



# Annual Report 2006



**Landsvirkjun**  
National Power





### Landsvirkjun's power stations

#### Hydropower stations **1,107 MW**

Búrfell	270 MW
Hrauneyjafoss	210 MW
Blanda	150 MW
Sigalda	150 MW
Sultartangi	120 MW
Vatnsfell	90 MW
Írafoss	48 MW
Laxá	28 MW
Steingrímsstöð	26 MW
Ljósifoss	15 MW

#### Geothermal stations **63 MW**

Krafla	60 MW
Bjarnarflag	3 MW

#### Fossil fuel stations **42 MW**

Straumsvík	35 MW
Akureyri	7 MW

#### Total installed capacity **1,212 MW**

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#### Landsvirkjun's mission:

To provide our customers with the best energy solutions to create the basis for a modern quality of life.

### Highlights of the annual accounts (ISK)

	2006	2005
Net profit	3,503 million	6,294 million
Cash gen. by operating activities	9,643 million	5,927 million
Liabilities	180.4 billion	122.3 billion
Owners' equity	61 billion	58,0 billion
Equity ratio	25.3%	31.9%

### Electricity production, purchases and sales (GWh)

	2006	2005
Total production	7,428 GWh	7,143 GWh
With hydropower	6,918 GWh	6,676 GWh
With geothermal power	510 GWh	467 GWh
Electricity purchases	463 GWh	504 GWh
Sales to general market	2,498 GWh	2,454 GWh
Sales to power-intensive industries	5,393 GWh	5,193 GWh
Sales increase	3.2%	1.4%



## Overview

At the beginning of the year, Alcan in Iceland and Landsvirkjun signed a Memorandum of Understanding initiating exclusive negotiations on an electricity sales contract for an extension to the aluminium smelter in Straumsvík, with the aim of completing the discussions before the turn of the year. At the end of last year, the negotiating committee had drafted an agreement on the main points of such a sales contract.

At the end of January, Landsvirkjun's Board of Directors agreed to postpone preparations for Nordlingaalda Diversion, south highlands.

At the beginning of February, Landsvirkjun and Theistareykir ehf hired Jarðboranir hf to drill three exploratory geothermal wells in North Iceland.

In February, at the start-up at the new Nordurál Aluminium extension, from 90,000 tonnes to 220,000 tonnes per year, Landsvirkjun entered into an agreement to supply electricity for the expansion until new plants owned by other power companies became operational in the fall.

The Intercultural Centre and Landsvirkjun entered into an agreement to stimulate discussion and to increase the number of public events relating to multiculturalism and other matters of special relevance for immigrants to Iceland.

The President of Iceland, Ólafur Ragnar Grímsson, laid the cornerstone of Fljótsdalur Hydro Station, the powerhouse of the Kárahnjúkar Power Project, on 12 May. The President was assisted by six youths who had won a competition held in elementary schools earlier in the year and focused on energy projects.

On 28 September impoundment of Háslón reservoir began. The reservoir is expected to fill up completely in late summer, 2007.

At the beginning of November, the municipalities of Reykjavík and Akureyri sold their part in Landsvirkjun to the Icelandic state. This sale took effect on 1 January, 2007.

At the same time a revised Act on Landsvirkjun took effect. This Act provides for the proprietorship of the company to be transferred from the Minister of Industry and Commerce to the Minister of Finance.

On 5 December the last TBM in the headrace tunnel at Kárahnjúkar broke through. This event marked the completion of the tunnel, which extends some 40 km from Háslón Reservoir to Fljótsdalur Station. During the coming months, completion work will ready the tunnel for being flooded by reservoir water.

In December the Landsvirkjun Board of Directors agreed to authorise the company CEO to initiate an invitation to tender for designing the power plants in the lower Thjórsá river. According to an agreement between Alcan and Landsvirkjun, Alcan will pay 2/3 of the cost of these preparations. In the event of extending its Straumsvík smelter, Alcan will be reimbursed for the full cost. Otherwise, Alcan will have limited reimbursement rights, should the electricity from these power plants be sold to others within a specified time limit.

### Full-time positions in 2006

In 2006, 208 man-years were performed by Landsvirkjun's permanent staff; this represented no change from the year before. The man-years performed by temporary staff amounted to approximately 41, which equals a reduction of 28 man-years compared to 2005.

A total of 181 youths were in Landsvirkjun's employment during the summer of 2006, thereof 148 teenagers in conventional summer tasks and 33 university students in various other types of work. This summer employment represented approximately 13% of the total staff man-hours.





# Board of Directors

A new Board of Directors took office at the 2006 Annual General Meeting.

Appointed by the Minister of Industry and Commerce

Mr. Jóhannes Geir Sigurgeirsson, *Chairman*

Mr. Illugi Gunnarsson, *Vice-Chairman*

Mr. Ágúst Einarsson

Elected by the City Council of Reykjavík

Ms. Álfheidur Ingadóttir

Ms. Steinunn Valdís Óskarsdóttir

Mr. Vilhjálmur Th. Vilhjálmsón

Elected by the Town Council of Akureyri

Mr. Kristján Thór Júlíusson

On 1 January 2007, the Minister of Finance appointed a new Board as the State gained full proprietorship of Landsvirkjun. The Board members are:

Mr. Jóhannes Geir Sigurgeirsson, *Chairman*

Mr. Valur Valsson, *Vice-Chairman*

Mr. Ágúst Einarsson

Ms. Margrét Sanders

Ms. Jóna Jónsdóttir

## Executive Committee

Managing Director | Mr. Fridrik Sophusson

Deputy Managing Director | Mr. Örn Marinósson

Heads of Divisions:

Finance | Mr. Stefán Pétursson

Energy | Mr. Bjarni Bjarnason

Human Resources | Ms. Sigthrudur Gudmundsdóttir

Information Technology | Mr. Bergur Jónsson

Engineering and Construction | Mr. Agnar Olsen

Corporate Communication | Mr. Thorsteinn Hilmarsón

Marketing for power-intensive industry | Mr. Edvard G. Gudnason



## From the Chairman of the Board and Managing Director

### Changes in Landsvirkjun ownership

As was indicated here last year, a variety of tentative discussions have taken place during the past few years about changes in the ownership of Landsvirkjun, the possible merger of the company with state-owned energy enterprises, and altered forms of operation. Last autumn one conclusion was reached in this process, as the owners of the company reached an agreement regarding the purchase by the State of the 50% share that Reykjavik and Akureyri municipalities had owned in Landsvirkjun. This purchase was subsequently confirmed by Parliament, and a new Act was passed on Landsvirkjun, defining it as a public partnership fully owned by the Icelandic State. When this change formally took place on 1 January 2007, a new five-member board of directors was appointed to act from the same date until the next annual general meeting, held in April. Among the modifications introduced by the new Act of Parliament is that from now on the Minister of Finance is in charge of the state proprietorship of Landsvirkjun, whereas previously the state share was the responsibility of the Minister of Industry and Commerce.

### Finances

Landsvirkjun's 2006 profits were slightly lower than in the previous year, amounting to ISK 3.5 billion compared to ISK 6.3 billion in the year before. The company's cash from operations was ISK 9.6 billion. Between years, Landsvirkjun assets increased by over ISK 60 billion, rising from ISK 182 billion to over ISK 243 billion. At year-end 2006, Landsvirkjun's equity was approximately ISK 61.1 billion, representing an equity ratio of 25.1%.

The consolidated operating revenues of Landsvirkjun increased significantly, by around 37%, so as to total ISK 21.3 billion in 2006. Rising energy prices to power-intensive industry due to high world aluminium prices provided the chief cause of increased income, combined with exchange rate developments in foreign currencies. Consolidated operating expenses rose by ISK 700 million between years, reaching a 2006 total of ISK 11.5 billion.

### Increased energy sales to power-intensive industry, planned power development

The past few years have been charac-

terised by a boom in the power sector. This is mainly the result of interest on the part of foreign industrial companies in investing in power-intensive industry in Iceland. As is generally known, large-scale construction is underway in East Iceland, where Landsvirkjun is engaged in building the Kárahnjúkar Power Project in order to generate electricity for the Alcoa Fjarðaál aluminium smelter in Reydarfjörður. Operations are expected to come into full production by the end of 2007, and the completion of the Kárahnjúkar Project is envisaged for 2008.

While these developments have continued as planned, other companies have also displayed considerable interest in buying electricity from Landsvirkjun. At the beginning of the year, it was clear that Alcan and Century Aluminium's Nordurál were looking to increase their electricity purchases for aluminium plants in the vicinity of Reykjavík. During discussions with these companies, Landsvirkjun requested a framework for the energy prices over which they were prepared to negotiate. It was decided on this basis to begin negotiations with Alcan regarding its proposed expansion of



the Straumsvík aluminium smelter. After continuing most of the year, discussions were concluded through an agreement in the negotiating committees on all the major points in an electricity sales contract. If these plans are realised, Landsvirkjun intends to build three power plants on the lower stretches of Thjórsá river, involving a capacity of 255 MW. As 2007 began, these proposals awaited final decision.

In addition to the above proposals regarding power plants and increased electricity sales to power-intensive industry south of the highlands, a declaration of intent was signed by Alcoa and Landsvirkjun concerning joint preparations towards an aluminium plant at Bakki near Húsavík and geothermal plants in North Iceland. According to a joint declaration of intent from early in 2006, intensive studies have been proceeding of high-temperature areas in that area and of the economic feasibility of build-

ing power plants there, accompanied by an aluminium plant near Húsavík. It is anticipated that the results of preliminary research and contracts on electricity sales should be ready by the end of 2008, if everything goes according to plan.

#### **Kárahnjúkar Hydropower Project**

Work on building the Kárahnjúkar Hydropower Project came to a high during 2006 and much of the construction was finished by the end of the year. Even though this project is larger and the complications greater than ever known before in Icelandic power development, we can here state with pleasure that the undertaking as a whole is in line with the original budget. Various delays in dam and tunnel building during the construction period are not altering plans for the power plant to achieve full capacity by year-end 2007, the time that was originally anticipated.

#### **Operating practices**

At the beginning of the year, Landsvirkjun was accredited according to the ISO 9001:2000 quality standard, which previously had been granted for the company's electricity production. By the end of the year, the ISO 14001 environmental management standard had been fully introduced with regard to the company's Energy Division. Therefore, Landsvirkjun's electricity production received certification according to the latter standard in January 2007. Preparations are now underway for all of Landsvirkjun's operations to earn this certification in 2007.

As may be gathered from the following report sections on social responsibility and environmental affairs, Landsvirkjun places strong emphasis on operating procedures that will keep it at the forefront among companies with exemplary operations, guided by modern management practices and a long-term view.



# Social responsibility

Landsvirkjun strives to harmonise its projects and operations with community and create trustworthy, long-term relationships with individuals and other businesses. Landsvirkjun takes note of the fact that among Iceland's largest companies, the company is unique in that its operations are centred in rural areas.

