Hagar hf.

Condensed Consolidated
Interim Financial Statements
for the Six Months Ended 31 August 2007
ISK

Hagar hf.
Hagasmára 1
201 Kopavogur
Iceland

Reg. no. 670203-2120

Contents

Endorsement and Signatures of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Hagar hf. ("the Company") for the period 1 March to 31 August 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for interim accounts, IAS 34. These are the group's first IFRS condensed consolidated interim financial statements. The Company's financial statements for the previous years have been prepared in accordance with the Financial Statements Act and accounting principles in Iceland. The transition to IFRS resulted in an increase of equity of ISK 73 million as at 1 March 2007 and decrease of 61 million as at 1 March 2006.

In April 2007, the Company acquired a 50% share in P/f SMS from its shareholder Baugur Group hf. and in June 2007 the Company acquired a 45% share in Húsasmiðjan hf. also from its shareholder Baugur Group hf.

According to the income statement, profit of the Group for the period amounted to ISK 715 million. According to the balance sheet, equity at the end of the period amounted to ISK 8,965 million.

The Board of Directors and the CEO of Hagar hf. hereby confirm the Interim Financial Statements of the Company for the period, by means of their signatures.

Reykjavík, 30 October 2007.

The Board of Directors:

Jóhannes Jónsson

Jón Ásgeir Jóhannesson

Tinna Ólafsdóttir

CEO:

Finnur Árnason

Report on review of interim financial information

To the Board of Directors and Shareholders of Hagar ehf.

Introduction

We have reviewed the accompanying balance sheet of Hagar hf as of 31 August 2007 and the related statements of income, changes in equity and cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting standards as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Our review also addressed those changes made to the Company's balance sheet in relation to the implementation of IFRS. As presented in the interim financial statements, amounts might change, among other things due to the fact that the financial reporting also takes note of the standards as they will be presented at the end of the year and changes thereto might therefore incur some effects.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the entity as at 31 August 2007, and of its financial performance and its cash flows for the six month period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 30 October 2007.

KPMG hf.

Anna Þórðardóttir
Kristrún Ingólfsdóttir

Consolidated Interim Income Statement for the six months ended 31 August 2007

	Note	2007 1.3-31.8	2006 1.3-31.8
Sales		25.474	22.241
Cost of goods sold		(18.899)	(16.602)
Gross profit		6.575	5.639
Other operating income		45	17
Salaries and salary-related expenses		(2.833)	(2.471)
Other operating expenses		(2.348)	(2.148)
Results from operating activities before depreciation and amortisation		1.439	1.037
Depreciation and amortisation of operating assets	7	(443)	(411)
Results from operating activities		996	626
Finance income		535	391
Finance expenses		(575)	(1.071)
Net finance expense	8	(40)	(680)
Share of loss of equity accounted investees	11	(39)	0
Profit (loss) before income tax		917	(54)
Income tax expense		(202)	10
Profit (loss) for the period		715	(44)

Earnings (loss) per share:

Basic and diluted earnings (loss) per share of ISK 1		0,63	(0,04)

The notes on pages 9 to 28 are an integral part of these consolidated interim financial statements.

Amounts are in ISK million

Consolidated Interim Balance Sheet 31 August 2007

	Note	31.8.2007	28.2.2007
Assets			
Operating assets	9	4.153	4.113
Intangible assets	10	9.650	9.645
Investments in equity accounted investees	11	2.670	82
Investments in other companies	12	793	287
Investment in listed company	12	908	2.197
Bonds	17	481	448
Deferred tax assets		0	8
Non-current assets		18.655	16.780
Inventories	13	3.157	3.063
Accounts receivable		610	674
Other receivables		260	282
Accounts receivable - customers' credit cards		3.118	2.667
Cash and cash equivalents		268	150
Current assets		7.413	6.836
Total assets		26.068	23.616
Equity			
Share capital		1.218	1.067
Share premium		6.536	3.975
Retained earnings		1.211	1.496
Total equity		8.965	6.538
Liabilities			
Loans from credit institutions	14	1.046	1.792
Bonds	14	8.792	8.641
Incentives from operating leases		403	434
Deferred tax liabilities		194	0
Non-current liabilities		10.435	10.867
Interest-bearing loans and borrowings	14	1.220	1.187
Trade and other payables, including derivatives	15	5.198	4.774
Provisions		250	250
Current liabilities		6.668	6.211
Total liabilities		17.103	17.078
Total equity and liabilities		26.068	23.616

