Flaga Group hf. – Annual Results for 2007

Highlights of the Consolidated Financial Statements of Flaga Group hf

Q4 2007:

- **Revenue was $9.19m a reduction of $460k or 5% from prior year.**
- **EBITDA was negative $334k compared to positive $828k in the prior year.**
- **Net income was a loss of $11.545k**

Year 2007:

- **Revenue was $33.16m, an increase of $687k or 2% from prior year**
- **EBITDA was $127k compared to $1,001k in the prior year**
- **Net income was negative $12,631k**

The Flaga Group hf. Annual Consolidated Financial Statements for 2007 were approved at a meeting of the Board of Directors on March 31st 2008. The statements, prepared in compliance with the International Financial Reporting Standards (IFRS), have been audited and endorsed by the Company's auditors.

Key figures from the consolidated accounts:

STATEMENT OF OPERATIONS USD '000	Q4 2007	Q4 2006	Jan 1,- Dec 31, 2007	Jan 1,- Dec 31, 2006
Sales	9,199	9,659	33,161	32,474
Cost of goods sold	4,638	4,149	14,056	13,168
Gross profit	**4,561**	**5,510**	**19,105**	**19,306**
Operating Expenses				
Sales, general and admin expenses	4,442	4,467	17,728	17,062
Research and development	736	564	2,652	2,363
Restructuring cost	0	0	-96	267
Total operating expenses	**5,178**	**5,031**	**20,284**	**19,692**
Operating profit (loss)	**-617**	**479**	**-1,179**	**-386**
Net financial expenses	-11,103	-158	-11,428	-890
Operating profit (loss) before taxes	**-11,720**	**321**	**-12,607**	**-1,276**
Taxes	175	341	-24	586
Profit (loss)	**-11,545**	**662**	**-12,631**	**-690**
EBITDA	**-334**	**828**	**127**	**1,001**

BALANCE SHEET

USD '000	**Dec 31, 2007**	**Dec 31, 2006**	**% Change**
Fixed assets	33,591	44,975	-25.3%
Current assets	14,348	17,149	-16.3%
Total assets	**47,939**	**62,124**	**-22.8%**
Equity	27,425	40,213	-31.8%
Long-term debt	3,312	4,287	-22.7%
Current liabilities	17,202	17,624	-2.4%
Equity and total liabilities	**47,939**	**62,124**	**-22.8%**

KEY RATIOS

	2007	**2006**	**2005**	**2004**	**2003**
Current ratio	0.83	0.97	1.18	1.59	2.75
Equity ratio	57%	65%	66%	66%	68%

QUARTERLY STATEMENTS

USD '000	**Q4 2007**	**Q3 2007**	**Q2 2007**	**Q1 2007**	**Q4 2006**
Sales	9,199	7,903	8,855	7,204	9,659
Cost of goods sold	4,638	3,162	3,445	2,811	4,149
Gross profit	**4,561**	**4,741**	**5,410**	**4,393**	**5,510**
Operating expenses					
Sales, general and admin exp.	4,442	4,082	4,873	4,331	4,467
Research and development	736	622	719	576	564
Restructuring cost	0	0	-96	0	0
Total operating expenses	**5,178**	**4,704**	**5,496**	**4,907**	**5,031**
Operating profit (loss)	**-617**	**37**	**-86**	**-514**	**479**
Net financial income (expenses)	-11,103	-7	-90	-228	-158
Operating profit (loss) bef. taxes	**-11,720**	**30**	**-176**	**-742**	**321**
Taxes	175	-84	-252	137	341
Profit (loss)	**-11,545**	**-54**	**-428**	**-605**	**662**
EBITDA	**-334**	**360**	**303**	**-202**	**828**

Summary of Activity

The Company made strides in 2007 despite its shortcomings in sales and the necessity to write off part of its goodwill. The Company continues to move forward and has at the end of the year a strategic and stronger position to grow profitably in the future.

Embla Systems

In November of 2007 the Company announced a major exclusive distribution contract with the Beth Israel Deaconess Medical Center (BIDMC). The distribution contract relates to a new sleep algorithm developed by the BIDMC for measuring Sleep Quality, as opposed to the conventional sleep event history. The technology called Cardio Pulmonary Coupling or CPC, is unique and creates, for the first time in the industry, an automatic tool for physicians to evaluate sleep quality and phenotype different forms of Sleep disorder. The algorithm will initially be developed in the existing Embla sleep analysis systems but will subsequently be developed into low cost screening and diagnostic tools that could be extended to over-the-counter type applications. The potential market for the device is as a diagnostic tool for individuals who suffer from a sleep disorder (estimated at over 60m in the United States alone) and to patients who currently have a CPAP (Sleep Apnea therapy device) machine (estimated at 13m in the United States alone) but who are either sporadically tracked, or not tracked at all for a true measure of Sleep Quality and therefore compliance. The device offers the Company an opportunity to redefine the way the industry measures Sleep Quality and the Company believes this exclusive contract will offer significant new opportunities.

