Landsvirkjun

The National Power Company

Visiting Ljósifoss in May 1961. Golda Meir with Gunnar Thoroddsen, Minister of Finance, and Geir Hallgrímsson, Mayor of Reykjavík, and their vifes.

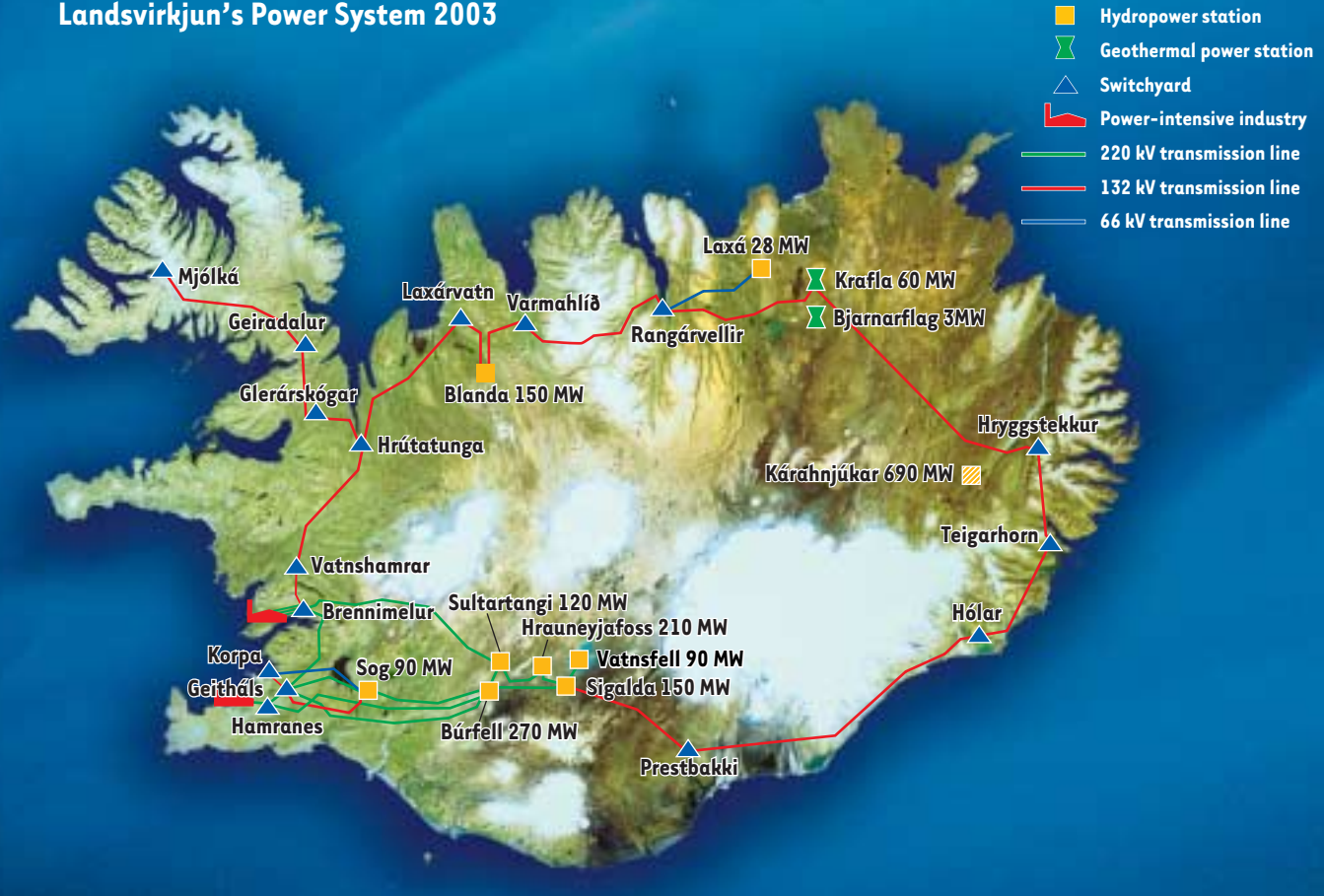
Electricity production, purchases and sales (GWh)

	2003	2002
Total production	7,245	7,173
Electricity purchases	612	633
Sales to general market	2,310	2,263
Sales to Power-intensive industries	5,232	5,222
Sales increase	0.8%	4%

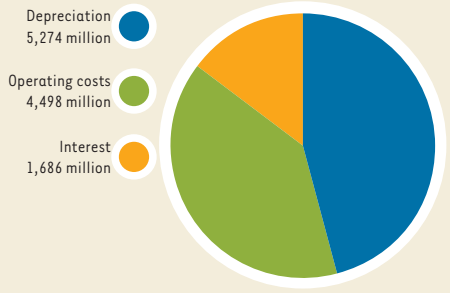
LANDSVIRKJUN'S POWER STATIONS

Hydropower stations	**1,107 MW**
Búrfell	270 MW
Hrauneyjafoss	210 MW
Blanda	150 MW
Sigalda	150 MW
Sultartangi	120 MW
Vatnsfell	90 MW
Írafoss	48 MW
Laxá	28 MW
Steingrímsstöd	26 MW
Ljósifoss	15 MW
Geothermal stations	**63 MW**
Krafla	60 MW
Bjarnarflag	3 MW
Fossil fuel stations	**42 MW**
Straumsvík	35 MW
Akureyri	7 MW
Total installed capacity	**1,212 MW**

Landsvirkjun's Power System 2003



Expenses 2003 – ISK 11,458 m.



Landsvirkjun's mission

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

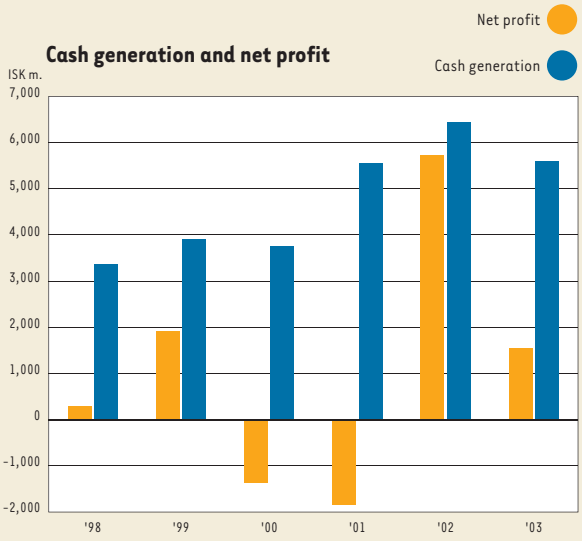
Highlights of the annual accounts (ISK)

	2003	2002
Net profit	1,551 million	5,729 million
Cash generated by operating activities	5,601 million	6,432 million
Liabilities	93.3 billion	81.3 billion
Owners' equity	41.2 billion	40.0 billion
Equity ratio	30.6%	33.0%

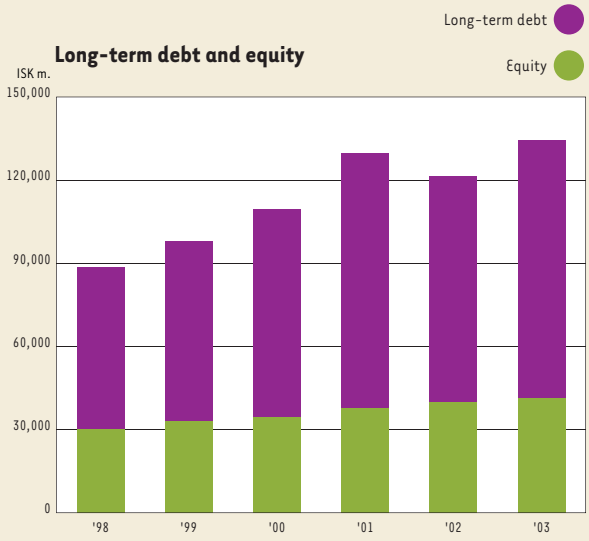
Landsvirkjun's credit rating on international markets

	Moody's	Standard & Poor's
Short term	P1	A1+
Long term	Aaa	A+

Cash generation and net profit



Long-term debt and equity



Fixing a projector in 1955.