The notes on pages 9 to 28 are an integral part of these consolidated interim financial statements.

Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity for the six months ended 31 August 2007

	Share capital	Share premium	Retained earnings	**Total equity**
Changes in equity from 1 March to 31 August 2006:				
Equity at 28 February 2006, IS-GAAP	1.015	3.611	2.320	6.946
Changes due to IFRSs adoption			(61)	(61)
Equity at 1 March 2006, IFRSs	1.015	3.611	2.259	6.885
Net loss for the period			(44)	(44)
Equity at 31 August 2006, IFRSs	1.015	3.611	2.215	6.841
Changes in equity from 1 March to 31 August 2007:				
Equity at 28 February 2007, IS-GAAP	1.067	3.975	1.423	6.465
Changes due to IFRSs adoption			73	73
Equity at 1 March 2007, IFRSs	1.067	3.975	1.496	6.538
Net profit for the period			715	715
Issued share capital	151	2.561		2.712
Dividends to equity holders			(1.000)	(1.000)
Equity at 31 August 2007, IFRSs	1.218	6.536	1.211	8.965

The notes on pages 9 to 28 are an integral part of these consolidated interim financial statements.

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows for the six months ended 31 August 2007

	Note	2007 1.3-31.8	2006 1.3-31.8
Cash flows from operating activities:			
Net profit (loss) for the period		715	(44)
Adjustments for non-cash transactions		550	1.051
Working capital provided by operating activities		1.265	1.007
Net change in operating assets and liabilities		(134)	(634)
Cash from operations before interest and taxes		1.131	373
Interest received		6	305
Interest paid		(160)	(270)
Net cash provided by operating activities		977	408
Cash flows from investing activities:			
Acquisition of intangible assets		(28)	(100)
Acquisition of operating assets		(480)	(494)
Acquisition of subsidiaries, net of cash acquired		0	(254)
Proceeds from sale of operating assets		22	16
Proceeds from forward sale of investments in other companies		1.000	0
Dividends received		225	0
Receivables and securities, changes		(15)	4.668
Net cash provided by investing activities		724	3.836
Cash flows from financing activities:			
Dividends paid		(900)	0
Repayment of borrowings		(175)	(5.625)
Short term borrowings, changes		(508)	1.369
Net cash used in financing activities		(1.583)	(4.256)
Net increase (decrease) in cash and cash equivalents		118	(12)
Cash and cash equivalents at 1 March		150	232
Cash and cash equivalents at 31 August		268	220
Investment and financing activities without cash flow effect:			
Acquisition of associates		2.712	0
Issued share capital		(2.712)	0

The notes on pages 9 to 28 are an integral part of these consolidated interim financial statements.

Amounts are in ISK million

Notes to the Consolidated Interim Financial Statements

1. Reporting entity

Hagar hf. (the "Company") is a company domiciled in Iceland. The address of the Company is Hagasmari 1, Kopavogur. The condensed consolidated interim financial statements of the Company for the period ended 31 August 2007 comprise the Company and its subsidiaries (together referred to as the "Group") and the Groups' interest in associates. The main acitvity of the Group is retailing and associated activities.

2. Basis of preparation

a. *Statement of compliance*

The condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) for interim financial statements, IAS 34. These are the Groups' first IFRS condensed consolidated interim financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1, First-time Adoption of International Financial Reporting Standards, has been applied. The condensed consolidated interim financial statements do not include all of the information required for full annual financial statements.