Also in November 2007 the Company concluded a non-exclusive distribution agreement with Fisher & Paykel to distribute the Company's home study Embletta device in the United States. This followed a draft decision by the Centers for Medicare and Medicaid (CMS) that has been subsequently confirmed, to approve home testing as an acceptable diagnosis for Sleep Apnea. The Company is a leading provider of home testing equipment in Europe and this decision will open the door for our product in the US. The final details of the reimbursement for the home testing have to still to be determined but this will be a significant opportunity for the Company.

The Company started negotiations for the sale of the ResMed distribution in Iceland in Q4 that has now been concluded. It was decided that after the Company closed the head office in Iceland and significantly reduced its presence there that the Companies ability to distribute the ResMed products in Iceland would not be as effective as a local presence. As a result the Company initiated a search and concluded the sale to Vistor, a fully integrated marketing and distribution company for health care products and pharmaceuticals in Iceland.

SleepTech

After initiating the strategic change in direction at the beginning of the year SleepTech has been successfully developing its strategy of growth with a number of new facilities. In the Tri-State area SleepTech continues to expand its operation with expanding existing programs and several proposals in place for new partnerships. Outside the Tri-State area Sleeptech has opened a new Physician partnership in California, completed a partnership for a new facility in Mississippi and it is in the closing phase of a new SleepTech owned operation in another state. These together with several other initiatives have broadened SleepTech's presence in North America and the Company will continue to expand taking advantage of the continued growth in sleep medicine.

The Company believes that the new reimbursement for home testing will grow the opportunities in the sleep lab as the dramatically underserved sleep disorder patient population will gain more access to sleep diagnosis through their primary care physicians and home care companies and the number of patient referrals that will not be satisfactorily served by the home testing will be directed to the sleep labs. As a result, SleepTech is embracing the home study model in all our facilities as an adjunct to our services.

Operations in 2007

Consolidated revenues for the year 2007 were lower than expected which resulted in a higher than expected consolidated net loss. As a result the Board of Directors of Flaga Group announced the impairment of goodwill which had a significant negative impact on the fourth quarter results and the annual accounts for the year 2007. An impairment of approximately USD 10.8 million was made on goodwill associated with the Company's acquisition of Medcare Systems U.S. in 2002 (now known as Embla Systems). The impairment is not related to the goodwill associated with the acquisition of Sleeptech in 2004.

In addition to this impairment test a number of other assets have been re-evaluated which have led to an additional set of adjustments associated with its Bad debt reserve, loaner equipment depreciation and inventory. These adjustments have impacted both the Revenue and Asset value of the Company in 2007.

Balance Sheet

Total assets at the end of Q4 2007 were $47.9m, a decrease of $14.2m from the end of the year 2006.

Shareholders' equity was $27.4m at December 31, in comparison to $40.2m at the beginning of the year. Equity ratio was 57% in comparison to 65% at year¬end 2006.

Cash Flow

Working capital provided by operating activities in the year was negative $1.2m compared to working capital of $1.4m the previous year.

Future Prospects

The market for sleep diagnostic products remains highly competitive. The Company expects to continue improving its competitive position in the US market, with the regulatory changes regarding reimbursement for home studies and the introduction of the CPC technology in 2008. The Company also expects to continue building relationships with distributors around the world for Embla to increase the Company’s sales and reputation as the “gold standard” of sleep diagnostic systems.

The Company expects to further build a presence for SleepTech outside of the United States Tri¬State area with a successful integration of its disciplined standards, as well as moving out of the “hospital only” relationships to build business relationships with physicians directly for their own practices or have SleepTech owned facilities.

The near future will continue to fluctuate, although it is the firm belief of the Management team of Flaga Group that the future prospect for the Company remains solid.

Reporting Schedule

Estimated dates of publication of financial statements in 2008:

Annual General Meeting 2007	April 17 2008
First Quarter	May 8, 2008
Second Quarter	August 21 2008
Third Quarter	November 13 2008
Fourth Quarter	February 19 2009

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