In late January, the acting Minister for the Environment issued a ruling concerning the environ- mental impact of the Nordlingaalda Diversion and permitted the project in a substantially altered form. In early September the Board of Directors of Landsvirkjun decided to postpone its decision on the construction of the project and withdraw Landsvirkjun from negotiations on the sale of electricity for the next expansion of the Nordurál aluminium smelter.

On 15 March, Landsvirkjun and Fjardaál signed a 40-year power contract for a 322 thousand ton aluminium plant in Reydarfjördur. Subsequently, Landsvirkjun signed a contract with the lowest bidder, the Italian company Impregilo, on the construction of the Kárahnjúkar dam and the headrace tunnel for the Kárahnjúkar Hydropower Project. Work began in the spring and was fully under way by the autumn. The first of three tunnel boring machines (TBMs) arrived in Iceland at year-end.

Following a tendering process, a contract was signed on 16 April with Saga Film on the production of a series of documentaries on the construction work at Kárahnjúkar, to be aired on public television during the time of construction. The first section was shown on national television in December.

At the end of June, Landsvirkjun opened a visitors' centre for the Kárahnjúkar Project at Végardur, the Fljótsdalur community centre. Also, facilities were set up at scenic points for travellers featuring information signs. Over 5000 visitors visited Végardur in July and August.

A new Electricity Act entered into force on 1 July and according to transitional provisions of the Act, which will remain in effect until 1 July 2004, the transmission grid of Landsvirkjun is defined as the principal transmission system of Iceland. In compliance with the new Electricity Act, the accounts and management of the operation of the Transmission Division were separated from other activities of Landsvirkjun.

In July, Landsvirkjun entered into a USD 400 million revolving credit facility with the participation of 19 international banks. The facility secures access for Landsvirkjun to back-up funds for the Kárahnjúkar Power Project.

Mrs. Valgerdur Sverrisdóttir, Minister for Industry, and Mr. Fridrik Sophusson, Managing Director of Landsvirkjun, signed an agreement on the termination of the co-operation between the Ministry and Landsvirkjun on the Icelandic Energy Marketing Agency (MIL). The agreement took effect on 1 January 2004 after sixteen years of outstanding results since 1988.

HUMAN RESOURCES IN 2003

In the course of the year, the permanent staff of Landsvirkjun produced 297 man-years of work , which represents an increase of six man-years between years. The man-years supplied by temporary personnel were 83, which represents a decrease of five man-years from the preceding year.

A total of 335 young people were hired by Landsvirkjun in the summer of 2003, of which 277 were employed in the traditional summer work school and 58 were university students engaged in various tasks. These summer hirings account for approximately 75% of the man-years of temporary personnel referred to above.

A great lottery prize, a "radiogrammophone" in 1956.

THE BOARD OF DIRECTORS

A new Board of Directors took office at the 2003 Annual General Meeting for a term of one year, ending 2 April 2004.

Appointed by the Minister for Industry and Commerce

Mr. Jóhannes Geir Sigurgeirsson, Chairman
Mr. Árni Grétar Finnsson, Vice-Chairman
Ms. Edda Rós Karlsdóttir

Elected by the City Council of Reykjavík

Ms. Álfheidur Ingadóttir
Mr. Helgi Hjörvar
Mr. Vilhjálmur Th. Vilhjálmsson

Elected by the Town Council of Akureyri

Mr. Kristján Thór Júlíusson

Children at a dam in a small creek at a farm in southern Iceland 1937.

THE EXECUTIVE BOARD

Managing Director • **Mr. Fridrik Sophusson**

Deputy Managing Director • **Mr. Örn Marinósson**

Heads of Division:

Finance • **Mr. Stefán Pétursson**
Energy • **Mr. Bjarni Bjarnason**
Human Resources • **Ms. Sigthrúdur Gudmundsdóttir**
Information Technology • **Mr. Bergur Jónsson**
Engineering and Construction • **Mr. Agnar Olsen**

Corporate Communication • **Mr. Thorsteinn Hilmarsson**
Marketing • **Mr. Edvard G. Gudnason**

EXECUTIVE MANAGEMENT, TRANSMISSION

The administration and finances of the division were separated from other activities of Landsvirkjun on 1 July 2003.

Mr. Thórdur Gudmundsson
Mr. Gudmundur I. Ásmundsson
Mr. Thorgeir J. Andrésson

Landsvirkjun's profit in 2003 amounted to ISK 1,551 million, which represents a substantial drop from the preceding year's profit of ISK 5,729. The difference in performance is mainly a result of reduced revenues and an increase in net financial expenses, which in turn can be attributed to exchange rate trends and changed accounting principles. The change in accounting procedure is that inflation adjustments have been discontinued and replaced by the cost price method. Also, Landsvirkjun has now prepared a consolidated financial statement for the first time. These changes were made to comply with new statutory provisions on annual accounts.

Landsvirkjun's total assets at year-end 2003 amounted to ISK 134.5 billion, liabilities amounted to ISK 93.3 billion, and equity stood at ISK 41 billion, which corresponds to 30.6% of total assets. Net cash from operating activities amounted to ISK 5,601 million, down by just over ISK 800 million from the preceding year. Return on equity was 3.8%. Investments over the year amounted to ISK 16,877 million, as compared to ISK 5,261 million in the preceding year. The substantial increase is a result of the fact that work on the Kárahnjúkar Power Project is now in full swing. Borrowings amounted to ISK 21,438 million, and payments on loans over the year amounted to ISK 9,947 million. During the course of the year, the operating revenues of the Landsvirkjun consolidation amounted to ISK 13,009 million and operating expenses amounted to 9,772.

Hydropower station at Vík, southern Iceland, 1914.

The new legislation on electricity and its impact on Landsvirkjun are discussed elsewhere in this Report. Opinion is divided as to whether the legislation is suitable for Icelandic circumstances, and there are those who believe that it will result in increased costs, which will be passed on to consumers. It should be noted, however, that Landsvirkjun sees the reform as an opportunity for development and improved performance, even though the new order presents some difficulties and challenges. In line with its position on this matter, the Company has in recent years been working hard on preparations for the separation of transmission activities from production activities. Even though there is endless room for discussion on the various possibilities of better arrangements in the legal environment of the electrical sector, Landsvirkjun is of the opinion that resistance to the changes will not serve the interests of the Company or its customers in the long term. The task at hand is to establish a strategy to take advantage of the competitive opportunities in the coming years as the provisions of the new legislation take effect and the market is opened to competition. Landsvirkjun intends to perform well in the new circumstances and the challenge is to achieve better results and improved efficiency to secure the best available service to customers at the lowest possible price.

