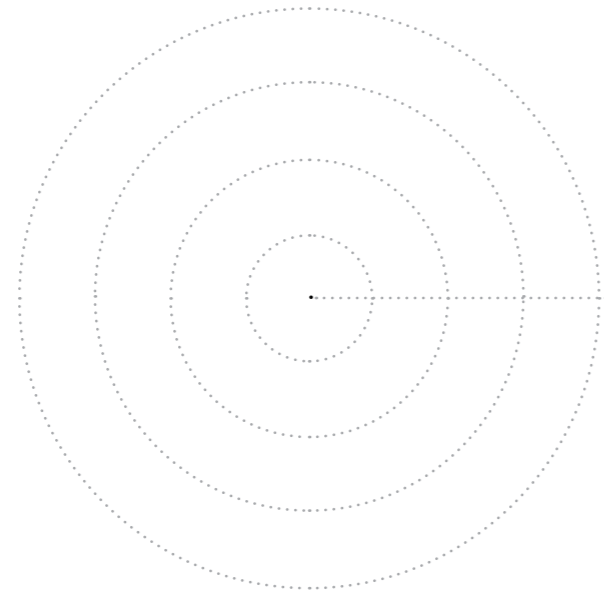


ANNUAL REPORT | ÁRSSKÝRSLA | 2007

Saga) *Capital*



OBJECTIVES | MARKMIÐ

1.

To provide first-class expert service

Að veita fyrsta flokks faglega þjónustu

2.

To employ staff ideas for our clients' benefit

Að virkja hugmyndir starfsmanna í þágu viðskiptavina

3.

To be a leading force in the financial market

Að vera leiðandi afl á fjármálamarkaði

4.

To provide shareholders with excellent return

Að veita hluthöfum framúrskarandi ávöxtun

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Halldor Johannsson, Chairman



Thorvaldur Ludvik Sigurjonsson, CEO

ADDRESS OF CHAIRMAN AND CEO

Saga Capital Investment Bank was formally established in June 2007. The main objective this first year of operations has been to establish a solid foundation for the future by forging the infrastructure and IT-systems as well as hiring first-class staff. Year-end 2007 reveals six months of income versus twelve months of expenses. During this time, world markets have been on a downward spiral, forming a liquidity crisis following the subprime loan dilemma in the US. Despite strenuous conditions, Saga Capital has created a solid platform in commissions and interest revenues. The bank is based on four profit centers: Corporate Finance, Capital Markets, Debt Finance, and Proprietary Trading.

ÁVARP FORMANNS OG FORSTJÓRA

Saga Capital Fjárfestingarbanki tók formlega til starfa í júnímánuði 2007. Á fyrsta starfsári hafa megináherslur bankans legið í því að byggja upp traustan grunn fyrir framtíðina, en unnið hefur verið að uppbyggingu innviða, tölvu- og upplýsingakerfa, auk ráðningar starfsfólks. Í árslok eru að baki sex tekjumánuðir en tólf útgjaldamánuðir. Á þessum tíma hafa markaðir um allan heim verið á hraðri niðurleið og lausafjárfreppa hefur breiðst út í kjölfar undirmáslánaerfiðleika í Bandaríkjunum. Þrátt fyrir erfið ytri skilyrði hefur bankinn byggt upp góðan grunn vaxta- og þóknunatekna. Bankinn hvílir á fjórum meginstöðum: Fyrirtækja-ráðgjöf, markaðsviðskiptum, útlánasviði og eigin viðskiptum.

This first year of operations has seen numerous achievements. As of this year, Saga Capital is in fourth place in terms of trade volume on the Icelandic Stock Exchange, following the three major Icelandic commercial banks. Corporate Finance completed several projects, the largest being the sale of a large share in Islenska Gamafélagid where managers and investors acquired the company from previous owners. Capital Market's commission revenues have grown at a steady pace, providing the bank's clients with direct access to major stock exchanges at a competitive rate. In addition, Capital Markets underwrote bond issues for both Baugur Group and Askar Capital. Dept Finance has mainly focused on real estate projects all over the world and on interim financing for various projects at home and abroad. Saga Capital has never held subprime loans and the bank's loan portfolio is diverse and solid. Proprietary Trading manages the bank's portfolio in listed securities and derivatives, bonds and stocks. The severe market situation set its mark on the department's efforts resulting in a loss in the bank's securities holdings.

OPERATION | The year was characterised by favourable and rising commission revenues, both in Corporate Finance and Capital Markets. Interest revenues were positive but limited by higher cost of carry on the bank's securities holdings. Proprietary losses were evenly divided between stocks and bonds. The bank's operation expenses were low and characterised by moderation and efficiency. A large portion of indirect operating expenses incurred during the year were initial investments in infrastructure and IT, and can be viewed as one-off expenses.

Á fyrsta starfsári hefur margt áunnist. Frá byrjun árs 2008 vermir Saga Capital fjórða sætið á eftir stóru viðskiptabönkunum þremur í umfangi viðskipta í Kauphöll Íslands. Í fyrirtækjaráðgjöf var nokkrum verkefnum lokið, þeirra stærst var sala á stórum eignarhlut í Íslenska gámafélaginu, en stjórnendur þess ásamt fjárfestum keyptu félagið af fyrri hluthöfum. Þóknunatekjur markaðs- viðskipta hafa vaxið jafnt og þétt, en meginþungi starfseminnar hefur beinst að því að veita viðskiptamönnum bankans beinan aðgang að helstu kauphöllum heims gegn lágrí þóknun. Að auki annaðist sviðið sölu skuldabréfa fyrir Baug Group og Askar Capital. Lán útlánasviðs hafa einkum beinst að fasteignaverkefnum víða um heim, auk millilagsfjármögnunar fyrir ýmis verkefni heima og erlendis. Saga Capital hefur aldrei átt undir málslán og það er mat stjórnenda að útlánasafn bankans sé vel dreift og tryggt. Svið eigin viðskipta bankans hefur umsjón með eignasafni hans í skráðum verðbréfum og afleiðum, skuldabréfum og hlutabréfum. Árferðið setti mark sitt á starf sviðsins, en tap var vegna verðbréfaeignar bankans.

REKSTUR | Árið einkenndist af góðum og stigandi þókn- anatekjum, bæði í fyrirtækjaráðgjöf og markaðsviðskiptum. Vaxtatekjur voru jákvæðar, en takmörkuðust af háum fjármögn- unarkostnaði við verðbréfaeign bankans. Tap vegna verðbréfa- eignar skiptist í grófum dráttum að jöfnu milli hlutabréfa og skulda- bréfa. Rekstrarkostnaður bankans var lágur og einkenndist af ráðdeild og varfærni. Af öðrum rekstrarkostnaði féll töluvert til vegna stofnunar bankans og uppbyggingu innviða hans og var sá kostnaður að mestu gjaldfærður á árinu.

ASSETS | At the end of the year 2007, the Saga Capital balance sheet amounted to ISK 38 billion with equity at ISK 9.7 billion and CAD ratio at 35.3%. The bank's major holdings at year-end consisted of bonds and loans. It is our belief that the bank's holdings in securities are solid and that care and reliable risk assessment was employed in compiling the loan and equity portfolio. The largest portion of the bank's balance sheet was tied up in inflation-indexed treasury bonds, a total of 22 billion ISK. Equities, domestic and foreign, amounted to ISK 1.9 billion and total lending came to ISK 3.6 billion.

In light of worsening financing conditions world-wide, the bank has been conservative in terms of balance sheet growth. Instead the bank has emphasised preparing for further growth with the bank's clients when opportunities arise.

FINANCIAL STRENGTHS | As previously stated, the bank's CAD ratio was 35.3% at year-end 2007 but in March 2008 it had escalated to 53%. The Icelandic regulatory minimum CAD ratio for banks is 8%. It is vital to maintain a high CAD ratio and a flexible balance sheet in times of strenuous financial conditions and capital costs at historical heights. It is therefore quite clear that our financial strength is significant, reflecting the bank's readiness to seize the opportunities ahead and to participate in the transformation and synergies that may lie ahead in the financial sector.

EIGNIR | Í árslok nam stærð efnahags Saga Capital Fjárfestingarbanka alls 38 milljörðum króna. Eigið fé nam 9,7 milljörðum króna og eiginfjárlutfall á CAD grunni nam 35,3%. Eignir Saga Capital í árslok samanstóðu af stærstum hluta af skuldabréfum og útlánum. Það er mat okkar að eignir bankans í verðbréfum séu traustar og að beitt hafi verið varfærni og traustu áhættumati við uppbyggingu útlána- og eignasafns. Stærsti hluti efnahagsreiknings bankans var bundinn í verð- tryggðum skuldabréfum með ríkisábyrgð, eða alls 22 milljarðar króna. Hlutabréfaeign bankans, í innlendum og erlendum hlutabréfum, nam alls 1,9 milljarði króna. Heildarútlán bankans námu 3,6 milljörðum króna.

Í ljósi versnandi fjármögnunarskilyrða um allan heim hefur verið farið varlega í vöxt efnahagsreiknings bankans, en þeim mun meiri áhersla lögð á að búa í haginn fyrir frekari vöxt með viðskipta- vinum bankans, þegar sóknarfærin gefast.

FJÁRHAGSLEGUR STYRKLEIKI | Eins og áður sagði nam CAD eiginfjárlutfall bankans í árslok 35,3%. Í byrjun mars 2008 var þetta hlutfall hins vegar komið í 53%. Lögbundið lágmarks eiginfjárlutfall fyrir bankastofnanir er 8%. Það er mikil- vægt að halda háu eiginfjárlutfalli og sveigjanlegum efnahags- reikningi um þessar mundir þegar fjármögnunarskilyrði eru erfið og fjármagnskostnaður í sögulegum hæðum. Það má því ljóst vera að fjárhagslegur styrkleiki okkar er mikill sem þýðir að bankinn er vel í stakk búinn til að nýta þau tækifæri sem skapast á næstu misserum og taka þátt í þeirri gerjun sem framundan er í fjármálageiranum.



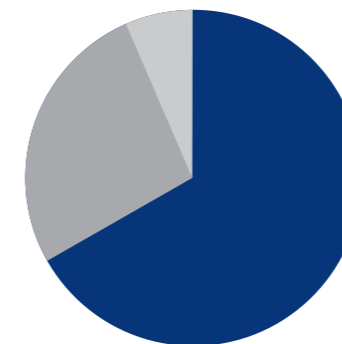
Board of Directors: **Johann Antonsson**, **Robert Melax**, **Orn Arnar Oskarsson**, **Thorvaldur Ludvik Sigurjonsson**, CEO, and **Halldor Johannsson**, Chairman. **Sigurdur G. Gudjonsson** was not present.

PROSPECTS | In early 2008 the bank applied for a commercial banking license with the Icelandic Financial Supervisory Authority and negotiated with the Central Bank of Iceland for access to its Real-Time Gross Settlement System. Membership to the Icelandic Banks Data Centre was also granted early in the year. Saga Capital thus seeks to meet increasing demand made by stockholders and clients for further service. We estimate that financing conditions will improve as the year progresses and create opportunities for further growth and advancement of Icelandic banks.

HORFUR | Í ársbyrjun 2008 sótti bankinn um viðskiptabankaleyfi til Fjármálaeftirlitsins, auk þess sem samið var við Seðlabanka Íslands um aðgang að stórgreiðslukerfi hans. Enn fremur hefur verið samið við Reiknistofu bankanna um aðild. Þetta er gert í kjölfar sívaxandi krafna frá hluthöfum og viðskiptamönnum Saga Capital sem vilja sækja aukna þjónustu til bankans. Það er mat okkar að fjármögnunarskilyrði muni batna er liður á árið og opna fyrir vöxt og framrás íslenskra banka á nýjan leik.

