Financial Statements 2006

Landsnet hf.
Krókhálsi 5c
110 Reykjavík

Reg.no. 580804-2410

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Endorsement by the Board of Directors and the Managing Director

Landsnet hf. was established in August 2004 on the basis of the Electricity Act passed by Congress in the spring 2003. The objective of Landsnets hf. is to administer the transmission of electricity and system management according to the provisions found in chapter III of the Electricity Act no. 65/2003. The company began it's operations in the year 2005. In year end 2005 the company purchased the transmission stations of Landsvirkjun, Rafmagnsveitur Rikisins and Orkubu Vestfjarda.

A loss was incurred from operations that amounted to 173,5 million ISK according to the income statement. Equity amounted 5.449,6 million ISK including share capital which amounted 5.502,7 million ISK according to the balance sheet. Regarding other changes in equity is referred to the Statement of Changes in Equity.

Share capital is owned by three parties in the year end. They are:

	Share
Landsvirkjun	69.44%
Rafmagnsveitur ríkisins ohf	24.15%
Orkubú Vestfjarða hf	6.41%

The company has begun it's preparation towards the implementation of International Financial Reporting Standards in accordance to regulations of the publication of financial statements of companys which have their securities registered in stock exchanges in the European Economic Area. It is not clear how much impact those standards will have on the book value of equity of the company.

The president and board of directors of Landsnet hf. hereby confirm the financial statements for the year 2006 with their signatures.

Reykjavík, February 22nd 2007

Board of directors:

Páll Harðarsson (sign)

Auður Finnbogadóttir (sign)

Kristján Jónsson (sign)

Managing Director:
Þórður G. Guðmundsson (sign)

Independent Auditor's Report

To the board of directors of Landsnet hf.

Report on the Financial Statements

We have audited the accompanying financial statements of Landsnet hf., which comprise the balance sheet as at December 31, 2006, and the income statement, statement of changes in 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 the Financial Statement Act. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, 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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from 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 judgment, 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 policies 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 (or "present fairly, in all material respects,") the financial position of Landsnet hf. as of December 31, 2006, and of its financial performance and its cash flows for the year then ended in accordance with the Financial Statement Act.

Reykjavík, February 22nd 2007

KPMG hf.
Matthías Þór Óskarsson (sign)

Income Statement 2006

	Note	2006	2005
Operating revenue:			
Transmission	3	5,577,720	5,081,806
Other income		150,695	63,591
Profit from sale of assets		683,795	0
		6,412,211	5,145,397
Operating expenses:			
Energy production costs		910,030	932,188
Transmission costs		652,951	652,686
System management		491,875	419,427
Other operating expenses		590,009	431,188
		2,644,866	2,435,489
Capital lease	2	249,702	2,490,252
Depreciation	2.6	1,192,385	8,329
		4,086,953	4,934,070
Operating profit		2,325,258	211,327
Net financial expenses	5	(2,538,665)	(90,959)
Operating profit (loss) before tax		(213,407)	120,368
Income tax		39,927	0
(Loss) profit		(173,480)	120,368

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Balance Sheet

Assets

	Note	31.12.2006	31.12.2005
Fixed assets			
Property, plant and equipment			
Substations		11,076,019	9,541,303
Power lines		17,010,813	13,962,329
Other assets		1,886,733	1,770,526
	2.6	29,973,565	25,274,157
Other fixed assets			
Developement cost		219,923	117,348
Projects under construction		9,833,104	7,855,965
	6	10,053,026	7,973,314
Shares and long-term receivables			
Shares in other companies	7	32,000	31,500
Deferred tax asset	8	39,927	0
		71,927	31,500
Fixed assets		40,098,518	33,278,971
Current assets			
Inventories	9	328,216	245,413
Accounts receivable		562,613	327,373
Other receivables		185,888	435,899
Cash and bank deposits		307,813	149,615
Current assets		1,384,530	1,158,300
Total assets		41,483,048	34,437,271