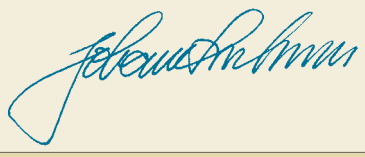
On 15 March 2003, Landsvirkjun and Fjardaál, a subsidiary of Alcoa, entered into contracts on the supply of electricity for an aluminium smelter in Reydarfjördur from the Kárahnjúkar Power Plant. Subsequently, contracts were negotiated with the Italian contractor Impregilo, the lowest bidder for the principal components of the Kárahnjúkar Power Project; work on the project began in the spring and by autumn work on the project was well under way. Procurement for other components has proceeded smoothly, and so far the budget has held. An aluminium smelter with a production capacity of 322 thousand tons is scheduled to start up in April 2007, powered by electricity from the Kárahnjúkar Power Plant. The project represents a milestone in the utilisation of environmentally sound hydropower in Iceland. It is clear that a larger hydropower project will not be built in Iceland, and in fact the capacity of the Kárahnjúkar Power Plant represents about one sixth of all the hydropower in the country which the National Energy Authority regards as feasible for utilisation. When the Kárahnjúkar Power Plant reaches full capacity this will mean a 60% increase in the total production capacity of Landsvirkjun from the current level.

Landsvirkjun attaches great importance to enabling the general public to observe the progress of the construction of the Kárahnjúkar Power Plant. An information centre has been set up at the Végardur Community Centre in Fljótsdalur, signposts have been put up, scenic viewing points have been identified and made accessible and a tourist map of the area published. In road construction, measures are taken to enable tourist operators to make use of the improved communications in Fljótsdalsheidi to offer tourists new options for outdoor activities and new opportunities to enjoy nature and at the same time to observe for themselves the work in progress. Landsvirkjun organised a competition among film makers last spring for the production of a series of documentaries on the Kárahnjúkar Power Project. Two films will be aired annually on television during the development period depicting the progress of the work and discussing various aspects of this major undertaking and related community issues.

At the beginning of last year, the acting Minister for the Environment issued a ruling confirming Landsvirkjun's permit to build the Nordlingaalda Diversion, but on conditions that required fundamental changes. Under the new conditions, any impact of the reservoir on the protected area of Thjórsárver was precluded, even though such an impact had been envisaged at the time that the area was protected. Following the ruling, Landsvirkjun entered into consultations with the Environment Agency and the municipal authorities in the area concerning the plans for the power project. The result was that Landsvirkjun's proposed design for the project was approved by all parties with the exception of the local authorities in Skeida- og Gnúpverjahreppur. Consequently, Landsvirkjun decided to postpone its plans for the project and withdrew from negotiations on the sale of electricity for the next enlargement of Nordurál. It is Landsvirkjun's hope that a consensus can be reached on plans for the Nordlingaalda Power Project in the near future.

Landsvirkjun's undertakings and plans are on such a large scale in proportion to the Icelandic community that it is unlikely that a general consensus can ever be reached on individual projects. However, the electrical system that Landsvirkjun has built in Iceland has few parallels in the world as regards sustainability and cleanness, and in fact the international community has recognised its positive value in global terms by its approval of the so called "Icelandic clause" in the Kyoto Protocol. Landsvirkjun is determined to reinforce public confidence in the Company by providing good access to information about its plans and by being consistent and honest in its work and its dealings with all stakeholders. The Company wishes to show impartiality and understanding of different perspectives and encourage the participation of all stakeholders in the discussion and resolution of issues that arise in the course of the decision making process on energy matters.

The Icelandic Energy Marketing Agency, operated as a joint venture by the Ministry of Industry and Landsvirkjun (MIL), was discontinued at the end of the year after operating with a record of excellent results since 1988. MIL has played an important role in the progress made in recent years in the sale of electricity to power-intensive industry. MIL engaged in extensive marketing work designed to promote Iceland and its clean sources of energy internationally. Also, the work of MIL was of key importance in assisting foreign investors to prepare for their operations in Iceland. Those who are in a position to know are all in agreement that the availability of information and assistance in one place gave Iceland an edge in the competition for foreign investment capital. MIL and its staff played an important role in the enlargement of ISAL and Icelandic Alloys in the nineties and it is thanks to MIL that Columbia Ventures chose Grundartangi in Iceland as a location for their Nordural aluminium smelter rather than some other part of the world. MIL also played a large role in putting together the agreements between Alcoa and Landsvirkjun and the Icelandic government on the construction of the prospective aluminium smelter in Reydarfjördur. Owing to the changed circumstances resulting from the new Electricity Act, it proved unavoidable to end this successful co-operation between Landsvirkjun and the Ministry of Industry. Landsvirkjun is grateful to Mr. Gardar Ingvarsson, head of the Marketing Agency from its establishment, and his staff for their effective work.



CHANGED LEGISLATIVE ENVIRONMENT

A new Electricity Act was passed by the Althing on 15 March 2003 for the purpose of complying in this respect with the basic requirements of the European Union.

THE PRINCIPAL CHANGES BROUGHT ABOUT BY THE NEW LEGISLATION WERE AS FOLLOWS:

- A framework has now been established for competition in the production and sale of electricity.
- Buyers will be permitted to select their own suppliers; this right will be granted in stages, and as of 1 January 2007 it will extend to all buyers, regardless of size.
- Concessions will be granted, on the one hand to transmit electricity and, on the other hand, to distribute electricity to end users.
- Electrical companies operating in both fields will be required to keep their accounts relating to concessioned activities separate from competitive operations.

As regards Landsvirkjun, the principal change resulting from the legislation is that the obligation of Landsvirkjun to supply all customers with adequate electricity at all times has been removed. To comply with the new legislation, the management of Landsvirkjun's Transmission Division has been separated from other activities of the Company as of 1 July 2003, and a separate executive board formed for the division. Separate accounting has been in effect since the beginning of the year. In the future the Transmission Division will form the core of a separate transmission company which will be responsible for system administration and the operation of the transmission grid. The company, when established, will be under the majority ownership of Landsvirkjun.

CORPORATE GOVERNANCE

Companies create value by producing goods and providing services to meet demand. In this way their activities benefit their owners, employees and the community at large. Landsvirkjun's vision is to be at the forefront of progressive companies where operations are conducted in a responsible manner under the banners of sustainability and sound environmental policy. Responsible operation must be grounded in a comprehensive vision, long-term interests and sensitivity to different perspectives.

Girl in front of a radio in 1940.

QUALITY MANAGEMENT

In May 2001, the decision was made to seek certification for Landsvirkjun's Quality Management System. The first power station to obtain certification was the Blanda Hydro Station, on 15 September 2003. The Quality Management System of Landsvirkjun as a whole is scheduled for certification before the end of 2005. Landsvirkjun's quality management takes the form of an integrated Quality Management System, Environmental Management System and Security Management System.

HUMAN RESOURCES

Landsvirkjun has a clear focus on modern human resource management, emphasising knowledge management, a family-oriented working environment, equal rights, promotion of health and opportunities for career advancement. Employees are polled regularly, and the results are used to improve morale and working conditions. It is worth noting that job satisfaction at Landsvirkjun ranks among the best of the 60 Icelandic companies polled by Gallup.

COMMUNITY

In recent years Landsvirkjun has been focusing its efforts on various community issues. Underlying these efforts is the perception that it is reasonable for the Company to pay attention to the context in which its activities are conducted and to accept responsibility for the environment in keeping with its role and position at any time.

ELECTRICITY TRANSMISSION

As a result of the new electricity legislation which took effect at mid-year, the structure of the Transmission Division was changed in order to separate the management and accounts of the Division from other activities of Landsvirkjun.

The Transmission Division has been engaged in diverse co-operation with companies in comparable operations overseas, including active co-operation within Nordel, the Organisation for Nordic Transmission System Operators, where delegates from the Division are represented both on the Board of Directors and various committees of the organisation. In addition, the Transmission Division has participated in an international comparison of transmission systems operation and the operation of control stations. The Transmission Division is also engaged in international co-operation relating to the asset management structure of transmission grids, which provides opportunities for the joint use of experience and knowledge.

