FLAGA GROUP

Innovators in Sleep

Contents

Financial Overview

STATEMENT OF OPERATIONS
USD '000

	2007	2006	2005	2004	2003*
Sales	33,161	32,474	34,747	26,446	19,134
Cost of goods sold	14,056	13,168	12,760	9,614	7,484
Gross profit	**19,105**	**19,307**	**21,987**	**16,832**	**11,650**
Operating expenses					
Sales, general and admin exp.	17,728	17,062	18,476	14,760	9,700
Research and development	2,652	2,363	2,693	2,529	2,507
Restructuring cost	-96	267	2,059		
Total operating expenses	**20,284**	**19,692**	**23,228**	**17,289**	**12,207**
Operating profit (loss)	**-1,179**	**-386**	**-1,241**	**-457**	**-557**
Net financial income (expenses)	-11,428	-1,071	-1,152	-56	-647
Amortization of goodwill and other expenses					
Operating profit (loss) bef. taxes	**-12,607**	**-1,456**	**-2,393**	**-513**	**-1,204**
Taxes	-24	766	948	583	689
Profit (loss)	**-12,631**	**-690**	**-1,445**	**70**	**-515**
EBITDA	**127**	**1,001**	**668**	**765**	**172**

* Numbers before 2004 have not been restated according to IFRS Accounting Standards or different allocation of G&A expenses to cost of goods sold and R&D cost. Therefore years prior to 2004 are not fully comparable

BALANCE SHEET

USD '000	Dec 31, 2007	Dec 31, 2006	Dec 31, 2005	Dec 31, 2004	Dec 31, 2003
Fixed assets	33,591	44,975	45,495	41,436	17,872
Current assets	14,348	17,149	16,259	15,619	13,314
Total assets	**47,939**	**62,124**	**61,754**	**57,055**	**31,186**
Equity	27,425	40,213	40,953	37,553	21,244
Subordinated loan	3,312	4,287	3,087	2,883	2,694
Long-term debt			3,957	6,703	2,406
Current liabilities	17,202	17,624	13,757	9,916	4,842
Equity and total liabilities	**47,939**	**62,124**	**61,754**	**57,055**	**31,186**

STATEMENT OF CASH FLOW
USD '000

	2007	2006	2005	2004	2003
Working capital from operations	-1,195	1,414	545	964	-191
Net cash from operations	1,793	-1,351	980	-596	-4,067
Net cash used in investing activities	-413	-658	-196	-24,489	-1,921
Net cash provided by financing activities	-1,497	2,232	-589	24,729	6,499
Change in Cash and Cash equivalents	**-117**	**223**	**195**	**-356**	**511**

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%

The Company

Flaga Group has been a listed company on the Icelandic stock exchange since 2003 and has its corporate headquarters in Reykjavik, Iceland. The Company operates two separate companies in the international sleep business: Embla, a global leader in the design, manufacture, development and sale of sleep diagnostic systems; and SleepTech, a leading U.S. service provider for hospital-based sleep diagnostic centers throughout the United States.

The Sleep Market

The sleep market is one of the fastest growing segments of the healthcare market. In 2007 two significant changes occurred in the market that will have an impact on how both SleepTech and Embla develop in the future. The American Academy of Sleep Medicine (AASM) released new guidelines on how Polysomnography should be recorded. Although this is an American based society its influence reaches around the world and recommendations made by the AASM are generally followed in many other countries. The new rules that will come into effect in July of 2008 have a broad impact on how Polysomnography is recorded and interpreted. The second major change was the acceptance of unattended home testing by the Centers for Medicare and Medicaid (CMS) in the United States. The decision by CMS was followed by recommendations from the AASM on unattended home testing. These new regulations allow for the reimbursement for Positive Airway Pressure (PAP) devices in the treatment of Obstructive Sleep Apnea using unattended diagnostic devices. This is a significant change in the United States and offers a market opportunity to Embla which has been marketing a popular home test device in Europe for several years, the Embletta product. It is currently estimated that more than 1 in 5 individuals suffer from an undiagnosed, treatable sleep disorder. If this population can be reached with the deployment of the home testing model, it will have a significant impact on the number of patients diagnosed and subsequently treated for sleep disorders.

A recent report from the National Sleep Foundation reports that in the United States alone, approximately 60 million Americans suffer from sleep deprivation and/or an untreated sleep disorder resulting in an estimated cost of more than $100 billion annually in lost productivity, medical expenses, sick leave and property and environmental damage. Awareness throughout the world continues to grow as sleep and sleep-related problems are identified as playing a larger role in overall health and affecting almost every field of medicine

Company Vision

The Company's vision is to be the leading player in the global sleep diagnostics and related sleep services market. A corporate structure and strategy have been developed that captures opportunities across the broad spectrum of the sleep diagnostics marketplace.

Corporate Structure

Under the umbrella of the Flaga Group, there are two companies: Embla and SleepTech.

Embla is a global leader in the design, manufacture development and sale of diagnostic sleep equipment and services.

The Embla corporate head office is located in Denver Colorado, USA with offices in Buffalo, New York, USA, Ottawa, Ontario, Canada Amsterdam, Holland and a sales office in Munich Germany. Embla's core focus is on custom hardware and software solutions for the sleep diagnostic community and has an extensive network of distributors and direct sales personnel throughout the world.

SleepTech is a regional sleep service provider to hospital-based sleep centers with headquarters in Wayne, New Jersey, USA. SleepTech's business model is based on a scalable formula that has been developed into long-standing contracts with hospitals in the New York Metropolitan Area. In 2007 the strategic direction of the company was broadened to expand outside the North East United States to both Hospital and Physician management models. This has resulted in new contracts outside SleepTech's traditional market. These partnerships provide a range of services from developing centers to staffing and scoring of reports generated from the sleep diagnostic testing. SleepTech has been a pioneer of quality services and a leader in its field.

Strategy

Embla

- Closer to our Customers -

Embla has one of the broadest ranges of sleep diagnostic equipment in the world and sells its products and services in countries throughout the world.

There have been a number of significant changes in the Sleep market and achievements for Embla in 2007;

The American Academy of Sleep Medicine (AASM) announced a major change in the way sleep Polysomnography had to be evaluated and scored. This resulted in changes to the Embla product line from both a hardware and software perspective. These changes will be completed by the June deadline.

The new reimbursement from the Centers for Medicare and Medicaid (CMS) is having a significant impact on the sleep industry in the United States. The Embletta fits very well in to the new criteria and the Company is expanding the manufacturing of the Embletta to satisfy these new regulations.

In late 2007 Embla completed the negotiation of an exclusive agreement with the Beth Israel Deaconess Medical Center (BIDMC) for the distribution of the Cardio Pulmonary Coupling (CPC) technology developed by Drs. Robert Thomas, Ary Goldberger, C-K. Peng, and Mr. Joseph Mietus.

CPC technology represents a breakthrough in how sleep can be visualized, by presenting a simple and accurate picture of sleep oscillations and interactions instead of the tedious manual sleep stage scoring and counting of respiratory events that has been the standard for the last 40 years. The analysis has been validated using over 10,000 sleep studies. The technique can track dynamic sleep physiology, and provide a unique ambulatory measure of sleep quality.

The introduction of reimbursement for home testing together with the integration of this technology into Embla’s existing product line will allow the Company to develop very low cost and reliable diagnostic tools to assist clinicians in diagnosing the presence of sleep apnea among the huge population of undiagnosed people who suffer from this condition.

Embla’s alliance with major academic institutions for intellectual technology ensures attaining the business and strategic goals of the Company to advance the science of sleep medicine and to bring evidence based medicine into general practice.

The market for sleep diagnostic equipment is estimated to be about US$230 million worldwide, which includes full polysomnography (PSG) equipment; ambulatory and portable sleep diagnostic equipment, screeners and accessories and estimated to be growing at about 10 to 12% per year. Embla has world-class products in each of these categories, and its strong position in the world market will continue to be the Company’s strength as it grows.

The Future

Through global teams providing cohesive support to our customers and distribution partners the Embla has built a strong and sustainable organization that is now very well positioned to take advantage of the sleep diagnostic market throughout the world.

We are forecasting above market growth in all our markets and profitability in 2008.

SleepTech

SleepTech continues to be the largest provider of sleep diagnostic and management services in the New York Metropolitan Area (New York, New Jersey and Connecticut). The Company has service agreements with 17 hospitals/healthcare systems/physicians and provides remote access and on-line interpretation services for over 50 physicians through its state-of-the-art MySleepTech system. The market for sleep services is much larger and may be in excess of a billion dollars in the U.S. alone. This includes services ranging from technical and clinical support to sleep lab management and billing services.

The Year 2007

Calendar year 2007 represented another record year financially for SleepTech.