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December 31, 2006

Liabilities and Owners' Equity

	Note	31.12.2006	31.12.2005
Owners' Equity			
Share capital		5,502,733	5,502,733
Legal reserve		0	12,037
Retained earnings		(53,112)	108,331
Owners' Equity		5,449,621	5,623,101
Long-term liabilities			
Loans from related companies	11	34,210,115	26,422,524
Short-term liabilities			
Accounts payable	12	888,522	1,411,643
Loans from related companies		934,791	980,003
		1,823,313	2,391,646
Liabilities		36,033,428	28,814,170
Total liabilities and Owners' Equity		41,483,048	34,437,271

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Statement of Changes in Equity for the year 2006

2005

	Share capital	Legal reserve	Retained earnings	Total equity
Equity 1.1.2005	10,000	0	0	10,000
Paid in capital	5,492,733			5,492,733
Profit for the year			120,368	120,368
Contribution to legal reserve		12,037	(12,037)	0
Equity 31.12.2005	5,502,733	12,037	108,331	5,623,101

2006

	Share capital	Legal reserve	Retained earnings	Total equity
Equity 1.1.2006	5,502,733	12,037	108,331	5,623,101
Loss for the year			(173,480)	(173,480)
Legal reserve set off against loss		(12,037)	12,037	0
Equity 31.12.2006	5,502,733	0	(53,112)	5,449,621

Amounts are in thousands of ISK

Statement of Cash Flows 2006

	Note	2006	2005
Operating activities			
Cash received from customers		5,452,477	4,801,927
Cash expenses		(2,856,087)	(4,746,628)
From operations excluding interest		2,596,390	55,299
Interest income received		28,072	5,402
Interest expenses paid and exchange rate loss		(217,789)	(820)
	15	2,406,674	59,881
Investment activities			
Investments in substations		(6,909,159)	(31,360,151)
Fixed assets sold		1,275,015	0
Other investments		(976,074)	(1,927,149)
Change in unpaid construction costs in the year end		(270,464)	577,315
	6	(6,880,683)	(32,709,985)
Financing activities			
Paid in capital		0	5,492,733
New long term debt		0	26,326,983
Change in loans from related companies	13	4,632,208	980,003
		4,632,208	32,799,719
Increase in cash during the year		158,198	149,615
Cash at beginning of year		149,615	0
Cash at end of year		307,813	149,615

Investment activities without payment:

		2006	2005
Capitalized accrued unpaid cost of capital		(761,223)	

Amounts are in thousand of ISK

Notes

1. General information

Landsnet hf. is domiciled at Krókháls 5c, Reykjavík. The company was established in 2004 on the basis of the Electricity Act passed by Congress in the spring 2003. The objective of the company is the transmission of electricity and system management according to provisions found in chapter III in the Electricity Act no. 65/2003 and is therefore unauthorized to engange in other activities but what is necessary to be able to take care of its duties according to the Electricity Act.

2. Basis of accounting

Significant accounting policies used in the preparation of these financial statements are identified below. The accounting policies have been applied consistently to all periods presented in these financial statements, unless other is specified.

The company is a subsidiary of Landsvirkjun and its financial statements are a part of Landsvirkjun's consolidated financial statements. The financial statments were approved by the board of directors on February 22, 2007.

a. Basis of preparation

The Financial Statements are prepared in compliance with the provisions of the Financial Reporting Act and the related regulation regarding the presentation and substance of financial statements and consolidated financial statements. The financial statements are prepared in Icelandic krona (ISK) and the figures are presented in thousands of ISK. The financial statements are prepared based on the historical cost convention of accounting and are consisted with previous years' statements.

b. Currencies

(i) Functional and presentation currency

The financial statements are presented in Icelandic krona (ISK) which is the company's functional currency.

(ii) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of the company 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. Foreign currency differences arising from retranslation are recognised in profit or loss. Material assets and liabilities measured at cost and arre denominated in foreign currencies are retranslated into ISK on the reporting date.

(iii) Indexation

Indexed debt is measured with price-increase compensation according to index number on January 1, 2007. Accrued price-increase compensation are recognised in profit or loss, but capitalized for projects under construction compared to note (f) here below.

c. Revenue recognition

Revenues from transmission of electricity are recognised in profit or loss based on recorded measurement during the year. Other revenue is recognised as earned or delivered.

d. *Financial income and expense*

Financial income and expense consist of interest expense of loans, price-increase compensation, interest income, exchange-rate losses and gains.

