 December .....	8,444	6,754

### (Loss) earnings per share:

Basic (loss) earnings per share (ISK) .....	( 8.18)	6.65
Diluted (loss) earnings per share (ISK) .....	( 7.96)	6.60

### (Loss) earnings per share from continuing operations:

Basic (loss) earnings per share (ISK) .....	( 8.18)	2.59
Diluted (loss) earnings per share (ISK) .....	( 7.96)	2.57

19. Financial assets and liabilities are classified as follows:

	Held for trading	Design. at fair value through profit or loss	Held to maturity	Loans and receivables	Financial liabilities at amortised cost	Total
<b>31.12.2007</b>						
<i>Financial assets:</i>						
Cash and cash equivalents .....				21,125		21,125
Equity investments .....	3,148	215,850				218,998
Bonds and debt investments .....	12,271		3,750			16,021
Derivatives .....	6,604					6,604
Restricted cash .....				53,060		53,060
Loans and receivables .....				49,848		49,848
Total financial assets .....	22,023	215,850	3,750	124,033	0	365,656

## Notes, contd.:

19. contd.:

	Held for trading	Design. at fair value through profit or loss	Held to maturity	Loans and receivables	Financial liabilities at amortised cost	Total
<b>31.12.2007</b>						
<i>Financial liabilities:</i>						
Derivatives .....	13,488					13,488
Short positions .....	3,350					3,350
Trade and other payables ..					14,469	14,469
Borrowings .....					204,979	204,979
Total financial liabilities ....	16,838	0	0	0	219,448	236,286
<b>31.12.2006</b>						
<i>Financial assets:</i>						
Cash and cash equivalents .....				47,022		47,022
Equity investments .....	20,859	160,178				181,037
Bonds and debt investments .....	124					124
Derivatives .....	4,309					4,309
Restricted cash .....				9,572		9,572
Loans and receivables .....				19,478		19,478
Total financial assets .....	42,130	160,178	0	76,072	0	261,542
<i>Financial liabilities:</i>						
Derivatives .....	7,021					7,021
Trade and other payables ..					5,908	5,908
Borrowings .....					104,955	104,955
Total financial liabilities ....	7,021	0	0	0	110,863	117,884

### Cash and cash equivalents

20. Cash and cash equivalents are specified as follows:

	2007	2006
Bank balances .....	15,947	6,786
Short-term deposits with credit institutions .....	5,178	27,057
Mutual-fund certificates .....	0	13,179
Total cash and cash equivalents .....	21,125	47,022

## Notes, contd.:

### Investment securities

21. Equity investments are specified as follows:

	2007		2006	
	Ownership	Fair value including related derivatives	Ownership	Fair value including related derivatives
<b>Listed equity investments:</b>				
<i>Listed on the Icelandic Stock Exchange:</i>				
Glitnir banki hf. ....	31.97%	104,430	30.36%	100,892
Other companies .....		15,309		50,410
Total listed on the Iceland Stock Exchange .....		<u>119,739</u>		<u>151,302</u>
<i>Listed on foreign stock exchanges:</i>				
Inspired Gaming Group PLC .....	18.97%	4,054		
Finnair Oyj .....	12.69%	12,091	22.42%	23,126
Royal Unibrew A/S .....	25.57%	9,927	24.38%	14,013
Aktiv Kapital ASA .....	13.27%	6,400	13.27%	6,671
Nordicom A/S .....	21.71%	6,859		
Comerzbank AG .....	2.90%	45,931		
AMR Corporation .....			6.00%	27,626
Bang & Olufsen A/S .....			11.45%	11,834
Other companies .....		( 7,944)		9,848
Total listed on foreign stock exchanges .....		<u>77,318</u>		<u>93,118</u>
Total listed equity investments .....		<u>197,057</u>		<u>244,420</u>
<b>Unlisted securities:</b>				
Eikarhald ehf .....	71.70%			
Þyrping hf. ....	49.33%			
Refresco Holding B.V. ....	49.00%		49.00%	
Geysir Green Energy ehf. ....	43.14%			
Landic Property hf. ....	43.08%			
Northern Travel Holding ehf. ....	34.78%		34.78%	
Highland Group Holding Limited .....	13.89%		13.89%	
Mutual-fund certificates .....				
Other companies .....				
Total unlisted equity investments .....		<u>90,019</u>		<u>14,819</u>
Total equity investments .....		287,076		259,239
Thereof equity derivatives, see note 24 .....		( 71,428)		( 78,202)
Thereof short positions .....		3,350		0
Fair value of equity investments at year-end .....		<u>218,998</u>		<u>181,037</u>