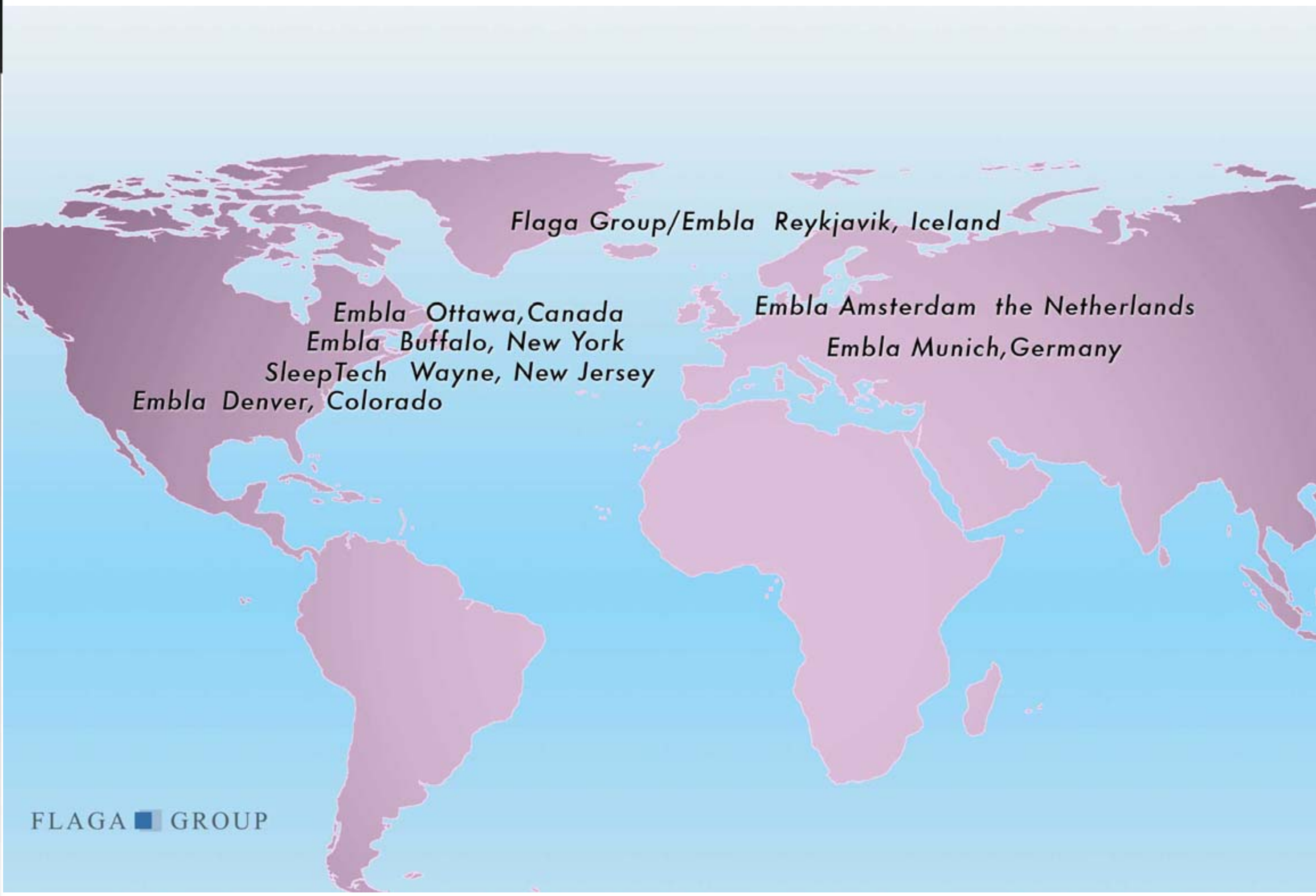
A new strategic direction was taken for SleepTech in 2007. A decision was made to expand the original business model that is focused on hospital contacts in the New York Metropolitan Area, to include building relationships with both hospital and private physicians outside our traditional geographic footprint. This has already proved to be successful with two new physician based facilities opening in California and Mississippi, a SleepTech owned facility opening in Florida and more facilities planned for 2008. In addition SleepTech continues to work closely with its partner hospitals to improve efficiency and patient care. An example is the work SleepTech is doing in accreditation. Every hospital that uses SleepTech’s services is

actively pursuing accreditation status by the American Academy of Sleep Medicine (AASM), which, when completed, will create one of the largest compilation of AASM accredited centers in the United States. SleepTech has and will continue to invest in clinical education and training programs, as well as commit technology and marketing resources towards creating a more flexible and efficient environment as we move into the future. The Company is in active discussions with an academic institution towards forming a partnership to create the first Commission on Accreditation for Allied Health Education Programs (CAAHEP) accredited training program for sleep technologists in the New York Metropolitan Area.

SleepTech has continued to invest in web-based services designed to assist sleep center operators and physicians alike to transfer and manage data to make their work more effective. Embla is working closely with SleepTech to develop these services. Examples of this work are the two software packages "Enterprise" and "MySleepTech", developed out of the expertise and operational experience learned at SleepTech.

The Future

The future for SleepTech in 2008 and beyond continues to show significant positive financial results and forecasted annual growth rates at or above industry norms. Several current hospital partners are looking to expand their service capacity while numerous potential new clients are looking to partner with SleepTech.

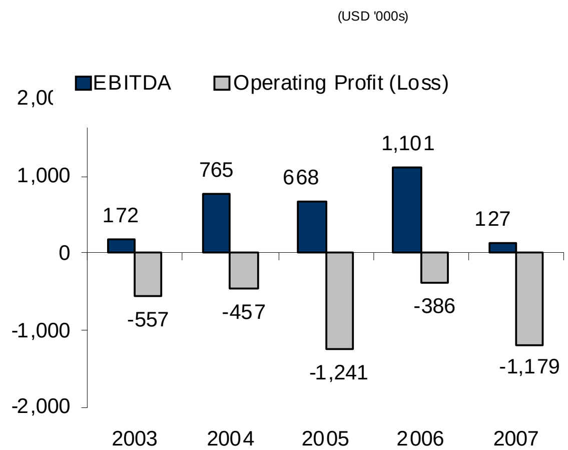


2007 Financials

The Consolidated Financial Statements of Flaga Group hf. for the year 2007 cover the Parent Company and its subsidiaries: Embla Systems ehf., Iceland; Embla Systems Inc., USA; Sleeptech LLC, USA; Embla Systems BV., The Netherlands; Embla Systems GmbH, Germany; Embla Systems Ltd. Canada. The Financial Statements are presented in USD.

Operating Income

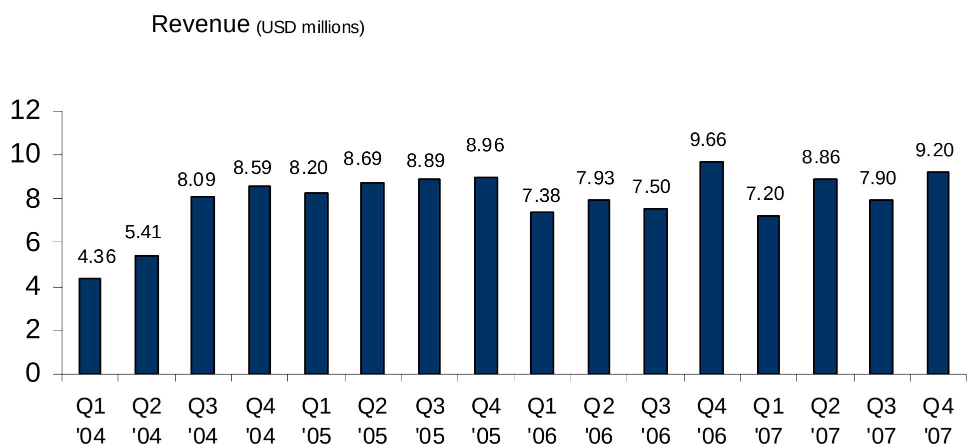
EBITDA was positive $127k compared to $1.0 million in 2006.



Sales

Total sales in 2007 were $33.16 million up from $32.47 million, in 2006, an increase of 2%. Revenue was primarily flat as result of uncertainty in the market around the new portable reimbursement issues introduced in 2007.

The gross profit margin was 58%, compared to 69% in the previous year.



Operating Expenses

Sales, general and administrative costs totaled $17.7 million in 2007 compared to $17.1 million in 2006, an increase of $0.6 million from 2006.

Research and development expenses were $2.65 million in 2007 compared to $2.36 million in 2006, an increase of $290 thousand from the prior year or 8.0% of revenue compared to 7.3% of revenue in 2006.

Before restructuring costs total operating expenses in 2007 were $20.4 million compared to $19.4 million in 2006 an increase in operating costs of $1.0 million or 4.9%.

Taxes

Income tax assets are capitalized at year-end 2007 and income tax on the profit and loss are recognized in the income statement. As a result, the deferred tax asset increased $184 thousand for the year 2007.

Financial Expenses

Financial expenses amounted to $1.6 million in 2007, compared with $1.5 million in 2006. Currency exchange fluctuations were positive in 2007, representing a net $615 thousand, in comparison to positive net $464 thousand in 2006.

Balance Sheet

Total assets at year-end were $47.94 million, down from $62.12 million from the beginning of the year.

Total liabilities amounted to $20.51 million, including current liabilities of $17.20 million. Total liabilities decreased by $1.39 million during the year 2007.

Shareholders equity was $27 million at the end of 2007.

Prospects in 2008

The company has come through a tough year in the sleep market with many uncertainties, but these are now largely in the past. With the changes in the reimbursement in the United States, the successful expansion of Sleeptech and the potential of the CPC project, the Company is well positioned to take advantage of the growing sleep market in 2008.

The revenue is expected to grow through 2008 as the new products, sales and marketing strategies take effect in the U.S., Europe and the rest of world. The long-term profitability for both SleepTech and Embla remains good.

Auditing

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Governance

Flaga Group hf. complies in full with the guidelines on Corporate Governance set forth in March 2004 by the Icelandic Stock Exchange, the Icelandic Chamber of Commerce and SA-Confederation of Icelandic Employers. An Audit Committee and a Compensation Committee, each with their own charter directing their operation, have been in place since 2002. The majority of the Board and each of the committees are independent as defined by the above mentioned rules.

Board of Directors

Bogi Pálsson, Chairman of the Board

Bogi was elected to the Board at the Company's AGM in March 2004. He invested in Medcare Flaga hf. shortly before the AGM and became one of the Company's core investors. Bogi has been an innovator and an entrepreneur for 20 years and he served as Chairman of the Iceland Chamber of Commerce between 2000 and 2004. Bogi is currently the owner and Executive Chairman/CEO of Eignarhaldsfelagið Stofn ehf. a private investment company based in Iceland.

Eggert Dagbjartsson, Independent Board Member

Eggert was elected to the Board in 2002. Eggert lives in Cambridge, Massachusetts, USA. Eggert is a partner and co-Managing Director of Equity Resource Investments, LLC. The company operates specialized investment funds investing in real estate based investments in the United States. He has, in addition, invested in high-growth technology companies. Eggert is on the board of several companies in the United States.