## Education and learning

It is extremely important to teach young people how electricity in Iceland is produced through using renewable and emission-free energy resources. Over the years many schools have taken the opportunity of visiting Landsvirkjun power stations with their pupils, in order to receive instruction on energy production. In addition, Landsvirkjun has been involved in the construction of an energy website, where teachers can

obtain information and materials for use in instruction on energy matters.

In the winter of 2005-2006, Landsvirkjun held a competition for the country's primary schools in which students worked on projects connected with energy matters. The winners from each school level assisted the President of Iceland in laying the cornerstone of the Fljótsdalur Powerhouse last spring.

Every year Landsvirkjun offers substantial grants to masters and doctoral students in diverse fields of study. The company also sponsors a professorship in geothermal studies at the University of Akureyri, North Iceland.

## Social responsibility towards employees

Part of Landsvirkjun's social respon-

sibility lies in striving to be a model employer. During recent years the company has received awards for outstanding results in improving the balance between work and private life, and systematically offering instruction and education to employees. Further work has gone into erasing gender-related wage differences within the company; significant results have already been achieved to this end.

## Community projects

Landsvirkjun supports community concerns that benefit areas where the company operates. In this regard the company wishes to cooperate on projects where the interests of Landsvirkjun and its partners correspond and both parties contribute. Landsvirkjun places emphasis on improving tourism and outdoor recreation infrastructure in the vicinity of its power plants and wishes to strengthen tourism there by cooperation in the field of culture, for example by staging exhibitions and other events at the company's centres of operation.

## Collaboration with the tourist industry

Several of the company's power stations, around the country, are open to the public over the summer months. Thousands of visitors come every year to acquaint themselves with energy matters and enjoy a diverse range of cultural and informative presentations. These undertakings have offered substantial



Laying of the cornerstone at Fljótsdalur

support towards building up the tourist industry in the communities closest to the stations.

Furthermore, such undertakings have broadened the assortment of attractions offered to tourists in power plant areas, while collaboration with local residents on maintaining and improving access to places of interest in the environs has led to an increasing volume of tourists in areas surrounding the power plants. Promotion of Icelandic electricity production also fits well into Iceland's clean eco-image, which is the essence of the tourist industry's message to foreign tourists.

Making power stations an interesting place for people to frequent creates a setting to work on projects with local residents. Examples of such pleasant projects are exhibitions for artists and the promotion of projects on which local residents are working.

### Immigrants and Icelandic Society

Landsvirkjun has often sought collaboration on specific projects related to its operations or to discussions about them in society. One example was Landsvirkjun's initiating the presentation of immigrant issues in Iceland last year, following discussions about foreign workers involved in hydropower projects. This was a collaborative project with the Icelandic Intercultural Centre,

in which Landsvirkjun helped support a Festival of Nations where Landsvirkjun for its part portrayed everyday life at Kárahnjúkar. In addition, Landsvirkjun sponsored a theatre group consisting of immigrants in its presentation of the stage production "Best in the World!", which is built on interviews about immigrants to Iceland and their concerns.

### Sustainability in East Iceland

Landsvirkjun has the policy of designing, building and operating Kárahnjúkar Power Plant in an exemplary manner by international comparisons and with minimal impact on the environment. An important factor in attaining this goal is the collaborative effort of Landsvirkjun and Alcoa to analyse and monitor the sustainability of the hydropower project and aluminium plant in East Iceland.

Open, transparent decision-making and consultation with stakeholders are a key element in sustainable development. At the outset of the sustainability project, Landsvirkjun and Alcoa brought together an Advisory Group which has substantially influenced project development. The Advisory Group is comprised of some 35 representatives of social groups, local councils, scientists, professional associations and universities, including representatives of Icelandic as well as international environmental organisations. More information about the "Sustainability Initia-

tive" project is available at the project website, [www.sjalfbaerni.is](http://www.sjalfbaerni.is).

### A competition for artwork associated with Kárahnjúkar Power Plant

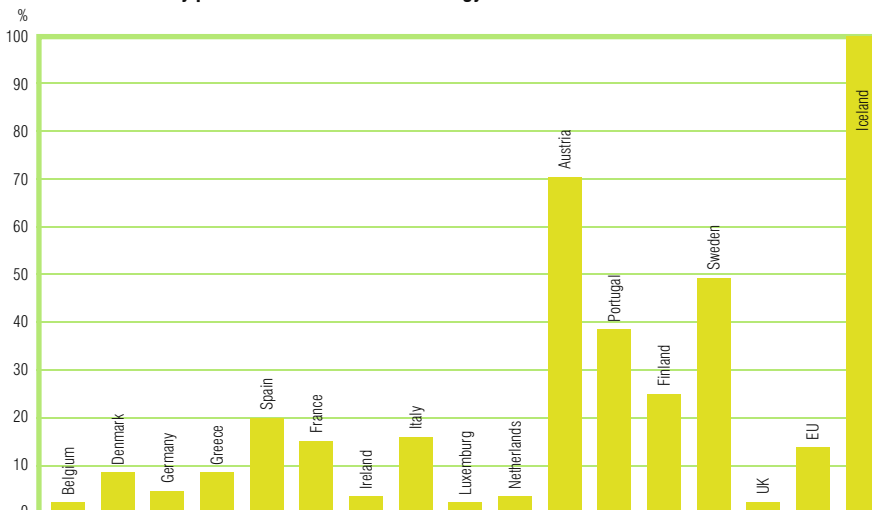
Landsvirkjun has upheld its tradition of decorating power stations with visual art, by holding competitions, open to all artists, on proposals for such works. Last year a competition was held on proposals for art works related to Kárahnjúkar Power Plant, and works by four artists are currently being set up.

### Many hands make light work

During the past decades, Landsvirkjun has employed a large number of youths in work over the summer months. They take on important maintenance and environmental projects in places where Landsvirkjun operates, situated all over the country.

Under the caption of "Many hands make light work", Landsvirkjun has in past years advertised collaboration in which Landsvirkjun offers its summer work groups for assisting with development in the fields of tourism and the environment. Numerous applications have been received from municipalities, social organisations and members of the tourist industry all around the country. The company has managed to fulfil most requests, thus establishing collaboration with innumerable groups and allowing for the development of further relations in the future.

Ratio of electricity production with renewable energy resources in EU-countries and Iceland



### "Our common future"

#### Gro Harlem Brundtland

The Brundtland Report, 'Our Common Future' urges the nations of the world to utilize renewable energy resources, including unharnessed hydro, on a global scale. This would allow a reduction in the greenhouse effect on the Earth's atmosphere and should be a priority energy issue in the 21st century.

See: "Our Common Future", pp. 192-196





# Environment

Landsvirkjun introduces environmental management according to ISO 14001 in two stages. The first stage covers the entire operations of the Energy Division, i.e. production and electricity sales and delivery, as well as maintenance, administration and the operation of Landsvirkjun production units. These operations were assessed and accredited at the end of 2006. The latter stage involves certifying the environmental management of all company operations, which is to be finished in 2007.

While preparing for accreditation, the significant environmental factors in Landsvirkjun's electricity production had to be specified. The company's environmental policy was reviewed, and

its chief goals in environmental matters were outlined, together with measurable objectives regarding electricity production.

Procedures were established for controlling and monitoring significant environmental effects; these procedures are reinforced through instructional documents on environmental management at individual workstations.

Entries in Green Accounts allow for recording all of the business' emissions into the atmosphere, water or soil, in addition to noting information on waste. While the first whole year showing a materials summary for all of the company's monitored environmental

effects due to electricity production will be 2007, there is already a comprehensive overview of certain factors, such as atmospheric emissions in 2006.

## Atmospheric emissions and the greenhouse effect

Various substances are released into the atmosphere during Landsvirkjun's pro-

### The Landsvirkjun Environmental Affairs Policy

Landsvirkjun aims at being in the forefront in environmental affairs and promotes sustainable development in Icelandic society.

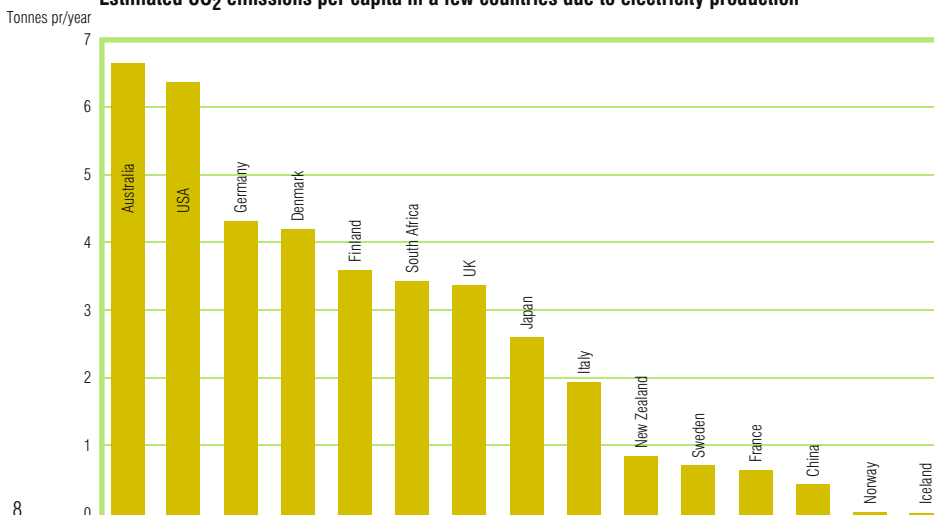
Landsvirkjun emphasises noting the environmental impact of its operations and endeavours to minimise that impact. In order constantly to increase its success in this area, the company monitors significant environmental factors and makes systematic efforts to improve them.

Landsvirkjun ensures that every legal requirement in the area of environmental affairs is fulfilled and places stricter standards on itself if appropriate.

Landsvirkjun stresses that its staff, as well as others working for the company, have the capability and expertise to carry out this Policy.

Landsvirkjun presents its Environmental Affairs Policy to the public and reports its outcome in environmental matters, thus encouraging open, objective discussion.

Estimated CO<sub>2</sub> emissions per capita in a few countries due to electricity production



duction of electricity. Two aspects are involved here: on one hand substances emitted directly on account of operation of power stations, such as natural steam released from geothermal plants, and on the other hand fossil-fuel combustion in vehicles and machinery. These substances have a variety of effects on the environment, with the greenhouse effect being one example. It is important to note that geothermal power production does not produce greenhouse gas, it induces natural emissions from the geothermal fields.

The greatest quantity of material released into the atmosphere consists of the natural steam from geothermal power plants. While such steam is mostly water vapour, 1-2% of it is other gases, for the most part carbon dioxide. Examination of the greenhouse effect resulting from power stations shows that carbon dioxide and methane emissions from geothermal power plants comprise some 99.3% of the company's greenhouse effects.