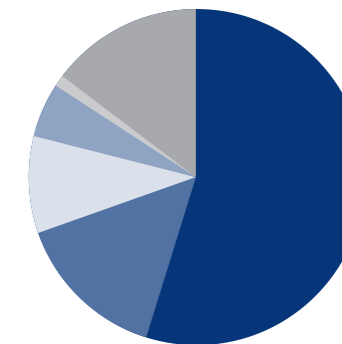
FEE INCOME

- Capital Markets
- Corporate Finance
- Other



ASSETS

- Government securities
- Corporate Bonds
- Loans
- Listed shares
- Unlisted shares
- Other assets



In historical context, current market conditions are extremely challenging. The early months of 2008 have nevertheless shown that Saga Capital rises to the challenge and is fully equipped to weather the storm. Every season provides opportunities and each moment has its pros and cons. The conditions dominating the financial sector have tried the bank's infrastructure and staff and both have withstood the pressure, showing strength and excellence in their outcome. Saga Capital Investment Bank is well prepared and awaits new challenges when the storm subsides. We look forward to the years ahead.

Núverandi aðstæður á öllum mörkuðum eru mjög krefjandi í sögulegu samhengi. Þeir mánuðir sem liðnir eru hafa sýnt fram á að Saga Capital á framtíðina fyrir sér og hefur burði til að standa af sér þau gervingaveður sem geislað hafa. Á hverjum tíma eru tækifæri og hver tímasetning hefur kosti og galla. Við þær aðstæður sem ríkt hafa sleitulaust frá því að Saga Capital tók til starfa hefur reynt á innviðina og starfsfólkið og í ljós komið að styrkur bankans og færni starfsfólks er eins og best verður á kosið. Saga Capital Fjárfestingarbanki kemur vel undan vetri og biður þess að nýta sóknarfærin er veðrinu slotar. Við horfum björtum augum til framtíðar.



Hafnarstraeti 53, 600 Akureyri



Skogarhlid 22, 105 Reykjavik

ABOUT SAGA CAPITAL

Saga Capital Investment Bank is a fast-growing financial service company with a carefully selected team of professionals. The bank operates in international financial markets and is an active member on all the markets on the Nordic Exchange, Nasdaq OMX Group.

Saga Capital provides services to companies and institutional investors through Corporate Finance, Debt Finance, and Capital Markets. The bank's focus is on small and medium-sized companies as well as providing its clients with fast and efficient execution at a competitive rate. Saga Capital trades actively for its own account through Proprietary Trading in all major markets, domestic and International.

In but a few short months, Saga Capital has made its mark on the Icelandic financial front and the bank's experts engage in projects ranging world wide, from the United States to the Middle East.

UM SAGA CAPITAL

Saga Capital Fjárfestingarbanki er ört vaxandi fjármálfyrirtæki þar sem valinn maður skipar hvert rúm. Bankinn starfar á alþjóðlegum fjármálamörkuðum og er aðili að öllum norrænu OMX kauphöllunum sem tilheyra Nasdaq OMX Group.

Saga Capital veitir þjónustu á sviði fyrirtækjaráðgjafar, útlána og verðbréfiðlunar til fyrirtækja og fagfjárfesta. Bankinn leggur áherslu á að þjóna litlum og millistórum fyrirtækjum og tryggja viðskiptamönnum bankans hröð og fagleg verðbréfiðskipti gegn hóflegri þóknun. Saga Capital tekur virkan þátt á innlendum og erlendum verðbréfamörkuðum með fjárfestingum fyrir eigin reikning.

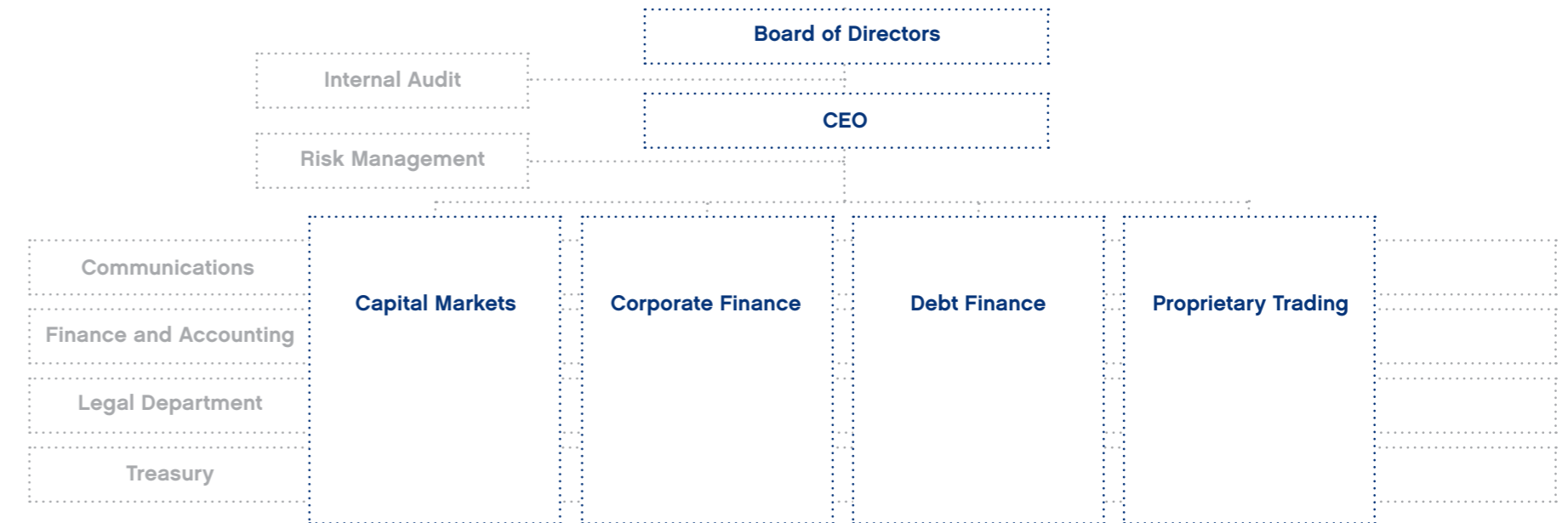
Á aðeins örfáum mánuðum hefur Saga Capital fest sig í sessi í fremstu röð íslenskra fjármálfyrirtækja og sérfræðingar bankans vinna að verkefnum víðs vegar um heim.

ORGANISATIONAL CHART

- Saga Capital Investment Bank operates in nine divisions.
- The bank's four profit centers are Capital Markets, Corporate Finance, Debt Finance, and Proprietary Trading
- The bank's support divisions are Communications, Finance and Accounting, Legal Services, Risk Management, and Treasury,

SKIPURIT

- Saga Capital Fjárfestingarbanki starfar á níu sviðum.
- Tekjusvið bankans eru fjögur: Markaðsviðskipti, fyrirtækjaráðgjöf, útlánasvið og eigin viðskipti.
- Stoðsvið bankans eru fimm: Samskiptasvið, fjármálasvið, lögfræðisvið, áhættustýring og fjárstýring.



SHAREHOLDERS

- Saga Capital's shareholders number almost 100.
- Employees own around 20% and several savings banks another 20%.
- The five largest shareholders own a total of 47% of the bank's equity.

HLUTHAFAR

- Hluthafar Saga Capital eru tæplega 100.
- Starfsmenn eiga um 20% í fyrirtækinu og ýmsir sparisjóðir um 20%.
- Fimm stærstu hluthafar Saga Capital eiga samtals 47% hlut í bankanum.

Saga Capital Investment Bank's ten largest shareholders | Tíu stærstu hluthafar Saga Capital Fjárfestingarbanka

1..... Thorvaldur Ludvik Sigurjonsson.....	11.4%.....	1,100,000,000
2..... Standholl ehf.....	10.3%.....	1,000,000,000
3..... Sundagardar hf.....	10.3%.....	1,000,000,000
4..... KEA eignir ehf.....	9.4%.....	913,043,487
5..... Vesturland ehf.....	5.7%.....	550,000,000
6..... Sparisjodur Nordlendinga.....	4.7%.....	460,000,000
7..... Gnipverjar ehf.....	4.1%.....	400,000,000
8..... Sparisjodur Svarfdaela.....	3.1%.....	300,000,000
9..... Gift fjárfestingarfelag.....	2.7%.....	260,869,565
10..... Sparisjodurinn in Keflavik.....	2.7%.....	260,869,565
Total Samtals.....	64.4%.....	6,544,782,617

MILESTONES 2007

— Saga Capital was founded in late 2006 by a few former employees of the large Icelandic commercial banks and carefully selected institutional investors. Equity equalled 2.5 billion ISK. In the beginning, the bank had a staff of four whose main objective was to prepare an application to the Financial Supervisory Authority for an investment banking license.

— In February 2007 Saga Capital initiated a private share offering which ended in April, raising additional 8 billion ISK. In March, the bank's staff of nine moved to Akureyri's old elementary school, a grand house well over a hundred years old with a remarkable history.

— In early May, the bank received its investment banking license and in June Saga Capital Investment Bank was formally established. The bank had already become a member of the

ÁFANGAR 2007

— Saga Capital var stofnað síðla árs 2006 af nokkrum fyrirverandi starfsmönnum stóru íslensku viðskiptabankanna og völdum fagfjárfestum. Hlutfé var 2,5 milljarðar. Í upphafi voru starfsmenn fjórir og eitt helsta verkefni þeirra var að sækja um fjárfestingarbankaleyfi til Fjármálaeftirlitsins.

— Hlutfjárútboð Saga Capital hófst í febrúar, 2007 og lauk í apríl þegar hlutfé var komið í 10,5 milljarða. Í mars fluttu starfsmenn bankans, sem þá voru orðnir níu, inn í Gamla barnaskólann á Akureyri. Húsið er ríflega hundrað ára gamalt og á sér mikla og merkilega sögu.

— Í byrjun maí fékk Saga Capital fjárfestingarbankaleyfi og tók formlega til starfa í júní. Þá strax var bankinn kominn með aðild að OMX kauphöllum á Íslandi, Helsinki og í Stokkhólmi. Starfs-

OMX exchanges in Iceland, Helsinki, and Stockholm. Staff had increased to 17 and a second office was opened in another old and historical building, Thoroddsstadir at Skogarhlid in Reykjavik.

— Saga Capital hosted a formal opening ceremony in August when H. E. Mr. Bjorgvin G. Sigurdsson, Minister of Business Affairs, inaugurated the bank's headquarters in the old elementary school following a thorough refurbishment of house and interior. The staff numbered 29 by that time.

— At the end of 2007, the bank had a staff of 34, with 25 in Akureyri and 9 in Reykjavik. In early 2008, the bank applied for commercial banking license to the Financial Supervisory Authority. The bank has also gained access to the Icelandic Banks Data Centre and reached an agreement with the Central Bank of Iceland for access to its Real-Time Gross Settlement System (RTGS).

mönnum hafði fjölgað í 17 og skrifstofa var opnuð í öðru gömlu og sögufrægu húsi, Þóroddsstöðum við Skógarhlíð í Reykjavík.

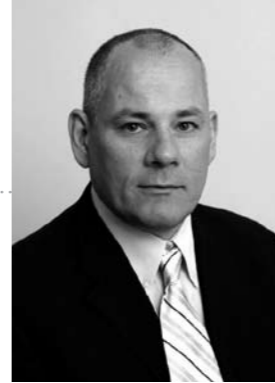
— Saga Capital hélt formlega opunarhátíð í ágúst þegar Björgvin G. Sigurðsson viðskiptaráðherra vígði höfuðstöðvar bankans í Gamla barnaskólanum eftir gagngerar endurbætur. Þá voru starfsmenn bankans orðnir 29.