Erlendur Hjaltason, Independent Board Member and Chairman of the Compensation and Audit Committees

Erlendur Hjaltason is the co-CEO of Exista hf, a Financial Services Company listed on the Icelandic Stock Exchange. He is an MBA graduate from Handelshøjskolen in Copenhagen (the Copenhagen Business School), and since graduating, Erlendur worked for Eimskipafélag Íslands (Eimskip). Eimskip is the largest transport group in Iceland. Erlendur led various departments in Eimskip and played a key role in the development of the company's overseas operations as Head of Overseas Operations, eventually becoming CEO of Eimskip in 2002. Erlendur joined Exista in September 2004 as the Group's CEO, and was elected the chairman of the Iceland Chamber of Commerce in February 2006.

Sveinn Thór Stefánsson, Independent Board Member

Sveinn Thór became a regular board member in May 2005. He is the CFO of Exista hf., a Financial Services Company listed on the Icelandic Stock Exchange. From 1995 to 2004, Sveinn Thór was the Financial Manager of Lýsing hf., a credit institution focused mainly on leasing financing for corporations in Iceland. He holds a degree in economics from the University of Iceland.

Hákon Sigurhansson, Independent Board Member

Hákon became a board member in March 2006. He holds an MSc in Electronic Engineering from Aalborg University and an MBA from ESCP-EAP in Paris. Hákon has over 15 years of management experience in the telecommunication and software industries in Iceland and the US. Hákon is the Managing Director for TM Software – Healthcare, a software engineering company in Iceland.

Board Committees

Compensation Committee

The Compensation Committee reviews and determines salaries, bonuses and all other elements of the compensation packages offered to the CEO. The committee also establishes the general compensation policies of the Company.

The Company believes that its executive compensation programs should reflect the Company's financial and operating performance. In addition, individual contribution to the Company's success should be supported and rewarded.

Members of the Compensation committee are the following independent board members: Erlendur Hjaltason, Chairman, Eggert Dagbjartsson and Bogi Pálsson.

Audit Committee

The responsibilities of the Audit Committee are to independently monitor the Company's internal control system and financial reporting process, to assess the efforts of the Company's internal audit function and its independent auditors, and to maintain free and open channels of communication among the directors, the independent auditor, the internal auditor, and the management of the Company.

Members of the Audit Committee are independent board members: Erlendur Hjaltason and Bogi Pálsson.

Senior Management

David Baker, CEO of Flaga Group hf. and President of Embla

Kevin Kelly, President of SleepTech

Criss Sakala, Chief Financial Officer, Flaga Group hf.

Terry Murphy, Director of Sales – Embla, Americas.

Manfred Koch, Director of Sales, Embla, Europe and non-America markets

Bill Kirschner; Director of Operations – Embla

Kassandra Keller, Vice President, Sales and Marketing, Sleeptech

Mark Rose, Vice President of Information and Equipment Systems, SleepTech

Jacqueline Ohnmeiss, Director of Operations, SleepTech

Glenn Migliorino, Finance Controller, SleepTech

Shareholders

The Company's shares are listed on the Nasdaq OMX Nordic Stock Exchange in Iceland Main List. Flaga Group's ISIN code is IS0000008753, and the Company's ticker symbol in the trading system of the Iceland Stock Exchange is FLAGA. See **www.OMXNORDICEXCHANGE.com** for information on stock trading.

There were 457 shareholders in Flaga Group hf. at year end 2007 compared with 464 shareholders at year-end 2006.

Endorsement by the Board of Directors

The Consolidated Financial Statements of Flaga Group hf. are prepared and presented in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The Consolidated Financial Statements contain the Group operations for the year 2007. The Consolidated Financial Statements are stated in US Dollars and include the Consolidated Financial Statements of the Parent Company Flaga Group hf. (the "company") and its subsidiaries , Embla Systems ehf., Embla Systems Inc., USA, SleepTech LLC, USA, Embla Systems Ltd., Canada, Embla Systems B.V., the Netherlands, Embla Systems GmbH, Germany and Midwest Sleep and Neurodiagnostic Institute, USA (the "Group").

Flaga Group operates two separate companies in the international sleep business: Embla, a global leader in the design, manufacture and sale of sleep diagnostic systems and SleepTech, a leading U.S. service provider for sleep diagnostic centers.

In September 2007, Criss Sakala was hired as Chief Financial Officer of Flaga Group hf.

Embla has global headquarters in Denver, Colorado, USA: distribution in Buffalo New York, USA: Development and Technical Support in Ottawa, Ontario, Canada: Technical Support and Distribution in Amsterdam, Holland and Sales and Technical Support in Munich, Germany.

SleepTech continues to be the largest provider of sleep diagnostic and management services in the New York Metropolitan Area (New York, New Jersey and Connecticut) and enjoyed another year of growth in its market.

The Group operating revenue amounted to USD 33.2 million based on the Consolidated Income Statement and the loss for the year 2007 amounted to USD 12.6 million. According to the Consolidated Balance Sheet, assets amounted to USD 47.9 million and the equity amounted to USD 27.4 million at year-end 2007.

There were 457 shareholders in Flaga Group hf. at year-end 2007 compared to 464 at the beginning of the year. The Company’s capital stock amounted to ISK 720.7 million at year-end 2007 (2006: ISK 720.7 million) which equals USD 9.8 million based on a conversion into USD at the exchange rate of the date of payment. The company does not own treasury shares. The entire share capital is of the same class listed on the Nasdaq OMX Nordic Exchange Iceland. All shares confer the same rights. Share option agreements have been concluded with several managers of the Group, which enables them to purchase shares in the Company at the exercise price of 6 over a period of three years, given that they work for the Group during that time. Further information on the share option program is in note 22.

At the year-end three shareholders owned more than 10% of the shares in the Company: Exista B.V. which owned 22% of the shares, Kaupthing hf. owned 19.6% and Lífeyrissjóðir Bankastræti owned 11.3%.

The Board of Directors proposes not to pay a dividend to shareholders in the year 2008. As regards to changes in net equity the Board refers to the Statement of Changes in Equity.

Flaga Group hf. complies in full with the guideline on Corporate Governance set in March 2004 by the Icelandic Stock Exchange, the Icelandic Chamber of Commerce and SA-Confederation of Icelandic Employers. Since 2002 the Board has appointed an Audit Committee and a Compensation Committee which each has a charter that they operate by. The majority of the Board and each of the committees is independent as defined by the above mentioned rules.

To the best of our knowledge the consolidated financial statements of Flaga Group hf. for the year 2007 give a true and fair view of the assets, liabilities, financial position and financial performance of the Company.

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

The Board of Directors and the CEO of Flaga Group hf. hereby confirm the Group's Consolidated Financial Statements for the year 2007 with their signatures.

Reykjavik, 31 March 2008.   Board of Directors:

Bogi Pálsson, Chairman

Eggert Dagbjartsson, Erlendur Hjaltason, Hákon Sigurhansson, Sveinn Þór Stefánsson

CEO: David Baker

Independent Auditors Report

Board of Directors and Shareholders of Flaga Group hf.

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

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material 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 our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 Flaga Group hf. as of 31 December 2007, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavik, 31 March 2008.

KPMG hf.

Eyvindur Albertsson

Símon Á. Gunnarsson

Consolidated Income Statement for the Year Ended December 31, 2007

	Notes	2007	2006
Revenue	6	33,160,408	32,474,364
Cost of sales		(14,055,912)	(13,167,854)
Gross profit		19,104,496	19,306,510
Sales, marketing, general and administrative expenses		(17,728,175)	(17,062,024)
Research and development expenses		(2,652,227)	(2,362,926)
Restructuring costs	23	95,912	(267,487)
		(20,284,490)	(19,692,437)
Operating loss before financing costs		(1,179,994)	(385,927)
Finance income		954,991	574,658
Finance expense		(1,583,194)	(1,464,583)
Net financing costs	10	(628,203)	(889,925)
Impairment loss	13	(10,800,000)	0
Loss before taxes		(12,608,197)	(1,275,852)
Income tax	11	(24,441)	585,711
Net loss attributable to equity holders of the Company		(12,632,638)	(690,141)
Earnings per share	19		
Basic loss per share (USD)		(0.0180)	(0.0010)
Diluted loss per share (USD)		(0.0165)	(0.0009)

The notes on pages 15 to 43 are an integral part of these consolidated financial statements.

Consolidated Balance Sheet

Assets	Notes	2007	2006
Property and equipment	12	1,498,738	1,854,509
Intangible assets	13	27,731,757	38,944,093
Deferred tax asset	14	4,360,688	4,176,318
Total non-current assets		33,591,183	44,974,920
Inventories	15	3,362,621	4,113,758
Trade and other receivables	16	9,590,735	11,575,802
Cash and cash equivalents	17	1,394,240	1,459,245
Total current assets		14,347,596	17,148,805
Total assets		47,938,779	62,123,725
Equity			
Share capital		9,794,691	9,794,691
Additional paid-in capital		33,235,083	33,235,083
Translation reserve		(281,530)	(68,506)
Share-based payments		98,693	221,501
Accumulated deficit		(15,421,914)	(2,969,473)
Total equity	18	27,425,023	40,213,296
Liabilities			
Loans and borrowings	20	3,312,097	4,286,668
Total non-current liabilities		3,312,097	4,286,668
Bank loans	21	7,558,577	7,668,413
Loans and borrowings, current maturities	20	4,659,417	5,003,848
Provisions	23	55,005	150,917
Trade and other payables	24	4,928,660	4,800,583
Total current liabilities		17,201,659	17,623,761
Total liabilities		20,513,756	21,910,429
Total equity and liabilities		47,938,779	62,123,725

The notes on pages 15 to 43 are an integral part of these consolidated financial statements.