#### International responsibilities

Landsvirkjun participated in the 2006 Global Roundtable on Climate Change (GROCC). The goal of GROCC is to

foster international consensus on responses to increasing greenhouse gases and global warming, whether in the fields of scientific research, economic measures or culture in general. A team from Landsvirkjun took part in compiling the joint GROCC statement.

Besides Landsvirkjun, over 80 companies and organisations around the world have become signatories to the GROCC statement, committing themselves to work in accordance with it. In addition, numerous leaders in various sectors have endorsed the endeavour with their personal support. One of these is Fridrik Sophusson, Managing Director of Landsvirkjun, while the President of Iceland, Ólafur Ragnar Grímsson, has played an active role in GROCC activities from the start.

#### Landsvirkjun's obligations according to the GROCC statement:

- Report information on greenhouse gas emissions from company operations.
- Engage in the mitigation of greenhouse gas emissions.
- Champion significant demonstration and development projects related to counteractive measures against atmospheric changes.
- Support public policy efforts to mitigate climate change and its impacts.
- Recognise scientific processes, including work by international organisations such as the Intergovernmental Panel on Climate Change (IPCC).
- Work to increase public awareness of climate change, risks and solutions.

#### The Stern Review on the Economics of Climate Change speaks of Iceland's energy arrangements as a model for others

As regards electricity production, the nation's emissions of CO<sub>2</sub> per capita are the lowest of any OECD country, with 70% of Iceland's primary energy originating from its own self-sustaining resources.

Expectations of future globalisation action to mitigate greenhouse gases emissions is already acting as a key driver in attracting investment of energy-intensive sectors away from high GHG energy suppliers and towards countries with renewable energy sources.

#### Atmospheric emissions and the greenhouse effects of Landsvirkjun operations, 2006

	USAGE	EMISSIONS INTO THE ATMOSPHERE	
		QUANTITY	GREENHOUSE EFFECT
<b>Steam from geothermal plants</b>	6,127,000 tonnes	4,210,000 tonnes	
carbon dioxide emissions		66,000 tonnes	65,994,000 kg CO <sub>2</sub> equivalents
methane emissions		13 tonnes	273,000 kg CO <sub>2</sub> equivalents
hydrogen sulphide emissions		6,080 tonnes	
<b>Petrol use in machinery and vehicles</b>	12,547 liters		
carbon dioxide emissions		29 tonnes	28,889 kg CO <sub>2</sub> equivalents
methane emissions		0.003 tonnes	59 kg CO <sub>2</sub> equivalents
nitrogen oxide emissions		0.008 tonnes	2,334 kg CO <sub>2</sub> equivalents
<b>Diesel use in machinery and vehicles</b>	147,772 liters		
carbon dioxide emissions		322 tonnes	365,190 kg CO <sub>2</sub> equivalents
methane emissions		0.008 tonnes	193 kg CO <sub>2</sub> equivalents
nitrogen oxide emissions		0.020 tonnes	7,120 kg CO <sub>2</sub> equivalents
<b>Electrical equipment</b>			
sulphur hexafluoride emissions		0.004 tonnes	95,600 kg CO <sub>2</sub> equivalents
<b>Total greenhouse effect</b>			<b>66,766,386 kg CO<sub>2</sub> equivalents</b>



## Power production, purchases and sales

Landsvirkjun's electricity production into the Landsnet transmission system amounted to 7,430 GWh during the year, which represents an increase of 4% relative to 2005. The share of hydropower in energy produced by Landsvirkjun is just over 93%, while geothermal power contributes some 7%. This is similar to the previous year. Landsvirkjun also purchased 463 GWh of electricity from Reykjavík Energy and Sudurnes Regional Power for resale to power-intensive industry. Thus Landsvirkjun's total energy acquisition

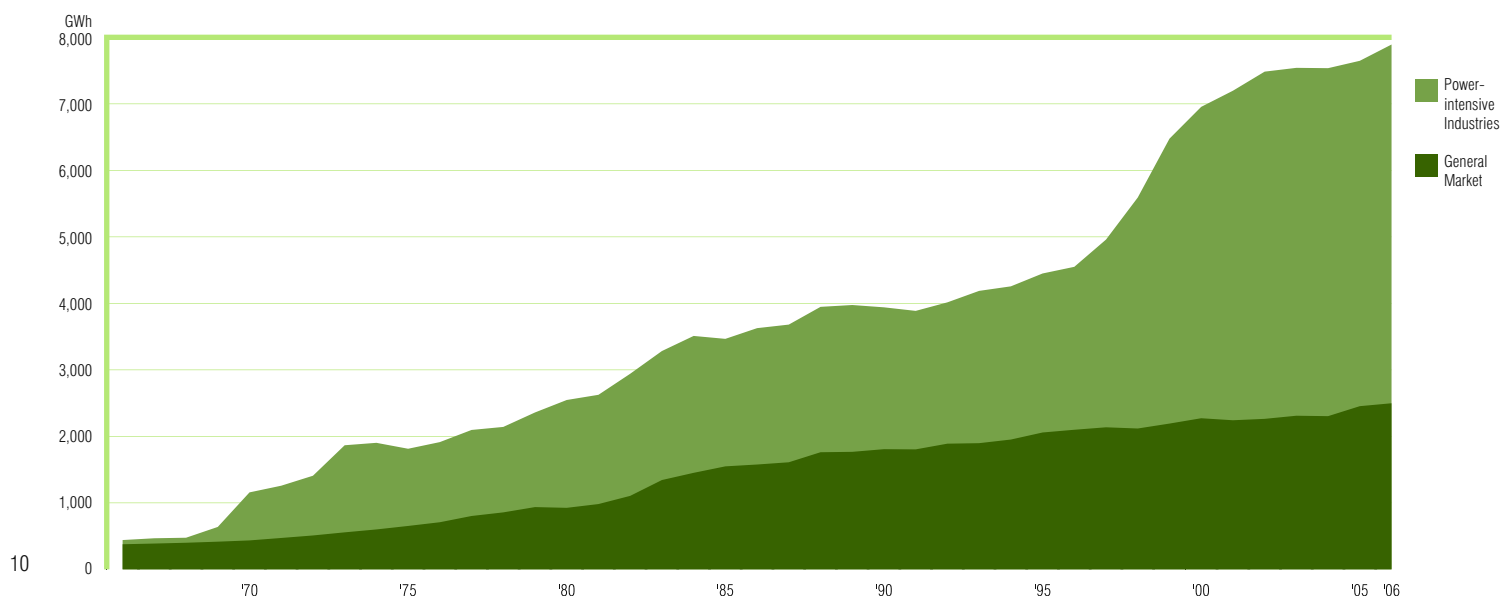
during 2006 was 7,893 GWh, or an increase of 3.2% compared to the previous year.

The 2006 electricity sales of Landsvirkjun reached 7,893 GWh. Sales of primary electricity to public utilities remained practically unchanged, increasing by only about 0.6%. Electricity sales to power-intensive industries, however, rose by almost 4%, even despite reduced sales to Alcan Iceland because of its potroom breakdown at Straumsvík. Sales to Nordurál increased, since

Landsvirkjun provided the company with short-term electricity due to its plant expansion last year.

Iceland's total electricity production amounted to 9,925 GWh; of this, Landsvirkjun's share comes to around 75%, a decrease of 7% from last year. On the other hand, the company's share of the total in hydroelectricity generation was 95%, and 19% in producing electricity geothermally.

Landsvirkjun's energy sales in 1966–2006





# Marketing

## Commercial developments

An endeavour was made to search for new, commercially viable business opportunities, placing special emphasis on new customers and new Landsvirkjun products, while at the same time stressing optimal services to Landsvirkjun's wholesale customers. With this aim in mind, various new business ideas were examined. In fact, diverse opportunities exist for future energy sales. An example of these is the sale of energy for the production of raw materials for solar-powered generators, an industry with foreseeably huge growth potential in the coming years and decades.

## The wholesale market

Landsvirkjun has six customers in the general electricity market. This market sector saw no particular changes during the year, although competition is beginning to manifest itself among retailers in the sector. The most apparent trend seems to be that larger companies with operations in many parts of the country are transferring their business to a single electricity vendor. Stiffer competition may be expected in the coming months and years.

## Power-intensive industry

The profile of operations according to energy contracts with customers in power-intensive industry was similar to that of previous years. In 2004 Landsvirkjun finalised an agreement with

Nordurál on energy sales for starting up a new potroom at Grundartangi in 2006. Landsvirkjun began transmitting this added energy to Nordurál at the end of February and continued delivery until October. More energy turned out to be needed from Landsvirkjun than originally anticipated because of delayed start-ups at new plants being built by Landsvirkjun's competitors. The increase in Landsvirkjun's energy sales to Nordurál as a result of this extra delivery amounted to approximately 310 GWh in excess of contractual annual sales for 2006.

On 19 June an electrical equipment malfunction occurred in Potroom 3 at Alcan, Straumsvík, necessitating closure of the potroom. This significantly reduced Landsvirkjun's energy sales to Alcan while the potroom was being restarted. Restarting went well, nonetheless, and was achieved more quickly than originally foreseen. Even so, this incident reduced the year's electricity sales to Alcan at Straumsvík by 5% below original plans.

During the course of the year, Landsvirkjun was engaged in negotiations with Alcan on energy sales for an expansion of the Straumsvík smelter. These negotiations proceeded throughout the year and concluded in December with an agreement on prices and the main terms. This agreement will depend

on various conditions by both parties which have yet to be fulfilled. In North-east Iceland, preparations continued in accordance with a declaration of intent by Alcoa and Landsvirkjun regarding geothermal power plants there to serve a proposed aluminium plant at Bakki, near Húsavík.

## An international perspective on energy and environment

In only a few decades, the climate and conditions for life on Earth might deteriorate so seriously as to threaten the health and lives of billions of people.

Here in Iceland we are in a unique position to play a part in the search for new solutions. The high proportion of renewable energy in our total consumption arouses more and more attention among other nations.

I have therefore decided to direct my efforts to make this vision a reality: that Iceland become a centre of international collaboration and discussion on clean energy, a centre of knowledge and activities aimed at saving our children and future generations from the threat of irreversible climate change, and at the same time laying the foundations for a sustainable future.

*New Year Address by the President of Iceland, Ólafur Ragnar Grímsson, 1 January 2007*



# Research and development

## Deep-drilling project

Design, planning and other preparations continued in 2006 towards drilling a geothermal well 4.5-5 km deep in order to test whether it will be possible to reach superheated geothermal liquid (i.e. at a temperature of over 380° and pressure of over 220 bar). This project is being carried out through cooperation within the Icelandic energy sector. Together the companies had, by the end of the year, invested a total of approximately ISK 150 million for preparations in the period from 2000 to 2006.