## Notes, contd.:

22. Bonds and debt investments are specified as follows:

<b>Listed bonds and debt investments:</b>	2007	2006
<i>Listed on the Icelandic Stock Exchange:</i>		
Held for trading .....	16,098	8,729
Held to maturity .....	3,750	0
Total listed on the Iceland Stock Exchange .....	19,848	8,729
Thereof bonds derivatives .....	( 3,827)	( 8,605)
Fair value of bond investments at year end .....	16,021	124
<i>Held to maturity bonds and debt investments are specified as follows:</i>		
Issued by the Government .....	74	124
Issued by financial institutions .....	3,617	0
Issued by municipalities .....	2	0
Issued by corporates .....	57	0
Total listed on the Iceland Stock Exchange .....	3,750	124

## Associates

23. As presented in note 4a(iii), investments in associates are accounted for at fair value through profit or loss and presented within equity investments in the balance sheet. At year end 2007, based on both direct and indirect ownership, the following investments are defined as associates:

	Ownership
Glitnir banki hf., Iceland .....	31.97%
Eikarhald ehf., Iceland .....	71.70%
Northern Travel Holding hf., Iceland .....	34.78%
Refresco Holding B.V., Holland .....	49.00%
Unity Investment ehf., Iceland .....	37.50%
Þyrping hf., Iceland .....	49.33%
Landic Property hf., Iceland .....	39.23%
Fasteignafélag Íslands hf., Iceland .....	32.32%
Íslensk endurtrygging hf., Iceland .....	38.32%
Geysir Green Energy ehf., Iceland .....	43.14%
VC Holdings Limited, United Kingdom .....	41.54%
Wyndeham Press Group Limited, United Kingdom .....	49.00%

In December 2007 the Company acquired shares in Landic Property hf. and other real estate companies and funds. As part of the investment the Company acquired 22.7% share in Eikarhald ehf. so the ownership after the acquisition increases to 71.7%. This investment was not consolidated since control was not obtained at year-end 2007.

## Notes, contd.:

### Derivatives

24. Net assets in derivatives are specified as follows:

	2007	2006
Equity derivatives - receivable, see note 21 .....	71,428	78,202
Equity derivatives - payable .....	( 78,307)	( 77,005)
Net position of equity derivatives .....	( 6,879)	1,197
Net position of other derivatives .....	( 5)	( 3,909)
Net position of derivatives .....	( 6,884)	( 2,712)
Derivatives - assets in the balance sheet .....	6,604	4,309
Derivatives - liabilities in the balance sheet .....	( 13,488)	( 7,021)
Net position of derivatives .....	( 6,884)	( 2,712)

### Restricted cash

25. Bank deposits amounting to ISK 53,060 million (2006: ISK 9,572 million) are restricted to use for the Group at year-end. Deposits are cash held by financial institutions as collaterals for derivative transactions and borrowings and are specified as follows:

	2007
Bank deposits as collateral for derivatives .....	24,995
Bank deposits as collateral for borrowings .....	28,065
Restricted cash total .....	53,060

### Loans and receivables, including insurance receivables

	2007	2006
26. Loans and receivables, including insurance receivables:		
Investment related loan portfolio .....	19,375	14,745
Collateralised loans .....	7,879	0
Insurance receivables .....	5,015	0
Investment related trade receivables .....	3,678	2,359
Other receivables .....	6,401	2,374
Total loans and receivables, including insurance receivables .....	42,348	19,478

Allowance account for impairment at year-end 2007 amounts ISK 363 million and is deducted from insurance receivables and collateralised loans in the Balance Sheet.

27. Repayments of loans and receivables, including insurance receivables:

Repayments in 2007 .....		6,966
Repayments in 2008 .....	19,687	0
Repayments in 2009 .....	14,195	12,512
Repayments in 2010 .....	1,365	0
Repayments in 2011 .....	1,065	0
Repayments in 2012 .....	825	0
Subsequent payments .....	5,211	0
Total loans and receivables, including insurance receivables .....	42,348	19,478

## Notes, contd.:

### Operating assets

28. Operating assets are specified as follows:

	Buildings	Other operating assets	Total
<b>Gross carrying amount</b>			
Additions during the year .....	0	449	449
Balance at 31.12.2006 .....	0	449	449
Exchange rate difference .....	0	( 1)	( 1)
Additions through business combinations .....	977	116	1,093
Additions during the year .....	211	555	766
Sales and disposals during the year .....	( 22)	( 10)	( 32)
Balance 31.12.2007 .....	1,166	1,109	2,275
<b>Depreciation and impairment losses</b>			
Depreciation .....	0	24	24
Balance 31.12.2006 .....	0	24	24
Depreciation .....	15	74	89
Sales and disposals during the year .....	0	( 5)	( 5)
Balance 31.12.2007 .....	15	93	108
<b>Carrying amounts</b>			
1.1.2006 .....	0	0	0
31.12.2006 .....	0	425	425
31.12.2007 .....	1,151	1,016	2,167
Depreciation ratios .....	2-4%	4-33%	