Statement of Changes in Equity

Changes in Equity 1 January - 31 December 2006

	Share capital	Additional paid-in capital	Translation reserve	Share-based payments	Accumu-lated deficit	Total equity
Balance at 1 January 2006	9,794,691	33,235,083	9,701	192,487	(2,279,332)	40,952,630
Translation differences of foreign operations	0	0	(78,207)	0	0	(78,207)
Net income (expense) recognized directly in equity	0	0	(78,207)	0	0	(78,207)
Loss for the year	0	0	0	0	(690,141)	(690,141)
Total recognized income and expense for the year	0	0	(78,207)	0	(690,141)	(768,348)
New shares issued	0	0	0	0	0	0
Share-based payments expensed in income statement	0	0	0	29,014	0	29,014
Balance at 31 December 2006	9,794,691	33,235,083	(68,506)	221,501	(2,969,473)	40,213,296

Changes in Equity 1 January - 31 December 2007

	Share capital	Additional paid-in capital	Translation reserve	Share-based payments	Accumu-lated deficit	Total equity
Balance at 1 January 2007	9,794,691	33,235,083	(68,506)	221,501	(2,969,473)	40,213,296
Translation differences of foreign operations	0	0	(213,024)	0	0	(213,024)
Net income (expense) recognized directly in equity	0	0	(213,024)	0	0	(213,024)
Loss for the year	0	0	0	0	(12,632,638)	(12,632,638)
Total recognized income and expense for the year	0	0	(213,024)	0	(12,632,638)	(12,845,662)
Share-based payments expensed in income statement	0	0	0	57,389	0	57,389
Share-based payments forfeited in the year	0	0	0	(180,197)	180,197	0
Balance at 31 December 2007	9,794,691	33,235,083	(281,530)	98,693	(15,421,914)	27,425,023

The notes on pages 15 to 43 are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flow 2007

	Notes	2007	2006
Cash flows from operating activities			
Net loss for the year		(12,632,638)	(690,141)
Adjustments for:			
Depreciation	12	1,162,610	1,410,768
Impairment loss	13	10,800,000	0
Income tax	14	(184,370)	(639,197)
Exchange rate fluctuations and finance cost		(487,528)	1,354,255
Other		147,055	(21,063)
Working capital provided by operating activities		(1,194,871)	1,414,622
Change in inventories		750,642	1,234,206
Change in trade and other receivables		2,158,371	(1,699,231)
Change in trade and other payables		1,122,039	(1,062,496)
Change in operating assets and liabilities		4,031,052	(1,527,521)
Interest paid		(991,671)	(1,139,182)
Income tax paid		(51,890)	(99,307)
Net cash provided by (used in) operating activities		1,792,620	(1,351,388)
Cash flows from investing activities			
Investment in intangible assets		(961)	(5,851)
Investment in property and equipment	12	(412,712)	(651,743)
Proceeds from sale of property and equipment		808	0
Cash flows from investing activities		(412,865)	(657,594)
Cash flows from financing activities			
Proceeds from loans and borrowings		0	6,222,146
Repayment of borrowings		(1,319,004)	(6,500,255)
Change in bank loans		(177,934)	2,509,763
Cash flows from financing activities		(1,496,938)	2,231,654
Net (decrease) increase in cash and cash equivalents		(117,183)	222,672
Cash and cash equivalents at 1 January		1,459,245	1,232,787
Effects of exchange rate fluctuations on cash held		52,178	3,786
Cash and cash equivalents at 31 December		1,394,240	1,459,245

The notes on pages 15 to 43 are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

1) Reporting entity

"Flaga Group hf. (the ""Company"") is a company incorporated and domiciled in Iceland. The address of the Company's registered office is Lækjargata 4, Reykjavik. The Consolidated Financial Statements of the Company for the year ended 31 December 2007 comprise the Company and its subsidiaries (together referred to as the ""Group""). The Group comprises the following main business segments: sleep diagnostics systems and sleep diagnostics services (see note 6).

2) Basis of Preparation

a) Statement of Compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

The Financial Statements were approved by the Board of Directors on 31 March 2008.

b) Basis of measurement

The Consolidated Financial Statements have been prepared on the historical cost basis.

The methods used to measure fair values are discussed further in note 4.

c) Functional and presentation currency

These Consolidated Financial Statements are presented in USD, which is the Company's functional currency.

d) Use of estimates and judgments

The preparation of Financial Statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the financial statements are described in the following notes:

Note 13 Goodwill - measurement of the recoverable amounts of cash-generating units

Note 14 Utilization of tax losses

Note 16 Trade and other receivables

3) Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

a) Basis of Consolidation

i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

ii) Transactions Eliminated on Consolidation

Intra-group balances, transactions and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the Consolidated Financial Statements.

b) Foreign Currency

i) Foreign Currency Transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale assets.

ii) Foreign Operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to USD at exchange rates at the reporting date. The income and expenses of foreign operations are translated to USD at rates approximating to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on retranslation are recognized directly in a separate component of equity.

iii) Foreign Currency Capital

The Company's shares are denominated in Icelandic Krona (ISK). The share capital and the additional paid-in capital are translated to the USD at the foreign exchange rate ruling at the dates of the relevant capital transactions.

c) Financial instruments

i) Non-Derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured at amortized cost using the effective interest method, less any impairment losses.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

ii) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares is recognized as a deduction from equity.

iii) Repurchase of share capital

When share capital recognized as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity.

d) Property and Equipment

i) Recognition and measurement

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

ii) Subsequent Costs

The Group recognizes in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognized in the Income Statement as an expense as incurred.

iii) Depreciation

Depreciation is recognized in the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives. The estimated useful lives are as follows:

Computer service equipment :	3 -5 years
Office equipment and machinery	3 -7 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

e) Intangible Assets

i) Goodwill

Goodwill (negative goodwill) arises on the acquisition of subsidiaries.

Acquisition prior to 1 January 2003

As part of its transition to IFRSs, the Group elected to restate only those business combinations that occurred on or after 1 January 2003. In respect of acquisitions prior to 1 January 2003, goodwill represents the amount recognized under the Group's previous accounting framework, Icelandic GAAP.

Acquisition on or after 1 January 2003

For acquisitions on or after 1 January 2003, goodwill represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess is negative (negative goodwill), it is recognized immediately in profit or loss.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses.

ii) Research and development

Expenditure on research and development activities, is recognized in the Income Statement as an expense when incurred.

iii) Software

Software that is acquired by the Group is stated at cost less accumulated amortization (see Note 12) and accumulated impairment losses.

iv) Subsequent Expenditure

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

v) Amortization

Amortization is charged to the Income Statement on a straight-line basis over the estimated useful lives of intangible assets other than goodwill, from the date that they are available for use, unless such lives are indefinite. The estimated useful live of software is 3 to 5 years.

f) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are classified as operating leases and the leased assets are not recognized on the Group's balance sheet.

g) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

h) Impairment

i) Financial assets

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

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognized previously in equity is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost and available-for-sale financial assets that are debt securities, the reversal is recognized in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognized directly in equity.

ii) Non financial assets

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

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

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

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

i) Employee benefits

Defined Contribution Plans

Obligations for contributions to defined contribution pension plans are recognized as an expense in the income statement when they are due.

Share-Based Payment Transactions

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

j) Provisions

A provision is recognized in the balance sheet when the Group has a present legal or constructive obligation as a result of past event that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. If no reliable estimate can be made of the amount of the obligation, no provision is recorded and a disclosure is made in the notes to the consolidated financial statements.

i) Warranties

A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty date and a weighting of all possible outcomes against their associated probabilities.

ii) Restructuring

A provision for restructuring is recognized when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

k) Revenue

i) Goods sold

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

ii) Services

Revenue from services rendered is recognized in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

l) Operating Lease Payments

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

m) Finance income and expenses

Finance income comprises interest income on funds invested, foreign currency gains. Interest income is recognized as it accrues, using the effective interest method.

Finance expenses comprise interest expense on loans and borrowings, bank loans, unwinding of the discount on provisions and foreign currency losses. All borrowing costs are recognized in profit or loss using the effective interest method.

n) Income Tax

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

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

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

o) Earnings per share

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

p) Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Group's primary format for segment reporting is based on business segments.

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

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments (other than investment property) and related revenue, loans and borrowings and related expenses, corporate assets (primarily the Company's headquarters) and head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.

q) New standards and interpretations

i) New standards and interpretations effective in 2007

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures became mandatory for the Group's 2007 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group.

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures became mandatory for the Group's 2007 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group.

ii) New standards and interpretations not yet adopted

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

IFRS 8 Operating Segments introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Group's 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. It is not expected to have any impact on the consolidated financial statements.

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

Revised IAS 23 Borrowing Costs removes the option to expense borrowing costs and requires that an entity capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised IAS 23 will become mandatory for the Group's 2009 financial statements and will constitute a change in accounting policy for the Group. In accordance with the transitional provisions the Group will apply the revised IAS 23 to qualifying assets for which capitalization of borrowing costs commences on or after the effective date.

The amendments to IFRS 2 Share Based Payment – Vesting Conditions and Cancellations (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Group's 2009 financial statements, with retrospective application required. The Group has not yet determined the potential effect of IFRS 2 (revised in 2008) on the consolidated financial statements.

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

- IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations

achieved by contract alone;

- The definition of a business combination has been revised to focus on control;
- The definition of a business has been amended;
- Transaction costs incurred by the acquirer in connection with the business combination do not form part of the business combination transaction;
- Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
- Disposals of equity interests while retaining control are accounted for as equity transactions;
- New disclosures are required.

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

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

IFRIC 12 Service Concession Arrangements provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Group's 2008 financial statements, is not expected to have any effect on the consolidated financial statements.

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

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

4) Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

i) Property, plant and equipment

The fair value of property and equipment recognized as a result of a business combination is based on market values. The market value of items of equipment, fixtures and fittings is based on the quoted market prices for similar items.

ii) Intangible assets

The fair value of acquired software is based on the discounted cash flows expected to be derived from the use and eventual sale of the assets.

iii) Inventory

The fair value of inventory acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventory.

iv) Trade and other receivables

The fair value of trade and other receivables, excluding construction work in progress, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

v) Share-based payment transactions

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

5) Financial risk management

Overview

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

- credit risk
- liquidity risk
- market risk.