— Í árslok 2007 voru starfsmenn Saga Capital orðnir 34, þar af störfuðu 25 á Akureyri og 9 í Reykjavík. Í byrjun árs 2008 sótti bankinn um leyfi fyrir viðskiptabankastarfsemi til Fjármálaeftirlitsins. Þá hefur Saga Capital fengið aðild að Reiknistofu bankanna og samið við Seðlabanka Íslands um aðgang að stór-greiðslukerfi hans.



THE PEOPLE

FÓLKID



CAPITAL MARKETS

The first year of business for Saga Capital's Capital Markets was successful despite extremely demanding conditions. The bank immediately became a member of the OMX exchanges in Reykjavik, Stockholm, and Helsinki, later adding Copenhagen to the list. In addition, the bank provides its clients with direct trading access to all major markets. Saga Capital was thus able, immediately in its first operating year, to provide its clients with most of what international markets have to offer.

Special emphasis was placed on providing institutional investors and high net worth individuals with excellent service. Institutional investors were also enabled to trade in stocks and bonds over the Internet through Saga Capital Trader, on best available terms. Clients' trading on Saga Capital Trader resulted in a huge turnover from the very beginning with Saga Capital now showing the fourth highest market share on the Iceland Stock Exchange as of this year.

MARKAÐSVIÐSKIPTI

Upphafsár markaðsviðskipta Saga Capital gekk vel þrátt fyrir mjög krefjandi markaðsaðstæður. Bankinn varð strax markaðsaðili að OMX kauphöllum í Reykjavík, Stokkhólmi og Helsinki og kauphöllin í Kaupmannahöfn hefur síðan bæst í hópinn. Að auki er bankinn með samninga sem gera honum kleift að eiga viðskipti beint með hlutabréf í öðrum kauphöllum. Þannig gat Saga Capital strax á upphafsárinu boðið viðskiptavinum sínum upp á velflestar þær vörur sem í boði eru á alþjóðamörkuðum.

Löggö var sérstök áhersla á að bjóða fagjáfrestum og efnameiri einstaklingum framúrskarandi þjónustu. Fagjáfrestum var jafnframt gert kleift að eiga viðskipti með hlutabréf og skuldabréf á veraldarvefnum í gegnum Saga Capital Trader, á betri kjörum en áður hefur þekkt. Viðskipti í gengum Saga Capital Trader skiluðu sér í mikilli veltu strax frá upphafi og er Saga Capital með fjórðu mestu markaðshlutdeild í Kauphöll Íslands það sem af er árinu 2008.

In addition to the traditional brokering of stocks and bonds, Capital Markets have also emphasised procuring financing to medium-sized and large companies for the issuing and listing of bonds. Saga Capital underwrote two bond issues in 2007, one for 2.5 billion ISK for Baugur Group and another for 2 billion ISK for Askar Capital. In addition, Capital Markets managed the listing of Askar Capital's bond issue on the OMX exchange in Iceland.

Capital Markets aim at establishing their name even further in both domestic and foreign markets by providing their clients with expert advice and professional and swift execution of trading in return for a modest fee. Emphasis will also be placed on actively participating in the refinancing of Icelandic companies through the issue of bond categories.

Fyrir utan hefðbundna miðlun hluta- og skuldabréfa hafa markaðsviðskipti einnig lagt áherslu á að bjóða miðlungsstórum og stærri fyrirtækjum fjármögnun í tengslum við útgáfu og skráningu skuldabréfa. Saga Capital sölutryggði tvö skuldabréfaútböð á árinu, annars vegar 2,5 milljarða skuldabréfaútböð fyrir Baugur Group og hins vegar 2 milljarða skuldabréfaútböð fyrir Askar Capital. Jafnframt sáu markaðsviðskipti um að skrá skuldabréfaflokk Askar Capital í kauphöll OMX á Íslandi.

Markaðsviðskipti stefna að því að festa sig enn frekar í sessi á innlendum og erlendum mörkuðum með því að veita viðskiptavinum sínum vandaða, faglega og skjóta framkvæmd viðskipta gegn hóflegri þóknun. Einnig verður löggö áhersla á að taka virkan þátt í endurfjármögnun fyrirtækja landsins með útgáfu skuldabréfaflokka.

CORPORATE FINANCE

Saga Capital's Corporate Finance provides advice and assistance on acquisitions, disposals and mergers of companies and operating units. Corporate Finance offers a vast range of services in relation to transactions, among them share offerings and listings, supervision of due diligence reports, mergers and acquisitions, assistance in relation to changes in holdings and participation in negotiations and contract making.

In 2007 Corporate Finance focused on introducing the bank's structure and objectives amongst companies and institutional investors. Staff members travelled far and wide to introduce Saga Capital and its Corporate Finance. Numerous projects and ideas have surfaced as a result, for example a price estimate and consultation for the Board of Directors of Vinnslustodin in relation to the Stilla and Eyjamenn takeover bids for the company. The Board's assessment of the aforesaid takeover bids was based on the Corporate Finance price estimate.

In July, Corporate Finance assisted the CEO of Íslenska Gamafélagid with a takeover of the company, as well as the refinancing

FYRIRTÆKJARÁÐGJÖF

Helstu verkefni fyrirtækjaráðgjafar eru ráðgjöf um kaup, sölu, samruna og yfirtöku fyrirtækja og rekstrareininga. Meðal þjónustuþátta sem fyrirtækjaráðgjöf býður í tengslum við sölu og kaup á félögum og fyrirtækjum má nefna: útboð og skráningu verðbréfa, umsjón með áreiðanleikakönnunum, aðstoð í tengslum við samruna og yfirtökur og hvers kyns breytingar á eignarhaldi og þátttaka í samningaviðræðum og samningagerð.

Starfsemi fyrirtækjaráðgjafar árið 2007 hefur einkennst af uppbyggingar- og kynningarstarfi meðal fyrirtækja og fjárfesta. Starfsmenn hafa farið víða í heimsóknir í fyrirtæki og kynnt Saga Capital og fyrirtækjaráðgjöfina. Mörg fjölbreytt verkefni og hugmyndir hafa komið inn á borð fyrirtækjaráðgjafar á árinu, til dæmis unnu starfsmenn sviðsins að verðmati og sinnu ráðgjöf fyrir stjórn Vinnslustöðvarinnar í tengslum við yfirtökutilboð Stillu og Eyjamanna í félagið. Álit stjórnar Vinnslustöðvarinnar á framangreindum yfirtökutilboðum byggðist á verðmati fyrirtækjaráðgjafar.

Í júlí aðstoðaði fyrirtækjaráðgjöf framkvæmdastjóra Íslenska gámafélagsins við yfirtöku á félaginu og endurfjármögnun þess og

of that same company and its subsidiaries. Amongst the company's assets is Velamidstodin. In recent years Íslenska Gamafélagid has acquired or merged with a total of twelve enterprises engaged in similar operations and is now in the forefront in its field in Iceland. The company's 2007 turnover exceeded 2.3 billion ISK.

Corporate Finance also mediated in the sale of Glerborg, one of the country's oldest glass production companies, to PGV in Hafnarfjörður. The merged company plans to become Iceland's largest in the production and sale of glass, windows, doors, sun lounges, balcony enclosures and other products. An example of Corporate Finance's offshore projects is assisting the Green Diamond Tire factory in New York with their stock increase.

The latter part of 2007 saw turmoil in financial markets leading to diminishing corporate trading activities both at home and abroad. In view of the current situation, 2008 is nevertheless off to a good start. The outlook for increased activities and corporate mergers is good as the year progresses and exciting investment opportunities are in the making.

dótturfélaga. Íslenska gámafélagið á meðal annars Vélamiðstöðina. Íslenska gámafélagið hefur á undanförunum árum keypt eða sameinast alls tólf fyrirtækjum í svipuðum rekstri og er nú í fremstu röð á Íslandi á sínu sviði. Velta félagsins á síðasta ári var rúmir 2,3 milljarðar króna.

Þá hafði fyrirtækjaráðgjöf milligöngu um sölu á Glerborg, einu elsta og rötgrónasta glerframleiðslufyrirtæki landsins, til PGV í Hafnarfirði. Sameinað fyrirtæki stefnir á að verða stærsta fyrirtæki á markaði í framleiðslu og sölu á gleri, gluggum, hurðum, sólstofum, svalalokunum og tengdum vörum. Af verkefnum erlendis má nefna að fyrirtækjaráðgjöf aðstoðaði dekkjaverksmiðjuna Green Diamond Tire í New York við hlutafjárukningu félagsins.

Seinni hluti ársins 2007 einkenndist af miklum hræringum á fjármálamörkuðum sem leiddu til minnkandi viðskipta með fyrirtæki á innlendum sem erlendum markaði. Í ljósi aðstæðna hefur árið 2008 farið vel af stað. Útlit er fyrir auknar hræringar og samruna fyrirtækja þegar líða tekur á árið og horfur á að víða skapist spennandi fjárfestingartækifæri.

DEBT FINANCE

Saga Capital's Debt Finance is off to a good start. The loan portfolio has seen a steady increase from day one, reaching ISK 3.7 billion at the end of 2007 with 170 borrowers in several countries. The United States, Norway and France are among the countries where the bank has provided loans although the bank's home market remains the largest.

The main objective has been to support other areas of the bank with, for example, securities financing through Capital Markets as well as financing the bank's clients who trade through Saga Capital Trader. Debt Finance also supports the bank's Corporate Finance where the main project in 2007 was the financing of a leveraged

ÚTLÁNASVIÐ

Starfsemi útlánaviðs Saga Capital hefur farið vel af stað. Útlánasafnið hefur vaxið stöðugt frá stofnun bankans og var í lok árs 3,7 milljarðar króna sem dreifast á 170 lántakendur í nokkrum löndum. Bandaríkin, Noregur og Frakkland eru meðal þeirra landa sem bankinn hefur lánað til þó heimamarkaður bankans sé stærstur.

Megináhersla sviðsins hefur verið að styðja við aðrar deildir bankans til dæmis með verðbréfafjármögnun í gegnum markaðsviðskipti og verðbréfafjármögnun þeirra viðskiptavina bankans sem eiga viðskipti í gegnum Saga Trader, viðskiptakerfi Saga Capital. Útlánasviðið styður einnig við starfsemi fyrirtækja-

acquisition of Íslenska Gamafélagid by the managers of the same company. Saga Capital pledged to refinance the company as well as provide interim financing for the purchase.

The bank's Debt Finance has not focused on one industry more than others, but rather emphasised the tailoring of individual solutions to best suit our diverse client base. Last year projects included the acquisition of a real estate company in Norway, the financing of a tire factory in the United States and a loan to the owners of primary capital of Sparisjodur Svarfdaela and Sparisjodur Nordfjarðar in relation to the savings banks' primary capital increase.

ráðgjafar bankans og á árinu bar hæst fjármögnun í tengslum við skuldsett kaup stjórnenda Íslenska gámafélagsins á félaginu sjálfu. Saga Capital skuldbatt sig til að endurfjármagna félagið ásamt því að veita millilagsfjármögnun til kaupanna.

Útlánasvið bankans hefur ekki lagt meiri áherslu á eina atvinnugrein umfram aðra heldur er lögð áhersla á að þjónusta alla viðskiptavini bankans með þeim fjármögnunarláusnum sem þeim henta. Meðal verkefna sem lánað var til á síðasta ári voru kaup á fasteignafélagi í Noregi, fjármögnun dekkjaframleiðslu í Bandaríkjunum og lán til stofnfjáreigenda Sparisjóðs Svarfdaela og Sparisjóðs Norðfjarðar í tengslum við stofnfjárukningu sjóðanna.