### Intangible assets

29. The Group's intangible assets are specified as follows:

	Goodwill	Trade name	Customer relationship	Other intangible assets	Total
Additions through business combination .....	28,446	2,784	575	54	31,859
Additions during the year .....	0	0	0	54	54
Exchange rate difference .....	42	4	2	0	48
Amortised during the year .....	0	0	( 24)	0	( 24)
Balance at 31 December 2007 .....	28,488	2,788	553	108	31,937

## Notes, contd.:

### Equity

#### 30. *Share capital*

The share capital was increased in September 2007 by ISK 974 million which was sold at ISK 23,656 million in relation to the purchase of 46.1% stake in Tryggingamiðstöðin hf. The share capital was further increased in October by ISK 326 million and was sold at ISK 7,922 million in relation to further purchase of shares in Tryggingamiðstöðin hf.

The share capital was increased in two stages in December 2007. First by ISK 680 million which was sold for ISK 10,000 million in a share offering, thereof ISK 7,500 million due 4 January 2008 and then by ISK 3,659 million sold for ISK 53,791 million in relation to the investment in Landic Properties hf. and other real estate companies and funds.

The Company's share capital, according to its Articles of Association amounts to ISK 13,584 million. The holders of ordinary shares are entitled to dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. Share capital was increased during the year 2007 by a nominal value of ISK 5,639 million, from ISK 7,945 million to ISK 13,584 million. The Company bought own shares at a nominal value of ISK 22 million during the year for ISK 622 million. The Company sold own shares with a nominal value of ISK 114 million for ISK 2,594 million. Share capital according to the balance sheet amounted to ISK 13,494 million at the end of the year, share capital is specified as follows:

	Amounts	Ratio
Total issued shares at the end of the year .....	13,494	99.3%
Shares owned by the Company and its subsidiaries .....	90	0.7%
Share capital according to the Articles of Association .....	13,584	100.0%

Share capital amounting to ISK 112 million was owned by associates.

The Board of Directors has the right to increase the share capital until 25 September 2012 by up to ISK 1,320 million with sale of new shares. Thereof are up to ISK 500 million subject to the pre-emptive purchase provisions of the Articles of Association. The Board of Directors decides the rules of sale each time, i.e. price, payments, subscription period etc. Additionally the Board of Directors can increase the share capital up to ISK 17 million for the purpose of financing the purchase of TM hf. The Board of Directors has the right to purchase up to 10% of the nominal value of the shares of the Company until 22 August 2008. The shares' purchase price may be up to 20% above the average sales price of shares on the Icelandic Stock Exchange.

#### *Share premium*

Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Company. According to Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

#### *Share option reserve*

The reserve includes the accrued part of the fair value of share options. This reserve is reversed if share options are forfeited and is transferred to share premium if share options are exercised.

#### *Translation reserve*

Foreign exchange differences arising on translation of financial statements of subsidiaries are recognised directly in a separate component of equity. When a foreign operation is disposed of, in part or in full, the relevant amount in the translation reserve is transferred to profit or loss.

## Notes, contd.:

### Trade and other payables

31. Trade and other payables are specified as follows:

	2007	2006
Trade payables .....	2,634	2,410
Insurance liability .....	4,224	0
Other payables .....	7,611	3,498
Total trade and other payables .....	<u>14,469</u>	<u>5,908</u>

### Insurance liabilities and reinsurance assets

32. Insurance liabilities and reinsurance assets are specified as follows:

	2007
Insurance liabilities (total):	
Unearned premium .....	6,147
Claims provisions .....	<u>23,479</u>
Insurance liabilities, total .....	<u>29,626</u>
Reinsurance assets:	
Reinsurers' share of insurance liabilities:	
Unearned premium .....	2,635
Claims provisions .....	11,017
Reinsurance receivable and retention money .....	<u>285</u>
Reinsurance assets, total .....	<u>13,937</u>
Net liability due to insurance contracts:	
Premium reserve .....	3,512
Claims provisions .....	12,462
Reinsurance receivable and retention money .....	<u>( 285 )</u>
Insurance liability (net), total .....	<u>15,689</u>

33. Changes in insurance claims liabilities and reinsurance assets in 2007:

	2007		
Claims provision	Total	Reinsurance	Net
Reported claims .....	13,946	( 4,299 )	9,647
Incurred but unreported claims .....	6,775	( 4,512 )	2,263
Total .....	<u>20,721</u>	<u>( 8,811 )</u>	<u>11,910</u>
Translation difference of balance .....	<u>( 11 )</u>	<u>8</u>	<u>( 3 )</u>
Claims provision total .....	<u>20,710</u>	<u>( 8,803 )</u>	<u>11,907</u>
Claims during the year .....	( 12,739 )	3,971	( 8,768 )
Incurred claims during the year .....	15,444	( 5,719 )	9,725
Fair value changes of receivables from previous year .....	273	( 453 )	( 180 )
Translation and exchange rate differences .....	<u>( 209 )</u>	<u>( 12 )</u>	<u>( 221 )</u>
Total .....	<u>2,769</u>	<u>( 2,213 )</u>	<u>556</u>