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

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board has assigned the CEO of the Group to be responsible for developing and monitoring the Group's risk management policies.

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

i) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, has less of an influence on credit risk. However, geographically there is no concentration of credit risk.

The Group has established credit policies under which customers are analyzed for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group's review includes when available, external ratings and/or customer financial information in addition to other subjective criteria. Customers that fail to meet the Group's determination of creditworthiness may transact with the Group on a prepayment basis.

A significant amount of the Group's customers have been transacting with the Group for multiple years, and losses have occurred infrequently. In monitoring customer credit risk, customers are grouped according to their credit characteristics, including whether they are an individual or legal entity, whether they are a wholesale, or end-user customer, geographic location, industry, aging profile, maturity and existence of previous financial difficulties.

The Group does not require collateral in respect of trade and other receivables.

The Group establishes an allowance for bad debts that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Guarantees

The Group's policy is to provide financial guarantees only to wholly-owned subsidiaries. At 31 December 2007 no guarantees were outstanding (2006: none).

ii) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they become due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group monitors its cash flow requirements on a daily basis in order to optimize its cash return on investments. Typically the Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, the Group maintains lines of credit as shown in note 21.

iii) Market risk

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

The Group does not buy or sell derivatives in order to manage market risks.

Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities, primarily the Euro, British Pound and the Canadian dollar.

Interest on borrowings is denominated in currencies that match the cash flows generated by the underlying operations of the Group, primarily Euro and USD. This provides an economic hedge and no derivatives are entered into.

Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board of Directors monitors the return on capital, which the Group defines as net operating income divided by total shareholders' equity, excluding non-redeemable preference shares and minority interests. The Board of Directors also monitors the level of dividends to ordinary shareholders.

There were no changes in the Group's approach to capital management during the year.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

6) Segment Reporting

Segment information is presented in respect of the Group's business and geographical segments. The primary format, business segments, is based on the Group's management and internal reporting structure.

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

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly loans and borrowings and expenses, and corporate assets and expenses.

Business Segments

The Group comprises the following main business segments: 1) Sleep diagnostics systems. and 2) Sleep diagnostics services.

Sleep diagnostic systems

Sleep problems have been shown to impact 15 to 20% of the population and cost us over $100 billion annually in lost productivity, medical expenses, sick leave and property and environmental damage. The diagnosis of these sleep problems involves monitoring patients to measure their state of sleep and respiratory condition. The market has changed dramatically in the last 20 years from most tests being run in sleep laboratories to many now recorded in the home. The market is also changing to providing tools to help manage the sleep lab and how it is run as a business. This includes tracking patients before and after they are tested and investigating different disease management protocols that allow health care providers to reduce costs and treat more patients for the health care dollar.

Sleep diagnostic services

The market of providing services to diagnose and treat the patients impacted by this debilitating disease is over a billion dollar business. The Reimbursement drives the standard and type of care that is provided and as time goes by these are shrinking and the successful service provider in the future will be one that can scale its operation to be efficient and at the same time provide high quality medicine to a more discerning and aware public.

Geographical Segments

The sale and service segments are managed on a worldwide basis, but operate in two principal geographical areas, Europe and America. In Europe, sales offices are operated in the Netherlands and Germany.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

Business Segments	Sleep diagnostics systems 2007	Sleep diagnostics systems 2006	Sleep diagnostics services 2007	Sleep diagnostics services 2006	Eliminations 2007	Eliminations 2006	Consolidated 2007	Consolidated 2006
Revenue from external customers	20,618,845	20,491,380	12,541,563	11,982,984			33,160,408	32,474,364
Inter-segment revenue	4,486,712	4,890,255	0	0	(4,486,712)	(4,890,255)	0	0
Total revenue	25,105,557	25,381,635	12,541,563	11,982,984	(4,486,712)	(4,890,255)	33,160,408	32,474,364
Segment result	(2,861,709)	(2,417,600)	2,275,613	2,630,567	65,524	(29,235)	(520,572)	183,732
Unallocated expenses							(659,422)	(569,659)
Operating loss							(1,179,994)	(385,927)
Net financing cost							(628,203)	(1,070,585)
Impairment loss	(10,800,000)						(10,800,000)	0
Income tax							(24,441)	766,371
Loss for the year							(12,632,638)	(690,141)
Segment assets	16,023,626	29,345,474	28,303,580	28,799,988			44,327,206	58,145,462
Unallocated assets							3,611,573	3,978,263
Total assets							47,938,779	62,123,725
Segment liabilities	3,891,102	4,350,820	1,374,573	1,751,154			5,265,675	6,101,974
Unallocated liabilities							15,248,081	15,808,455
Total liabilities							20,513,756	21,910,429
Capital expenditure	324,190	959,864	187,646	70,852	99,124	170,234	412,712	860,482
Depreciation/amortization	675,460	833,011	651,799	718,756	(164,648)	(140,999)	1,162,611	1,410,768

Geographical segments	America	America	Europe	Europe	Other regions	Other regions	Consolidated	Consolidated
Revenue from external customers	22,021,380	22,314,608	9,668,838	8,629,154	1,470,190	1,530,602	33,160,408	32,474,364
Segment assets	36,238,418	47,888,614	11,700,361	14,235,111	0	0	47,938,779	62,123,725

Quarterly statements (unaudited)

7) Quarterly Income Statement for the years 2007 and 2006 (amounts are in thousands of USD):

	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2007 Total
Revenue	9,199	7,903	8,855	7,204	33,161
Cost of sales	(4,638)	(3,162)	(3,445)	(2,811)	(14,056)
Gross profit	4,561	4,742	5,411	4,393	19,107
Sales, general and admin expenses	(4,442)	(4,082)	(4,873)	(4,332)	(17,729)
Research and development expenses	(736)	(622)	(719)	(576)	(2,653)
Restructuring cost	0	0	96	0	96
Profit (loss) profit from operations	(617)	38	(85)	(515)	(1,179)
Net financial expense	(303)	(7)	(90)	(229)	(629)
Impairment loss	(10,800)	0	0	0	(10,800)
Profit (loss) before taxes	(11,720)	31	(175)	(744)	(12,608)
Taxes	175	(84)	(252)	137	(24)
Profit (loss)	(11,545)	(53)	(427)	(607)	(12,632)

EBITDA is specified as follows:

	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2007 Total
Revenue	9,199	7,903	8,855	7,204	33,161
Cost of sales	(4,638)	(3,162)	(3,445)	(2,811)	(14,056)
Gross profit	4,561	4,741	5,410	4,393	19,105
Operating expenses, less depreciation	(4,895)	(4,381)	(5,107)	(4,595)	(18,978)
EBITDA	(334)	360	303	(202)	127

	2006 Q4	2006 Q3	2006 Q2	2006 Q1	2006 Total
Revenue	9,659	7,498	7,934	7,383	32,474
Cost of sales	(4,149)	(3,066)	(3,222)	(2,731)	(13,168)
Gross profit	5,510	4,432	4,712	4,652	19,306
Sales, general and admin expenses	(4,467)	(3,968)	(4,361)	(4,266)	(17,062)
Research and development expenses	(564)	(458)	(506)	(835)	(2,363)
Restructuring cost	0	0	0	(267)	(267)
(Loss) profit from operations	479	6	(155)	(716)	(386)
Net financial expense	(158)	(109)	(377)	(427)	(1,071)
(Loss)/Profit before taxes	321	(103)	(532)	(1,143)	(1,457)
Taxes	341	(5)	164	266	766
(Loss) profit	662	(108)	(368)	(877)	(691)

EBITDA is specified as follows:

	2006 Q4	2006 Q3	2006 Q2	2006 Q1	2006 Total
Revenue	9,659	7,498	7,934	7,383	32,474
Cost of sales	(4,149)	(3,066)	(3,222)	(2,731)	(13,168)
Gross profit	5,510	4,432	4,712	4,652	19,306
Operating expenses, less depreciation	(4,682)	(4,116)	(4,516)	(4,990)	(18,304)
EBITDA	828	316	196	(338)	1,002

Other operating expenses

8) Fees to auditors of the Company:

	2007	2006
Audit of the Financial Statements	261,469	199,862
Review of interim Financial Statements	77,543	76,673
Other services	60,189	117,284
Total	399,201	393,819
Whereof payment to the auditors of the parent company	188,839	138,017

Personnel expenses

9) Salaries, salary-related expenses and other payroll expenses are specified as follows:

	2007	2006
Salaries	15,181,712	14,015,749
Salary-related expenses	2,286,334	2,512,159
Share-based payments	57,389	29,014
Total salaries and salary-related expenses	17,525,435	16,556,922
Number of employees at the year-end	197	203
Average number of employees	211	193

Salaries and salary-related expenses are not presented as a separate item in the Income Statement but are allocated as follows:

	2007	2006
Cost of sales	4,785,049	4,703,208
Sales and marketing- and general and administrative expenses	10,501,559	9,366,955
Research and development expenses	2,238,827	2,486,759
Total salaries and salary-related expenses	17,525,435	16,556,922

Salaries of the Management of the Company, stock options and ownership are specified as follows:

	Salary and benefits USD	Stock option (number of shares)	Ownership 31.12.2007 (number of shares)
Board of Directors:			
Bogi Pálsson	18,400		73,860,000
Eggert Dagbjartsson	0		10,627,895
Erlendur Hjaltason	9,200		0
Hákon Sigurhansson	9,200		467,894
Sveinn Þór Stefánsson	9,200		0

	Salary and benefits USD	Stock option (number of shares)	Ownership 31.12.2007 (number of shares)
Managers of Subsidiaries/Sales:			
David Baker	200,000	3,000,000	5,449,000
Kevin Kelly	292,000		1,019,698

Ownership by Board members and management at year-end represents shares held either in their own names or through companies which they control.

The Management's stock options are at share price of ISK 6. The stock options contracts were made in the years 2002-2005 and are exercisable in the years 2006–2010, See note 21.