PROPRIETARY TRADING

Proprietary Trading manages the Saga Capital portfolio through participation in domestic and foreign securities markets. Proprietary Trading also acts as a market maker for various types of financial instruments.

Proprietary Trading is continuously on the lookout to increase the bank's long-term yields. Ranging from short to long term, every investment made in the name of Proprietary Trading must receive approval of the bank's Risk Management and fall within the risk policy set by the bank.

The previous year, the bank's first operating year, was extremely demanding on both domestic and foreign securities markets. Since the bank began its formal operations in June, conditions have worsened dramatically, beginning with the sub prime loan crisis in the United States. One would have to look decades

EIGIN VIÐSKIPTI

Eigin viðskipti annast stýringu á fjárfestingum Saga Capital með þátttöku á innlendum og erlendum verðbréfamörkuðum, auk þess að sinna viðskiptavakt með hlutabréf og skuldabréf.

Eigin viðskipti leita tækifæra til þess að auka arðsemi bankans til lengri tíma. Fjárfestingar fyrir eigin reikning eru allt frá fjárfestingum innan hvers dags til fjárfestinga yfir lengri tímabil. Allar fjárfestingar fyrir eigin reikning bankans þurfa samþykki áhættu-stýringar bankans og falla undir þann áhætturamma sem bankinn hefur sett sér.

Síðastiðild starfsár og það fyrsta í sögu bankans var mjög krefjandi á innlendum og erlendum verðbréfamörkuðum. Frá því bankinn hóf formlega starfsemi í júní hafa skilyrði á verðbréfamörkuðum hriðversnað en rekja má upphaf þess til undirmáls-lánakrisu í Bandaríkjunum. Leita þarf áratugi aftur í tímann til að

back to see such conditions as have raged within the financial sector recently. Last year has thus truly tested the bank's foundations and the staff of Proprietary Trading.

The main reasons for last year's exchange loss are a decrease in bond prices and losses in the bank's holdings in European stocks, where the market has experienced a dramatic decrease ever since the bank was founded.

During 2007, Proprietary Trading negotiated with Glitnir, 365, Marel, Icelandair, Spron, Housing Financing Fund and the Government Debt Management Agency for market making in issuers' stocks and/or bonds on the Icelandic Stock Exchange. These contracts ensure commissions to the bank and underscore its strength in the domestic securities market.

sjá önnur eins skilyrði og myndast hafa á fjármálamörkuðum að undanfögnu. Það má því með sannri segja að síðasta ár hafi reynt á stoðir bankans og starfsmenn eigin viðskipta.

Helstu ástæður gengistaps síðasta árs má rekja til lækkunar á gangvirði skuldabréfa í eigu bankans og taps á skráðri hlutabréfa-eign bankans í evrópskum hlutabréfum en veruleg lækkun hefur orðið á helstu verðbréfamörkuðum frá stofnun bankans.

Á árinu gerðu eigin viðskipti samninga við Glitni, 365, Marel, Icelandair, Spron, Íbúðalánasjóð og Lánasýslu ríkisins um viðskiptavakt á hlutabréfum og/eða skuldabréfum útgefenda í Kauphöll Íslands. Þessir samningar tryggja bankanum þókn-anatekjur og undirstrika styrkleika hans á innlendum verðbréfamarkaði.

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ENDORSEMENT AND STATEMENT BY THE MANAGEMENT

The financial statements of Saga Capital Investment Bank hf. are prepared according to International Financial Reporting Standards (IFRSs), as adopted by the EU.

Saga Capital provides its customers with services in relation to corporate advisory service, loans and security broking.

The bank incurred a loss on its operation in the year 2007 to the amount of ISK 825 million according to the income statement. Equity at year end amounted to ISK 9,750 million according to the balance sheet. The Bank's equity ratio calculated according to law on financial companies was 35.3% at year end 2007. According to law the ratio shall not be lower than 8%.

The Bank's Board of Directors proposes that no dividends be paid to shareholders in the year 2008 due to the year 2007. Ref-

erence is made to the financial statements for further information on the allocation of profit or loss and other changes in equity.

During the Bank's first operating year, a considerable cost was incurred due to the structuring of the operation and that cost was in main part expensed. Furthermore, operating cost was incurred during the entire year, whereas income was generated from June.

During the year, the Bank's closed share tender ended and paid in share capital during the year amounted to ISK 9,549 million. Paid in share capital at year end 2007 amounted to ISK 9,554 million and has been recognised in the Bank's balance sheet. Shareholders numbered 93 at year end compared with 3 at the beginning of the year. At year end, three shareholders owned more than 10.0% in the Bank, Thorvaldur Ludvik Sigurjonsson, with a 11.5% share, Standholl ehf., with a 10.5% share and Sundagardar hf., with 10.5%.

Statement by the Board of Directors and the CEO

According to the best of our knowledge, it is our opinion that the financial statements give a fair view of the Bank's financial performance in the year 2007, assets, liabilities and its financial standing as at 31 December 2007 and changes in cash and cash equivalents during the year 2007.

Furthermore, it is our opinion that the financial statements and the endorsement and statement by the Board of Directors include a fair overview of the development and results in the Bank's operation, its standing and describes the main risk factors faced by the Bank.

The Board of Directors and the CEO of Saga Capital Investment Bank hereby confirm the Bank's financial statements for the year 2007 by means of their signatures.

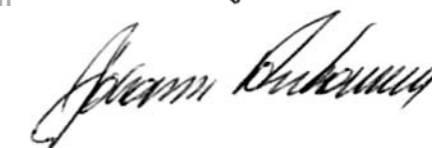
Akureyri, 22 February 2008

The Board of Directors

Halldor Johannsson, Chairman



Johann Antonsson



Robert Melax



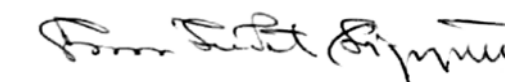
Thorleifur Stefan Bjornsson



Orn Arnar Oskarsson



Thorvaldur Ludvik Sigurjonsson, CEO



INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Saga Capital Investment Bank hf.

We have audited the accompanying financial statements of Saga Capital Investment Bank hf., which comprise the balance sheet as at December 31, 2007, and the income statement, statement of equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements give a true and fair view of the financial position of the Bank as at December 31, 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

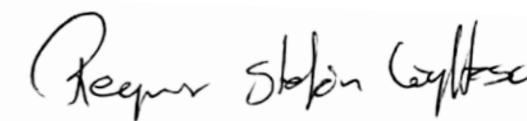
Akureyri, 22 February 2008

KPMG Endurskoðun Akureyri hf.

Arnar Arnason



Reynir Stefan Gylfason



INCOME STATEMENT FOR THE YEAR 2007

	Notes	2007	2006
Interest income		1,068,583	245
Interest expenses		(927,747)	(6)
Net interest income	30	<u>140,836</u>	<u>239</u>
Fee income		415,265	0
Fee expenses		(103,575)	0
Net fee income	31	<u>311,690</u>	<u>0</u>
Net (expenses) income on financial assets and liabilities	32	(908,361)	0
Various operating revenue		7,750	0
Total other operating income		<u>(900,611)</u>	<u>0</u>
Net operating income		<u>(448,085)</u>	<u>239</u>
Salaries and salary related expenses	34	243,193	0
Other operating expenses		267,055	3,463
Depreciation of operating assets	51-52	19,974	0
Total operating expenses		<u>530,222</u>	<u>3,463</u>
Impairment loss on loans	45	29,245	0
Loss before income tax		<u>(1,007,552)</u>	<u>(3,224)</u>
Income tax	37	182,871	580
Loss for the year		<u>(824,681)</u>	<u>(2,644)</u>
Loss per share			
Basic loss per share	38	(0.13)	(3.17)
Diluted loss per share	38	(0.13)	(3.17)

Notes on page 44 - 78 are an integral part of these financial statements | Amounts are in ISK thousand

BALANCE SHEET 31 DECEMBER 2007

	Notes	2007	2006
Assets			
Cash and cash equivalents	40	1,059,303	1,113
Receivable from credit institutions	41	803,779	0
Loans and receivables	42-46	3,656,459	0
Trading assets	47	22,888,547	0
Assets designated at fair value	50	6,039,068	0
Intangible assets	51	36,617	862
Operating assets	52	67,421	5,186
Deferred tax asset	53	183,451	580
Other assets	54	3,713,418	25
Total assets		<u>38,448,063</u>	<u>7,766</u>
Liabilities			
Trading liabilities	55	232,688	0
Borrowings	56	23,297,521	0
Other liabilities	57	5,168,251	5,410
Total liabilities		<u>28,698,460</u>	<u>5,410</u>
Equity			
Share capital		9,554,645	5,000
Share premium account for paid in capital		1,022,283	0
Accumulated deficit		(827,325)	(2,644)
Total equity	58	<u>9,749,603</u>	<u>2,356</u>
Total equity and liabilities		<u>38,448,063</u>	<u>7,766</u>

Notes on page 44 - 78 are an integral part of these financial statements | Amounts are in ISK thousand

STATEMENT OF EQUITY FOR THE YEAR 2007

	Share capital	Share premium	Accumulated deficit	Total
Changes in equity in year 2006				
Paid in upon establishment	5,000	0	0	5,000
Loss for the year	0	0	(2,644)	(2,644)
Equity as at 31 December 2006	<u>5,000</u>	<u>0</u>	<u>(2,644)</u>	<u>2,356</u>
Changes in equity in year 2007				
Equity as at 1 January 2007	5,000	0	(2,644)	2,356
Paid in new share capital	9,666,314	1,074,784	0	10,741,097
Purchased own shares	(116,669)	(52,501)	0	(169,170)
Loss for the year	0	0	(824,681)	(824,681)
Equity as at 31 December 2007	<u>9,554,645</u>	<u>1,022,283</u>	<u>(827,325)</u>	<u>9,749,603</u>

Notes on page 44 - 78 are an integral part of these financial statements | Amounts are in ISK thousand

CASH FLOW STATEMENT FOR THE YEAR 2007

	Notes	2007	2006
Cash flows from operating activities:			
Loss before income tax		(1,007,552)	(3,224)
Operating items not affecting cash flows:			
Depreciation of intangible assets	51	6,253	0
Depreciation of operating assets	52	13,721	0
Impairment loss on loans	45	29,245	0
Changes in operating assets and liabilities:			
Receivable from credit institutions		(803,779)	0
Trading assets		(22,888,547)	0
Loans and receivables		(3,685,704)	0
Financial assets at fair value		(6,039,068)	0
Other assets		(3,713,393)	(25)
Trading liabilities		232,688	0
Borrowings		23,297,521	0
Other liabilities		5,162,841	5,410
Cash flows (to operation) from operation		<u>(9,395,774)</u>	<u>2,161</u>
Cash flows from investing activities:			
Investment in intangible assets	51	(42,007)	(862)
Investment in operating assets	52	(75,956)	(5,186)
Cash flows from investing activities		<u>(117,963)</u>	<u>(6,048)</u>
Cash flows from financing activities:			
Paid in share capital		10,741,097	5,000
Purchased own shares		(169,170)	0
Cash flows from financing activities		<u>10,571,928</u>	<u>5,000</u>
Increase in cash and cash equivalents		1,058,190	1,113
Cash and cash equivalents at the beginning of the year		1,113	0
Cash and cash equivalents at year end	40	<u>1,059,303</u>	<u>1,113</u>

Notes on page 44 - 78 are an integral part of these financial statements | Amounts are in ISK thousand

NOTES TO THE FINANCIAL STATEMENTS

GENERAL INFORMATION

1. General information on Saga Capital Investment Bank hf.

Saga Capital Investment Bank hf. operates and is located in Iceland. Saga Capital Investment Bank hf.'s headquarters are at Hafnarstraeti 53, Akureyri.