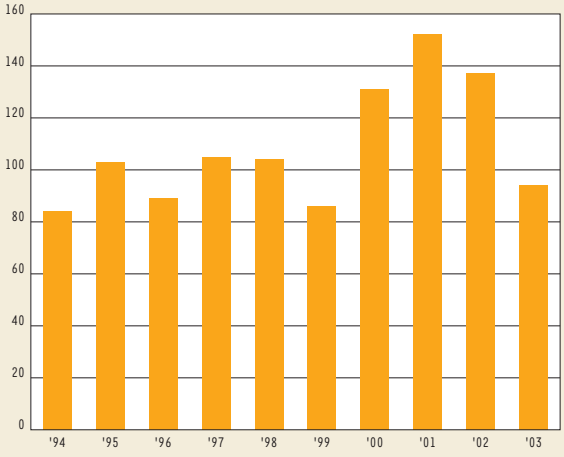
The total transmission of electricity through the transmission grid in 2003 amounted to 7,855 GWh. Transmission losses amounted to 271 GWh, which corresponds to 3.4% of the total transmission. Disruptions in operation without notice occurred 94 times in 2003, as compared to 137 times in 2002. The resulting system outage amounted to a total of 15 minutes, which is considerably less than in the previous year. If the West Iceland line is not included, the system outage was 13.9 minutes

The year's operation of the new energy control system was successful, with minimal operating disturbances in the system itself. The principal focus in the work over the year was to correct various initial difficulties, which can largely be attributed to adaptation to the new operating environment of Landsvirkjun.

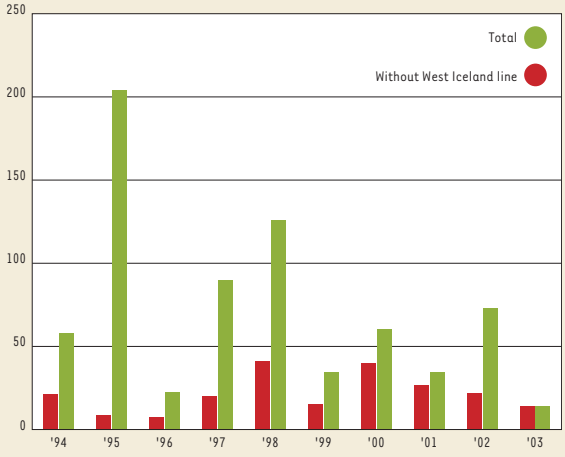
The Transmission Division operates 30 transformer stations and 1,830 km of transmission lines at a currency of 66 to 220 kV. It is vital for the division to be able to assess the maintenance needs and feasible lifetime of equipment in the transmission infrastructure. The Transmission Division has conducted studies in the methodology of age and condition assessment of equipment, which has been adapted to Icelandic conditions with a view to extending the technical lifetime of the equipment.

A big boost to northwest Iceland! Increasing voltage from 11 to 19 thousand volts in 1971.

Disruptions without notice



System outage minutes



POWER PRODUCTION, PURCHASE AND SALES

Last year was a successful year in the production of electricity. Landsvirkjun has set itself the target that all the units in the Company's power stations should be available for running 99% of the time over the winter months, from 1 October to 1 April. This target was not achieved in 2003, but the generation units were available 98.9% of the time, as compared to 93.1% for the same period in 2002. Landsvirkjun will continue to seek its target of 99% availability of generation units in the power stations in the first and fourth quarters of 2004.

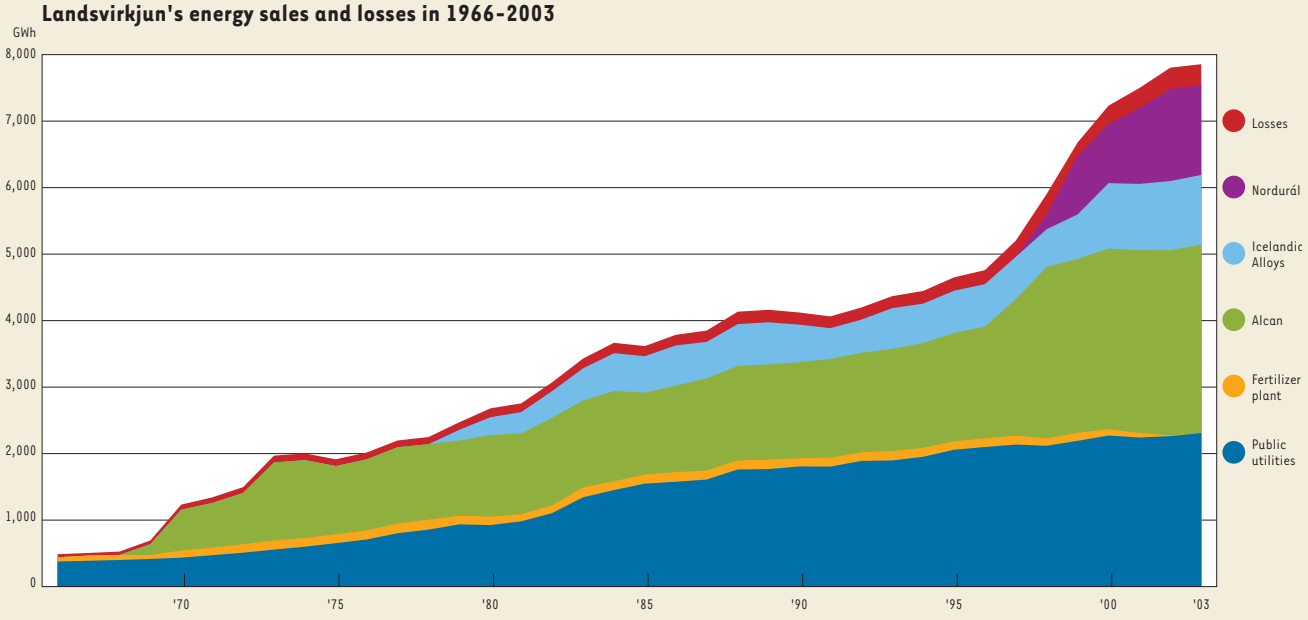
Scheduled maintenance work was carried out in the second and third quarters of the year, when there is less load on the electrical system. The generation units in the Company's power stations were available 92.2% of the year as a whole, which represents a 2.8% improvement over last year. Landsvirkjun currently operates 10 hydropower stations and two geothermal stations, in addition to two fossil fuel stations for emergency use.

Landsvirkjun's power generation amounted to a record 7,245 GWh in 2003, which corresponds to a 1% increase from the preceding year. The total production of electricity in Iceland was 8,490 GWh, which puts Landsvirkjun's share at just over 85%, the same ratio as last year. Landsvirkjun's share in the total production of hydroelectric plants was 6,833 GWh, or 96%, and 412 GWh in geothermal power plants, or 29%. In addition, Landsvirkjun purchased 612 GWh of energy from Reykjavik Energy and Sudurnes Regional Heating for resale to power-intensive industry.

Landsvirkjun's power sales amounted to 7,542 GWh in 2003, which represents an increase of 0.8% from the preceding year. Losses in the transmission system and own energy use amounted to 315 GWh, or just over 4% of the total production. Sales of primary electricity to public utilities decreased by 0.3%, but total sales to public utilities increased by just over 2% if secondary electricity is included. The sale of electricity to power-intensive industry remained the same as in the preceding year.

No sweat! A sewing shop in Reykjavík 1940.