Finance income and expense

10) Finance income and expense are specified as follows:

	2007	2006
Interest income	10,100	5,544
Foreign exchange gain	944,891	569,114
Finance income	954,991	574,658
Interest expense	(1,252,910)	(1,359,799)
Foreign exchange loss	(330,284)	(104,784)
Finance expense	(1,583,194)	(1,464,583)
Net finance income and expense	(628,203)	(889,925)

Income Tax Revenue

11) Recognized in the income statement:

	2007	2006
Current Tax Expense		
Income tax payable	(208,811)	(53,486)
Deferred Tax Revenues		
Changes in temporary differences	(4,057)	458,537
Currency difference	188,427	180,660
	184,370	639,197
Total income tax (expense) revenue in the income statement	(24,441)	585,711

The deferred tax revenues in the income statement amounting to USD 184.370, is calculated for the subsidiary Embla ehf. in Iceland and the parent company, which have a taxable profit for the year. Due to uncertainty of utilization of carry forward tax losses in the USA, Canada, Germany and Holland, the deferred tax asset for the joint taxable subsidiaries in the USA has not been increased despite a taxable loss in the year.

Reconciliation of Effective Tax Rate

	2007	2007	2006	2006
Loss before tax		(12,608,197)		(1,275,852)
Income tax using the company's domestic tax rate	18%	2,269,475	18%	229,653
Effect of tax rates and tax not recognized in foreign jurisdictions	-8%	(986,938)	-24%	(310,247)
Non-deductible expenses	0%	(13,298)	0%	0
Permanent difference due to taxable amortization of goodwill	5%	677,294	49%	624,182
Impairment loss	-15%	(1,944,000)	0%	0
Other differences	0%	(26,974)	3%	42,123
	0%	(24,441)	46%	585,711

Property and equipment

12) Property and equipment are specified as follows:

	Computer and service equipment	Office equipment and machinery	Total
Cost			
Balance at 1 January 2006	5,642,418	1,479,340	7,121,758
Additions during the year	482,422	169,321	651,743
Effects of foreign exchange movement	9,080	1,911	10,991
Balance at 31 December 2006	6,133,920	1,650,572	7,784,492
Balance at 1 January 2007	6,133,920	1,650,572	7,784,492
Additions during the year	211,788	200,924	412,712
Disposals and sale	(1,167,707)	(96,350)	(1,264,057)
Effects of foreign exchange movement	27,141	2,321	29,462
Balance at 31 December 2007	5,205,142	1,757,467	6,962,609
Depreciation			
Balance at 1 January 2006	3,872,260	692,571	4,564,831
Depreciation	836,319	525,455	1,361,774
Effects of foreign exchange movement	2,305	1,073	3,378
Balance at 31 December 2006	4,710,884	1,219,099	5,929,983
Balance at 1 January 2007	4,710,884	1,219,099	5,929,983
Depreciation	387,588	257,186	644,774
Disposals and sale	(1,023,151)	(95,856)	(1,119,007)
Effects of foreign exchange movement	4,021	4,100	8,121
Balance at 31 December 2007	4,079,342	1,384,529	5,463,871

	Computer and service equipment	Office equipment and	Total
Carrying amounts			
At 1 January 2006	1,770,158	786,769	2,556,927
At 31 December 2006	1,423,036	431,473	1,854,509
At 1 January 2007	1,423,036	431,473	1,854,509
At 31 December 2007	1,125,800	372,938	1,498,738
Depreciation ratios	20-33%	17-33%	

Depreciation and amortization of Assets

Depreciation of assets is not presented as a separate item in the Income Statement but is divided between cost of goods sold and general administrative expenses and is specified as follows:

	2007	2006
Depreciation/Amortization is allocated in income statement as follows:		
Cost of sales	837,155	738,783
Sales, marketing, general and administrative expenses	325,456	1,038,631
Research and development expenses	0	137,097
Total depreciation and amortization	1,162,611	1,914,511
- Thereof charged to provision for restructuring cost	0	(503,743)
Depreciation and amortization recognized in the income statement	1,162,611	1,410,768
Depreciation of property and equipment	644,774	1,361,774
Amortization of intangible assets, see note 13	517,837	552,737
Total depreciation and amortization	1,162,611	1,914,511

Insurance Value

Insurance value of computer equipment, tools and machinery at year-end 2007 is USD 2.2 million.

Mortgages

SleepTech, a subsidiary of the Company, has USD 1.0 million line of credit. Borrowings are secured by SleepTech inventories, accounts receivable and fixed assets. The loan agreement contains certain covenants which require the maintenance of minimum tangible net worth and certain financial ratios. As of December 31, SleepTech was in compliance with the covenant requirements.

Intangible assets

13) Intangible assets are specified as follows:

	Goodwill	Capitalized software	Total
Cost			
Balance at 1 January 2006	38,000,243	2,201,272	40,201,515
Additions during the year	0	5,851	5,851
Effects of foreign exchange movement	90,325	0	90,325
Balance at 31 December 2006	38,090,568	2,207,123	40,297,691
Balance at 1 January 2007	38,090,568	2,207,123	40,297,691
Additions during the year	0	961	961
Effects of foreign exchange movement	104,540	0	104,540
Balance at 31 December 2007	38,195,108	2,208,084	40,403,192
Amortization			
Balance at 1 January 2006	0	800,861	800,861
Amortization for the year	0	552,737	552,737
Balance at 31 December 2006	0	1,353,598	1,353,598
Balance at 1 January 2007	0	1,353,598	1,353,598
Amortization for the year	0	517,837	517,837
Impairment loss	10,800,000	0	10,800,000
Balance at 31 December 2007	10,800,000	1,871,435	12,671,435
Carrying amounts			
At 1 January 2006	38,000,243	1,400,411	39,400,654
At 31 December 2006	38,090,568	853,525	38,944,093
At 1 January 2007	38,090,568	853,525	38,944,093
At 31 December 2007	27,395,108	336,649	27,731,757

For the purpose of impairment testing on goodwill, goodwill is allocated to the Group's segments which represent the lowest level within the Group, at which the goodwill is monitored for internal management purpose.

The carrying amount of goodwill allocated to each business segment is specified as follows:

	1/1/2007 Book value	Translation difference	Impairment loss	12/31/2007 Book value	12/31/2007 Fair value
Sleep diagnostic systems	14,071,775	104,540	(10,800,000)	3,376,315	3,376,315
Sleep diagnostic services	24,018,793	0	0	24,018,793	38,239,000
Total	38,090,568	104,540	(10,800,000)	27,395,108	41,615,315

	1/1/2006 Book value	Translation difference	Impairment loss	12/31/2006 Book value	12/31/2006 Fair value
Sleep diagnostic systems	13,981,450	90,325	0	14,071,775	19,405,201
Sleep diagnostic services	24,018,793	0	0	24,018,793	34,550,604
Total	38,000,243	90,325	0	38,090,568	53,955,805

The recoverable amount of the Sleep diagnostic systems cash-generating unit was based on it's value in use. The carrying amount of the unit was higher than its recoverable amount and an impairment loss of USD 10.8 million (2006: nil) was recognized. The impairment loss was allocated fully to goodwill, and is shown in a separate line in the income statement.

The recoverable amount of the Sleep diagnostic services cash-generating unit was based on it's value in use. The carrying amount of the unit USD 24.1 million and was lower than its recoverable amount USD 34.6, therefore no impairment loss was recognized.

Value in use was determined by discounting the future cash flows generated from the continuing use of each unit and was based on the following key assumptions:

- Cash flows were projected based on actual operating results and the five year business plan. Cash flows were extrapolated for determining the residual value using a 5% constant growth rate which was consistent with the long-term average growth rate for the industry. Management believes that this forecast period was justified due to the long-term nature of the business.

- The anticipated average annual revenue growth included in the cash flow projections the years 2008 to 2012 was 11% and 12% for Embla Systems and SleepTech respectively.

- An after-tax discount rate of 14% and 12% was used for Embla Systems and SleepTech respectively in determining the recoverable amount of the units. The discount rate was estimated based on an industry average weighted average cost of capital, which was based on a 15% debt leveraging.

Deferred tax assets

14) The Groups deferred tax asset is specified as follows:

	2007	2006
Deferred tax asset at the beginning of year	4,176,318	3,537,121
Deferred tax revenue in the income statement	184,370	639,197
Calculated deferred income tax asset at year-end	4,360,688	4,176,318

The deferred tax revenues in the income statement amounting to USD 184.370, is calculated for the subsidiary Embla ehf. in Iceland and the parent company, which have a taxable profit for the year. Due to uncertainty of utilization of carry forward tax losses in the USA, Canada, Germany and Holland, the deferred tax asset for the joint taxable subsidiaries in the USA has not been increased despite a taxable loss in the year.

Deferred income tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2007	2006	2007	2006	2007	2006
Property and equipment................	0	0	(493,492)	(529,358)	(493,492)	(529,358)
Trade and other receivables	0	0	(99,630)	(55,553)	(99,630)	(55,553)
Inventories....................................	0	0	(20,562)	(25,960)	(20,562)	(25,960)
Trade and other payables............	8,072	50,380	0	0	8,072	50,380
Intercompany interest...................	783,676	783,676	0	0	783,676	783,676
Carry forward tax loss	4,182,624	3,953,133	0	0	4,182,624	3,953,133
Deferred tax asset at year-end	4,974,372	4,787,189	(613,684)	(610,871)	4,360,688	4,176,318

Movement in temporary differences during the year:

	Balance 1.1.2007	Recognized in income statement	Currency differences	Balance 31.12 2007
Property and equipment..	(529,358)	35,866	0	(493,492)
Trade and other receivables..	(55,553)	(44,077)	0	(99,630)
Inventories..	(25,960)	5,398		(20,562)
Trade and other payables..	50,380	(42,310)	0	8,070
Intercompany interest..	783,676	0	0	783,676
Carry forward tax loss	3,953,133	41,066	188,427	4,182,626
Deferred tax asset at year-end	4,176,318	(4,057)	188,427	4,360,688

	Balance 1.1.2006	Recognized in income statement	Currency differences	Balance 31.12 2006
Property and equipment..	(503,674)	(25,684)	0	(529,358)
Trade and other receivables..	(13,726)	(41,827)	0	(55,553)
Inventories..	0	(25,960)	0	-25,960
Trade and other payables..	331,280	(280,900)	0	50,380
Intercompany interest..	379,675	404,001	0	783,676
Carry forward tax loss	3,343,566	428,907	180,660	3,953,133
Deferred tax asset at year-end	3,537,121	458,537	180,660	4,176,318

Unrecognized deferred tax assets

The Group's total deferred tax asset year-end amounted to USD 4.4 million. Due to uncertainty regarding the utilization of tax asset arising from carry forward tax losses it is not recognized in full.