2. Basis of preparation

a) Statement of Compliance

The 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 Saga Capital Investment Bank hf. on 22 February 2008.

Amounts are in ISK thousand

b) Basis of Measurement

The Bank's Financial Statements have been prepared on the historical cost basis except for:

- trading assets and liabilities, including derivatives, which are stated at fair value,
- financial assets designated at fair value are stated at fair value.

Note no. 74 includes further information regarding measurement of fair values.

c) Functional and presentation currency

These financial statements are presented in Icelandic kronas,

which is the Bank's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest thousand unless otherwise stated.

d) Use of estimates and judgements

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions, which affect the application of accounting policies and the reported amount of assets and liabilities as well as income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. 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 estimates are 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 included in note no. 29.

SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements.

3. Foreign currency

Transactions in foreign currencies are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities stated at cost value in foreign currencies are retranslated to Icelandic kronas at the transaction date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in the income statement.

4. Interest income and expenses

Interest income and expenses presented in the income statement consist of:

- Interest income on receivables from credit institutions, based on the effective interest method and amortised cost,
- interest income on loans to customers, based on the effective interest method and amortised cost,

- interest expenses on borrowings and other financial liabilities, based on the effective interest method and amortised cost,
- fair value changes of trading assets and liabilities attributable to interest income and expense,
- fair value changes in financial assets designated at fair value attributable to interest income and expense.

The effective interest rate is the rate that exactly discounts the estimated future cash payment and receipts through the expected life of the financial asset or liability, or where appropriate, a shorter period, to the carrying amount of the financial asset or liability in the balance sheet. When the effective interest rate is calculated the Bank estimates cash flow in terms of all contractual provisions of the financial instrument but does not allow for future losses. The effective interest rate is established on initial recognition of the financial asset and liability recognised at amortised cost value.

5. Fee income and expenses

The Bank provides its customers with various services in exchange for fees. Among this income is income due to agreements on transactions for third parties, fee income due to securities and bond transactions, in addition to other income. Fee income is recognised in the income statement as the service is provided. Fees for performance

based services are recognised when premises for the performance are met with.

Fee expenses are mainly payments due to service acquired by the Bank. They are expensed as the service is received.

6. Net (expenses) income on financial assets and liabilities

Net (expenses) income on financial assets and liabilities include net (expenses) income on trading assets and liabilities, net (expenses) income on financial assets designated at fair value, dividend income and foreign exchange difference, and all realised and unrealised fair value changes, except for fair value changes attributable to interest income and expense. Dividend income is recognised when the right to receive the dividends is established.

7. Impairment of financial assets

The carrying amount of the Bank's assets, other than trading assets and financial assets designated at fair value, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

a) Impairment of loans

Two methods are used to calculate impairment losses, one

based on an assessment of individual loans and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes information about the following events and conditions:

- significant financial difficulty of the borrower;
- a breach of contract, such as a default on installments or on interest or principal payments;
- the bank grants the borrower, due to legal reasons or reasons related to business and related to the borrower's financial difficulty, a concession in form of refinancing, which otherwise would be an option on the borrower's part;
- it is likely that the borrower will be bankrupt or will undergo a financial reorganisation;
- effective market is no longer available for the relevant financial asset due to financial difficulty; or
- Observable indicators indicating measurable decrease in the estimated future cash flow from a loan group from the initial recognition of the assets, though a decrease can not yet be identified on single assets in the group, including:

- unfavourable changes in the borrower's or the group's payment standing; or
- general macro-economical or local economical reasons related to assets in the group.

Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired. This method is applied to all important loans. The assessment takes into account:

- the Bank's overall risk towards the customer;
- amounts and timing of estimated payments and redemptions;
- likely payments to the Bank upon division or bankruptcy;
- how complex it is to determine the total amounts and assessment of all receivables from borrowers and the extent of legal and insurance related uncertainty at hand;
- sales value of insurances (decrease factors of credit risk) and probability of redemption; and

Amounts are in ISK thousand

- probable reduction of cost upon collection of outstanding amounts.

Impairment losses are measured as the difference between the carrying amount of loans and receivables and the present value of estimated cash flows discounted at the assets' original effective interest rate. When a loan has variable interests the imputed rate of interest is the same and the current effective interests of the loan. Losses are recognised in an allowance account, which will be entered to the reduction of their book value.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets;
- historical loss experience in portfolios of similar risk

Amounts are in ISK thousand

characteristics (for example, by industry sector, loan grade or product);

- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly to minimise any differences between loss estimates and actual losses.

Write-off

Loans written-off, partially or in full, when there is no realistic probability that they will be redeemed.

Reversal of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised,

the previously recognised impairment loss is recognised as revenue in the income statement.

b) Calculation of the recoverable amount

The recoverable amount of the Bank's investments in financial assets recognised at amortised cost value are calculated as the present value of the estimated discounted future cash flow, based on the effective interest method.

The recoverable amount of other assets is the lower of the net fair value or their value in use. When the recoverable amount is assessed, the estimated future cash flow is discounted based on the imputed rate of interest before taxes, which reflects current market conditions and the risk inherent with the asset. For an asset not generating much independent cash flow the recoverable amount is estimated for the cash generating unit to which the asset appertains.

8. Income tax expense

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement 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 substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

A deferred tax asset is calculated and entered in the financial statements. The calculation is based on the difference between balance sheet items according to the tax return on the one hand, and the financial statements on the other, taken into account carry forward tax losses. Difference of balance sheet items, as thus stated, is due to the fact that income tax assessment is based on different premises than the Bank's financial statements and is in main respect a temporary difference between the recognition of income and expenses in the tax return on the one hand, and in the financial statement on the other.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset 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.

9. Cash and cash equivalents

Cash and cash equivalents include fund, demand deposits in the Central Bank and repayable on demand receivables from credit institutions.

Cash and cash equivalents in the balance sheet are recognised with accrued interests.

10. Loans and receivables from credit institutions

Loans and receivables consist of financial instruments, other than derivative agreements, carrying fixed or calculable payments,

or not listed in active markets, except for those instruments that the Bank denominates and enters at fair value. Loans and receivables include loans granted by the Bank to its customers, loans that the Bank takes part in granting together with other credit institutions and purchased loans, which are unlisted and that the Bank has no intention of selling in the nearest future.

Loans and receivables are initially stated at fair value, which is the loan amount in addition to transaction cost. Loans are then measured at amortised cost, which is determined on the basis of the effective interest method. Accrued interests are recognised as part of the book value of loans and receivables.

11. Trading assets

Trading assets are mainly acquired in order to make profit on short term value changes or on broker fees. Trading assets consist of bonds, shares and derivatives with positive fair value.

Trading assets are measured at fair value. Redeemed and unredeemed profit and loss on those assets is recognised in the income statement. Fair value changes are recognised on the one in net interest income and expenses (interest factor of fair value changes) and on the other, among net income and expenses on financial assets and liabilities (fair value changes due to other factors). Interest and dividend income on those assets is recognised in interest income and dividends in the income statement. Trading assets are not reclassified after initial classification.

Amounts are in ISK thousand

12. Derivatives

Derivative agreements are financial instruments or other agreements, which value is based on changes in underlying factors (such as price of securities, goods or bonds, indices, currencies or interest rates), and require no or insubstantial initial investment compared to other comparable agreements with comparable connection to changes in market factors and that are settled at a determined time in the future.

The Bank uses derivative agreements in order to gain on short term price changes and to hedge against financial risk.

Derivative agreements are recognised among current assets and liabilities in the balance sheet. They are stated at fair value. Fair value changes are recognised in the income statement as interests (among interest income and interest expenses) and foreign exchange difference (among net income and expenses on financial assets and liabilities). Derivative agreements with positive balance are recognised in trading assets and derivative agreements with negative balance are recognised in trading liabilities.

Embedded derivatives, which are a part of other agreements are treated as separate derivative agreements when economic characteristics and risk are not closely connected with the host contract, of which they are part, and the entire instruments is not recognised at fair value through profit and loss.

The fair value of derivative agreements is determined in accordance with the accounting method defined in note no. 14.

13. Financial assets stated at fair value

The Bank designates certain financial asset upon initial recognition in its books as financial assets at fair value when that definition returns better information to the Bank's key management. Fair value changes are recognised in the income statement. Fair value changes are on the one hand recognised among interest income and expenses (interest factor of fair value changes) and on the other, among net income and expenses on financial assets and liabilities (fair value changes due to other factors).

14. Fair value determination

Fair value of financial assets and liabilities listed in an active market is the same as their listed value. Valuation methods are applied to all financial instruments in the calculation of their fair value. A financial asset or a financial liability is considered to be listed in an active market if official price is available from a stock exchange or other independent party and if the price reflects real and regular market transactions between unrelated parties.

Valuation methods can consist in the use of prices in recent transactions between unrelated parties, use of the value of other financial instruments comparable to the instrument in question or the discounted cash flow or other valuation models. When applying valuation methods all factors are

used that market parties would use in a valuation and the methods are in accordance with generally accepted methods for the valuation of financial instruments. The Bank verifies on a regular basis its valuation methods and makes tests thereon by using prices obtained from active markets with the same instrument, without adjustments or changes, or that are based on market information.

When transactions are made financial instruments are stated at fair value upon initial recognition. Market prices are considered to be the best indication of fair value, even though fair value according to valuation models is different from market values. If there is a difference between the fair value due to a valuation method it is recognised in the income statement based on the premises at each time and no later than when market information become visible.

15. Recognition and derecognition of financial assets and liabilities

Purchase and sale of financial assets are recognised on the date of transaction. They are stated at the date that the Bank enters into an obligation to purchase or sell the asset, unless due to loans and receivables, which is registered when the financial asset is handed over to the borrower.

Financial assets are derecognised when the right to receive cash flow from the asset no longer exists or when the Bank has transferred considerably all risk and benefit from the ownership.

A Financial liability is recognised when the Bank becomes a part of contractual debt instrument. A financial liability is derecognised when the Bank's obligation is settled by payment, the creditor has renounced the claim or the liability lapses. The Bank makes transactions where recognised assets in the balance sheet are transferred but the risk and reward is retained in part or in full. If all or nearly all risk and reward is retained the recognition of the asset in the balance sheet continues. Transfer of assets where nearly all risk and reward is retained consists for example of loans for securities and repurchases. The right and obligations retained upon transition are each recognised as assets and liabilities, whichever is applicable. Upon transition where control over the asset is retained the Bank continues to recognise the asset to the extent that the participation continues to cover and on the basis of the extent of the effects due to value changes of the transferred asset.

In certain transactions the Bank retains its right to provide services to transferred assets in exchange for fees. The transfer of an asset is discontinued in full if it meets with all the relevant requirements thereon. An asset or a liability is recognised as for what relates to service rights depending on whether the service fee is sufficiently high in order to cover the cost due to the service (asset) or whether it is too low so that it will not be able to cover the cost of the service (liability).

16. Off-setting

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when the legal right exists

Amounts are in ISK thousand

on off-setting and recognition will take place by off-setting of financial assets and liabilities.

Income and expenses are only set off if allowed by accounting policies. Furthermore, income and expenses are set off when they are derived from comparable transactions such as transactions with trading assets.

17. Sales and repurchase agreement

Sales and repurchase agreements are agreements on sale and repurchase of securities with the terms that the securities are repurchased at a fixed date and price. Purchase and resale agreements are agreements made on the purchase and resale of securities with the terms that the securities are resold at a fixed date and price. Initially received cash and cash equivalents with accrued interests is recognised in the balance sheet as loan from financial companies and the Central Bank. Initially paid cash and cash equivalents with accrued interests is recognised as receivables from credit institutions. Accrued interests are recognised as interest expenses or interest income over the term of each agreement.