Interest income are recognised in profit or loss when incurred.

e. *Income tax*

Landsnet hf. has been exempted from income taxation, but as of January 1, 2006, the company became taxable with respect to their operations based on the provisions of Act no. 50/2005. Income tax for the year is the result of deferred income tax. Income tax is recognised in profit or loss unless it is because of items which are recognised directly through equity but in these cases income tax is included in those items.

Deferred tax asset is only recognised to the extent that it is likely to be used.

f. *Fixed assets*

(i) Fixed assets in operation

Fixed assets in operation are recognised at cost net of depreciation, as seen in note 6.

Cost of renewing parts of fixed assets is recognised at book value if it is likely that future benefits of those parts will be used by the company and the cost is measurable. Cost of operation of fixed assets is recognised in profit or loss.

(ii) Other fixed assets

Projects under construction are capitalized at cost of purchased services, materials, direct wages and other direct costs. Assets that have not been put in use already are not depreciated. Cost of capital of financing projects under construction is capitalized when the projects are under construction and is considered a part of the cost of the asset. Capitalized cost of capital is the company's weighted average cost of capital. Projects under construction are mainly because of a substation and powerlines 3 and 4 in Fljotsdalur.

Cost of general research is recognised in profit or loss on the year it is incurred. Developement cost is capitalized among other fixed assets, but cost of capital attributable to developement cost is not capitalized. When evaluating the capitalization of the cost the accounting policies set out are obeyed. The cost is not depreciated in this state but any impairment losses have been considered, as seen in note 6.

(iii) Depreciation

Depreciation is charged as an annual fixed percentage based on the estimated useful life with salvage value estimated as one year's depreciation. The depreciation rates are as follows:

	Estimated useful life
Substations	20 - 40 years
Power lines	50 years
Other assets	4 - 50 years

g. *Subsiduaries*

Subsiduaries are capitalized at cost

h. *Deferred tax asset*

A deferred tax asset is now recorded in the financial statements. The calculation of the deferred tax asset is based on the difference between the balance sheet amounts as per the financial statements and the relevant tax-based amounts. The difference is explained by the fact that tax accounting rules are not consistent with financial reporting methods, thus creating timing differences. Additionally, deferred tax asset can be explained by carry-forward of losses.

i. *Inventories*

Inventories are measured at cost net of a reduction for older inventories. Cost includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition.

j. *Receivables*

Accounts receivable and other receivables are measured at cost.

k. *Cash and bank deposits*

Cash balances and call deposits comprise cash and bank deposits.

l. *Provisions*

A provision is recognised if, as a result of a past event, the company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

m. *Payables*

Account payables and other payables are measured at cost.

n. *Capital lease*

Capital lease is recognised in the financial statements and comprises of cost of capital and depreciation because of the usage of transmission stations of other power companies. The capital lease cost is recognised through profit or loss.

Operating revenue

3. Transmission revenue consists of:

	2006	2005
Energy transmission	3,700,339	3,238,737
Transmission losses and system services	935,525	1,041,001
Input fees	941,856	802,068
	5,577,720	5,081,806

Personel expenses

4. Salaries and salary-related expenses are specified as follows:

	2006	2005
Salaries	607,648	492,648
Salary-related expenses	119,572	99,341
	727,220	591,989
Average number of employees measured as full time equivalent positions	84	80

The salaries of the board of directors, president and two managing directors in the year 2006 were as follows:

Salaries of the board of directors	2,840
Salaries and benefits of president	16,421
Salaries of two managing directors	25,757

Net financial expense

5. Net financial expense is specified as follows:

	2006	2005
Interest income	28,072	6,002
Tax on capital income	0	(600)
Total financial income	28,072	5,402
Interest expense	(1,534,428)	(119,171)
Price-increase compensation	(1,836,519)	(95,542)
Foreign currency exchange losses	(31,194)	(701)
Total financial expense	(3,402,141)	(215,414)
Capitalized interest expense related to projects under construction	(835,404)	(119,053)
Net financial expense	(2,538,665)	(90,959)

Capitalized cost of capital was 10,9% of the carrying amount of substations.