Landsvirkjun's energy sales and losses in 1966-2003



MARKETING

Conditions remained good in Landsvirkjun's water budget throughout the year, and January was especially favourable as regards reservoir inflow. Landsvirkjun passed the benefits of this favourable position to customers by reducing the price of excess power. This situation virtually eliminated the need for the operation of the fossil fuel generators often used by utilities to produce electricity at peak load times.

Sales of secondary energy have increased substantially in recent years, and several new contracts were concluded during the course of 2003. Secondary energy is sold at a lower price than primary energy, as Landsvirkjun is permitted to cut off its delivery in the event of water shortage.

Landsvirkjun began systematic preparations for the prospective competitive environment, e.g. with the issue of new and amended general contract conditions for Landsvirkjun's wholesale customers.

A power contract was concluded with Fjardaál hf., a subsidiary of Alcoa, on 15 March providing for the sale of electricity by Landsvirkjun to Fjardaál's 322,000 ton aluminium smelter in Reydarfjördur, starting in 2007. The electricity will be produced primarily at the Kárahnjúkar Power Plant, which will commence operation at about the same time. During the construction period, Landsvirkjun will also supply electricity for the construction of the Kárahnjúkar Power Project, which will require a substantial quantity of electricity, e.g. as a result of the extensive use of electrical tunnelling equipment (TBMs).

During the first half of the year, negotiations were continued with Nordurál hf. relating to the sale of electricity for a 90,000 ton enlargement of the company's aluminium smelter at Grundartangi. In connection with the procurement of energy to meet that contract, work was also in progress on contracts for purchasing energy from Sudurnes Regional Heating and Reykjavík Energy, in addition to the preparations for the construction of the Nordlingaalda Diversion. The ruling of the Planning Agency relating to the environmental impact assessment for the Nordlingaalda Diversion was appealed to the Minister for the Environment, who made substantial changes to Landsvirkjun's proposed plan for the Diversion. Negotiations were continued into September in an attempt to reach a consensus relating to various aspects of the new plan so that the feasibility of the project could be assessed, but it eventually became clear that Landsvirkjun would be unable to supply electricity for the enlargement of Nordurál at the scheduled time. Landsvirkjun therefore withdrew from the negotiations with Nordurál concerning the sale of electricity for the enlargement of the aluminium smelter.

Discussions were held with several new parties concerning sales of electricity for new plants in various places in Iceland. A preliminary study of the feasibility of laying a marine cable from Iceland to mainland Europe was completed in co-operation with Statoil and Statnett in Norway. The conclusion of the study was that the profitability of such a connection was still insufficient in the prevailing circumstances.

Early integration of power and telecommunications. Powerlines on extensions to telephone poles at Eyrarbakki in south Iceland 1920.

DEEP DRILLING

Over the last 2-3 years, Landsvirkjun, in co-operation with the Icelandic energy companies, has been studying the possibilities of reaching high-energy 400-600°C steam in the ground at a depth of 4-5 km. The study covers the geological and engineering aspects of such an undertaking. At the start of the project it was unclear whether a well could be drilled at such a high temperature and pressure. It also had to be determined what would be the most sensible way to handle the liquid from the well during the testing period. Finally, the most feasible location had to be identified for the first deep well. A report on all these aspects was concluded in the first half of 2003. Electricity production from high-temperature wells in Iceland amounts to approximately 4-5 MW_e per well. One deep well could be equivalent to up to 10 average wells, but would probably be approximately three times more expensive to drill.

Following discussions of the conclusions of the report, the decision was made to seek overseas funding for the project and plan for multinational co-operation on the drilling. Toward the end of the year, work was in progress on preparing an application to the International Continental Drilling Program, and the work has also been presented to high-ranking officers of the EU 6th Framework Programme, as well as the US Department of Energy and the US Academy of Science.

NORDLINGAALDA DIVERSION

On 30 January, the Minister for the Environment issued a ruling concerning the environmental impact assessment prepared by the Planning Agency for the Nordlingaalda Diversion Project and overruled the decision of the Agency relating to a reservoir height of 578 m above sea level, but confirmed the decision of the Planning Agency on the condition of limiting the reservoir height to 575 m above sea level with extensive changes. Since that time Landsvirkjun has been working on the details of the development in consultation with the Environmental Agency and the apropriate municipal authorities, as provided in the decision of the Minister for the Environment.

LOWER THJÓRSÁ

Work was largely completed on the design of hydropower development, on the one hand at Núpur, where there are two potential projects, and on the other hand at Urridafoss. These potential developments amount to a total of approximately 250 MW and a generation capacity of about 1,750 GWh per year.

THE TRANSMISSION SYSTEM

Project designs and design specifications were completed for the Sultartangi Transmission Line at Sandafell by Sultartangar and the switchyard at Brennimelur in Hvalfjördur. The line will be approximately 120 km in length and constructed on traditional stayed steel masts for a nominal voltage of 420 kV.

The project design and design specifications for the Fljótsdalur lines 3 and 4 between the switchyard in Fljótsdalur and the aluminium smelter in Reydarfjördur were completed. Work on

Unlikely beginnings! Jóhannes Reykdal's carpender's shop housing the first hydrostation in Iceland in 1904. He sold electricity to nearby houses. There were no meters so he rented out the light bulbs.

the design and preparation of procurement documents began in September, following a call for tenders. The lines will be approximately 51 km in length, constructed on traditional stable steel frame pylons for a nominal voltage of 420 kV, although the initial operating voltage of the lines will be 220 kV.

Work was completed on all aspects of the construction of a 145/36/12 kV substation at Bessastadir in Fljótsdalur. The station was connected at the end of May, and was thereby ready for delivery of electricity for the developments at the Kárahnjúkar power plant. The substation is temporary and will be dismantled following the construction of the power station at Kárahnjúkar.

KÁRAHNJÚKAR POWER PROJECT

Preparations for the Kárahnjúkar Power Project, which began in late summer in 2002, were completed in 2003. The work involved road and bridge construction, electrification of the worksite and miscellaneous preparatory work on the Kárahnjúkar Dam and the adits on Mt. Valthjófsstadafjall and by the river Axará. Tenders for the largest work component of the project, the Kárahnjúkar Dam and headrace tunnel, were opened in December 2002. In February, the Board of directors authorised the conclusion of a contract with the lowest bidder, the Italian company Impregilo S.p.A, for the construction of the Kárahnjúkar Dam and the headrace tunnel of the project, together with part of the headrace tunnel from the River Jökulsá in Fljótsdalur. A contract for the work was signed on 18 March 2003.

Impregilo began its work in April, hiring Icelandic sub-contractors for various tasks. Setting up the work camp proved an extensive task, which was not quite completed during the year, with camps being set up in four places for a workforce of over one thousand people. The progress of the work itself has been normal, and although the drilling of the tunnel was a few weeks behind schedule at the turn of the year, there is plenty of scope to make up for the lost time.

On 5 June, tenders were opened for the powerhouse, electromechanical equipment and steel lining for the pressure shafts of the plant. The lowest bids for the last two components were below Landsvirkjun's estimate, but the bid for the powerhouse was somewhat above the initial estimate. Following authorisation by the Board of Directors, contracts for these components were signed on 9 September with Fosskraft JV (Hochtief Construction AG, Pihl & Søn, Ístak hf. and Iceland Prime Contractor hf.) on the construction of the powerhouse, on 16 October with VA-Tech Escher Wyss GmbH on electromechanical equipment, and on 21 November with DSD-Noell Stahlwasserbau GmbH for the steel lining. Work on the powerhouse site in Fljótsdalur began in September, and before long a camp had been established for a workforce of 200 people. Drilling of adits and tail began in October and is on schedule. The powerhouse vault is approximately 1 km inside the mountain, but work on the vault will not begin until April 2004. Work on electromechanical equipment began in October, starting with the design of the equipment, which is included in that component of the project. The same applies to the steel lining.