As for sales and repurchase agreements, control over securities remains with the Bank during the contractual term and the securities are continually recognised in the balance as financial assets denominated at fair value.

18. Lease agreements

The Bank classifies lease agreement based on whether the

risk and rewards inherent with the ownership of the leased asset are materially transferred to the Bank or not. A financial lease agreement is a lease agreement where risk and rewards inherent with the assets are materially transferred over to the lessee. An operating lease agreement is any lease agreement not considered to be a finance lease agreement.

Lease payments according to an operating lease agreement where the Bank is the lessee are expensed on a straight-line basis over the contractual term of the lease agreement.

19. Intangible assets

Subsequently incurred cost due to intangible assets is capitalised if it increase the value of the asset. All other cost is expensed in the income statement when incurred. Amortisation is recognised on a straight-line basis in the income statement based on the estimated useful life of intangible assets. Other intangible assets are amortised from the time that they are taken into use. Software is amortised over a three year period.

20. Operating assets

Operating assets are capitalised at cost less accumulated depreciation and impairment losses. Cost incurred subsequently due to a renewal of items in some operating assets is capitalised as operating asset if it is likely that the financial gain inherent with the asset will go to the Bank and the cost can be assessed reliably. All other cost is expensed in the income statement when incurred. Depreciation is recognised on a

straight-line basis in the income statement based on the useful life of the operating asset. Estimated useful lives are specified as follows:

Furnishings.....	5 years
Equipment and machines.....	3-5 years
Scrap value is remeasured on an annual basis.	

21. Trading liabilities

Trading liabilities consist of derivative agreements with negative fair value.

22. Borrowings

The Bank's borrowings are mainly from financial companies. Borrowings are initially recognised at fair value less transaction cost. Borrowings are then measured at the amortised cost value based on effective interests. Accrued interests are recognised as a part of the book value of borrowings.

23. Financial guarantees

Financial guarantees are agreements that bind the Bank to repay a specific amount to the guarantee holder due to a loss that he incurs when a debtor can not meet with his obligation on due date in accordance with the terms of a debt instrument.

Liabilities due to financial guarantees are initially stated at fair value and the fair value is recognised in the income statement over the estimated term of the agreement. The

agreement is then recognised at the higher of the initial fair value, taken into account recognised fees, or the present value of estimated payments when the a payment due to a guarantee is considered to be likely. Financial guarantees are recognised in the balance sheet among other liabilities.

24. Salary related payments

The Bank pays pension fund contributions due to the Bank's employees, which are recognised in the income statement as salaries and salary related expenses as they are incurred.

25. Other assets and liabilities

Other assets and liabilities are stated at cost value.

26. Equity

a) Own shares

Share capital acquired from a shareholder (own shares), including transaction cost in recognised as a reduction in equity. Profit and loss arising due to sale, purchase, issue and write down or own shares is not recognised in the income statement but under equity.

b) Accumulated deficit

Accumulated includes the loss for the year.

c) Dividends

Dividends on share capital are entered as a reduction in equity in the period they are approved in an Annual General Meeting.

Amounts are in ISK thousand

27. Loss per share

The Bank calculates the loss and diluted loss per share for its shares. Loss per share is calculated by dividing the loss for the year distributed to the Bank's shareholders by the weighted average number of outstanding shares over the year. Diluted loss per share is calculated by adjusting the loss for the year distributed to the Bank's shareholders and the average of outstanding shares over the year to all the probable effects due to the dilution. A dilution arises due to issue of purchase options to employees.

28. 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 financial statements:

IFRS 8 Operating segments. States how an entity shall in its financial statements account for information on its operating segments, goods and services sold, geographical areas in which it operates and its main customers. IFRS 8 is applicable for the period starting from January 1 2009.

IAS 1 Presentation of Financial Statements (revised 2007) replaces IAS 1 Presentation of Financial Statements (revised 2003) with changes from 2005. IAS 1 (revised 2007) requires the disclosure of information on an entity's objectives, policies and processes for managing capital, and has specific requirements when the entity's capital is regulated. The main change

with revised IAS 1 is the requirement of providing information on all changes in equity not related to shareholders (changes in equity not due to transactions with shareholders in their position as shareholders in one or two overviews: whether in one overview over the total return or in the income statement and statement of total return. Unlike the present IAS 1 is will not be allowed to publish only a part of the total return in an equity statement. Should IAS 1 confirmed by the EU it will apply to the Bank's financial statement for the year 2009 and will probably affect the Bank's income statement and statement of 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. The revised IAS 23 will become mandatory for the Bank's 2009 Financial Statements and will have effect on the Bank's accounting policies.

Revised IFRS 2 Share-based payment – vesting conditions and cancellations (January 2008) in which the concepts vesting condition and its accounting treatment when an agreements on share-based payments are revoked. If revised IFRS 2 will be confirmed by the EU it will apply to the Bank's financial statements for the year 2009, with retroactive effect. Revised IFRS 2 is not expected to have effect on the financial statements.

"IFRS 3 Merger of companies (revised 2008) and relative changes of IAS 27 Consolidated Financial Statements and

separate financial statements includes changes in financial statements upon merger of companies and for shareholders not having controlling interest or that are minority interest. The main changes from IFRS 3 (2004) and IAS 27 (2003) are the following:

- IFRS 3 (2008) applies also to merger of companies where mutual units are involved and where merger of companies is obtained by an agreement thereon;
- The definition of merger of companies has been changed so the more emphasis is put on controlling interest;
- The definition of operation has been changed;
- Cost incurred with a takeover company upon a merger is not considered as a part of the purchase cost;
- Purchase of an additional share following a merger shall be treated in accordance with the equity method;
- Sale of a share when there is still a controlling interest shall be treated in accordance with the equity method;"

If IFRS 3 (revised 2008) and relative changes of IAS 27 will be confirmed by the EU they will apply to the Bank's financial statements for the year 2010. Book value of assets and liabilities arising upon a merger of companies before the implementation of IFRS 3 (revised 2008) will not be reestablished but

changes in IAS 27 will have retroactive effect. The changes are not assumed to have effect on the Bank's 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 Bank's 2008 Financial Statements, with retrospective application required. IFRIC 11 is not expected to have any impact on the 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 Bank's 2008 Financial Statements will presumably have no effect on the 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 Bank's 2009 Financial Statements is not expected to have a material impact on the 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 Company's 2008 Financial Statements with retrospective application required. This will have no effect of the interpretation on the Financial Statements.

29. Management's evaluation and judgement in relation to the application of accounting methods.

The Bank's management makes decisions, assessments and assumptions that may have effect on items in the Bank's balance sheet in the next accounting year. Management revalues on a regular basis decisions and assessments based on historical experience of previous years and other appropriate factors, such as estimated future events when decisions on assumptions and assessments are made.

a) Impairment loss on loans

The Bank reviews its loan portfolio in order to test for impairment every three months. Before a decision is made on the recognition of impairment loss the Bank must assess whether there is objective evidence indicating a measurable decrease in the estimated future cash flow either from single loans or from a loan portfolio before the decrease becomes perceptible with single loans in the portfolio. Those can be indications of changes in the borrowers credit facility or economic

conditions. The management uses estimates that are based on the historical experience of assets with comparable risk characteristics and objective evidence of impairment loss when the future cash flow shall be evaluated. The methodology and assumptions used in both evaluating amounts and timing of future cash flow are reviewed on a regular basis aiming at reducing the difference between estimated loss and actual loss.

b) Fair value of derivative agreements

Fair value of derivative agreements not listed in active markets is determined by use of valuation methods, which are reviewed on a regular basis by independent employees. All valuation methods used must be approved and tested in order to ensure that the results reflect the data used.

Amounts are in ISK thousand

NOTES TO THE INCOME STATEMENT

	Interest income	Interest expenses	Net interest income
Net interest income			
30. Interest income and expenses are specified as follows:			
Receivable from credit institutions	131,356	0	131,356
Loans	225,307	0	225,307
Trading assets and liabilities	493,729	191,869	301,860
Financial assets and liabilities designated at fair value	211,929	0	211,929
Borrowings	0	730,778	(730,778)
Other	6,261	5,100	1,162
Interest income and expenses	1,068,583	927,747	140,836
Division of interest income and expenses:			
Interest income and expenses on fin. assets and liabilities at fair value	705,658	191,869	513,789
Interest income and expenses on financial assets and liabilities not at fair value through profit and loss	362,925	735,878	(372,953)
Interest income and expenses	1,068,583	927,747	140,836
Net fee income			
31. Fee income and expenses are specified as follows:			2007
Fees on securities transactions			276,658
Fees on loans			27,142
Other fees			111,465
Fee income			415,265
Fee expense on securities transactions			70,036
Other fee expenses			33,538
Fee expenses			103,575
Net fee income			311,690

Amounts are in ISK thousand

Net (expenses) income on financial assets and liabilities

	2007
32. Net (expenses) income on financial assets and liabilities are specified as follows:	
Dividends	8,399
Net income on trading assets and liabilities	(896,989)
Net income on financial assets designated at fair value	(114,133)
Net foreign exchange difference	94,361
Net (expenses) income on financial assets and liabilities	(908,361)
a) All dividends are due to trading assets	
b) Net (expenses) income on trading assets and liabilities are specified as follows:	
Shares and related derivatives	(741,451)
Bonds and related derivatives	(155,539)
Net (expenses) income on trading assets and liabilities	(896,989)
c) Net (expenses) income on financial assets designated at fair value are specified as follows:	
Bonds	25,764
Derivative agreements	(139,897)
Net (expenses) income on financial assets designated at fair value	(114,133)

Personnel

33. Total number of employees is specified as follows:	
Average number of employees during the year is recalculated to full time equivalent units	21
Number of full time equivalent units at year end	32
34. Salaries and salary related expenses are specified as follows:	
Salaries	206,018
Pension premium	19,697
Other salary related expenses	17,478
Salaries and salary related expenses	243,193

Amounts are in ISK thousand

Management's salaries

35. Salaries of management, purchase options and shares at year end are specified as follows:

	Salaries	Purchase option	Share capital
Director, Thorvaldur Ludvik Sigurjonsson	22,600	50,000	1,100,000
Board of Directors:			
Halldor Johannsson, Chairman of the Board	1,500	0	0
Johann Antonsson	1,000	0	100,000
Robert Melax	0	0	1,000,000
Sigurdur G. Gudjonsson	1,000	0	250,000
Orn Arnar Oskarsson	1,000	0	0
Reserve Directors	500	9,000	10,000
Managing Directors (6)	75,361	300,000	700,000
	102,961	359,000	3,160,000

Included in the above shares are shares of spouses and children that are minors and shares owned by companies controlled by management.