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Fixed assets

6. Property, plant and equipment

Property, plant and equipment

	Substations	Power lines	Other assets	Total
Balance 1.1.2006	9,541,564	13,962,620	1,778,300	25,282,484
Increase during the year	2,016,817	3,676,428	832,766	6,526,011
Sold/transferred during the year	(52,132)	0	(628,262)	(680,394)
Balance 31.12.2006	11,506,249	17,639,048	1,982,804	31,128,101
Balance 1.1.2006	262	291	7,775	8,328
Depreciation for the year	429,968	627,944	93,739	1,151,651
Sold during the year	0	0	(5,443)	(5,443)
Balance 31.12.2006	430,230	628,235	96,071	1,154,536
Carrying amount 31.12.2006	11,076,019	17,010,813	1,886,733	29,973,565

Other fixed assets:

	Develope-ment cost	Projects under construction	Total
Balance 1.1.2006	117,348	7,855,965	7,973,313
Increase during the year	143,309	7,662,151	7,805,460
Impairment for the year	(40,734)	0	(40,734)
Total	219,923	15,518,116	15,738,039
Assets transferred to operations during the year	0	(5,685,013)	(5,685,013)
Book value 31.12.2006	219,923	9,833,103	10,053,026

Rateable value and insurance value

Rateable value of the properties of the company that are valued with rateable value is about 2,1 billion ISK. Assessed value for fire insurance for the same properties is about 2,7 billion ISK. Insurance value of the properties of the company is about 20,3 billion ISK, other than power lines and strings that are insured with emergency insurances like other properties. The company has a emergency insurance at the value of 53,5 billion ISK. The book value of insured property is 13 billion ISK.

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Shares in other companies

7. Shares in affiliates is recognised at cost. The equity method is not used for the affiliates have negligible effect on the company.

	Share	Nominal value	Book value
Netorka hf., Hafnarfjordur	35.0%	8,400	31,500
Landsnet ehf.	100.0%	500	500
			32,000

Deferred tax asset

8. Calculated deferred tax asset is 39,9 billion ISK in the year end 2006 according to the balance sheet. Changes in the deferred tax asset is specified as follows:

Tax asset in the beginning of year 2006	0
Calculated income tax	39,927
Tax asset in the year end 2006	39,927

The deferred tax asset is attributable to the following items:

Carry-forward losses	170,979
Fixed assets in operation	(129,000)
Other items	(2,052)
Tax asset in the year end 2006	39,927

Inventories

9. Inventory is measured at cost net of reduction.

Equity

Share capital

10. According to the company's articles of association, the total share capital of the company is 5.503 million ISK. One vote is accompanied to one krona share in the company. An overview iof changes in equity is found on a special statement of changes in equity on page 8.

Amounts are in thousand of ISK

Notes, continued

Long-term liabilities

11. Long-term liabilities are specified as follows:

	2006	2005
Bond loan from parent company in ISK, interest rate 4,21%	28,259,043	26,422,524
Loan from related companies in ISK, interest rate REIBOR + interest margin	5,951,072	0
	34,210,115	26,422,524

The bond is an indexed bullet bond with maturity in the year 2020 and an interest payment once a year. The company has made a contract with it's parent company to one year with the possibility of an prolongation. It is now known that the loan will be prolonged and therefore the loan is classified among long-term liabilities.

Short-term liabilities

12. Short term liabilities and other liabilities are specified as follows:

	2006	2005
Accounts payable	751,795	1,326,746
Other short-term liabilities	136,727	84,897
	888,522	1,411,643

Taxes

13. A carry-forward loss according to the tax act is amounted to 171 million ISK in the year 2006. A carry-forward loss that is not used in ten years from its developement is cancelled. The company's carry forward loss it usable till the year end 2016.

Cash-flows

14. Cash flow from operating activities is specified as follows according to the indirect method:

	2006	2005
(Loss) profit	(173,480)	120,368
Depreciation and other calculated items	2,817,610	103,870
Working capital from operations	2,644,130	224,238
Change in current assets	(358,741)	(578,883)
Change in current liabilities	121,285	414,527
Cash flow from operating activities	2,406,674	59,882

Financial ratios

15.

	2006	2005
Current Ratio - Current assets / Current liabilities	0.76	0.48
Equity ratio - Equity / Total assets	13.14%	16.33%

Amounts are in thousand of ISK