On 15 October, tenders were opened for the power transformers for the plant. At year-end, work was in progress on finalising a contract with the lowest bidder, the Hungarian company Ganz Transelectro.

Tenders for the two dams at Desjarárdalur and Saudárdalur were opened on 19 December. Extremely favourable bids were received from the contracting company Sudurverk hf. for both dams, and by year-end work was in progress on concluding a contract with that company.

On 19 June, following an invitation to tender, a contract was signed with a group of companies, Visen-Ingar JV (Mott-McDonald Ltd, Coyne et Bellier, Sweco International AB, Norconsult AS, Línuhönnun hf., Hnit hf. and Fjarhitun hf.) on the supervision of work on the dams at Kárahnjúkar and the headrace to the power plant. This is the largest contract on engineering consultancy ever signed in Iceland.

On 22 August, following a call for tenders, a contract was signed with the group KSJV (Lahmeyer International GmbH, Almenna verkfrædistofan hf., Hönnun hf., Rafhönnun hf. and VSÓ-rádgjöf ehf.) on the supervision of construction work on the powerhouse and other installations at the powerhouse site in Fljótsdalur.

By year-end, tenders had been received and/or contracts made for approximately 86% of the estimated cost of the Kárahnjúkar Power Project.

FINANCES

As revealed in the annual accounts, the operation of Landsvirkjun returned a profit of ISK 1,551 million in 2003, as compared to a profit of ISK 5,729 million in 2002. The deterioration in performance between years is attributed primarily to reduced revenues, on the one hand, and increased net financial expenses, on the other hand. The return on equity in 2003 was 3.8%. In the preparation of its financial statement for 2003 Landsvirkjun has changed its accounting procedures and now bases its reporting on cost price instead of the inflation-adjusted reporting of previous years. This is also the first time that consolidated accounts are prepared for Landsvirkjun and its two subsidiaries, Fjarski ehf. and Icelandic Power Insurance Ltd. The discussion of the annual accounts is based on the amounts of the consolidated accounts, but the impact of the two subsidiaries is minor in comparison with the accounts of the parent company. These changes mean that Landsvirkjun is now using the same accounting standards as most other companies in Iceland. In any comparison between years, the change in accounting procedures must be kept in mind when comparing financial items.

INCOME STATEMENT

Operating expenses in 2003 amounted to ISK 13,009 million, down by ISK 568 million over the year, or 4.2%. Notwithstanding this result, the Company's income target for the year was met. Sales to public utilities increased by 2% from the preceding year, but the increase was almost exclusively in secondary electricity. The tariff for public utilities was raised by only 2.0% on 1 August, as in fact the Company has endeavoured to achieve the targets of its owners dating from 1996 of a 2.5% annual real-term reduction in the price of electricity to public utilities, starting in 2001. Sales to heavy industry remained virtually unchanged between years, but at the same time the world market price of aluminium rose. The reduction in operating revenues is the result of the plunge of the price of the dollar against the Icelandic króna, as the revenues of the Company from sales to heavy industry are linked to the price of aluminium and calculated in foreign currencies.

Total operating expenses amounted to ISK 9,772, increasing by ISK 160 million, or 1.7%, from 2002. Depreciation increased by ISK 93 million, while general operating and maintenance costs increased by ISK 67 million, or 15%.

With respect to capital derived from the Company's operations, earnings before depreciation and financial items amounted to ISK 8,512 million, or 65.4%, i.e. ISK 634 million short of the preceding year's results. Landsvirkjun's profit before financial costs was ISK 3,237 million, decreasing by 18.3% between years.

Net interest expenses amounted to ISK 1,686 million, increasing by ISK 3,450 million between years. The reason for this substantial increase is that net interest expenses were negative last year as a result of the hefty rise in the price of the Icelandic króna in 2002. The price of the króna continued to rise in 2003, although less than in the preceding year, which accounts for the low financing cost. Net interest expenses amounted to ISK 2,908 million, down by ISK 248 million between years. Average nominal interest remained unchanged between years at 3.5%.

BALANCE SHEET AND CASH FLOWS

Landsvirkjun's total assets increased by ISK 13.3 billion over the year, while liabilities increased by ISK 12.1 billion. The book equity if the Company therefore increased by ISK 1.2 billion. As stated earlier, Landsvirkjun has changed its accounting procedures from the preceding year, with the result that assets are no longer restated as in previous years. The total assets of the Company at year-end amounted to ISK 134.5 billion. Liabilities amounted to ISK 93.3 billion, and equity amounted to ISK 41.2 billion. The equity ratio at year-end was 30.6%, as compared to 33% at year-end 2002.

Net cash from operating activities amounted to ISK 5,601 million, which represents a reduction of ISK 831 million from the preceding year.

Overall investments during the year amounted to ISK 16,877 million, mostly relating to the Kárahnjúkar Hydropower Project.

RISK MANAGEMENT

Landsvirkjun attaches great importance to monitoring and actively controlling the Company's financial risk. The Company's risk management activities are designed to defend the Company against currency market fluctuations and fluctuations in income resulting from changes in the world price of aluminium. The staff of the Finance and Marketing Division includes a Risk Management Supervisor, who is responsible for

these activities. The Company has also appointed a Risk Management Committee, which is responsible for the supervision of risk management and reports directly to the Managing Director. The Executive Director of Finance and Marketing serves as the Chairman of the Risk Management Committee, which also includes the head of the Finance Department and the Risk Management Supervisor.

Landsvirkjun employs various financial instruments to manage its risk, in particular forward contracts, debt and/or currency swaps and options. These instruments are generally referred to collectively as derivatives. The impact of these risk hedging contracts is entered in the accounts of the company in their respective terms of duration.

Landsvirkjun has set itself the target that over the longer term approximately 50% of its aluminium price risk should be hedged against price fluctuations in the world aluminium market and approximately half of its borrowings should carry fixed interest. In addition, it is the goal of risk management to minimise the impact of exchange rate fluctuations on the performance of the company.

In entering into derivatives contracts, a decision is made at the outset whether the contract is a hedging contract or whether it involves market trading. The determination is made on the basis of the intent underlying the trade. Trading for the purpose of risk management is intended to reduce the negative impact on performance today and/or in the future from fluctuations in aluminium prices, interest rates or currency exchange rates.

Landsvirkjun has for a long time maintained a large proportion of its debt in variable interest instruments and has benefited substantially as interest rates have been falling. Interest rates in the principal currencies are now at their lowest point in decades. For this reason, Landsvirkjun took measures over the year to fix its interest rates to some extent. The risk management staff of Landsvirkjun also worked on hedging part of the Company's revenues from heavy industry in US dollars, with some success.

Do not try this at home! Checking the wires on the outskirts of Reykjavík in 1977.

FUNDING

Landsvirkjun's funding in international markets was successful over the year. The Company issued bonds in the amount of USD 100 million, EUR 83 million, JPY 1,800 million and ISK 670 million. All the bond issues, except for one, were floated within the Company's EMTN programme, which provides for bond issues up to a maximum of USD 1 billion. The terms granted to Landsvirkjun on these loans were extremely favourable, and it is clear that the Company continues to retain its access to loan funding in international markets. The maturity of the bonds is also longer than previously, up to 15 years.