Since 2004, the aim had been to drill the first of such deep wells on the Reykjanes peninsula and Sudurnes Regional

Power was prepared to provide a well 2.5-3.0 km deep as their contribution to the project. Unfortunately, however, this well collapsed at the beginning of the year and no other borhole was available in the area. Consequently, a revision was thought appropriate for all of the plans and assessments on which the choice of location had been based. As a result of this revision, it was decided to bore the first deep-drill hole in a different geothermal system, the most suitable option for which was Landsvirkjun's Krafla area. Since the middle of last year, therefore, preparations have been directed towards locating the first deep-drill well at Krafla. Tenders have been called for the drilling, and con-

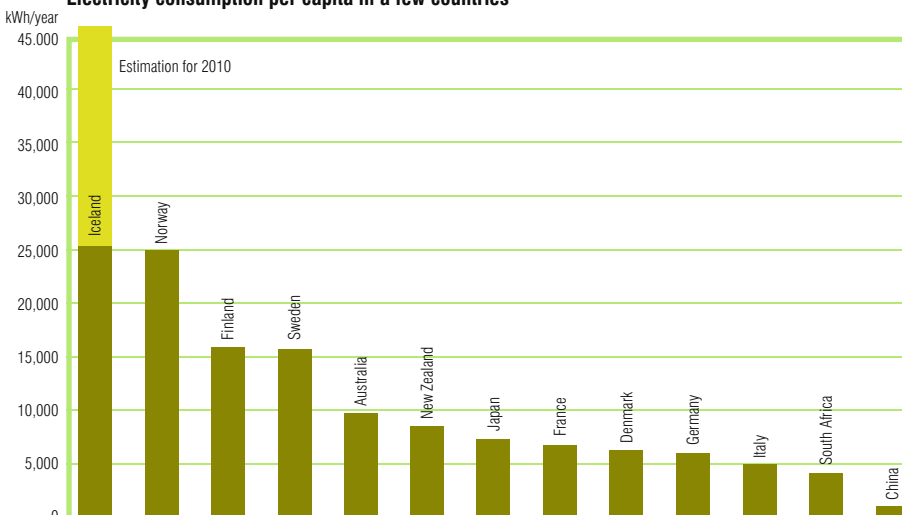
tracts are being prepared on the project. The target is to be able to begin drilling in the first half of 2008.

It must be emphasised that the deep-drilling project is a long-term experimental undertaking which is by no means certain to succeed. Many years will have passed before all the technical problems that must be dealt with have been overcome.

## Lower Thjórsá river

At the end of 2005 Landsvirkjun and Alcan in Iceland began discussions on electricity sales to the aluminium plant in Straumsvík following enlargement of the smelter. The first stage in the talks

Electricity consumption per capita in a few countries



Source: NationMaster.com

## Icelandic emissions below the EU average

Iceland's overall emissions of greenhouse gases came to around 10.7 tonnes per capita in 2004, having decreased by 17% since 1990. Iceland's 2006 emissions lie below the European Union average.

Thus Iceland is performing quite well in respect of the Kyoto Protocol, with 2004 emissions 12% under the average target which was set for the period of 2008 to 2012, whereas the fifteen EU states are 8% above the comparable target, leaving them much farther to go in achieving the target. The report also presents a comparison of emissions per unit of GDP, or gross domestic product; this is also a standard according to which Iceland comes out well.

Report by the European Environment Agency



was completed by signing a declaration of intent on 27 January 2006. Those discussions led to Landsvirkjun deciding to initiate research in preparation for an invitation to tender on the construction options for a power plant in Thjórsá river, downstream from Búrfell Station. The plan calls for developing Thjórsá beneath Búrfell in three stages. The total estimated power output of these plants is some 250 MW, with an estimated capacity of about 2,000 GWh/year. In the spring, preparations also began on putting consultancy services for these power plants out to tender. The tender was advertised in December.

### Geothermal research in North Iceland

Research is being carried out on geothermal areas in North Iceland in accordance with a declaration of intent by Landsvirkjun and Alcoa regarding the procurement of energy for the proposed aluminium plant at Húsavík. The aim of the investigations is to examine by the end of 2008 whether it is possible to obtain sufficient energy for a 250,000 tonne aluminium smelter by means of geothermal steam plants in North Iceland.

### The European Union and renewable energy

The European Commission has set the objective of obtaining 20% of the energy used within the EU from renewable energy sources by 2020. In 1997, the EU had adopted the objective that the percentage of renewable energy would be 12% by 2010, although it has now become clear that this aim will not be achieved. In Iceland, on the other hand, the same percentage is already just over 70%, and is increasing through the addition of new geothermal and hydropower plants. The energy Iceland imports in the form of oil and petrol is principally used for fisheries and transportation.

### Landsvirkjun's power stations





# Kárahnjúkar Hydropower Project

Having begun in 2003, construction of Kárahnjúkar Hydropower Project is now well under way, with little uncertainty remaining about most of the major project components. As hitherto, numerous consultants and contractors from Iceland and abroad are involved in the project.

Construction proceeded smoothly during the year, as several major phases in the project were completed. The most important milestones were as follows: the filling of Háslón reservoir began on 28 September, and on 5 December the drilling of the headrace tunnel from Háslón was completed. On 14 December, the service building in Fljótisdalur valley was delivered to the Energy Division ready for use.

It turned out to be impossible to compensate fully for the delays that had occurred earlier in the construction period, in relation to drilling the headrace tunnel and lining the pressure shafts with steel, so that these two components were still about five months behind the original schedule at year end. In spite of the delays, Landsvirkjun will be able to meet its commitment on delivering energy to Fjarðaál smelter at the beginning of April 2007. This energy, however, will be provided through the country's main transmission grid. The power plant's first generator unit is expected to start production in July 2007.

## **Kárahnjúkar Dam**

Impregilo's operations at Kárahnjúkar Dam went smoothly during 2006, so

that the filling of Háslón reservoir began on schedule in September. During the year, the last of the dam materials were brought into place and the concrete face on the upstream side of the dam was finished. Operations on the spillway proceeded at a reasonable pace, even though considerable work still remains to be done and will not be completed until early in the summer of 2007. Late in 2006, work began along the dam crown on a concrete parapet wall that is due to be completed in spring 2007.

## **Saddle dams**

Construction of the saddle dams on each side of the Kárahnjúkar dam was completed late in the year, apart from final touches on roads atop the dams. This will be completed in early summer 2007.

## **Headrace tunnel**

Work on the headrace tunnel went well, seeing the completion during the year of tunnel boring from Háslón reservoir to the upper end of the penstocks. It was spectacular to observe the drill heads of the giant boring machines break through the final rock that separated them on the headrace route. A variety of completion work is now proceeding in the tunnel. Reservoir water is expected to be allowed into the headrace tunnel in June 2007.



In 2006, 18 km of headrace tunnel were

added, besides adjacent tunnels. In the end, a total of 50.3 km had been completed, which is the sum of the entire headrace tunnel, adits to it, and the surge tunnel.

### The Jökulsá and Hraunaveita diversions

Work continued on the Ufsarveita diversion tunnel connecting the river Jökulsá in Fljótisdalur to the headrace tunnel coming from Háslón reservoir. Tunnel excavation at the intake began mid-year 2004. By year-end 2006, 3 km had been completed out of the overall 3.4 km in the upstream part of the tunnel. By 2008 a further 9.5 km of the di-



version tunnel will be finished by a TBM working from the headrace tunnel end. Tenders for the Ufsarstífla dam and Hraunaveita diversion were opened at the end of January 2006. Subsequently, a contract was negotiated with the lowest bidder, Arnarfell. Work commenced on every component during the year.



### Powerhouse

As previously, construction by Fosskraft in the powerhouse went very well during 2006. Concrete work was finished during the course of the year, and completion work on the powerhouse was virtually over by the end of the year.

### Service building

The service building in Fljótisdalur houses a station control centre, staff facilities and a workshop. The building was handed over to the Energy Division in fully operational condition on 14 December 2006.

### Gate equipment

The installation of gate equipment in the bottom outlet of Kárahnjúkar Dam was completed during the year and the equipment was tested in November. While the installation of gates to the Háslón inlet was finished, there were final tasks on equipment connected to them that remained to be completed. The manufacture of butterfly valves for the upper end of the penstock tunnels and for the junction with the diversion tunnel from Jökulsá í Fljótisdal was completed in December, and they arrived in Iceland in February 2007. The design and manufacture of gates for the bottom outlet of Ufsarstífla dam began in the course of the year, following an agreement in March 2006 with the lowest bidder, Montavar in Slovenia.

### Steel linings in the penstock tunnels

The installation of the vertical length of the penstock pipes and the pouring of filling concrete around them was completed during the year, as was also the painting of the penstocks and their branches into the powerhouse. Some work remained to be done on the gate housing at the upper end of the penstocks.

### Machinery and electrical equipment

The installation of machinery and other equipment proceeded smoothly. The assembly of Generator Unit 1 was completed, and pre-testing commenced just after the turn of the year. Work on Generator Units 2 and 3 was well advanced, and the installation of Units 4-6 was in keeping with schedule. The cable tunnel has been completed, including cables leading from all six transformers to the switchgear house. Three of the powerhouse's power transformers have been assembled and tested, while two were still under production. Work on building systems went according to schedule and was nearly half done at year-end.

### Nelson Mandela had the following to say when launching a report by the UN's World Commission on Dams:

"The problem, though, is not the dams. It is the hunger. It is the thirst. It is the darkness of a township. It is townships and rural huts without running water, lights or sanitation. It is the time wasted gathering water by hand. There is a real pressing need for power in every sense of the word."

*Nelson Mandela, 16 Nov. 2000*





# Finance

Landsvirkjun's profit amounted to ISK 3.5 billion in 2006, down from ISK 6.3 billion the year before. Return on equity amounted to around 6.0% in 2006, compared to 12.3% in 2005. The net cash from operating activities, i.e. the funds that company operations create which can be utilised for investments and the repayment of loans, totalled ISK 9.6 billion in 2006. The company's assets in the consolidated statement for 2006 were ISK 243.2 billion, compared to ISK 182.0 billion the year before. At the end of 2006, Landsvirkjun's equity amounted to ISK 61.1 billion and the equity ratio was 25.1%.

### Profit and loss statement

The group's 2006 operating revenue was ISK 21.3 billion, rising by 36.9% from the year before. The increase was mainly due to a rise in energy prices to power-intensive industry, with revenues from sales to such industry depending partially on world market prices for aluminium and the exchange rates of foreign currencies.

The operating expenses of the Group were ISK 11.5 billion in 2006, up from ISK 10.8 billion the year before. The depreciation of operating assets made up the largest part of operating expenses, ISK 5.1 billion in 2006 compared to ISK 4.9 billion in 2005, and thus rose 4.6% from year to year. Operating expenses rose in other respects by just over 7.9% between 2005 and 2006.