## Notes, contd.:

33. contd.:

	2007		
	Total	Reinsurance	Net
<b>Claims provision</b>			
Reported claims .....	15,210	( 5,388 )	9,822
Incurred but unreported claims .....	8,269	( 5,628 )	2,641
Total .....	23,479	( 11,016 )	12,463
<b>Premium liabilities</b>			
Premium liability from previous year .....	5,385	( 2,279 )	3,106
Translation difference .....	( 152 )	34	( 118 )
Increase of the year .....	914	( 390 )	524
Total .....	6,147	( 2,635 )	3,512

## Borrowings

34. Borrowings are specified as follows:

		2007	2006
	Currency	Carrying amount	Carrying amount
Bank loan .....	ISK	86,200	39,987
Bank loan .....	EUR	96,415	41,762
Bank loan .....	DKK	931	1,231
Bank loan .....	NOK	3,878	1,048
Bank loan .....	USD	7,771	20,927
Bank loan .....	CHF	3,837	0
Bank loan .....	JPY	2,006	0
Bank loan .....	CAD	650	0
Subordinated loan .....	ISK	3,291	0
Borrowings .....		204,979	104,955
Weighted average interest .....		9.23%	8.27%

Group's assets amounting to ISK 224,666 million (2006: ISK 163,301) are mortgaged to secure derivative contracts and debt with the remaining balance of ISK 124,137 million at the end of the year 2007 (2006: ISK 79,969).

35. Repayment of borrowings are specified as follows:

Repayments in 2007 .....		43,838
Repayments in 2008 .....	55,609	0
Repayments in 2009 .....	89,753	50,144
Repayments in 2010 .....	44,697	0
Repayments in 2011 .....	0	0
Repayments in 2012 .....	11,629	10,973
Subsequent repayments .....	3,291	0
Borrowings .....	204,979	104,955

## Notes, contd.:

### Income tax liability

36. Income tax liability is specified as follows:

	2007	2006
Current tax .....	6	782
Deferred income tax .....	558	895
Income tax liability 31.12. ....	<u>564</u>	<u>1,677</u>

### Deferred income tax

37. The deferred income tax liability is specified as follows:

Deferred income tax liability 1.1. ....	895	4,694
Additions through business combination .....	3,764	0
Exchange rate difference .....	( 92)	0
Income tax expense recognised in income statement .....	( 12,534)	( 3,413)
Income tax recognised in equity .....	( 92)	( 34)
Other changes .....	0	( 352)
Net deferred income tax (asset) liability 31.12. ....	<u>( 8,059)</u>	<u>895</u>

The deferred income tax is attributable to the following items:

Equity investments .....	( 1,393)	22
Loans and trade receivables .....	( 896)	( 266)
Operating assets .....	1,918	1,310
Other balance sheet items .....	( 807)	( 171)
	( 1,178)	895
Tax losses carried forward .....	( 6,881)	0
Net deferred income tax (asset) liability 31.12. ....	<u>( 8,059)</u>	<u>895</u>

	Assets		Liabilities		Net deferred tax (asset) liability	
	2007	2006	2007	2006	2007	2006
Equity investments .....		( 1,393)	23	( 1,393)	23	
Loans and receivables, including insurance receivables .....	( 896)	( 267)	0	( 896)	( 267)	
Investments in companies .....	( 4)			0	( 4)	
Operating assets .....			1,918	1,310	1,918	1,310
Tax loss carry-forwards .....	( 6,881)			( 6,881)	0	
Other items .....	( 840)	( 167)	33	( 807)	( 167)	
	<u>( 8,617)</u>	<u>( 438)</u>	<u>558</u>	<u>1,333</u>	<u>( 8,059)</u>	<u>895</u>

## Notes, contd.:

37. contd.:

	1 January 2007	Recognised in equity	Additions through business combination	Recognised in profit and loss	Exchange rate difference	31 December 2007
Equity investments .....	23		4,217	( 5,627)	( 6)	( 1,393)
Loans and receivables ...	( 267)			( 630)	1	( 896)
Operating assets .....	1,311		378	329	( 100)	1,918
Tax loss carry-forwards .....	0		( 307)	( 6,574)		( 6,881)
Other items .....	( 172)	( 92)	( 524)	( 32)	13	( 807)
	<u>895</u>	<u>( 92)</u>	<u>3,764</u>	<u>( 12,534)</u>	<u>( 92)</u>	<u>( 8,059)</u>

38. At 31 December 2007 deferred tax liability amounting to ISK 12,942 million (2006: ISK 9,485 million) is not recognised for temporary differences of ISK 71,901 million (2006: ISK 52,694 million) related to an investment in subsidiaries because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

When the Group pays dividends to its shareholders, it is required to pay a portion of the dividends to tax authorities on behalf of shareholders, i.e. withholding tax. The amount paid to tax authorities is charged to equity as a part of the dividends.