Auditors' fees

36. Auditors' fees are specified as follows:

	2007	2006
Audit of financial statements	1,164	0
Internal audit	628	0
Review of interim financial statements	2,622	0
Other services	5,212	90
Auditors' fees	9,626	90

Amounts are in ISK thousand

Income tax

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

	2007	2006
Income tax payable	0	0
Increase in calculated tax asset	182,871	580
Recognised income tax	182,871	580
Effective tax rate:		
Loss before income tax	(1,007,552)	(3,224)
Income tax on loss for the year	18.0% (181,359)	(580)
Dividends exempt from tax	0.2% (1,512)	0
Effective income tax	18.2% (182,871)	(580)

Loss per share

38. Loss per share is specified as follows:

Loss for the year distributed on shareholders	(824,681)	(2,644)
Share capital according to the financial statements at year beginning	5,000	0
Effect of increase/sale of share capital during the year	6,251,711	833
Weighted average of shares during the year	6,256,711	833
Effect of purchase options	12	0
Weighted average of shares during the year, diluted	6,256,723	833
Basic loss per share	(0.13)	(3.17)
Diluted loss per share	(0.13)	(3.17)
Number of outstanding shares at year end	9,554,645	5,000
Number of outstanding shares at year end, diluted	10,034,645	5,000
Number of own shares at year end	116,669	0

NOTES TO THE BALANCE SHEET

Financial assets and liabilities

39. According to the International Accounting Standard IAS 39 Financial instruments: recognition and measurement, financial assets and liabilities are divided into specific categories. The classification has an effect of how the relevant financial instrument is evaluated. Those categories to which the Bank's financial assets and liabilities appertain and their basis of measurement are specified as follows:

- Trading assets and liabilities - stated at fair value in the income statement.
- Financial assets and liabilities designated at fair value - stated at fair value in the income statement.
- Loans and receivables - stated at amortised cost.
- Other financial liabilities - stated at amortised cost value.

The following table specifies the classification of the Bank's financial assets and liabilities and their fair value (less accrued interests).

31 December 2007	Notes	Trading	Design at fair value	Amortised cost	Book value	Fair value
Cash and cash equivalents	40	0	0	1,059,303	1,059,303	1,059,303
Loans and receivables	41-46	0	0	4,460,238	4,460,238	4,457,609
Trading assets	47	22,888,547	0	0	22,888,547	22,888,547
Financial assets at fair value	50	0	6,039,068	0	6,039,068	6,039,068
Other financial assets	54	0	0	3,603,551	3,603,551	3,603,551
		<u>22,888,547</u>	<u>6,039,068</u>	<u>9,123,092</u>	<u>38,050,707</u>	<u>38,048,078</u>
Trading liabilities	55	232,688	0	0	232,688	232,688
Borrowings	56	0	0	23,297,521	23,297,521	23,297,521
Other financial liabilities	57	0	0	4,573,098	4,573,098	4,573,098
		<u>232,688</u>	<u>0</u>	<u>27,870,619</u>	<u>28,103,307</u>	<u>28,103,307</u>

Amounts are in ISK thousand

Cash and cash equivalents

40. Cash and cash equivalents are specified as follows:

	2007	2006
Bank accounts	157,886	1,113
Money market loans	901,418	0
	<u>1,059,303</u>	<u>1,113</u>

Receivable from credit institutions

41. Among receivable fom credit institutions are bound bank deposits

which are specified according to maturity:

	2007
Receivables on demand	0
Up to three months	803,779
	<u>803,779</u>

Receivable from credit institutions

Loans to customers

42. Loans to customers are specified as follows by loan type:

Bonds	3,685,704
Depreciation allowance account for loans	(29,245)
	<u>3,656,459</u>

Loans to customers

43. Loans to customers are specified as follows by borrowers:

Commerce	3.0%
Service	85.0%
Individuals	12.0%
	<u>100.0%</u>

44. Loans to customers are specified as follows according to maturity:

Repayable on demand	306,775
Up to three months	996,427
3 months to 1 year	473,386
1 to 5 years	1,799,307
Over 5 years	80,563
	<u>3,656,459</u>

Loans to customers

Impairment allowance account for loan

45. Changes in the impairment allowance account for loans are specified as follows:

	Specific contribution	General contribution	Total
Impairment loss on loans during the year	29,245	0	29,245
Impairment allowance account for loans at year end	29,245	0	29,245

46. Impaired loans and specific impairment allowance account are specified as follows by borrowers at year end 2007:

Sectors:	Amount of impaired loan	Impairment	Book value
Service	298,283	29,245	269,038
Specific depreciation allowance account	298,283	29,245	269,038

There is no default on loans that are not impaired

Trading assets

47. Trading assets are specified as follows:

	2007
Bonds	20,854,606
Securities	1,938,812
Derivative agreements	95,129
Trading assets	22,888,547

Assets to the amount of ISK 18,496 million have been pledged against week and day loans with the Central Bank and guarantees of financial institutions.

Amounts are in ISK thousand

Derivative agreements

48. The Bank has entered into derivative agreements to the amount of ISK 117 million against its shareholding. The agreements are to meet listed securities and they are listed at market value. Furthermore, the Bank has entered into derivative agreements to the amount of ISK 2,280 million against its shareholding.

49. Derivative agreements, maturity of principal and book value are specified as follows at year end 2007:

	Up to 3 months	Principal		Total	Book value	
		Over 3 months and up to year	Over 1 year		Assets	Liabilities
Unlisted currency and interest swaps:						
Forwards currency agreements	3,741,637	0	0	3,741,637	20,533	19,282
Total	3,741,637	0	0	3,741,637	20,533	19,282
Unlisted securities derivatives:						
Forwards agreements	2,282,993	0	0	2,282,993	26,350	0
Securities agreements	846,522	0	0	846,522	6,528	213,406
Total	3,129,515	0	0	3,129,515	32,878	213,406
Unlisted bond derivatives:						
Bond agreements	1,035,751	0	0	1,035,751	41,718	0
Total	1,035,751	0	0	1,035,751	41,718	0
Total derivatives agreements	7,906,903	0	0	7,906,903	95,129	232,688

Financial assets designated at fair value**50. Financial assets designated at fair value are specified as follows:**

	2007
Bonds	5,786,654
Securities	252,414
Financial assets designated at fair value	6,039,068

Intangible assets**51. Intangible assets are specified as follows:**

	2007	2006
Software at the beginning of the year	862	0
Additions during the year	42,007	862
Amortisation during the year	(6,253)	0
Intangible assets at year end	36,617	862

Operating assets**52. Operating assets are specified as follows:**

	Furnishings, equipment and tools	
Total value at the beginning of the year	5,186	0
Additions during the year	75,956	5,186
Total value at year end	81,142	5,186
Depreciations during the year	13,721	0
Total depreciation	13,721	0
Book value of operating assets at year end	67,421	5,186

Amounts are in ISK thousand

Tax asset**53. Tax asset is specified as follows:**

	2007	2006
Tax asset at the beginning of the year	580	0
Recognised calculated tax asset	182,871	580
Tax asset at the end of the year	183,451	580

Other assets**54. Other assets are specified as follows:**

	2007
Unsettled securities transactions	3,603,551
Various assets	79,618
Prepaid expenses	30,248
Other assets	3,713,418

Unsettled securities transactions were settled within three days from the accounting date.

Trading liabilities**55. Trading liabilities are specified as follows:**

Derivative agreements with financial institutions	211,876
Other derivative agreements	20,812
Trading liabilities	232,688

Borrowings

56. Borrowings are specified as follows:

	2007
Loans from financial companies	22,411,389
Loans from other parties	886,132
Borrowings	23,297,521

Borrowings are specified as follows by maturity:

Up to 3 months	22,944,079
3 months to 1 year	353,442
Borrowings	23,297,521

Other liabilities

57. Other liabilities are specified as follows:

Unsettled securities transactions	4,573,098
Other liabilities	595,152
Other liabilities	5,168,251

Unsettled securities transactions were settled within three days from the accounting date.

Amounts are in ISK thousand

Equity

58. The Bank's share capital amounted to ISK 9,700 million at year end. Own shares and share options amounted to ISK 145 million and deducted in the balance sheet. Equity at year end amounts to ISK 9,750 million. Equity ratio calculated according to provisions of Article 84 of the Act on Financial Companies is 35.3% at year end 2007. According to the act the ratio may not be lower than 8.0%.

The ratio is calculated as follows:	Book balance	Weighted balance
Risk base:		
Assets	38,448,063	25,990,688
Assets to the reduction of equity		(868,368)
Guarantees and other off balance sheet items		22,600
		<u>25,144,920</u>
Equity:		
Equity factor A:		
Book value of equity		9,749,603
Equity factor B:		
Shares in financial institutions		(868,368)
		<u>8,881,235</u>
Equity ratio		35.3%

OFF-BALANCE SHEET ITEMS

59. The Bank has entered into guarantees for its customers to the amount of ISK 113 million at year end.

Credit risk due to granted guarantees is measured at ISK 23 million upon calculation of the Bank's equity ratio.

60. On 31 December 2007, the Bank was bound by noncancellable operating lease agreements for real estates and vehicles. The rental agreements are in accordance with general terms for industrial housing and provisions on changes to the rental payments based in price indices. Duration term of agreements due to vehicles are maximum three years.

61. The Bank has entered into rental agreements due to real estates used for the operation. The agreements are valid for up to 7 years and the Bank has the priority right of purchase to the assets or the right to extend the agreement term. Rental payments are specified as follows over the contractual term:

Rental payments 0 to 1 year	33,223
Rental payments 1 to 5 years	125,564
Rental payments over 5 years	42,609
Minimum future rental payments over the contractual term	201,396

Pledged assets

62. Assets have been pledged as insurance for the following liabilities and uncertain liabilities: 2007

Liabilities	
Repurchase agreements with financial institution	1,018,198
Repurchase agreements with the Central Bank of Iceland	800,732
	1,818,930

Related parties

63. The Bank's related parties are its management, managing directors and parties that have considerable influence as major shareholders in the Bank. Information on related parties are the following.

Loans to the Director and Managing Directors (6)	137,832
Loans to Directors of the Board and companies related to them	816,265
	954,097

No unusual transactions have been made with related parties during the year.

Transactions with related parties have been made on a comparable basis as with unrelated parties.

Information on salaries of key management and Directors of the Board are in note no. 35.

Amounts are in ISK thousand

Share options

64. On 27 August 2007, the Bank's Board of Directors agreed a share option schedule that grants the Bank's employees the right to purchase shares in the Bank. In December, share option agreements were made, which grant Managing Directors the right to purchase 350,000 thousand shares at a contractual rate of 1.4. The option may be exercised during the period from 1 August to 1 September 2010. At the same time share option agreements were made with other employees of the Bank, which grant them the right to purchase 130,000 thousand shares. One third of the option may be exercised during the period from 1 August to 1 September each year, first time in year 2008 and last time in year 2010. The option is at the contractual rate 1.4 in the first exercise period, 1.47 in the second and 1.54 in the third. Employees have the right to defer to exercise their right within the contractual term but the contractual price increase to the price valid in the period that the option is exercised.

Cost due to the agreements has been calculated on the basis of the Black-Scholes valuation model and is expensed during the contractual term among salaries and salary related expenses, for the first time in the year 2008. A counter recognition will be made to a special item among equity where the option agreements will be settled by cession of shares. Estimated cost due to the agreements is ISK 193 million. Important premises used in the calculation of values are specified as follows:

Share options granted in the year 2007	480,000
Fair value of share options at agreement date	192,662
Share option rate	1,4 -1,54
Estimated fluctuation (weighted average fluctuation)	23.0%
Risk free interests (based on treasury bonds)	12.5%

Events after the accounting date

65. No events have taken place after the balance sheet date that would require any adjustments and corrections to the financial statements for the year 2007. The financial statements will be presented in a shareholders' general meeting for approval.

RISK MANAGEMENT

66. The Bank faces various types of risks related to its business as a financial institution arising from its day to day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below. The core risks are credit risk, liquidity risk and market risk. Market risk consists of currency risk, interest risk and price risk.

Risk policy

Many risk factors can affect the Bank's operation. The Bank's Board of Directors sets with the Bank's risk policy a benchmark for acceptable risk limits in daily operation regarding risk factors that could affect income and equity, and the Bank's will to take risk in respect of estimated profit. The Director and the Managing Director of risk management follow the Board of Directors' decision on the Bank's benchmarks for risk and risk policy. Furthermore, it is the role of the Bank's internal auditor monitor the operation in order to ensure compliance with rules in accordance with the Bank's Board of Directors Articles of Association.