In addition to the above bond issues, a separate loan was taken in the amount of USD 400 million. The loan is a syndicated loan in the form of a five-year Multi-Currency Revolving Credit Facility. According to the terms of the loan, Landsvirkjun can draw on the loan principal under the facility at short notice and pay back as needed. In this way, the loan secures Landsvirkjun's access to cash, which is extremely important to the Company at this time owing to the Kárahnjúkar Project. The loan is the largest syndicated loan ever taken by an Icelandic party in the international banking market; a total of 19 banks in Europe, the United States and Japan participated in the float and in fact the loan was oversubscribed. It was particularly satisfying that three of the largest banks in Iceland saw an advantage in participating. An older revolving credit facility of Landsvirkjun amounting to USD 200 million and dating from 1997 was terminated concurrently with the signature of the new loan agreement.

INTERNATIONAL ACCOUNTING STANDARDS

Landsvirkjun has listed bonds in the Iceland Stock Exchange and the Bourse in Luxembourg, where the Company's EMTN Programme is listed. For this reason, Landsvirkjun intends to change its financial reporting procedures in the preparation of its consolidated accounts to comply with international accounting standards applicable to companies with listed securities. Landsvirkjun is planning to begin preparations for these changes in the near future, but it is unclear as yet when the Company will be required to adopt the new standards.

DIRECTORS' REPORT

The financial statements of the Company for 2003 are in all material respects in conformity with the financial statements of the previous year, with the exception that the inflation adjustments of previous years have now been abandoned to comply with the provisions of law enacted by the Icelandic Parliament in 2001. Comparative figures have not been changed, which is consistent with international accounting standards.

For the first time the company has prepared consolidated financial statements which include the financial statements of the company and its two wholly owned subsidiaries, Fjarski ehf. and Icelandic Power Insurance Ltd. Further detailed information regarding the effects of changes in accounting principles are included in note 7.

Operating revenues amounted to 13,009 million ISK in 2003 and operating expenses were 9,772 million ISK, leading to a net operating performance of 3,237 million ISK, as compared with 3,965 million in net operating income for the previous year. Net borrowing costs amounted to 1,686 million ISK; thus the net income amounted to 1,551 million ISK in 2003, as compared with 5,729 million ISK in the previous year. The effects of the two subsidiaries on the parent company´s net income and owners' equity are negligible. The change in net income is primarily the result of lower revenues from power-intensive industries and the change in net borrowing costs. At the end of 2003, total assets amounted to 134,528 million ISK. Owners' equity amounted to 41,180 million ISK at the end of 2003, which represents 30.6% of total assets.

Total investments in long-term assets amounted to 16.9 billion ISK in 2003, most of which was for the new hydropower project at Kárahnjúkar. New long-term financing amounted to 21.6 billion ISK and repayment of long-term debt amounted to 10 billion ISK during the year.

The company is a partnership, half of which is owned by the Government of Iceland. The remaining half is held by the City of Reykjavik (45%) and Township of Akureyri (5%).

The Board of Directors will recommend that dividend declaration and payments to the owners should be in conformity with the partnership agreement. If accepted at the annual meeting, the cash payment will amount to 358 million ISK to be paid in 2004. Other information regarding the financial statements is to be found in the notes accompanying the financial statements.

The Board of Directors and the Managing Director hereby confirm that the consolidated financial statements are prepared in conformity with applicable laws and regulations regarding the preparation of annual financial statements.

Reykjavík, March 10th, 2004.

BOARD OF DIRECTORS:

Jóhannes Geir Sigurgeirsson

Álfheidur Ingadóttir — Helgi Hjörvar

Árni Grétar Finnsson — Kristján Thór Júlíusson

Edda Rós Karlsdóttir — Vilhjálmur Th. Vilhjálmsson

MANAGING DIRECTOR:

Fridrik Sophusson

AUDITOR'S REPORT

To the Board of Directors of Landsvirkjun.

We have audited the accompanying balance sheet of Landsvirkjun as of December 31, 2003, and the related statement of income and statement of cash flows for the year then ended. These financial statements are the responsibility of the company´s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of Landsvirkjun as of December 31, 2003, and the results of its operation and its cash flows for the year then ended, in accordance with the law and generally accepted accounting principles in Iceland.

Reykjavík, March 10th, 2004.

KPMG Endurskoðun hf.

Jón Eiríksson — Sigrídur Helga Sveinsdóttir

INCOME STATEMENT 2003

	Note	GROUP 2003	PARENT COMPANY 2003	PARENT COMPANY 2002
OPERATING REVENUES				
Power sales	2	12,919,789	12,919,789	13,528,581
Sale of steam from geothermal wells		22,434	22,434	20,888
Other income		67,158	25,313	27,285
Total operating revenues		13,009,381	12,967,536	13,576,754
OPERATING EXPENSES				
Energy		2,326,789	2,395,335	2,387,093
Transmission		807,399	813,694	717,265
Engineering and construction		(59,097)	(59,097)	(51,271)
Cost of general research		346,937	346,937	302,856
General administrative expenses	19	1,075,492	1,046,745	1,074,614
Depreciation	3,10	5,274,491	5,226,393	5,181,524
Total operating expenses		9,772,011	9,770,007	9,612,081
Operating profit		3,237,370	3,197,529	3,964,673
FINANCIAL COSTS				
Interest revenues		108,000	100,751	214,347
Interest expenses		(2,907,579)	(2,883,304)	(3,156,034)
Exchange-rate gains		1,113,609	1,119,508	11,329,608
Loss on net monetary position		0	0	(6,623,517)
Net profit of subsidiary companies	11	0	16,916	0
	7,8	(1,685,970)	(1,646,129)	1,764,404
NET PROFIT	17	1,551,400	1,551,400	5,729,077

All amounts are in ISK thousand.

BALANCE SHEET AS AT DECEMBER 31, 2003

ASSETS

	Note	GROUP 2003	PARENT COMPANY 2003	PARENT COMPANY 2002
PROPERTY, PLANT AND EQUIPMENT				
In operation				
Power stations		87,541,135	87,541,135	88,613,920
Substations		9,193,090	9,193,090	9,239,327
Power lines		10,995,339	10,995,339	11,732,643
Telecommunication equipment		519,828	0	0
Vehicles, equipment and dredger		205,554	205,554	221,093
Office buildings and equipment		1,703,778	1,703,778	1,657,073
Total in operation	9	110,158,724	109,638,896	111,464,056
Contruction and research	4			
Developement costs		2,325,498	2,325,498	2,168,954
Projects under construction	22	16,346,186	16,346,186	2,424,066
Total construction and research	4	18,671,684	18,671,684	4,593,020
Shares and long-term notes receivable				
Wholly owned subsidiaries	11	0	355,609	260,304
Shares in other companies	11	132,183	41,483	193,235
Long-term notes receivable		282,534	245,967	127,275
Total shares and long-term notes receivable		414,717	643,059	580,814
Total property, plant and equipment		129,245,125	128,953,639	116,637,890
CURRENT ASSETS				
Accounts receivable - trade		1,732,278	1,628,421	1,547,654
Accounts receivable - other		667,856	662,460	159,889
Inventories (oil)		33,958	33,958	33,809
Cash and bank deposits		2,848,697	2,718,240	2,861,056
Total current assets		5,282,789	5,043,079	4,602,408
TOTAL ASSETS		134,527,914	133,996,718	121,240,298

All amounts are in ISK thousand.