	2007	2006
Tax asset based on carry forward tax losses	7,143,763	5,472,623
Impairment based on uncertainty regarding utilization	(2,961,139)	(1,519,490)
Carrying amount of income tax asset based on carry forward tax loss	4,182,624	3,953,133

Inventories

15) Inventories are specified as follows:

	2007	2006
Material and components purchased	67,758	363,865
Fully processed goods and goods for resale	3,294,863	3,749,893
Inventories at end of the year	3,362,621	4,113,758

The insurance value of inventories amounted to USD 2.2 million at the year-end 2007.

Mortgages

To secure payments of the Company's debt to its commercial bank the Company has pledged its inventories as they are at any given time. In addition the Company's subsidiaries, Embla Systems Inc. has guaranteed payment of the Parent Company's debt in a guarantee agreement where inventories are pledged as collateral. The Company's debt with its commercial bank amounted to USD 16 million at December 31, 2007.

SleepTech, a subsidiary of the Company, has USD 1.0 million line of credit. Borrowings are secured by SleepTech inventories, accounts receivable and fixed assets. The loan agreement contains certain covenants which require the maintenance of minimum tangible net worth and certain financial ratios. As of December 31, SleepTech was in compliance with the covenant requirements.

Trade and other receivables

16) Trade and other receivables are specified as follows:

	2007	2006
Trade receivables	8,903,523	11,226,698
Other receivables and pre-payments	1,406,653	669,235
Impairment losses	(719,441)	(320,131)
Trade and other receivables at year end	9,590,735	11,575,802

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 5.

Mortgages

To secure payments of the Company's debt to its commercial bank the Company has pledged its accounts receivables as they are at any given time. In addition the Company's subsidiary, Embla Systems Inc., has guaranteed payment of the Parent Company's debt in a guarantee agreement where accounts receivables are pledged as collateral. The Company's debt with its commercial bank amounted to USD 16 million at December 31, 2007.

SleepTech, a subsidiary of the Company, has USD 1.0 million line of credit. Borrowings are secured by SleepTech inventories, accounts receivable and fixed assets. The loan agreement contains certain covenants which require the maintenance of minimum tangible net worth and certain financial ratios. As of December 31, SleepTech was in compliance with the covenant requirements.

17) Cash and cash equivalents

Cash and cash equivalents comprise only bank balances.

18) Capital and reserves

According to the Company's Articles of Association the share capital at 31 December 2007 was 720,695,133 shares which equals to USD 9.8 million based on the conversion at the exchange rate at the payment date. Each share in the Company is of nominal value ISK 1 and carries one vote.

Changes in the nominal value of share capital:	2007 ISK	2007 USD	2006 ISK	2006 USD
Share capital at the beginning of the year	720,695,133	9,794,691	720,695,133	9,794,691
Share capital at end of year	720,695,133	9,794,691	720,695,133	9,794,691

The Articles of Association of the Company authorize the Board of Directors to issue new shares for the following purposes:

- Up to 80 million shares to meet obligations of stock option contracts.
- Issue new shares to fulfill the obligations of the convertible bond.

Translation reserve

The translation reserve comprises all foreign exchange differences arising from their translation of the financial statements of foreign operations that are not integral to the operations of the Company, as well as from the translation of liabilities that hedge the Company's net investment in foreign subsidiary.

Stock Option Contracts

Stock option contracts allow Company employees to purchase shares in the Company. In the period from January 1, 2003 to August 31, 2008 employees have the right to purchase up to 5.3 million shares at a weighted average price of ISK 6.0 per share. The fair value of services received in return for share options granted are measured by reference to the fair value of the share options granted.

Loss per share

19) Basic loss per share

The calculation of loss per share at December 2007 was based on the loss attributable to equity holders of the company of USD 12.6 million (2006: USD 0.7 million) and a weighted average number of ordinary shares outstanding during the year ended December 31, 2007 of 720.7 million shares (2006: 720.7 million shares), calculated as follows:

	2007	2006
Loss for the year attributable to equity holders of the Company..	(12,632,638)	(690,141)
Total average number of shares outstanding during the year	720,695,133	720,695,133
Weighted average number of ordinary shares		
Issued shares at January 1	720,695,133	720,695,133
Weighted average number of ordinary shares	720,695,133	720,695,133

Diluted loss per share

The calculation of diluted loss per share at 31 December 2007 was based on loss attributable to ordinary equity holders of the Company of USD 12.6 millions (2006: USD 0.7 millions) and a weighted average number of ordinary shares outstanding after adjustment for the effects of all dilutive potential ordinary shares of 767.1 millions (2006: 767.1 millions), calculated as follows:

Loss attributable to equity holders of the Company (diluted)	2007	2006
Loss for the year attributable to equity holders of the Company..	(12,632,638)	(690,141)
Weighted average number of ordinary shares (diluted)		
Weighted average number of ordinary shares (basic)...	720,695,133	720,695,133
Effects of convertible loan..	46,400,000	46,400,000
Weighted average number of ordinary shares (diluted) at 31 December...	767,095,133	767,095,133

The stock options granted to employees (see notes 22) are antidilutive potential ordinary shares because their exercise price exceeds the average market price of the Company's ordinary shares during the periods presented in these consolidated financial statements. Accordingly, they have not been included in the calculation of diluted earnings per share.

20) Loans and Borrowings

The Company's loans and borrowings are specified as follows:

	Weighted average interest rate	2007 Carrying amount	2006 Carrying amount
Secured loans in USD	7.7%	4,661,668	5,980,670
Secured loans in USD, subordinated loans	7.0%	3,309,846	3,309,846
		7,971,514	9,290,516
Current maturities*		(4,659,417)	(5,003,848)
Loans and borrowings in the Balance Sheet total		3,312,097	4,286,668

*The company is currently in discussion with its commercial-bank to renew or extend certain of its loans and borrowings.

Aggregate annual maturities at year-end are specified as follows:

	2007	2006
On demand or within 12 months	4,659,417	5,003,848
Within 24 months	1,807,258	1,661,668
Within 36 months	1,504,839	1,500,000
Within 48 months	-	1,125,000
Total loans and borrowings, including current maturities	7,971,514	9,290,516

Subordinated convertible loan

The Company was granted a subordinated convertible loan by Kaupthing hf. in the amount of USD 5.0 million in the year 2002. The loan bears a fixed interest of 7% during the loan period. In November 2003 part of the loan was converted into shares in accordance with the loan terms. At December 31, 2007 the subordinated convertible loan amounted to USD 3.3 million. Interest expensed in income statement in the year 2007, amounts to USD 261 thousand. The convertibility right grants the creditor the right to convert the principal and earned interest into shares in the Company as follows: Shares in the Company for a nominal value of ISK 14.5 are received for each USD 1, however a maximum of 1/5 of the original principal plus interest for each year. The loan was scheduled to be repaid with interest on September 15, 2007. The Company is currently in discussion with holders of the convertible loan and managements anticipates the extension will be granted through January 2009.

Fair value comparison of the company's convertible loan versus a similar liability without equity option, did not indicate any equity component.

21) Bank loans

Bank loans amount to USD 7.7 million at year end. The Company has USD 6.7 million line of credit at year end which is payable to Kaupthing hf. The line of credit bears 7.15% interest rate at year end. The line of credit is due 1st of May 2008. The company is currently in discussion with its commercial-bank to extend line of credit and management anticipates that the line of credit will be renewed for another year. Borrowings are secured by the Company's accounts receivable and inventories. In addition the Company's subsidiary, Embla Systems Inc., has guaranteed payment of the Parent Company's debt in a guarantee agreement where accounts receivables and inventories are pledged as collateral.

SleepTech a subsidiary of the Company has USD 1.0 million line of credit which bear interest at the prime rate 7.25% at year end and is payable in full on May 1, 2008. Management anticipates that the line of credit will be renewed for another year. As of December 31, 2007, the SleepTech has borrowings of USD 0.9 million under this line of credit. Borrowings are secured by SleepTech accounts receivable, inventory and personal property and fixtures. The loan agreement contains certain covenants which require the maintenance of minimum tangible net worth and certain financial ratios. As of December 31, SleepTech was in compliance with the covenant requirements.

22) Share-based payments

Stock option contracts allow Company employees to purchase shares in the Company. In the period from January 1, 2003 to August 31, 2008 employees have the right to purchase up to 5.3 million shares at a weighted average price of ISK 6.0 per share. The recognition and measurement principles in IFRS 2 have been applied

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares:

Grant date/employees entitled		Vesting conditions	Contractual life of options
Option granted to employees at 3 April 2003 2003	2,046,000	Three individual periods, one year apart with three years of service for each period	5
Option granted to employees at 15 September 2003	233,334	Three individual periods, one year apart with three years of service for each period	5
Option granted to employees at 1 April 2005 2005	3,000,000	Three individual periods, one year apart with three years of service for each period	5
Total share options	5,279,334		

The number and weighted average exercise prices of share options are as follows:

	Price 2007	Number of options 2007	Price 2006	Number of options 2006
Outstanding at the beginning of the year	6	15,722,000	6	18,709,000
Forfeited during the year	6	(10,442,666)		(2,987,000)
Granted during the year	6	0	6	0
Outstanding at the end of the year	6	5,279,334	6	15,722,000
Exercisable at the end of the year	6	5,279,334	6	2,820,000

The options outstanding at 31 December 2007 have an exercise price of ISK 6 per share six and a weighted average contractual life of 3.4 years.