An explanation of how the transition to IFRSs has affected the reported financial position and financial performance of the Group is provided in note 20. This note includes reconciliations of equity and net profit for comparative periods reported under Iceland's generally accepted accounting principles ("IS-GAAP") to those reported for those periods under IFRSs.

The condensed interim financial statements were approved by the Board of Directors on 31 October 2007.

b. *Basis of measurement*

The condensed interim consolidated financial statements have been prepared on the historical cost basis except that derivative financial instruments and financial instruments are measured at fair value through profit or loss.

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

c. *Functional and presentation currency*

These condensed consolidated interim financial statements are presented in Icelandic kronas (ISK), which is the Company's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest million.

d. *Use of estimates and judgements*

The preparation of the condensed consolidated interim financial statements in conformity with the IFRSs requires management to make judgements, 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 recognised in the period in which the estimate is revised and in any future periods effected.

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

- Note 15 – measurement of share-based payments.
- Note 12 – valuation of financial instruments.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements and in preparing an opening IFRS balance sheet at 1 March 2006 for the purposes of the transition to IFRSs. The accounting policies have been applied consistently by Group entities.

a. *Basis of consolidation*

i) *Subsidiaries*

Subsidiaries are entities controlled by the Group. Control exists when the Group 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 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. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

Associates (equity accounted investees)

ii) Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are initially recognised at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated interim financial statements include the Group's share of the income and expenses and equity movements of associates from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the carrying amount of that interest (including any long-term investments) is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the associate.

Transactions eliminated on consolidation

iii) Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the interim 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. 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 difference arising on the retranslation of foreign operation, which are recognised directly in equity, (see (ii) below).

ii) *Foreign operations*

The assets and liabilities of foreign operations, including goodwill arising on acquisition, are translated to ISK at exchange rates at the reporting date. The income and expenses of foreign operations are translated to ISK at exchange rates at the dates of the transactions.

Foreign currency differences are recognised directly in equity. When a foreign operation is disposed of, in part or in full, the relevant amount in the FCTR is transferred to profit or loss.

3. Significant accounting policies, cont.:

c. *Financial instruments*

(i) *Non-derivative financial instruments*

Non-derivative financial instruments comprise investments in equity, bonds, trade and other receivables, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and expense is discussed in note 3(m).

Held-to-maturity investments

If the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Upon initial recognition attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Other

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

(ii) *Derivative financial instruments*

The Group holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit and loss when incurred. Subsequent to initial recognition, derivatives are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. The gain or loss on remeasurement to fair value of cash flow hedge of purchase of goods for sale is included in cost of goods sold.

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in profit or loss as part of foreign currency gains and losses.

3. Significant accounting policies, cont.:

c. *Financial instruments, cont.:*

(iii) *Share capital*

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

Repurchase of share capital (treasury shares)

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is net of any tax effects, and is recognised 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 recognised as a increase in equity, and the resulting surplus or deficit on the transaction is transferred to / from share premium.

d. *Operating assets*

(i) *Recognition and measurement*

Items of operating assets are measured at cost less accumulated depreciation and accumulated 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, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of operating assets have different useful lives, they are accounted for as separate items (major components) of operating assets.

Gains and losses on disposal of an item of operating assets are determined by comparing the proceeds from disposal with the carrying amount of operating assets and are recognised net within “other income” in profit or loss.

(ii) *Subsequent costs*

The cost of replacing part of an item of operating assets is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of operating assets are recognised in profit or loss as incurred.

(iii) *Depreciation*

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of operating assets. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

Buildings	20-50 years
Fixtures, equipment and machinery	3-14 years
Transportation equipment	7 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

3. **Significant accounting policies, cont.:**

e. ***Intangible assets***

(i) *Goodwill*

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

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions that have occurred since 1 March 2004, 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 recognised immediately in profit or loss.