## Share-based payments

39. The terms and conditions of grants are as follows:

Grant date / employees entitled	Number of instruments in thousands	Vesting conditions	Contractual life of option
Options granted 2005 .....	130,500	12/24/36 months service	3 years
Options granted 2006 .....	120,460	12/24/36 months service	3 years
Options granted 2007 .....	<u>433,900</u>	12/24/36 months service	3 years
Total .....	<u>684,860</u>		

All options are to be settled by physical delivery of shares. Options vesting in 12 months can be exercised three times during the contractual life, at the end of each 12 month period. Accordingly 24 month options can be exercised two times and the 36 month options only once at the end of the 36 month period.

The number and weighted average exercise price of share options is as follows in thousands:

	Weighted average exercise price 2007	Number of options 2007	Weighted average exercise price 2006	Number of options 2006
Outstanding at 1 January .....	14.3	250,960	13.6	217,650
Forfeited during the year .....	25.7	( 144,502 )	13.6	( 46,100 )



## Notes, contd.:

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39. contd.:	Weighted average exercise price 2007	Number of options 2007	Weighted average exercise price 2006	Number of options 2006
Exercised during the year .....	12.2	( 59,087 )	13.6	( 41,050 )
Granted during the year .....	18.0	440,900	20.4	120,460
Outstanding at 31 December .....	14.6	488,271	16.9	252,966
Excercisable at 31 December .....	11.2	61,937	13.6	43,500

The options outstanding at 31 December 2007 have an exercise price in the range of 10.6 to 31.1 and a weighted average contractual life of 1.7 years. The share price at the date of exercise for share options exercised in 2007 was 24.2 to 33.0.

Total recognised expenses for the year arising from share-based payment transactions amounted to ISK 567 million (2006: ISK 435 million) including adjustments for forfeited options during the year.

#### **40. Financial risk management**

##### *Overview*

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk
- underwriting risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and responsibilities.

The frame for asset allocation is monitored by a sub Committee of the Board of Directors, the Investment Committee. The Committee advises on the investment policy as well as on investment opportunities, exit opportunities and evaluates major individual investments. The Committee is authorised to approve transactions on behalf of the Group up to a predetermined level. Divergence from target asset allocations and the composition of the portfolio is monitored on intraday bases by the Group's employees.

The Group maintains positions in a variety of derivative and non-derivative financial instruments in accordance with its investment strategy. The Group's investment portfolio comprises quoted and non-quoted equity and debt investments.

##### ***Credit risk***

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Group. The Group's management looks to minimize this risk factor by only entering agreements with solid and well known institutions in addition to closely monitoring the credit risk on an ongoing basis.

Transactions involving derivative financial instruments are usually with counterparties with whom the Group has signed master netting agreements. Master netting agreements provide for the net settlement of contracts with the same counterparty in the event of default. The impact of the master netting agreements is to reduce credit risk.

Regarding loans and trade receivables internal procedures are used to manage the default risk, settlement risk, exposure risk and collateral risk. The subsidiary TM hf. is defined according to Icelandic law as a financial institution and is regulated by the FSA and reports quarterly to FSA on defaulted customers, exposure concentration and equity limits.

## Notes, contd.:

### 40. contd.:

TM hf. holds collateral against loans to customers in the form of mortgage interests over vehicles, properties, ships and machinery. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

The Group's policy is to provide only financial guarantees to wholly-owned subsidiaries. At year-end guarantees were outstanding as disclosed in note 50.

41. The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	2007	2006
Cash and cash equivalents .....	21,125	47,022
Held-to-maturity investments .....	3,750	0
Restricted cash .....	53,060	9,572
Loans and receivables .....	49,848	19,478
Reinsurance assets .....	13,937	0
Maximum exposure to credit risk at year-end .....	141,720	76,072

### *Liquidity risk*

42. Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The risk management of the Group mitigates the liquidity by assuring adequate liquidity through unforeseen changes in funding sources or market disruption. The Group's financial instruments include investments in unlisted equity investments and derivative contracts traded over-the-counter, which are not traded in an organised public market and which generally may be illiquid. As a result, the Group may not be able to liquidate quickly some of its investments in these instruments at an amount close to its fair value in order to meet its liquidity requirements, or to respond to specific events such as a deterioration in the credit-worthiness of any particular issuer.

To mitigate this risk the Group has a policy of minimum available cash at any given time and in addition to that, the Group's listed financial investments, which represent large part of the total assets, are considered to be readily realisable.