Employee expenses		2007	2006
Share options granted in 2003		-	17,822
Share options granted in 2005		57,389	11,192
Total expense recognized as employee costs	Note 9	57,389	29,014

The fair value of services received in return for share options granted, based on the fair value of share options granted, measured using a Black-Scholes model, with the following inputs:

	2007	2006
Fair value at grant date, average 12, 24, and 36 month options	1.441	1.441
Share price	6	6
Expected volatility (weighted average volatility)	25-30	25-30
Option life (expected weighted average life)	3.4	3.6
Risk-free interest rate (based on government bonds)	8.8%	8.8%

23) Provisions

Provisions are specified as follows:

	Restruct. cost	Warranties	Total
Balance at 1 January 2007	95,912	55,005	150,917
Provisions made during the year	0	0	0
Provisions used during the year	(95,912)	0	(95,912)
Balance at 31 December 2007	0	55,005	55,005

Provisions are specified as follows:	Restruct. cost	Warranties	Total
Balance at 1 January 2006	1,967,615	76,068	2,043,683
Provisions made during the year	267,487	(21,063)	246,424
Provisions used during the year	(2,139,190)	0	(2,139,190)
Balance at 31 December 2006	95,912	55,005	150,917

Restructuring

In February 2006 it was decided to move the hardware research and development team from Iceland to Denver, Colorado and prototyping and manufacturing design was outsourced as required. The restructuring costs related was estimated and a provision of USD 267 thousand was made in Q1 2006, the remaining figure at year end 2006 was USD 96 thousand. The restructuring is now fully completed, the remaining provision at year end 2006 was not used. This leads to reverse of cost in Q2 2007 of USD 96 thousand as shown in the income statement.

Warranties

The provision for warranties relates to equipment sold during the year ended 31 December 2007. The provision is based on estimates made from historical warranty experience. The Group expects to incur the liability over the next year.

24) Trade and other payables

Trade and other payables are specified as follows:

	2007	2006
Trade payables	3,067,159	3,596,451
Other payables	1,861,506	1,204,132
Balance at year end	4,928,665	4,800,583

Financial instruments

25) Credit risk

Exposure to credit risk

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

	Note	Carrying amount 2007	2006
Trade and other receivables	16	9,590,735	11,575,802
Cash and cash equivalents	17	1,394,240	1,459,245
		10,984,975	13,035,047

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

	Note	Carrying amount 2007	2006
European & Asia		5,094,272	5,066,923
USA		3,809,251	6,159,775
	16	8,903,523	11,226,698

Impairment losses

The aging of trade receivables at the reporting date was:	Principal amount		Impairment	
	2007	2006	2007	2006
Not past due	3,548,668	4,176,891	0	0
Past due 0-30 days	1,676,367	2,478,109	10,000	21,313
Past due 31-150 days	2,124,895	2,280,929	82,000	22,780
More than 150 days	2,240,805	2,639,924	627,441	297,351
	9,590,735	11,575,853	719,441	341,444

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	2007	2006
Balance at the beginning of the year	341,444	170,722
Write off during the year	0	(97,732)
Impairment loss for the year	377,997	268,454
Balance at year end	719,441	341,444

Based on historic default rates, the Group believes that no impairment allowance is necessary in respect of trade receivables not past due or past due by up to 30 days; the majority of the balance relates to customers that have a good track record with the Group.

Liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

31 December 2007	Carrying amount	Contractual cash flows	With in 1 year	1-2 years	5 years	More than 5 years
Non-derivative financial liabilities						
Loans and borrowings....................	7,971,514	(7,971,514)	(4,659,418)	(1,807,258)	(1,504,838)	0
Bank loans.....................................	7,558,577	(7,558,577)	0	0	0	0
Trade and other payables...............	4,983,665	(4,983,665)	0	0	0	0
	20,513,756	(20,513,756)	(4,659,418)	(1,807,258)	(1,504,838)	0

31 December 2006	Carrying amount	Contractual cash flows	With in 1 year	1-2 years	5 years	More than 2-5 years
Non-derivative financial liabilities						
Loans and borrowings....................	9,290,516	(9,290,516)	(5,003,848)	(1,661,668)	(1,500,000)	(1,125,000)
Bank loans.....................................	7,668,413	(7,668,413)	0	0	0	0
Trade and other payables...............	4,800,583	(4,800,583)	0	0	0	0
	21,759,512	(21,759,512)	(5,003,848)	(1,661,668)	(1,500,000)	(1,125,000)

Currency risk

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows based on notional amount

31 December 2007	ISK	EUR	GBP
Trade and other receivables..	11,768,000	822,986	88,722
Cash and cash equivalents	1,866,981	581,000	1,000
Trade and other payables..	7,313,000	(66,000)	(118,000)
Balance sheet exposure...	20,947,981	1,337,986	(28,278)

31 December 2006	ISK	EUR	GBP
Trade and other receivables..	17,743,000	1,673,411	36,557
Cash and cash equivalents	13,501,000	199,000	54,000
Trade and other payables..	(12,573,000)	(270,000)	(120,000)
Balance sheet exposure...	18,671,000	1,602,411	(29,443)

The following significant exchange rates applied during the year

USD	Average rate 2007	Average rate 2006	Reporting date spot rate 2007	Reporting date spot rate 2006
ISK	64.22	70.10	62.60	71.13
EUR	0.73	0.80	0.68	0.76
GBP	0.49	0.54	0.50	0.51

Sensitivity analysis

A 10 percent strengthening of the USD against the following currencies at 31 December would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2006.

	Equity	Profit or loss
31 December 2007		
ISK	10,000	10,000
EUR	196,000	196,000
GBP	(6,000)	(6,000)
31 December 2006		
ISK	26,000	26,000
EUR	211,000	211,000
GBP	(6,000)	(6,000)

A 10 percent weakening of the USD against the above currencies at 31 December would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Interest rate risk

Profile

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

Fixed rate instruments	Carrying amount 2007	Carrying amount 2006
Financial liabilities	13,855,179	15,242,016

Variable rate instruments	Carrying amount 2007	Carrying amount 2006
Financial liabilities	6,658,577	6,668,413

Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2006.

	Profit or loss		Equity	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
31 December 2007				
Variable rate instruments	67,000	(67,000)	67,000	(67,000)
Cash flow sensitivity (net)	67,000	(67,000)	67,000	(67,000)
31 December 2006				
Variable rate instruments	67,000	(67,000)	67,000	(67,000)
Cash flow sensitivity (net)	67,000	(67,000)	67,000	(67,000)

Fair values

Fair values versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	31 December 2007		31 December 2006	
	Carrying amount	Fair value	Carrying amount	Fair value
Trade and other receivables	9,590,735	9,590,735	11,575,853	11,575,853
Cash and cash equivalents	1,394,240	1,394,240	1,459,245	1,459,245
Bank loans	15,530,091	15,530,091	16,958,929	16,958,929
Trade and other payables	(4,983,665)	(4,983,665)	(4,950,560)	(4,950,560)

The basis for determining fair values is disclosed in note 4.

Operating leases

26) The Group as Lessee

	2007	2006
Lease payments recognized as an expense in income statement for the year	821,574	867,526

At the balance sheet date, the Group had outstanding commitments under non-cancellable operating leases, which fall due as follows:

	2007	2006
On demand or within 12 months	721,783	681,580
Within 24 months	597,934	261,603
Within 36 months	512,978	177,850
Within 48 months	332,947	170,894
Subsequent years	862,921	0
	3,028,563	1,291,927

The Company has entered into lease agreements on buildings for its operations in Iceland, USA, Canada, Germany and the Netherlands. The total obligation at year-end was USD 3.8 million. Expensed lease payments in the Income Statement for the year 2007 were USD 767 thousand (2006: USD 770 thousand). The lease periods are from 1-5 years.

Related party transactions

27) Identity of related parties:

The Group has a related party relationship with its subsidiaries (see note 28), one of its shareholders and with management.

Transactions with key management

See note 9.

Loans payable to related parties were as follows:

	2007	2006
Shareholder		
Kaupthing hf.	14,468,423	15,715,378

All agreements are priced at an arms length basis.

Group entities

At December 31, 2007 the Company's subsidiaries were seven. The subsidiaries included in the Consolidated Financial Statements are the following:

Name of subsidiary	Place of registration and operation	Ownership %	Principal activity
Embla Systems Inc., USA	USA	100%	Sleep diagnostics systems
Embla Systems B.V., the Netherlands	Netherlands	100%	Sleep diagnostics systems
Embla Systems GmbH, Germany	Germany	100%	Sleep diagnostics systems
Midwest Sleep & Neurodiagnostic Institute, USA	USA	100%	Sleep diagnostics systems
SleepTech LLC, USA	USA	100%	Sleep diagnostics services
Embla Systems Ltd, Canada	Canada	100%	Sleep diagnostics systems
Embla Systems ehf.	Iceland	100%	Sleep diagnostics systems

The ownership in the subsidiaries did not change during the year.

28) Litigation and Contingencies

The subsidiary SleepTech, along with other defendants, has been named in a lawsuit that alleges the wrongful death of the plaintiff's decent who died during the performance of a polysomnogram on July 2, 2004. A preliminary conference was held on March 5, 2007 to set a schedule for the conduct of discovery in the case. The depositions have now been completed and the case has been certified for trial. The trial date is expected to be late April 2008. A court administered mediation session has been scheduled in advance of the trial. Management, based upon the advice from its legal counsel, finds it difficult to render a complete assessment of the likelihood of an unfavorable outcome. Management does not believe that any claims resulting from this lawsuit will have a material adverse impact on the financial position or result of operations of the Company since the litigation is covered by insurance.