Subsequent measurement

Goodwill is measured at cost less any accumulated impairment losses. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment.

(ii) *Other intangible assets*

Other intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and accumulated impairment losses.

(iii) *Subsequent expenditure*

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

(iv) *Amortisation*

Amortisation is recognised in profit or loss 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. The estimated useful lives for the current and comparative periods are as follows:

Software	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 operating leases and the leased assets are not recognised on the Group's balance sheet.

g. ***Inventories***

Inventories are measured at the lower of cost and net realisable 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.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

3. Significant accounting policies, cont.:

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 amortised 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.

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 recognised in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in profit or loss.

(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, 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 recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised 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 recognised 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 amortisation, if no impairment loss had been recognised.

3. Significant accounting policies, cont.:

h. *Impairment, cont.:*

i. *Employee benefits*

(i) *Defined contribution plans*

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in profit or loss when they are due.

(ii) *Short-term benefits*

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(iii) *Share-based payment transactions*

The fair value of the amount payable to employees in respect of share appreciation rights, which are settled in cash, is recognised as an expense, with a corresponding increase in liabilities, over the period that the employees become unconditionally entitled to payment. The liability is remeasured at each reporting date and at settlement date. Any changes in the fair value of the liability are recognised as personnel expense in profit or loss.

j. *Provisions*

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

k. *Revenue*

Goods sold

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised 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, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

l. *Lease payments*

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

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Incentives from operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

3. **Significant accounting policies, cont.:**

m. ***Finance income and expenses***

Finance income comprises interest income on funds invested, dividend income, changes in the fair value of financial assets at fair value through profit or loss and gains on hedging instruments that are recognised in profit or loss. Interest income is recognised as it accrues, using the effective interest method. Dividend income is recognised in profit or loss on the date that the Group's right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Finance expenses comprise interest expense on borrowings, unwinding of the discount on provisions, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in profit or loss. All borrowing costs are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

n. ***Income tax***

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is recognised 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 recognised for the following temporary differences: 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 and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. 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. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

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 could be issued.

3. Significant accounting policies, cont.:

p. ***New standards and interpretations not yet adopted***

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

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures require extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Company's 2007 financial statements, will require extensive additional disclosures with respect to Group's financial instruments and share capital.

IFRS 8 Operating Segments sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers. If adopted by the EU, IFRS 8, which becomes mandatory for the Company's 2009 financial statements, is not expected to have any significant impact on the consolidated financial statements.

IFRIC 11 IFRS 2 Group and Treasury Share Transactions deals with how certain types of agreements on securities related payments shall be recognized in the financial statements of a company and its subsidiaries. If adopted by the EU, IFRIC 11 applies for accounting periods starting as of March 1, 2007.

IFRIC 12 Service Concession Arrangements. If adopted by the EU, IFRIC 12 will become mandatory for the Company's 2007 financial statements. IFRIC 12 is not expected to have any impact on the consolidated financial statements of the Company.

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

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.

4. Determination of fair values, cont.:

a. *Operating assets*

The fair value of operating assets recognised as a result of a business combination is based on market values. The market value of property is the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of items of equipment, fixtures and machinery is based on the quoted market prices for similar items.

b. *Intangible assets*

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

c. *Inventories*

The fair value of inventories 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 inventories.

d. *Investments in equity and debt securities*

The fair value of financial assets at fair value through profit or loss is determined by reference to their quoted bid price at the reporting date.

d. *Trade and other receivables*

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

e. *Derivatives*

The fair value of forward exchange contracts, foreign exchange option contracts and forward sale contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate (based on government bonds).

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

f. *Share-based payment transactions*

The fair value of the amount payable to employees in respect of share appreciation rights, which are settled in cash, is estimated based on the forecast of Company's EBITA on the settle date.

5. Financial risk management

Exposure to credit, interest rate and currency risks arises in the normal course of the Group's business.