The breakdown by contractual maturity of financial liabilities:

31 December 2007	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
<b>Liabilities:</b>					
Derivatives .....	13,488	0	0	0	13,488
Short positions .....	0	3,350	0	0	3,350
Trade and other payables .....	14,469	0	0	0	14,469
Borrowings .....	55,609	146,079	3,291	0	204,979
Total financial liabilities .....	83,566	149,429	3,291	0	236,286

## Notes, contd.:

42. contd.:

31 December 2006	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
<b>Liabilities:</b>					
Derivatives .....	7,021	0	0	0	7,021
Trade and other payables .....	5,908	0	0	0	5,908
Borrowings .....	43,838	50,144	10,973	0	104,955
Total financial liabilities .....	56,767	50,144	10,973	0	117,884

Commitments amounting to ISK 18,979 million at year-end are payable on demand as disclosed in note 51.

### *Market risk*

43. Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group's strategy on the management of market risk is driven by the Group's investment objectives. The Group's market risk is managed on a daily basis in accordance with policies and procedures in place. The Group's overall market positions are monitored on a monthly basis, or in some cases more frequently, by the Board of Directors.

### *Currency risk*

44. The Group entities may invest in financial instruments and enter into transactions denominated in currencies other than their functional currencies. Consequently, the Group is exposed to risks that the exchange rate of its currency relative to foreign currencies may change in a manner that has an adverse affect on the value of that portion of the Group's assets or liabilities denominated in currencies other than the Icelandic kronas (ISK).

The Group's total net currency balance is monitored on daily basis and traded as any other calculated financial position.

The breakdown of financial assets and financial liabilities by currency:

2007	Assets	Liabilities	Net
DKK .....	8,701	1,200	7,501
EUR .....	104,773	99,358	5,415
GBP .....	8,500	1,289	7,211
JPY .....	317	2,031	( 1,714)
NOK .....	8,982	3,661	5,321
SEK .....	3,099	1,514	1,585
USD .....	4,736	13,086	( 8,350)
Other currencies .....	817	4,594	( 3,777)
Total .....	139,925	126,733	13,192

## Notes, contd.:

44. contd.:

2006	Assets	Liabilities	Net
DKK .....	2,290	1,427	863
EUR .....	18,498	41,878	( 23,380)
GBP .....	( 1,695)	67	( 1,762)
NOK .....	1,159	1,051	108
SEK .....	622	0	622
USD .....	3,615	25,043	( 21,428)
Other currencies .....	160	0	160
Total .....	24,649	69,466	( 44,817)

A 10% weakening of the Icelandic Krona against the above currencies at 31 December 2007 would have increased equity and decreased post-tax loss by ISK 1,081 million (2006: ISK 3,721 million). This analysis assumes that all other variables, in particular interest rates, remain constant.

### *Interest rate risk*

45. The majority of the Group's financial assets are non-interest-bearing. Interest-bearing financial assets reprice in the short-term, no longer than twelve months. As a result, the Group is subject to limited exposure to fair value interest rate risk due to fluctuations in the prevailing levels of market interest rates when it comes to assets. The Group is however exposed to interest risk from interest bearing liabilities and that risk is mitigated by active risk management. Any excess cash and cash equivalents of the Group are invested in short-term commercial paper or reverse repurchase agreements with the term to maturity no longer than one month.

A change of 1% in interest rates at the reporting date would have increased post-tax loss by ISK 800 million. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	2007		2006	
	Increase	Decrease	Increase	Decrease
Profit .....	( 800)	800	( 612)	612

### *Price risk*

46. Equity price risk is the risk that value of the instrument will fluctuate as a result of changes in equity prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market.

As the majority of the Group's equity investments are carried at fair value with fair value changes recognised in the income statement, all changes in market conditions will directly affect investment income.

Market fluctuations are monitored by the Group's management on intraday basis which enables the Group to react quickly to any changes in the market.

## Notes, contd.:

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46. contd.:

The investment portfolio of TM hf. is also monitored by the Icelandic Financial Supervisory Authority (FSA), but the portfolio of the respective subsidiaries is structured to ensure that capitalisation is adequate and financial strength is maintained at all times.

### ***Insurance risk***

47. The customer base of the insurance operation is well diversified and the company is not reliant on any individual client or customer. The insurance companies in the Group are TM hf. and its subsidiaries.

In order to limit the underwriting risk of the insurance operation, part of the risk is transferred to reinsurers. The amount of risk that the companies carry for their own account is determined with respect to the financial strength of each of the insurance company and the nature of the risk.

### ***Capital management***

48. The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Policies have been implied regarding equity ratio and loan to value ratios both in respect of on and off balance sheet financing. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

To maintain its balance and desirable loan to value ratios the Group increased the share capital during the year.

The subsidiary TM hf. is subject to externally imposed capital requirements by the FSA. TM hf. has complied with all imposed capital requirements throughout the year.

There have been no material changes in the Group's management of capital during the year.

### **Financial instruments and fair values**

49. The fair values of financial assets and liabilities at year-end is not significantly different than the carrying amounts shown in the balance sheet.