In accordance with this, the Group's 2006 earnings before interest and taxes (EBIT) increased by nearly ISK 5,054 million from the year before. Earnings before interest, tax, depreciation and amortisation (EBITDA) rose by ISK 5,281 million from the previous year to ISK 14.9 billion in 2006. That amount is important by virtue of indicating the company's ability to meet interest payments and pay off long-term debts. Below is a table showing EBITDA as a percentage of long-term loans, including next year's payments of long-term debt. It should be noted that included with long-term debt are loans due to the Kárahnjúkar Hydropower Project,

even though the project is not yet generating revenue. This indicates a positive development, as the percentage has not changed much in spite of increased long-term debt.

Year	EBITDA	Long-term	
		debt	Percentage
2006	14.9	170.5	8.7%
2005	9.6	113.4	8.5%
2004	9.0	96.9	9.3%
2003	8.4	88.1	9.5%
2002	9.2	77.2	11.9%

Interest expenditures amounted to ISK 3.6 billion in 2006, compared to ISK 2.2 billion the year before. The average nominal interest on long-term loans was about 4.6%, as opposed to approximately 3.5% the previous year. Interests on funds that are invested in fixed assets are capitalized until these assets are put into operation. Such capitalised interest expense reached ISK 2,941 million in 2006, compared to ISK 1,621 million the year before, the reason being that





investments in projects under construction had risen by ISK 34.7 billion to ISK 97.9 billion at year-end.

Interest expense in excess of interest revenue totalled ISK 26.2 billion in 2006, whereas interest revenue had exceeded interest expense by about ISK 1.6 billion the year before. The difference between years, ISK 27.8 billion, is mostly due to exchange rate losses and increased expenses associated with hedging activities, along with an increase in capitalised interest. In 2005 there were exchange rate gains of ISK 4.2 billion, while 2006 demonstrated exchange rate losses of ISK 19.9 billion. Hedging expenses in 2006 of around ISK 3,2 billion are included in the exchange rate losses.

Electricity companies had been exempt from income tax, but became taxable as of 1 January 2006, pursuant to Act No. 50 of 2005. Therefore, accrued tax assets of ISK 19.9 billion have been entered in the financial statement.

#### **Balance sheet**

In the 2006 consolidated statement, company assets amounted to ISK 243.2 billion, dividing into fixed assets of ISK 231.4 billion and current assets of ISK 11.8 billion. In the previous year, assets amounted to ISK 182.0 billion. The increase is mainly due to 2006 investments in Kárahnjúkar Hydropower Project, involving a cost of ISK 33.4 billion in addition to around ISK 6.9 billion for transmission structures.

At year-end 2006, Landsvirkjun had equity of approximately ISK 61.1 billion.

The company's equity ratio was 25.1%, compared to 31.9% at the end of the previous year. Owner's equity had thus risen by ISK 3.1 billion from the previous year, since out of ISK 3.5 billion in 2006 profits, owners were paid a dividend of ISK 427 million.

With the inclusion of next year's payments, the company's long-term debt totalled ISK 170.5 billion at the end of 2006, while the corresponding figure for the previous year was ISK 113.4 billion.

#### **Statement of cash flows**

Operations returned ISK 9.6 billion to meet 2006 investments and repayment of liabilities. Revenues were ISK 19.8 billion, compared to ISK 15.4 billion the year before. Operating expenses amounted to ISK 5.8 billion in 2006, down from ISK 6.9 billion the year before. As a result net cash from operating activities, excluding interest, increased by ISK 5.4 billion between years. In 2005, net cash outflow due to the cost of capital was ISK 2.6 billion, but ISK 4.3

billion in 2006. However, that amount includes an outflow of around ISK 3 billion for risk hedging, so that net interest outflow in 2006 was ISK 1.3 billion.

Investment in fixed assets paid for in 2006 was ISK 45.4 billion, up from ISK 28.6 billion during the year before. By far the largest portion of both years' investments was due to Kárahnjúkar Hydropower Project. Investments in fixed assets were financed through loans, with 2006 borrowings of ISK 57.7 billion, as opposed to ISK 25.1 billion the previous year. Dividends of ISK 427 million were paid to company owners in 2006, rising from ISK 394 million in 2005.

#### **Funding**

Last year, 2006, was Landsvirkjun's largest funding year ever, owing to both peak activities in the Kárahnjúkar Hydropower Project and some refinancing. The company issued bonds equivalent to just short of USD 750 million, in four foreign currencies, with terms of two years to twenty years. At the beginning of 2006, several foreign analysts is-



sued reports on the Icelandic economy which had negative effects on foreign investors. Although this instability lasted well into the year in regard to Icelandic borrowers, it had little effect on Landsvirkjun, which completed its funding at the beginning of September. Every loan but one was issued under the company's Euro Medium Term Note Programme. The Nordic Investment Bank in Helsinki provided Landsvirkjun with a 20-year loan of EUR 70 million. In addition, Landsvirkjun has access to a multi-currency revolving credit facility to the amount of USD 400 million. The said facility is extremely important to the company, ensuring that it always has sufficient liquidity when circumstances in the bond markets change temporarily.

### Risk management

Landsvirkjun emphasises the monitoring and active control of financial risk. The Board of Directors sets the strategy for risk management, although decisions and the supervision of how hedging is implemented are entrusted to a risk management committee. The risk management department monitors and measures the risks related to individual market factors and suggests measures for controlling risks.

The objective of active risk management is to reduce the company's uncertainty over cash flow and financial position on account of financial risk and also to ensure that performance corresponds with company objectives. The financial risk mainly considered in this respect involves fluctuations in aluminium prices on the world market, interest and currency risk, and liquidity risk.

A considerable part of Landsvirkjun's revenue is linked to the world market price of aluminium. It is therefore crucial for the company to analyse thoroughly the conditions in that market. In 2002 and throughout most of 2003 the price of aluminium was rather low in relation to the past ten years. Towards the end of 2003, prices began to rise, and

the period 2004 to 2006 experienced continuous price escalation. During the first half of 2003, the three-month average price of aluminium at the LME lay below USD 1,400/tonne, but had climbed to USD 2,800/tonne by the end of 2006.

The current high aluminium prices are explained by various factors such as increased investor demand for raw materials, rising electricity prices, the robust position of the world's major economies and an enormous demand from China. Because of this complex interplay of numerous factors, the company has supplemented its own analysis by seeking assistance from foreign specialists in order to forecast future aluminium prices.

In order to strengthen its revenue basis, the company has entered into derivative contracts intended to minimise the business effects of downturns in aluminium prices. In most instances, such contracts set a certain price range for aluminium, which obviously means the company may forego revenue upon aluminium price increases. Conversely, in the event of falling aluminium prices these same derivatives will give the company higher revenues than prevailing market prices would indicate.

Payments for derivative contracts on aluminium totalled close to ISK 3,200 million in 2006. However, revenue from energy sales rose even more than this amount between years, leaving company cash flow positive as a result of higher aluminium prices. At the end of 2006 the fair value of the derivative contracts for aluminium was negative by ISK 10.7 billion. Even though these agreements will remain in effect for the next seven

years, increases in company revenue should counter them, if the grounds for these calculations hold true.

Landsvirkjun has also made agreements on interest-rate swaps, mainly in order to fix interest over the long term. Not only have agreements on fixed interest reduced company risk, but the agreements outstanding at year-end 2006 are expected to be in favour of the company. It must be kept in mind that the company's objective in managing interest by these means is to minimise interest cost in the long run. As 2006 ended, the positive fair value of Landsvirkjun's interest-swap agreements was approximately ISK 130 million. The notional amounts underlying these interest swaps totalled ISK 19 billion. Furthermore, the company has concluded currency-swap agreements relating to long-term loans, and the positive fair value of these agreements was ISK 919 million at the end of 2006, with a notional amount of around ISK 57 billion. Forward contracts made for the purpose of cash-flow hedging displayed a positive fair value of about ISK 45 million at the end of 2006. The underlying notional amount was approximately ISK 864 million.

#### Landsvirkjun's credit rating in international markets

	Moody's	Standard & Poor's
Short term	P-1	A-1
Long term	Aaa	A+/stable





# Financial Statements 2006

## Directors' Report

The Consolidated Financial Statements for 2006 are prepared in conformity with last year's statements. The objective of Landsvirkjun is to engage in operations in the energy sector and any other business and financial activities pursuant to the decisions of the Board of Directors at any time. The Consolidated Financial Statements comprise the parent company accounts in addition to the Financial Statements of four subsidiaries, Fjarski ehf, Icelandic Power Insurance Ltd, Landsnet hf and Islensk jarðhitatækni ehf.

The consolidated operating revenues amounted to 21.3 billion ISK in 2006, as compared to 15.6 billion ISK in the previous year. Operating expenses amounted to 11.5 billion ISK in 2006, as compared to 10.8 billion in 2005. Thus, the operating profit amounted to 9.8 billion ISK in 2006, as compared to 4.7 billion ISK in the previous year. The increase is mainly due to an increase in tariffs to power-intensive industries without a corresponding increase in expenses.

Financial costs exceeded financial income by 26.2 billion ISK in 2006, as compared to a net financial income of 1.6 billion ISK in 2005. The change amounts to 27.8 billion ISK and it leads to a decrease in the profits of the company by that amount. This unfavourable change is explained by net negative exchange-rate losses, indexation and hedging payments in the total amount of 23 billion ISK in 2006, as compared to a net

positive amount of 3.4 billion ISK in 2005. The exchange-rate loss on long-term debt is primarily the result of unfavorable changes in the Euro and US dollar vis-a-vis the Icelandic krona. This loss is unrealized, which must be kept in mind when interpreting the Financial Statements.

Energy companies became taxable as of January 1, 2006 according to Act no. 50/2005. A deferred tax asset was recognized in the Consolidated Financial Statements which amounts to 19.9 billion ISK and is recorded as an income tax benefit in the income statement, as explained in more detail in note 8 to the accounts.

The net profit for the year amounted to 3.5 billion ISK and the Board of Directors propose that the amount should be transferred to the retained earnings account.

The investment in property, plant and equipment amounted to 42 billion ISK in 2006 and was financed primarily by new long-term borrowings. The investment in the Kárahnjúkar project amounted to 33.4 billion ISK during the year, as compared to 21.1 billion ISK in 2005 with the total cumulative investment being 88.8 billion ISK at the end of 2006. The consolidated assets of the company amounted to 243.2 billion ISK at the end of 2006. Total liabilities were 180.4 billion ISK and owners' equity amounted to 61.1 billion ISK, or 25.1% of total assets.

Cash flows from operations amounted to 9.6 billion ISK in 2006, as compared to 5.9 billion ISK in the preceding year.