Credit risk

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. 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.

At the reporting date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives in the balance sheet.

Currency risk

The Group is exposed to currency risk on purchases and borrowings that are denominated in a currency other than the respective functional currencies of Group entities.

The Group hedges percent of its trade payables denominated in a foreign currency. The Group uses forward exchange contracts to hedge its currency risk, most with a maturity of less than one year from the reporting date.

Interest rate risk

The Group adopts a policy of ensuring that percent of its exposure to changes in interest rates on borrowings is on a fixed rate basis. This is achieved by entering into interest rate swaps.

6. **Segment reporting**

The Group does not present business nor geographical segments as its' operation is only in retail and in Iceland.

7. **Depreciation and amortisation**

Depreciation and amortisation are specified as follows:	2007 1.3-31.8	2006 1.3-31.8
Depreciation of operating assets, see note 9	420	405
Amortisation of intangible assets, see note 10	23	6
Depreciation and amortisation recognised in the income statement	443	411

8. **Finance income and expense**

Financial income and financial expenses are specified as follows:

Interest income	46	305
Net foreign exchange gain	132	0
Dividend received	140	0
Net changes in fair value of financial assets at fair value through profit or loss	217	86
Total finance income	535	391
Interest expenses	(575)	(976)
Net foreign exhange loss	0	(95)
Total finance expense	(575)	(1.071)
Net finance income and expense	(40)	(680)

9. **Operating assets**

Operating assets and their depreciation is specified as follows:	Buildings	Fixtures and equipment	Total
Balance at 1 March 2007	40	8.628	8.668
Acquisitions during the period	0	480	480
Balance at 31 August 2007	40	9.108	9.148
Depreciation and impairment losses			
Balance at 1 March 2007	3	4.552	4.555
Depreciation	1	419	420
Other disposals	0	20	20
Balance at 31 August 2007	4	4.991	4.995
Carrying amounts			
At 1 March 2007	37	4.076	4.113
At 31 August 2007	36	4.117	4.153

Amounts are in ISK million

10. Intangible assets

The Group's intangible assets are specified as follows:

	Lease rights	Software	Goodwill	Total
Balance at 1 March 2007	120	229	16.177	16.526
Acquisitions during the period	0	28	0	28
Balance at 31 August 2007	120	257	16.177	16.554
Amortisation and impairment losses				
Balance at 1 March 2007	12	60	6.809	6.881
Amortisation	6	17	0	23
Balance at 31 August 2007	18	77	6.809	6.904
Carrying amounts				
At 1 March 2007	108	169	9.368	9.645
At 31 August 2007	102	180	9.368	9.650

11. Equity accounted investees

The Company's share of loss in its equity accounted investees for the period amounted to ISK 39 million (2006: ISK 0 million).

The Groups's investments in associates are specified as follows:

	Ownership	Carrying amount at 31.8.2007	Ownership	Carrying amount at 28.2.2007
Max ehf.	51%	43	51%	82
Húsasmiðjan hf.	45%	1.700	-	-
P/f SMS	50%	927	-	-
		2.670		82

The Company owns 51% of outstanding shares in Max ehf. The Company's investment in the company is classified as investment in associates as the Company does not have the power to govern the financial and operating policy of the entity.

In April 2007, the Company acquired a 50% share in P/f SMS from its shareholder Baugur Group hf. The acquisition price was settled by issuing new shares in the Company.

In June 2007, the Company acquired a 45% share in the Húsasmiðjan hf. from its shareholder Baugur Group hf. The acquisition price was settled by issuing new shares in the Company.