### **Financial Guarantees**

50. The Group has provided guarantees to several companies.

The Group issued guarantee' to Sterling's creditors through the associate Northern Travel Holding ehf., amounting to ISK 2,852 million, when it sold Sterling at year-end 2006. The Group receives arms length fee for providing the guarantee.

The Group issued guarantee to Icelandair Group hf., when it sold the company in 2006. The Group has issued guarantee on aircraft financing agreement amounting to ISK 2,700 million. The Group has also undertaken obligation of non-recourse of several associated companies of Icelandair Group hf. The associated companies own aircrafts. It is expected that the obligations will be transferred to Icelandair Group hf. during the year 2008. The buyer of Icelandair Group hf. has committed it self to hold FL GROUP hf. harmless of any claims or cost deriving from the aforementioned guarantee.

The Group has issued a guarantee to creditor of one of its associates Fasteignafélag Íslands hf. amounting to ISK 750 million.

### **Commitments**

51. The Company has committed itself to further investments in several investment projects. Total payments, if all the projects will develop, could be up to ISK 18,979 million.

The Group has entered into operating lease agreements for offices and vehicles for the next 8 years. Non-cancellable operating lease rental payments, are not included in the balance sheet.

### **Related parties**

#### ***Identity of related parties***

52. The Group has a related party relationship with entities with significant influence over the Company, its associates as disclosed in note 23 and with its Board Directors, CEO and managing directors, referred to as the management. Entities with significant influence over the Company during the year were Baugur Group hf. and related parties, Oddaflug B.V.

## Notes, contd.:

52. contd.:

### *Transactions with management*

Salaries and benefits of management paid for their work for Group companies, share option agreements and shares in the Company are specified as follows:

	Salaries and bonuses	Net gain on exercised options	Share options	Share held at year-end 2007
<b>Board of Directors:</b>				
Jón Ásgeir Jóhannesson, Chairman of the Board .....	5.8			
Þorsteinn M. Jónsson .....	5.5			
Gunnar Sigurðsson .....	0.2			
Hannes Smáráson, former CEO .....	139.5			1,475.1
Kristín Edwald .....	0.2			
Pálmi Haraldsson .....	0.3			635.1
Þórður Már Jóhannesson .....	0.2			
Smári S. Sigurðsson, alternative board member .....	3.8			
Skarphéðinn Berg Steinarsson, former Chairman .....	5.9			
Jón Kristjánsson, former board member .....	3.4			
Kristinn Björnsson, former board member .....	0.4			
Magnús Ármann, former board member .....	3.8			
Paul Davidson, former board member .....	6.1			
<b>Managing directors:</b>				
Jón Sigurðsson, CEO .....	32.5		201.5	0.01
Five Managing Directors of FL Group hf. ....	183.7	216.8	85.0	11.0

Included in the above mentioned list of shares held by management and directors are shares held by companies controlled by them and derivative agreements entered into regarding shares in the Company.

### *Other transactions with related parties*

During the year 2007 the Group made transactions with related parties. These transactions were priced on an arm's length basis.

The Group expensed rental payments to a company owned indirectly by its former CEO for service rendered during the year. Receivables from the same company at year-end are included in Loans and trade receivables.

The Group owns 31.97% share in Glitnir banki hf. During the year the Group and the bank made transactions which are included in the following amounts from associates. The Group paid the bank interest for borrowings, received interest income from its cash equivalents placed at the bank. The Group also purchased derivatives from the bank and paid fees for services, such as investment banking and sale of new shares. The Group has granted loans to two of its associates, Northern Travel Holding ehf. and Unity Investments ehf.

Included in Loans and trade receivables are loans to Materia Invest ehf., which is held by Þorsteinn M. Jónsson board member and Magnús Ármann former board member, for services rendered. The loan was paid in January 2008.



## Notes, contd.:

52. contd.:

Outstanding balances at year-end, income and expenses during the year are specified for each group of related parties as follows:

	Entities with significant influence	Associates	Management / board members
<b>Income statement:</b>			
Net (expense) income from investments .....	0 (	1,838)	0
Interest income .....	0	958	0
Interest expense .....	0 (	518)	0
Operating expenses .....	( 85)	0	0
<b>Balance sheet:</b>			
Cash and cash equivalents .....	0	5,908	0
Loans and trade receivables .....	94	18,547	73
Derivatives .....	0 (	1,170)	0
Borrowings .....	0 (	25,296)	0

In December 2007 the Company acquired shares in Landic Property hf. and other real estate companies and funds from Baugur Group hf. for ISK 53,791 million. The purchase price was paid with new shares in the Company with the nominal value of ISK 3,659 million, sold at the rate of 14.7 per share.