Market risk is the biggest single risk factor in the Bank's operation. A market risk committee, consisting of the Director, Managing Director of risk management and Managing Director

Amounts are in ISK thousand

of equity management, following benchmarks set by the Board regarding market risk.

Counterparty risk is a considerable risk factor in the Bank's operation and consists mainly in counterparty risk due to loans to customers. The Bank's Board of Directors establishes credit policies which set the aim and acceptable limits for counterparty risk. A loan committee, which consists of Director, Managing Director of risk management and Managing Director of the loan department, makes decisions on all of the Bank's loans and complies with the Board of Directors' policy.

Risk management process and risk control

a) Agreements including counterparty risk

Counterparty risk is the risk that the counterparty does not fulfill its obligation towards the Bank. The Bank's main counterparty risk arises in relation to loan grantings. The maximum amount of counterparty risk in this respect is stated in the book value of assets in the balance sheet. Counterparty risk consists in the Bank's various other financial assets, such as derivative agreements and market bonds and current counterparty risk is reflected in the book value of those assets in the balance sheet. In addition to the aforementioned counterparty risk, the Bank also faces counterparty risk due to off-balance sheet items such as guarantees granted.

Loans: The Bank's main assets are loans. In order to main-

tain and improve the quality of the Bank's loan portfolio it is important to continually monitor current loan portfolio and review all loan applications thoroughly where those that do not fulfill requirements for loan granting are immediately rejected. It is the Bank's policy that interests of granted loans reflect both the related risk and cost. This means that an in-depth assessment of single customers, their financial standing and guarantees make the premises for loan granting.

Derivative agreements: The Bank enters into derivative agreements with its customers including forward agreements, swaps, options and other comparable agreements, where value is subject to interest rate, foreign exchange rate, exchange rate of shares or price indices. The Bank monitors derivative agreements with open balances and sees to that there are always sufficient insurances at hand. Insurances depend on the customer and the type of agreement. In general, insurances are required in order to meet possible loss on an agreement. Acceptable insurances for a derivative agreement are assets that can be redeemed with short notice, such as cash or market shares. If the balance of derivative agreements goes under certain limit an increased insurance will be required.

b) Loan processing and authorisations

The Bank's loan committee reviews and makes decisions in all loan issues except when the risk is higher than 10% of the Bank's equity, in which case the approval of the Board of Directors is needed. Credit policies approved by the Bank's Board of Directors include limits on employees credit

authorisations and limits on risk towards different counterparties. The Bank's legal department supervises all document preparation related to loans.

c) Counterparty risk monitoring

Risk management monitors counterparty risk. The department handles numerical analysis of the loan portfolio, assesses estimated loss, probable risk inherent with the loan portfolio and monitors defaults in a systematic way. The results are presented to the management with emphasis on possible risk within the loan portfolio in terms of counterparty risk, risk in single sectors and countries. The Bank's loan process is continually being reviewed in terms of data collecting, loan authorisations, loan applications, document preparation, assessment and registration of insurances.

Loan impairment

Contribution due to loss on loan is entered when there are certain indications that the Bank will not be able to collect the entire amount receivable, for example loans, obligations, guarantees etc., according to initial contractual provisions or comparable provisions. Depreciation account due to loss on loans is reduced by book value of loans in the balance sheet but depreciation account due to off balance sheet items, such as due to obligations and guarantees is entered among other liabilities. Contribution to the depreciation account is entered as impairment loss on loans. The depreciation account for loans is assessed, mainly in relation to single counterparties or a group of counterparties according to the following rules:

a) Specific depreciations

A receivable is considered to be impaired when there is clear indication that the Bank will not be able to collect the entire receivable according to initial contractual provisions. Counterparty risk is assessed on the basis of the standing of the borrower, his overall financial standing, assets and payment history, possibility of financial support by financially responsible guarantors and sales value of insurances, where applicable.

Estimated recoverable amount is the current value of estimated cash flow from the loan, calculated by using initial interests of the loan. Impairment is the difference between the book value and estimated recoverable amount. Upon impairment loss interest income on the basis of initial terms of the receivable is no longer recognised but the increase in the current value of impaired receivables from previous periods is entered among interest income.

Impaired loans are reviewed and assessed at least every three months. All subsequent changes in amounts and timing of estimated cash flow compared to previous assessments, which lead to changes in the depreciation account are expensed as impairment loss on loans.

Impairment is only reversed when loan quality has improved sufficiently enough in order to give reason that the principal

and interests in accordance with initial contractual provisions of the loans can be collected in time. Final write-offs are made when a receivable, in part or in full, is considered to be uncollectible. Final depreciations are entered as reduction in the total value of the receivable against the depreciation account or as impairment loss on loans in the income statement. Repayments of previously depreciated receivables are entered as reduction in expensed impairment loss on loans.

b) General depreciation

All loans not recognised in a specific depreciation account are grouped in a uniform loan portfolio and impairment loss is assessed on the entire loan portfolio. Allowance due to overall assessment of impairment loss is entered as impairment loss on loans in the income statement and to the reduction of loan balance. As impairment is not recognised for each single loan, interest is calculated on all loans according to contractual provisions.

All loans where there is no impairment loss with the counterparty are grouped in an economic uniform loan portfolio, and impairment is tested on loans within the group. Depreciation due to overall assessment of impairment loss is entered as expenses due to loss on loan and leads to a counter recording on loan balance. As depreciation is not entered for each single loan, interest is calculated on all loans according to contractual provisions.

Amounts are in ISK thousand

Liquidity risk control and management

67. Liquidity risk is the risk that the Bank will not be able to meet its financial obligations as they fall due. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. The Bank must have sufficient liquidity in order to be able to meet both its foreseeable and unforeseeable payment obligations. The Bank has set rules regarding liquidity and financing in order to ensure and maintain flexibility. The rules consist among other things in access to credit lines, loan facilities and financial assets, which easily and quickly can be liquidated, such as treasury bills and treasury bonds.

Furthermore, liquidity risk is monitored with reports on liquidity ratio, which are sent on a monthly basis to the Central Bank of Iceland. The liquidity ratio shows the proportion between assets and liabilities depending on their due date. In order to determine the liquidity base the Central Bank of Iceland assesses single asset groups so the ratio is prudently assessed.

The Bank's undiscounted financial assets and liabilities are specified as follows by maturity at year end 2007:

	Book value	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years
2007						
Financial assets						
Cash and cash equivalents	1,059,303	1,059,303	0	0	0	0
Loans and receivables	4,460,238	306,775	1,800,206	473,386	1,799,307	80,563
Trading assets	22,888,547	22,888,547	0	0	0	0
Fin. assets design. at fair value	6,039,068	0	0	3,304,357	2,734,711	0
Total financial assets	34,447,156	24,254,625	1,800,206	3,777,743	4,534,018	80,563
Financial liabilities						
Trading liabilities	232,688	1,530	231,158	0	0	0
Borrowings	23,297,521	22,944,079	0	353,442	0	0
Total financial liabilities	23,530,209	22,945,609	231,158	353,442	0	0
Total financial assets and liabilities	10,916,947	1,309,016	1,569,048	3,424,302	4,534,018	80,563

Market risk control and management

68. The Bank's policy is to monitor closely its market risk and assure that limits set by the Board are not exceeded. Market risk is managed by regular reviews and by setting limits on assessments, risk benchmarks, and daily control on both. The market risk committee regularly reviews the Bank's market risk and takes action whenever needed.

Interest rate risk

69. The Bank's operation faces risk due to interest rate fluctuations to the extent that interest bearing assets (including investments) and interest bearing liabilities have different maturity are recalculated at different points of time or at different amounts. As for variable interests of assets and liabilities, the Bank is also at risk due to fluctuations of various variable interest benchmarks, such as borrowing interests and LIBOR-interests and other different types of interests. The operation of risk management also consists in the optimisation of net interest income, provided that market interests are in accordance with the Bank's business policies.

Unsubstantial part of loans has fixed interests or between 1 and 2% of the Bank's loan portfolio.

Total amount of the Bank's indexed assets amounted to ISK 22,904 million at year end but indexed liabilities were none.

Price risk

70. Price risk is the risk of changes in market prices. The Bank's balances in shares and bonds are most sensitive to such changes. Price risk management is separate from currency risk.

Currency risk

71. Currency risk is the risk of losses due to unfavourable movements in foreign currencies. The open currency balance of each currency in the Bank is monitored. The Bank aims at limiting currency risk and monitors it in respect of the Fund's total equity.

Amounts are in ISK thousand

72. Breakdown of assets and liabilities by currencies at year end 2007:

	ISK	EUR	USD	CHF	Other currencies	Total
Assets						
Cash and cash equivalents	977,130	2,192	20,332	8,312	51,336	1,059,303
Receivable form credit institutions	254,888	541,640	0	0	7,251	803,779
Loans and receivables	1,067,073	569,999	202,055	848,810	968,522	3,656,459
Trading assets	22,841,641	2,797	4,688	2,513	36,908	22,888,547
Fin. assets design. at fair value	5,801,654	0	0	0	237,414	6,039,068
Intangible assets	36,617	0	0	0	0	36,617
Operating assets	67,421	0	0	0	0	67,421
Tax asset	183,451	0	0	0	0	183,451
Other assets	3,713,418	0	0	0	0	3,713,418
Total assets	34,943,292	1,116,629	227,075	859,636	1,301,432	38,448,063
Liabilities						
Trading liabilities	213,406	8,652	1,014	3,123	6,492	232,688
Borrowings	23,297,521	0	0	0	0	23,297,521
Other liabilities	4,980,602	114,659	3,466	0	69,524	5,168,251
Equity	9,749,603	0	0	0	0	9,749,603
	38,241,132	123,311	4,480	3,123	76,016	38,448,063
Net balance in the balance sheet	(3,297,840)	993,318	222,594	856,513	1,225,416	0
Net balance off balance sheet	3,417,448	(1,107,177)	(235,608)	(843,739)	(1,230,924)	0
Net balance of currency	119,608	(113,859)	(13,014)	12,774	(5,508)	0

Operating risk

73. Operating risk is the risk arising due direct or undirect loss due to various reasons related to the Bank's development, work procedures, personnel issues, technology or bank infrastructure. External reasons, other than credit, market or liquidity risk, can be due to legal claims or generally accepted company work procedures.

Operating risk arises due to the Bank's entire operation and relates to all of its units. The Bank aims at finding a balance between limiting risk and loss and optimising gains without restricting employees' initiative.

The Bank's key management develops and implements the policies for each unit. Management relies upon the Bank's general benchmarks developed for risk management for each of the following items:

- Requirements on appropriate work division

- Reports on policies and work procedures

- Development of a contingency plan

- Training of employees

- Distribution of risk and risk control

- Protocol and operating procedures

Fair value of Financial instruments

74. The fair value of a financial instrument is the amount that can be received for the instrument on an arm's length basis of willing parties, i.e. not through forced sale or liquidation. The existence of a known value in an active market is the best indicator of fair value and when it is available the Bank uses it in the assessment of monetary assets and liabilities. If a registered price for a financial instrument does not reflect real

and regular transactions in an active market or if the price is not available, fair value is calculated with the relevant valuation method.

As for listed and saleable shares and bonds and certain derivative agreements the fair value is obtained by using the market value. Those instruments are stated in the balance sheet under the item current assets and liabilities or as financial assets designated at fair value.

Financial instruments that do not have a listed market value are measured by generally accepted valuation methods where market information is used. Among generally accepted valuation methods are transactions between willing and unrelated parties in arm's length transactions, information on the fair value of a comparable instrument, cash flow analysis and other generally accepted valuation methods used by market parties.

Amounts are in ISK thousand

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