Amounts are in ISK million

12. Investments in other companies / listed company

The Group's investment in other companies is specified as follows:	31.8.2007 Carrying amount	28.2.2007 Carrying amount
FL Group hf. - listed company	908	2.197
BYR sparisjóður	790	284
Investment in other companies	3	3
	1.701	2.484

In Agust 2007, the Company entered into a forward sale contract where 37.9 million shares in FL Group were sold forward. The Company will receive any gain or loss from the shares against paying interest and bear foreign currency risk from the contract until the settlement of the contract. The net fair value of the forward sale contract is classified as derivatives and is recorded with other payables and amounted to ISK 10 million at 31 August 2007. Gain or loss from the contract is classified as finance income or loss on a net basis.

13. Inventories

Inventories are specified as follows:	31.8.2007	28.2.2007
Groceries	1.614	1.770
Speciality goods	1.402	1.250
Goods in transit	141	43
Total inventories	3.157	3.063

14. Loans and borrowings

Terms and conditions of outstanding loans were as follows:	Weighted average interest rate	31.8.2007 Carrying amount	28.2.2007 Carrying amount
Debt in ISK	5,60%	9.999	10.479
Debt in EUR	5,31%	207	217
Debt in USD	7,02%	131	139
Debt in SEK	4,96%	381	424
Debt in JPY	2,12%	102	110
Debt in CHF	3,78%	238	251
Non-current loans and borrowing, including current portion		11.058	11.620
Current portion of non-current loans and borrowings		(1.220)	(1.187)
Total loans and borrowings		9.838	10.433

Contractual repayments of non-current borrowings are specified as follows:		
Repayments in 2007	1.220	1.187
Repayments in 2008	1.503	2.537
Repayments in 2009	8.165	7.588
Repayments in 2010	42	287
Repayments in 2011	10	21
Subsequent repayment	118	0
Total	11.058	11.620

Amounts are in ISK million

15. Trade and other payables, including derivatives

Trade and other payables are specified as follows:	31.8.2007	28.2.2007
Trade payables	3.769	3.417
Other payables	1.297	1.237
Share-based payments obligation	11	0
Derivatives - forward sale contract	10	0
Derivatives - foreign exchange option contract	49	58
Incentives from operating leases	62	62
Total trade and other payables, including derivatives	5.198	4.774

In May and June 2007, the Company entered into share-based option contracts with its executives. The contracts, which are cash settled, are exercisable at end of May 2010. The total liability is estimated to ISK 127 million whereof ISK 11 million are recorded as salary related expenses for the period and as a liability at 30 August 2007.

16. Statement of cash flows

Adjustments for non-cash transactions specified as follows:	2007 1.3-31.8	2006 1.3-31.8
Gain on sale of assets	(1)	0
Depreciation	443	411
Net finance cost	(100)	680
Share of loss in associates	39	0
Income tax	202	(10)
Other items	(33)	(30)
	550	1.051

17. Related parties

Identity of related parties

The Company has a related party relationship with its parent company, associates and with its directors and executive officers.

Related party transactions

Unsecured loans to directors issued during the year ended 28 February, 2007 amounted to ISK 481 million (ISK 448 million at 28 February 2007). The loans were made in connection to directors' share purchase. The loans are interest-bearing and carry a floating interest rate of 15% at fiscal year end. The bonds are repayable in full in January 2012.

Among other receivables is a claim on Baugur Group hf. in the amount of ISK 83 million (ISK 67 million at 28 February 2007). Baugur Group hf. has granted the Company a subordinated loan amounting to ISK 675 million. The loan will mature on 30 November 2008.

During the period the Company acquired two associated companies from Baugur Group hf. The acquisition price was settled by issuing new shares in the Company.