### Group entities

The Company holds twelve subsidiaries which all are included in the consolidated financial statements. The direct subsidiaries included in the consolidated financial statements are specified as follows:

	Share 31.12.2007
<b>Investments:</b>	
FL GLB Holding B.V., The Netherlands .....	100%
FL Group Danmark ApS, Denmark .....	100%
FL Group Midtown Miami Ltd., USA .....	100%
FL Group UK limited, England .....	100%
FL Group Property LLC, USA .....	99%
FL Group USA Ltd., USA .....	100%
FL Holding B.V., The Netherlands .....	100%
FL Holding ehf., Iceland .....	100%
FL Trading AS, Norway .....	100%
Kjarrhólmi ehf., Iceland .....	100%
Tónvís ehf., Iceland .....	100%
<b>Insurance:</b>	
Tryggingamiðstöðin hf. ....	100%
Fjárvíar hf., Iceland .....	66%
Liftryggingamiðstöðin hf., Iceland .....	51%
Nemi Forsikring ASA, Norway .....	100%
Trygging hf., Iceland .....	100%
TM fé ehf., Iceland .....	100%

The subsidiaries own six subsidiaries that are included in the consolidated financial statements. These subsidiaries have immaterial effects on the accounts.

## Notes, contd.:

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52. contd.:

The Company acquired 100% of the shares in BG Fasteignir ehf., Dial Square Holdings ehf. and Baugur Group B.V., all holding companies with investments in real estate funds. These investments are recognised among equity investments in the balance sheet and are not consolidated since control was not obtained before year-end 2007. Consolidation for these companies would not have increased the Group's total assets or liabilities.

### Subsequent events

53. Large part of the Group's assets are in listed companies. Subsequent to 31 December 2007 the OMXI 15 index, which is a stock market index consisting of the 15 most valuable share listed in Iceland has decreased by 21.0% on 12 February 2008 and the shares in Glitnir banki hf. have decreased by 20.3% at the same time.

Since year-end 2007 until 12 February 2008 the exchange rate of the Icelandic Krona has decreased by 8.6%.

### Financial Ratios

54. The Group's principal financial ratios:

	2007	2006
Equity ratio .....	36.9%	54.3%
Internal value of shares .....	11.55	18.38

## Unaudited financial information

### Quarterly Statements

Summary of the Group's results by quarters:

<b>Year 2007</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Net income (expense) from securities and derivatives .....	12,472	7,658	( 23,651 )	( 60,161 )	( 63,682 )
Interest income .....	1,498	473	973	2,038	4,982
Interest expense .....	( 3,017 )	( 3,263 )	( 4,972 )	( 6,314 )	( 17,566 )
Net foreign exchange gain (loss) .....	4,627	4,208	( 3,121 )	( 3,238 )	2,476
<b>Net investment income (expense) .....</b>	<b>15,580</b>	<b>9,076</b>	<b>( 30,771 )</b>	<b>( 67,675 )</b>	<b>( 73,790 )</b>
Insurance premium .....	0	0	0	2,769	2,769
Insurance claims .....	0	0	0	( 2,598 )	( 2,598 )
Other operating expenses .....	( 884 )	( 1,022 )	( 1,193 )	( 3,054 )	( 6,153 )
<b>Profit (loss) before income tax .....</b>	<b>14,696</b>	<b>8,054</b>	<b>( 31,964 )</b>	<b>( 70,558 )</b>	<b>( 79,772 )</b>
Income tax .....	388	( 12 )	4,817	7,341	12,534
<b>Profit (loss) for the period .....</b>	<b>15,084</b>	<b>8,042</b>	<b>( 27,147 )</b>	<b>( 63,217 )</b>	<b>( 67,238 )</b>
<b>Year 2006</b>					
Net income (expense) from securities and derivatives .....	10,537	( 2,137 )	4,409	11,147	23,956
Interest income .....	172	143	211	328	854
Interest expense .....	( 326 )	( 1,310 )	( 1,655 )	( 1,657 )	( 4,948 )
Net foreign exchange gain (loss) .....	75	1,958	( 1,754 )	( 2,650 )	( 2,371 )
<b>Net investment income (expense) .....</b>	<b>10,458</b>	<b>( 1,346 )</b>	<b>1,211</b>	<b>7,168</b>	<b>17,491</b>
Other operating expenses .....	( 485 )	( 523 )	( 695 )	( 1,068 )	( 2,771 )
<b>Profit (loss) before income tax .....</b>	<b>9,973</b>	<b>( 1,869 )</b>	<b>516</b>	<b>6,100</b>	<b>14,720</b>
Income tax .....	( 1,684 )	534	1,101	2,680	2,631
<b>Profit (loss) from continuing operations .....</b>	<b>8,289</b>	<b>( 1,335 )</b>	<b>1,617</b>	<b>8,780</b>	<b>17,351</b>
(Loss) profit from discontinued operations net of income tax .....	( 2,450 )	1,217	3,640	24,801	27,208
<b>Profit (loss) for the period .....</b>	<b>5,839</b>	<b>( 118 )</b>	<b>5,257</b>	<b>33,581</b>	<b>44,559</b>