Landsvirkjun has entered into various types of derivative contracts in order to manage the company's operating risk. The contracts relate to interest and currency rate risks as well as risks associated with sales revenues which are linked to the world market price of aluminium. Additionally, the company has entered into foreign exchange contracts to profit from short-term changes in the currency market. Information about the effects of these contracts on the operation of the company for 2006 are provided in the notes, where information is also provided on the fair value of the outstanding contracts at the end of 2006, regardless of whether such contracts were made for risk management or speculative purposes. The net negative market-to-market value of option contracts to hedge sales revenues amounted to 10.7 billion ISK at the end of 2006. The net positive fair value of other derivative contracts amounted to 1,387 million ISK, of which the value of interest rate swaps amounted to 130 million ISK, and the remaining positive balance in the amount of 1,257 million ISK relates to currency swaps, forwards and options.

The company is in the process of valuing the embedded derivatives contained in sales contracts with aluminium smelters. The indications are that they have a significant net

positive value for the company, but these derivatives will be recorded in the Financial Statements for 2007 as the company adopts IFRS as of January 1, 2007.

Landsvirkjun is a partnership, half of which was owned by the State Treasury of Iceland and the other half by the City of Reykjavik (44.525%) and the Township of Akureyri (5.475%). As of January 1, 2007 the partnership is owned by the State Treasury and Eignarhlutir ehf. Eignarhlutir is a wholly owned subsidiary of the State Treasury of Iceland. The State Treasury owns directly 99.9% and Eignarhlutir the remaining 0.1%. At the annual meeting the Board of Directors propose to pay dividends to its owners for the year 2006. If its proposal is accepted the cash dividend in 2007 will amount to 500 million ISK. Other information with respect

to changes in owners' equity is contained in the notes accompanying the Financial Statements.

The City of Reykjavik and the Township of Akureyri provide a guarantee of collection along with the State Treasury of Iceland on all obligations of the company entered into before the end of 2006. The company paid the owners a guarantee fee in the amount of 366 million ISK in 2006 relating to its long term debt. The State Treasury and Eignarhlutir provide a guarantee of collection for all obligations entered into after January 1, 2007 .

The Board of Directors and the Managing Director confirm the Financial Statements which are prepared in compliance with laws and regulations.

Reykjavik, March 12, 2007

Board of Directors:

Jóhannes Geir Sigurgeirsson

Ágúst Einarsson

Jóna Jónsdóttir

Valdimar Hafsteinsson

Valur Valsson

Managing Director:

Fridrik Sophusson

## Independent Auditor's Report

*To the Board of Directors of Landsvirkjun.*

### Report on the Financial Statements

We have audited the accompanying Consolidated Financial Statements of Landsvirkjun which comprise the Balance Sheet as at December 31, 2006, and the Consolidated Income Statement and Consolidated 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 Consolidated Financial Statements in accordance with the Icelandic Act on Financial Statements. 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 Consolidated Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated 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 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 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 Consolidated Financial Statements give a true and fair view of the consolidated financial position of Landsvirkjun as of December 31, 2006, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with the Icelandic Act on Financial Statements.

Reykjavik, March 12, 2007

KPMG hf.

Jón Eiríksson

# Income Statement for 2006

	Note	2006	Consolidated 2005
<b>Operating revenues</b>			
Power sales .....		17,243,387	12,781,221
Transmission .....		3,060,148	2,593,040
Other income .....		994,153	177,563
	3	<u>21,297,688</u>	<u>15,551,824</u>
<b>Operating expenses</b>			
Energy production costs .....		2,629,981	2,430,643
Transmission costs .....		1,255,839	1,364,811
Cost of general research .....		333,026	335,447
General administrative expenses .....	25	2,158,359	1,781,797
Depreciation .....	4,12	<u>5,131,378</u>	<u>4,904,450</u>
		<u>11,508,583</u>	<u>10,817,148</u>
		Operating profit	<u>4,734,676</u>
		9,789,105	
<b>Financial costs</b>			
Interest revenues .....		453,080	376,310
Interest expenses .....		( 3,584,963 )	( 2,166,928 )
Exchange-rate gains (losses), indexation and hedging .....		( 23,068,646 )	3,386,566
	9	<u>( 26,200,529 )</u>	<u>1,595,948</u>
		(Loss) profit before taxes	<u>6,330,624</u>
		( 16,411,424 )	
Income tax benefit .....	8	19,863,164	0
Minority interest .....		51,720	( 36,686 )
<b>Net profit</b>		<u>3,503,460</u>	<u>6,293,938</u>

# Balance Sheet December 31, 2006

## Assets

	Note	2006	Consolidated 2005
<b>Property, plant and equipment</b>			
In operation:			
Power stations . . . . .		79,245,765	82,124,009
Transmission system . . . . .		27,953,450	23,503,632
Telecommunication equipment . . . . .		440,829	452,245
Vehicles and equipment . . . . .		202,135	222,697
Office buildings and equipment . . . . .		3,081,868	2,932,456
	4,11	<u>110,924,047</u>	<u>109,235,039</u>
Construction and development costs:			
Development costs . . . . .	5	2,091,545	1,815,689
Projects under construction . . . . .	26	97,935,884	63,212,563
		<u>100,027,429</u>	<u>65,028,252</u>
Shares and long-term receivables:			
Shares in other companies . . . . .	13	550,026	408,707
Long-term notes receivable . . . . .		42,810	160,283
Deferred tax asset . . . . .	14	19,861,666	0
		<u>20,454,502</u>	<u>568,990</u>
		<u>231,405,978</u>	<u>174,832,281</u>
<b>Total property, plant and equipment</b>			
<b>Current assets</b>			
Accounts receivable - trade . . . . .		3,392,085	2,498,179
Prepayments . . . . .		69,109	91,795
Receivables - other . . . . .	15	3,341,475	1,220,007
Inventories . . . . .		362,616	279,498
Cash and bank deposits . . . . .		4,647,730	3,063,577
		<u>11,813,015</u>	<u>7,153,056</u>
		<u>243,218,993</u>	<u>181,985,337</u>
<b>Total assets</b>			

## Liabilities and Owners' Equity

	Note	2006	Consolidated 2005
<b>Owners' Equity</b>			
Owners' contributions .....		36,363,718	32,750,143
Other equity .....		24,742,949	25,252,418
Total owners' equity	16	<u>61,106,667</u>	<u>58,002,561</u>
Minority interest .....		<u>1,668,399</u>	<u>1,720,119</u>
<b>Obligations</b>			
Accrued pension liabilities .....	17	<u>2,180,439</u>	<u>1,950,597</u>
<b>Long-term liabilities</b>			
Long-term debt .....	6.18	<u>163,740,062</u>	<u>101,020,690</u>
<b>Current liabilities</b>			
Accounts payable .....		5,371,984	5,460,737
Accrued interest payable .....		2,358,094	1,467,272
Current maturities of long-term debt .....	19	6,793,348	12,363,361
		<u>14,523,426</u>	<u>19,291,370</u>
Total liabilities		<u>180,443,927</u>	<u>122,262,657</u>
<b>Total liabilities and owners' equity</b>		<u>243,218,993</u>	<u>181,985,337</u>



# Statement of Cash Flows for 2006

	Note	2006	Consolidated 2005
<b>Operating activities</b>			
Cash received from customers .....		19,778,751	15,432,379
Cash expenses .....		( 5,829,008 )	( 6,873,461 )
From operations excluding interest .....		13,949,743	8,558,918
Interest income received .....		1,176,711	282,154
Interest expenses paid, exchange-rate loss and hedging .....		( 5,483,586 )	( 2,913,733 )
	20	<u>9,642,868</u>	<u>5,927,339</u>
<b>Investment activities</b>			
Kárahnjúkar project - power station .....		( 33,438,405 )	( 21,061,402 )
Transmission .....		( 6,909,159 )	( 9,008,104 )
Power stations in operation .....		( 271,073 )	( 405,453 )
Development costs .....		( 954,103 )	( 133,572 )
Other capital expenditure .....		( 1,179,656 )	( 529,498 )
Assets sold .....		1,287,012	73,754
Increase (decrease) in paid investments .....		( 526,718 )	2,094,818
		( 41,992,102 )	( 28,969,457 )
(Increase) decrease in long-term receivables .....		( 3,389,828 )	386,985
		<u>( 45,381,930 )</u>	<u>( 28,582,472 )</u>
<b>Financing activities</b>			
New long-term loans .....		57,683,462	25,080,066
Amortization of long-term debt .....		( 19,960,895 )	( 4,050,969 )
Increase in share capital .....		0	1,678,765
Cash dividends .....		( 426,839 )	( 394,390 )
		<u>37,295,728</u>	<u>22,313,472</u>
<b>Increase (decrease) in cash during the year</b> .....		1,556,666	( 341,661 )
<b>Effects of subsidiaries</b> .....		27,486	7,969
<b>Cash at beginning of year</b> .....		<u>3,063,578</u>	<u>3,397,269</u>
<b>Cash at end of year</b> .....		<u>4,647,730</u>	<u>3,063,577</u>

# Notes

## Summary of accounting policies

### General information

1. Landsvirkjun is a partnership which was owned by the State Treasury of Iceland and the City of Reykjavik and the Township of Akureyri until the end of 2006. As of the beginning of 2007 the company is a partnership owned by the State Treasury of Iceland and Eignarhlutir ehf. The State Treasury ownership share is 99.9% and Eignarhlutir owns the remaining 0.1%. Eignarhlutir is a wholly owned subsidiary of the State Treasury of Iceland. Landsvirkjun's operations are based on the Act on Landsvirkjun no. 42/1983

### Basis of accounting

2. The Consolidated Financial Statements for Landsvirkjun comprise the Financial Statements of the parent company as well as its subsidiaries. Intercompany transactions and balances between the parent and its subsidiaries have been eliminated on consolidation. Subsidiaries are companies in which the parent company has a controlling interest. Control refers to the parent company's ability to have, directly and indirectly, a significant influence on the subsidiaries' operations, including control of their operating policies.

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 consistent with previous years' statements.

### Revenue recognition

3. Revenues consist of electricity sales and transmission of electricity to power intensive industries and distribution companies based on recorded measurements during the year. Discounts are netted from operating revenues. Other service revenues are recorded as earned or delivered. Included in other revenues is a gain on the sale of buildings. Interest income and other revenues on monetary assets are recorded as earned.

### Property, plant and equipment in operation

4. Property, plant and equipment are stated at historical cost less accumulated depreciation. Depreciation is charged as an annual fixed percentage based on the estimated useful life with salvage value being estimated as one year's depreciation. The depreciation rates are as follows:

		Estimated useful life
Hydropower stations:		
Powerhouses and other structures . . . . .	1.67%	60 years
Machinery . . . . .	3.33%	30 years
Housing . . . . .	2.00%	50 years
Dams and waterways . . . . .	1.67%	60 years
Thermal stations . . . . .	4-5%	20-25 years
Substations . . . . .	5-20%	20-40 years
Power lines . . . . .	2.00%	50 years
Office building . . . . .	2.00%	50 years
Equipment . . . . .	10-25%	4-10 years
Vehicles . . . . .	10-20%	5-10 years
Telecommunication equipment . . . . .	5-15%	7-20 years

### Other fixed assets

5. Expenditures for general research costs are expensed as incurred. Development costs for future power projects are capitalized, except that borrowing costs relating to these expenditures are not capitalized. The capitalization of these costs is based on accounting standards and tested for impairment, which is expensed if applicable.