Amounts are in ISK million

18. Group entities

At 31 August 2007 the Company's subsidiaries were seven. The subsidiaries included in the condensed consolidated interim financial statements are the following:

	Place of registration and operation	Ownerhip interest 31.8.2007	28.2.2007
Bananar ehf.	Iceland	100%	100%
DBH á Íslandi ehf.	Iceland	100%	100%
Eignarhaldsfélagið Dagar ehf.	Iceland	100%	100%
Ferskar kjötvörur ehf.	Iceland	100%	100%
Íshöfn ehf.	Iceland	100%	100%
Noron ehf.	Iceland	100%	100%
Res ehf.	Iceland	100%	100%

19. Financial Ratios

The Group's primary financial ratios are as follows:

Balance Sheet:	31.8.2007	28.2.2007
Current ratio - Current assets/current liabilities	1,1	1,1
Equity ratio - equity/total capital	34,4%	27,7%
Internal value of share capital	7,4	6,1

Amounts are in ISK million

20. Explanation of transition to IFRSs

Changes to accounting policies in accordance with International Financial Reporting Standards (IFRSs)

As stated in note 2(a), these are the Groups' first condensed consolidated interim financial statements for part of the period covered by the first IFRS annual financial statements prepared in accordance with IFRSs, as adopted by the EU.

The condensed interim consolidated financial statement for the period 1 March to 31 August 2007 is prepared in accordance with the accounting policies specified in note 2 on significant accounting policies. This also applies to comparative information for the six months ended 31 August 2006, the financial statements for the year ended 28 February 2007 and the preparation of an opening IFRS balance sheet at 1 march 2006 (the Group´s date of transition).

Amounts in the opening Balance Sheet of 1 March 2006 have been changed in accordance with IFRS, but were previously presented in accordance with Icelandic generally accepted accounting principles (referred to as IS-GAAP). The following tables and notes show the effects the change from IS-GAAP to IFRS has had on the financial position of the Group and its financial results. There are no significant changes to the cash flows summary according to IFRS compared with how it was previously under IS-GAAP.

Changes in equity from IS-GAAP to IFRSs:

		Equity
Equity according to IS-GAAP at 28 February 2007		6.465
Equity according to IFRS's at 1 March 2007		6.538
Change in equity from IS-GAAP to IFRSs		73
Adjustments at 1 March 2006:		
Intangible assets	IAS 38	(74)
Income tax	IAS 12	13
Total changes due to transit to IFRS at 1 March 2006		(61)
Changes in profit for the year 2006-2007:		
Amortization of intangible assets	IAS 38	74
Lease rights	IAS 38	(12)
Fair value of investments in other companies	IAS 39	101
Income tax effects	IAS 12	(29)
Total changes due to IFRS in the year 2006-2007		134
Change in equity from IS-GAAP to IFRSs		73

Total effects of the transition to IFRSs is an increase in equity amounting to ISK 73 million. Following is an explanation of the effect of transition on the income statement and balance sheet.

Intangible assets
Previously capitalised research start up cost is expensed in profit or loss in accordance with IAS 38. The changes made result in a reduction of equity, at 1 March 2006, in the amount of ISK 74 million but no changes to equity at 1 March 2007.

Amounts are in ISK million

20. Explanation of transition to IFRSs, cont.:

Investments in other companies
In accordance to IAS 39, investments in unlisted companies are classified as financial assets at fair value through profit or loss but were previously measured at cost. This change increases equity at 28 February 2007 by ISK 101 million.

Intangible assets
Capitalised software was reclassified in accordance with IAS 38. The effect of this changes is that operating assets decrease by ISK 169 million and intangible assets increase by same amount. A portion of goodwill from purchase of subsidiaries in March 2006 has been allocated to lease rights in the total amount of ISK 120 million at 1 March 2006. The lease right asset is amortized over the time of the lease but was not amortized before. This change decreases equity at 28 February 2007 by ISK 12 million.

Income tax
Total income tax effect is that equity decreases by ISK 16 million at 28 February 2007.

Changes from IS-GAAP to IFRS

The following tables provide an overview of the effect of the transition to IFRSs by valuation and presentation.