The borrowing costs of financing are capitalized during the construction cost period, see note 9. Once the related assets are put into operation the borrowing costs are expensed in the Income Statement.

### Foreign currencies and indexation

6. Assets and liabilities denominated in foreign currencies are converted into Icelandic krona (ISK) based on the rates of exchange prevailing at the end of the year. Indexed liabilities are recorded with accrued indexation at the end of the year, reflecting the price-level as indicated by the index as at January 1, 2007. Operating revenues and expenses in foreign currencies are recorded based on the exchange rates on the date of transaction. Exchange rate differences and indexation on liabilities are charged to the Income Statement.

### Derivative financial instruments

7. The gains or losses on derivative financial instruments are recorded in the Income Statement. Derivatives used to hedge future transactions are recorded in the Financial Statements at the same time as the transactions to which they relate. Information on outstanding amounts of open contracts and their fair value is contained in note 21.

### Income tax

8. Landsvirkjun and its subsidiary Landsnet hf. have been exempted from income taxation, but as of January 1, 2006, the companies became taxable with respect to their operations based on the provisions of Act no. 50/2005.

A deferred tax asset is now recorded in the Financial Statements. The calculation of the deferred tax asset is based on the difference between 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. The deferred tax asset is recognized to the extent that it can be used to lower tax payments in the future. Further information is contained in notes 10 and 14, where explanations are provided concerning the calculation of the deferred tax asset.

### Financial costs

9. Interest costs, net, consist of the following (ISK million):

	2006	2005
Interest income . . . . .	453	376
Interest expenses . . . . .	( 6,160 )	( 3,531 )
Guarantee fee paid to owners . . . . .	( 366 )	( 257 )
Exchange-rate losses, indexation and hedging . . . . .	( 23,069 )	3,387
Capitalized interest costs . . . . .	<u>2,941</u>	<u>1,621</u>
	<u>( 26,201 )</u>	<u>1,596</u>

Expenses and revenues from hedging activities are recorded amongst financial costs. The borrowing costs on new long-term debt used for financing construction expenditure was 3.92%. The interest cost capitalized, including the guarantee fee, was 4.17% on funds invested in assets under construction.

### Income tax

10. The effective income tax can be analysed as follows in ISK million:

		2006
Loss before income tax benefit . . . . .		( 16,411 )
Income tax benefit based on current rate for parent. . . . .	-26%	4,267
Tax benefit at beginning of taxable operations . . . . .	-96%	15,812
Non-deductible expenses . . . . .	0%	( 13 )
Effect of various tax rates within consolidation. . . . .	0%	28
Other items . . . . .	1%	( 230 )
Effective income tax . . . . .	-121%	<u>19,863</u>

## Property, plant and equipment

11. Property, plant and equipment in operation consist of the following (ISK million):

	Power- stations	Trans- mission system	Communi- cation equipment	Other assets	Total
Consolidated amounts:					
Balance at January 1, 2006	167,872	23,504	692	4,553	196,621
Increase in 2006	271	5,556	42	981	6,850
Retired/sold in 2006	0	(52)	0	(903)	(955)
Balance at December 31, 2006	168,143	29,008	734	4,631	202,516
Accum. depr. at beginning of year	85,748	0	240	1,398	87,386
Depreciation in 2006	3,149	1,055	53	202	4,459
Retired/sold in 2006	0	0	0	(253)	(253)
Accum. depr. at end of year	88,897	1,055	293	1,347	91,592
Book value at end of year	79,246	27,953	441	3,284	110,924

The official assessment value of fixed assets amounts to 21.5 billion ISK. The insurance value of assets is 270 billion ISK, including an insurance assessment amount for the Kárahnjúkar project at the end of 2006.

12. Depreciation in the consolidated accounts consists of the following (ISK million):

	2006	2005
Power stations	3,149	3,126
Power transmission	1,055	1,324
Communication equipment	53	56
Other assets	202	159
Depreciation of assets in operation	4,459	4,665
Capitalized depreciation	(7)	(6)
Impairment loss on development costs, see note 5	679	245
	5,131	4,904

## Long-term investments

13. At the end of 2006 Landsvirkjun's subsidiaries comprised the following four companies (ISK million):

	Percentage share	Par value
Fjarski ehf	100.0%	250.0
Icelandic Power Insurance Ltd	100.0%	USD 0.1
Íslensk jarðhitatækni ehf	74.0%	0.4
Landsnet hf	69.4%	3,821.1

Investments in other companies amounted to 168 million ISK during the year, consisting of investments in Enex, Hecla, DMM Lausnir and Orkusalan.

Ownership shares in other companies are recorded at historical cost and are specified as follows (ISK million):

	Percentage share	Par value	Book value
Enex hf	24.29%	50.1	256
Farice hf	1.3%	0.4	1
Hecla SAS	30.0%	EUR 0.09	15
Tengir hf	38.3%	15.3	2
Íslensk orka ehf	27.1%	44.2	1
Netorka hf	40.0%	9.6	43
Badfélag Mývatnssveitar ehf	12.5%	15	15
Sipenco GmbH	25.0%	CHF 0.06	3
Theistareykir ehf	31.97%	110.8	260
Neydarlínan hf	7.9%	1.5	50
Orkusalan ehf	28%	3	3
DMM Lausnir ehf	6.69%	1	12
Vistorka hf	13.6%	10.1	31
			693
Allowance account			(143)
			550

The equity method is not used for the associates above since their effect on the consolidated operation is not significant.

An allowance account in the amount of 143 million ISK was in place at the end of 2006 due to the uncertainty of the financial position of the companies involved, most of which are start-up projects.

### Deferred tax asset

14. The deferred tax asset amounted to 19.9 billion ISK at the end of 2006. The change during the year can be broken down as follows:

Deferred tax asset at beginning of year . . . . .	0
Income tax benefit for parent company during the year . . . . .	19,829
Income tax benefit for subsidiaries during the year . . . . .	33
Deferred tax asset at the end of 2006 . . . . .	<u>19,862</u>

The deferred tax asset account relates to the following items:

Loss carry-forward . . . . .	3,783
Property, plant and equipment . . . . .	15,739
Other items . . . . .	340
Deferred tax asset at the end of 2006 . . . . .	<u>19,862</u>

### Other current assets

15. Included in other receivables in current assets is a deposit with a bank in the amount of 2.059 million ISK, which represents a contractual collateral payment. This is explained by the net negative value of hedging instruments at the end of 2006, see note 21.

### Owners' equity

16. Changes in owners' equity can be analysed as follows (ISK million):

	Owners' contributions	Other equity	Total equity
Balance at January 1, 2006 . . . . .	32,750	25,253	58,003
Cash dividends . . . . .	( 427 )		( 427 )
Restatement of owners' contributions . . . . .	4,041	( 4,041 )	
Translation adjustment on foreign subsidiary . . . . .		28	28
Net profit for the year . . . . .		3,503	3,503
Owners' equity at end of 2006 . . . . .	<u>36,364</u>	<u>24,743</u>	<u>61,107</u>

Based on an agreement dated 1981, and with reference to subsequent amendments to that agreement, capital contributions amounted to ISK 14 billion in terms of prices at the end of 1995. The capital contributions restated to reflect changes in price levels to the end of 2006 amounted to ISK 24,273 million. The former partnership agreement stipulated that dividends were to be 5.5% of the restated capital contributions and the balance for accrued dividends. The part of the dividends accrued which was not paid increased capital contributions by the owners. The cash payments of dividends were based on certain operating indicators, i.e. profit before depreciation and interest charges on long-term debt, and amounted to 427 million, which was paid during the first half of 2006.

### Pension obligations

17. The company's obligation to refund the indexation charges on retirement payments to current and former employees amounted to 2,180 million ISK at the end of 2006 based on an actuarial estimate. The calculation takes into account estimates of future changes in compensations and price levels. The real discount rate is 3.5% and on average the increase in salaries in excess of price level changes is projected at 1.5% annually. Assumptions on life expectancy, mortality rates and other relevant estimations are in conformity with the provisions of the regulation (no. 391/1998) governing such calculations for pension funds. The retirement age is 68 years for current employees and 65 years for non-employees with vested benefits, and this is consistent with the relevant pension funds' regulations. The obligation amounted to 1,951 million ISK at the beginning of the year and has thus increased by 229 million ISK during the year. Additionally, 99 million ISK were paid during the year leading to a total pension charge for the year of 328 million ISK.

## Long-term liabilities

18. Long-term debt can be broken down as follows in terms of currencies (ISK million):

	Foreign amount	ISK amount	Indexation exch.rate loss
Consolidated:			
US dollar . . . . .	1,076.4	77,500	3,949
Euro . . . . .	439.6	41,708	9,780
Icelandic krona . . . . .		29,912	2,121
Japanese yen . . . . .	4,529.6	2,745	296
Swiss franc . . . . .	218.1	12,875	2,395
Pounds sterling . . . . .	41.0	5,793	2,214
		<u>170,533</u>	<u>20,756</u>
Current maturities . . . . .		6,793	
Net long-term liabilities . . . . .		<u>163,740</u>	

The nominal interest rates on outstanding debt range from 0.5-14.5%. The average nominal interest rates were 4.63% during 2006, as compared to 3.51% for the previous year.

The company has entered into cross currency and interest rate swaps in order to limit its risk exposure to currency changes and interest costs. The breakdown of long-term debt takes into account the swap agreements made, including the interest costs of these agreements. The State Treasury of Iceland, the City of Reykjavik and the Township of Akureyri provide a guarantee of collection on long-term liabilities entered into before the end of 2006. As of January 1, 2007 the State Treasury of Iceland and Eignarhlutir provide a guarantee of collection for long-term debt assumed after that date.

19. The following is the maturity schedule as per loan agreements for long-term debt in ISK million:

	Consolidated
2007 . . . . . Đ	6,793
2008 . . . . . Đ	17,631
2009 . . . . . Đ	1,732
2010 . . . . . Đ	10,740
2011 . . . . . Đ	15,188
Later . . . . . Đ	<u>118,449</u>
	<u>170,533</u>

This repayment schedule will change as a result of refinancing measures in accordance with the company's policy of retirement of long-term debt.