Income Statement for the period 1 March 2006 to 31 August 2006, change from IS-GAAP to IFRS

According to IS-GAAP		Change in valuation	Change in presentation	IFRS	
Sales	22.241			22.241	Sales
Cost of goods sols	(16.602)			(16.602)	Cost of goods sols
Other operating income	17			17	Other operating income
Salaries- and salary related expense	(2.471)			0 (2.471)	Salaries- and salary related expense
Other operating expense	(2.148)			(2.148)	Other operating expense
Depreciation	(418)	7		(411)	Depreciation
Net financial expenses	(766)	86	1.071	391	Finance income
			(1.071)	(1.071)	Finance expenses
Income tax	26	(16)		10	Income tax expense
(Loss) for the period	(121)	77	0	(44)	**(Loss) for the period**

Amounts are in ISK million

20. **Explanation of transition to IFRSs, cont.:**

Income Statement for the year 2006-2007, change from IS-GAAP to IFRS

According to IS-GAAP		**Change in valuation**	**Change in presentation**	**IFRS**	
Sales	46.513			46.513	Sales
Cost of goods solds	(34.645)			(34.645)	Cost of goods solds
Other operating income	76			76	Other operating income
Salaries- and salary related expense	(5.288)			(5.288)	Salaries- and salary related expense
Other operating expense	(4.582)			(4.582)	Other operating expense
Depreciation	(918)	62		(856)	Depreciation
Net financial expenses	(1.128)	101	2.150	1.123	Finance income
			(1.600)	(1.600)	Finance expenses
Net gain on the sale of shares in companies and loan write-downs	550		(550)	0	
Share of profit of associated companies	(18)			(18)	Share of loss of equity accounted investees
Income tax	(143)	(29)		(172)	Income tax
Net profit for the year	417	134	0	551	**Profit for the year**

Amounts are in ISK million

20. **Explanation of transition to IFRSs, cont.:**

Balance sheet 28 February 2007, change from IS-GAAP to IFRS

According to IS-GAAP 28 February 2007		Change in valuation	Change in presentation	IFRSs 1 March 2007	
Assets					**Assets**
Non-current assets:					
Operating assets	4.282		(169)	4.113	Operating assets
Intangible assets	9.488	(12)	169	9.645	Intangible assets
Investments in associates	82			82	Investments in equity accounted investees
Investments in other companies	186	101	2.197	2.484	Investments in other companies
Bonds	448			448	Bonds
Deferred tax asset	24	(16)		8	Deferred tax assets
Non-current assets	14.510	73		16.780	Non-current assets
Current assets					
Inventories	3.063			3.063	Inventories
Accounts receivable	674			674	Accounts receivable
Other receivables	282			282	Other receivables
Accounts receivable - customers' credit cards	2.667			2.667	Accounts receivable -customers' credit cards
Short-term investments in listed companies	2.197		(2.197)	0	
Cash and cash equivalents	150			150	Cash and cash equivalents
Current assets	9.033	0	(2.197)	6.836	Current assets
Total assets	23.543	73	(2.197)	23.616	**Total assets**
Equity					**Equity**
Share capital	1.067			1.067	Share capital
Share premium	3.975			3.975	Share premium
Retained earnings	1.423	73		1.496	Retained earnings
Equity	6.465	73	0	6.538	Total equity
Subordinated loan	675		(675)	0	
Equity and subordinated loan	7.140	73	(675)		
Long-term debt					
Loans from credit institutions	2.226		(434)	1.792	Loans from credit institutions
Bonds	7.966		675	8.641	Bonds
	0		434	434	Incentives from operating leases
Total liabilities	10.192	0	675	10.867	Non-current liabilities
Current liabilities					
Interest-bearing borrowings	1.249		(62)	1.187	Interest-bearing borrowings
Trade and other payables	4.712			4.712	Trade and other payables
			62	62	Incentives from operating leases
Provisions	250			250	Provisions
	6.211	0	0	6.211	Current liabilities
Total liabilities	16.403	0	675	17.078	Total liabilities
Total equity and liabilities	23.543	73	0	23.616	**Total equity and liabilities**

Amounts are in ISK million