## Cash flow statement

20. Cash flow from operating activities is a good indicator of the company's ability to repay liabilities. The Statement of Cash Flows is particularly useful when comparative figures for several years are presented. For this reason, the following table shows the cash flows from operations using the direct method for the last four years (ISK million):

	Consolidated			
	2006	2005	2004	2003
Operating profit . . . . .	3,503	6,294	7,195	1,551
Depreciation and asset write-offs . . . . .	5,257	4,955	5,387	5,437
Gain on sale of assets . . . . .	( 668 )	( 18 )	( 10 )	0
Exchange rate losses and indexation . . . . .	21,751	( 4,592 )	( 8,298 )	( 1,129 )
Income tax benefit . . . . .	( 19,863 )	0	0	0
Minority interest . . . . .	( 52 )	37	0	0
Working capital from operations . . . . .	9,928	6,676	4,274	5,859
Current assets, change . . . . .	( 2,008 )	( 349 )	( 64 )	( 168 )
Current liabilities, change . . . . .	1,723	( 400 )	412	( 90 )
Cash flow from operations . . . . .	<u>9,643</u>	<u>5,927</u>	<u>4,622</u>	<u>5,601</u>
Cash flow from operations as percentage of long-term liabilities . . . . .	<u>5.7%</u>	<u>5.2%</u>	<u>4.8%</u>	<u>6.4%</u>

## Risk management

21. The company uses derivative instruments to manage its financial risk in accordance with strategies and limits set by the Board of Directors and the operation is overseen by both internal and external auditors.

The financial risk the company has to manage is of three types. First, the risk of changes in the world market price of aluminium, since more than half of the company's revenues are linked to the price of aluminium. Second, risk associated with interest rates on the company's financing, and third, the risk resulting from foreign currency fluctuations on foreign denominated debt and revenues linked to foreign currencies. The purpose of the company's risk management is to measure and monitor market risk with the aim of reducing fluctuations in operating performance by means of using derivatives to reduce the impact of volatility in currencies, interest rates and aluminium prices.

The company has set benchmarks in each risk category with respect to the hedging limits. These are long-term strategies set by the Board of Directors for each risk category. Effective risk management allows management to deviate within certain limits set by the Board provided that such deviations are for the benefit of the company.

Landsvirkjun uses derivative financial instruments for risk management purposes as well as for speculation. The purpose of using such instruments must be decided beforehand, regardless of whether the use is for risk management or speculation. The decision in each case is based on the purpose for these transactions. The purpose of using derivatives for risk management is to reduce the negative effects of fluctuations in aluminium price, interest rates and exchange rates. The purpose of speculation is to make a profit in the short term.

The Financial Reporting Act requires information to be provided on the fair value of outstanding derivative contracts to the extent that they are not recorded as assets and liabilities at fair value, and such information is provided below. Fair value represents the amount for which an asset could be sold or liability settled in a transaction between informed and unrelated parties.

The company has entered into cross-currency swaps in connection with long-term liabilities and net positive fair value at the end of 2006 amounted to 919 ISK million, while the book value of the same contracts amounted to 900 ISK million. The underlying notional amounts in these contracts were approximately 57 billion ISK at the end of 2006.

The interest rate swap contracts that the company has entered into are mainly for the purpose of converting variable rates into fixed rates. The fair value of these contracts was positive at the end of 2006 in the amount of 130 million ISK, while the related book value of the same contracts was 53 million ISK. The underlying notional amounts in these contracts were approximately 19 billion ISK.

The company has entered into forward contracts for the purchase and sale of foreign currencies in order to hedge sales revenues. The net positive fair value of these contracts was 45 million ISK at the end of 2006, whereas the underlying notional amounts were approximately 864 million ISK.

The positive fair value of outstanding option contracts at the end of 2006 amounted to 293 million ISK, while the underlying notional amounts were approximately 12 billion ISK.

The company has entered into forward and option contracts in order to hedge sales revenues. Their net negative fair value amounted to 10.7 billion ISK at the end of 2006, while the underlying notional amounts were approximately 34 billion ISK. The fair valuation takes into account the present value of estimated cash flows based on forward prices of aluminium, taking into consideration applicable optionality provisions. The amount expensed during the year 2006 on these hedging contracts amounted to 3.2 billion ISK.

The company is in the process of valuing the embedded derivatives in power sales contracts. The indications are that the embedded derivatives are of significant positive value and their value will be recorded as of the beginning of 2007 upon adoption of the International Financial Reporting Standards (IFRS).

## Other notes

### 22. Interim Financial Reports:

The operation of the consolidated company was as follows in the first and second half of 2006 (ISK million):

	1.1.-30.6.	1.7.-31.12.	Total
Operating revenues	10,013	11,285	21,298
Operating expenses:			
Operations and maintenance	( 2,970 )	( 3,408 )	( 6,378 )
Depreciation	( 2,389 )	( 2,742 )	( 5,131 )
Operating profit	4,654	5,135	9,789
Financial income and (financial costs)	( 27,613 )	1,413	( 26,200 )
Income tax benefit	16,108	3,754	19,862
Minority interest	361	( 309 )	52
Net profit (loss)	( 6,490 )	9,993	3,503
Cash flow from operations	5,588	4,055	9,643

23. At the end of 2005 Landsvirkjun entered into an agreement with the association of landowners adjacent to the glacial river Jökulsá á Dal and the representatives of the holders of the water rights relating to the Kárahnjúkar project to form a separate committee to value the water rights and propose methods of allocating payments for those rights. The claims will be heard by the committee in May 2007 with conclusions expected at mid-year.

24. Total wages and salaries on a consolidated basis amounted to 2,180 million ISK and related expenses, including pensions and accrued vacation pay, amounted to 868 million ISK for a total of 3,048 million ISK. The average number of employees was 338 during the year.

The remuneration to the Board of Directors, the Managing Director and five Directors were as follows in 2006 (ISK million):

	Parent
Board of Directors . . . . .	10
Managing Director . . . . .	18
Deputy Managing Director and five Directors . . . . .	73

25. General administrative expenses can be specified as follows for 2006 (ISK million):

	2006	2005
Corporate office	234	257
Finance . . . . .	236	227
Human resources	80	81
Information technology	124	128
Engineering and construction	267	114
Pension payments	328	254
Impairment of shares	27	41
Accrued vacation pay	69	142
Other shared costs	112	76
	<u>1,477</u>	<u>1,320</u>
Other costs - relating to subsidiaries	681	462
	<u>2,158</u>	<u>1,782</u>

26. The construction of the Kárahnjúkar project started in 2003 after power supply contracts were entered into with Fjarðaál, a subsidiary of Alcoa Inc. The power station's capacity will be 690 MW and transmission lines will be erected to Reydarfjörður. The current estimate is for the first generating unit to commence operations in July 2007. Further information on the project can be found at the power project's website: [www.karahnjukar.is](http://www.karahnjukar.is).

At the end of 2006 the cumulative expenditures for the Kárahnjúkar project amounted to 88.8 billion ISK. The total cost of transmission assets under construction amounted to 9.1 billion ISK at the end of 2006.





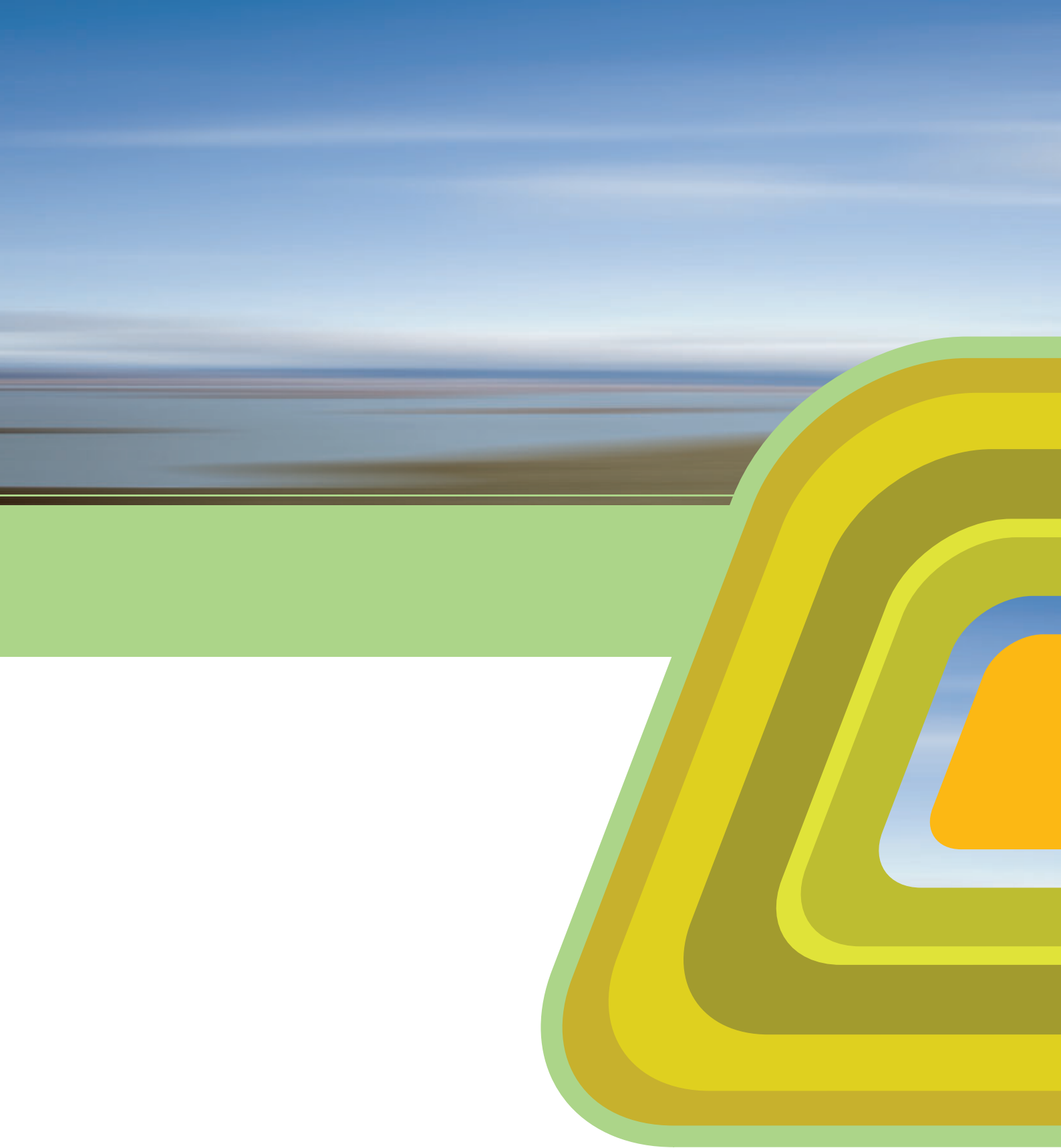
The photographs in this annual report are from Landsvirkjun's various places of operation and of the people that work there.  
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