LIABILITIES AND OWNERS' EQUITY

	Note	GROUP 2003	PARENT COMPANY 2003	2002
OWNERS' EQUITY				
Owners' contribution		27,450,328	27,450,328	25,463,981
Retained earnings		13,729,883	13,729,883	14,514,876
Total owners' equity	12	41,180,211	41,180,211	39,978,857
OBLIGATIONS				
Accrued pension obligation	13	1,691,156	1,691,156	1,645,379
LONG-TERM LIABILITIES				
Long-term liabilities	5,14	85,107,365	84,745,059	68,855,967
CURRENT LIABILITIES				
Accounts payable		2,524,071	2,399,053	1,207,471
Wholly owned subsidiary		0	20,050	0
Accrued interest payable		1,072,559	1,070,404	1,113,871
Current maturities og long-term liabilities	15	2,952,552	2,890,785	8,438,753
Total current liabilites		6,549,182	6,380,292	10,760,095
Total liabilities		93,347,703	92,816,507	81,261,441
TOTAL LIABILITIES AND OWNERS' EQUITY		134,527,914	133,996,718	121,240,298

All amounts are in ISK thousand.

STATEMENT OF CASH FLOWS IN 2003

	Note	GROUP 2003	PARENT COMPANY 2003	2002
OPERATING ACTIVITIES				
Cash received from customers		13.042.531	12.895.602	13.738.834
Cash expenses		(4.584.625)	(4.514.192)	(4.332.254)
		8.457.906	8.381.410	9.406.580
Interest income		108.000	100.751	226.164
Cash payment for interest costs		(2.964.426)	(2.941.467)	(3.200.477)
	16	5.601.480	5.540.694	6.432.267
INVESTING ACTIVITIES				
Vatnsfell project		(969.993)	(969.993)	(538.369)
Kárahnjúkar project		(14.070.269)	(14.070.269)	(1.023.170)
Refurbishment of Búrfell station		(84.376)	(84.376)	(202.665)
Refurbishment of Sog stations		(43.400)	(43.400)	(393.610)
Extention of Krafla station		(113.215)	(113.215)	(147.510)
Sigalda station - generator circuit breakers		(137.040)	(137.040)	
Thórisós - refurbishment of gate structure		(366.882)	(366.882)	(316.051)
Vatnsfell gate struckture		(80.118)	(80.118)	(256.127)
Energy management system		(47.619)	(47.619)	(165.161)
Substations		(310.594)	(310.594)	(250.964)
Research and development		(852.838)	(852.838)	(1.143.318)
Other capital expenditure		(543.200)	(490.609)	(529.472)
Increase (decrease) in unpaid investments		876.853	876.853	(208.192)
		(16.742.691)	(16.690.100)	(5.174.609)
(Increase) in long-term notes receivable		(134.360)	(134.360)	(87.135)
		(16.877.051)	(16.824.460)	(5.261.744)
FINANCING ACTIVITIES				
New long-term loans		21.588.420	21.438.420	0
Amortization of long-term liabilities		(9.999.255)	(9.947.424)	(1.605.359)
Cash dividend		(350.046)	(350.046)	(321.303)
		11.239.119	11.140.950	(1.926.662)
(DECREASE) IN CASH DURING PERIOD		(36.452)	(142.816)	(756.139)
CASH AT BEGINNING OF YEAR		2.885.149	2.861.056	3.617.195
CASH AT END OF YEAR		2.848.697	2.718.240	2.861.056

All amounts are in ISK thousand.

SUMMARY OF ACCOUNTING POLICIES

BASIS OF FINANCIAL ACCOUNTING

1. The financial statements of the company now show for the first time the consolidated financial statements of the parent company as well as the financial statements for the parent itself. All significant intercompany transactions and balances between the parent and its subsidiaries have been eliminated on consolidation.

The financial statements are prepared in conformity with the provisions of the Financial Reporting Act and the related regulation regarding the presentation and substance of the financial statements and consolidated financial statements. The financial statements have been prepared in Icelandic krona (ISK) and the figures are presented in thousands of ISK. In conformity with the amendment to the Financial Reporting Act enacted in 2001, the company has abandoned the inflation adjustments which have been entered into the financial statements for the last twenty years. The inflation adjustments in the income statement to account for the effects of inflation on monetary items are no longer made, nor are the fixed assets adjusted in the balance sheet to reflect yearly changes in the replacement cost of these assets. Fixed assets are now stated in terms of historical cost. Note 7 explains in more detail the substance of these changes.

REVENUE RECOGNITION

2. Power sales are recognised based on the delivery of power to customers according to meter readings during the financial year. Power sales consist of sales to the ordinary market as well as sales to power-intensive industries.

PROPERTY, PLANT AND EQUIPMENT IN OPERATION

3. Property, plant and equipment are stated in the balance sheet at historical cost. Assets acquired prior to 2003 are stated at revalued cost as of the end of 2002 but assets acquired in 2003 are stated in terms of historical cost. Depreciation is charged so as to write off the revalued cost or historical cost of assets over their estimated useful life leaving the estimated salvage value until the assets are disposed of. The assets are depreciated using the straight-line method based on the following useful lives:

		Estimated useful life
Power plants		
Construction expenditure, etc.	1,67%	60 years
Machinery	3,33%	30 years
Apartments	2,00%	50 years
Dams and waterways	1,67%	60 years
Thermal stations	4-5%	20-25 years
Substations	3,33%	30 years
Power lines	2,78%	36 years
Office buildings	2,00%	50 years
Equipment	12-25%	4-8 years
Vehicles	20,00%	5 years
Research projects	12,50%	8 years
Telecommunication equipment	5,00%	7-20 years

RESEARCH COSTS AND COST OF CONSTRUCTION IN PROGRESS

4. Expenditures for general research costs are expensed as incurred. Other research costs and various developmental costs for future power projects are capitalized; borrowing costs relating to these expenditures are not capitalized. These costs are amortized on a straight-line basis over a period of eight years. This is due to the uncertainty regarding the future use of the research projects. If a reseach project becomes operational, the remaining book value of the cost is transferred to assets under construction. The choice of one project over another can lead to the postponement or abandonment of other projects.

   The borrowing costs of financing are capitalized during the construction cost period. Once the related assets are put into operation the borrowing costs are expensed in the income statement.

FOREIGN CURRENCY AND INDEXATION

5. Monetary assets and liabilities denominated in foreign currencies are converted into ISK based on the rates of exchange prevailing at the end of the year. Liabilities linked to a local price index are stated in terms of accrued indexation at the end of the year, reflecting the price-level as indicated by the index as of January 1st 2004. Revenues and expenses denominated in foreign currencies are recorded based on the exchange rates on the date of transaction. Exchange rate differences and indexation on liabilities are charged to the income statement.

DERIVATIVE FINANCIAL INSTRUMENTS

6. The company uses derivative financial instruments in its risk management to hedge against foreign currency fluctuations and for trading purposes. The company primarily uses forward contracts, interest-rate and foreign debt currency swaps as well as options.

   The financial risk the company has to manage is of three types. Firstly, the risk of changes in the world market price of aluminium, since a substantial part of the company's revenues are linked to the price of aluminium. Secondly, risk associated with interest rates on the company's financing, and thirdly, the risk related to foreign currency fluctuations on foreign denominated debt and revenues linked to foreign currencies.

   The purpose of using derivative financial instruments must be decided beforehand. The contracts to manage risk are made with the purpose of reducing the negative impact of current fluctuations on net income, and/or the future fluctuations due to changes in the price of aluminium, interest rates or foreign currencies.

   It is the company's long-term strategy to effectively hedge 50% of the risk associated with changes in the world market price of aluminium, and to maintain fixed interest rates for one half of the long-term debt. It is also the company's aim in risk management to minimize the effects of foreign currrency fluctuations on net income.

   The gains or losses on contracts in derivative financial instruments are recorded in the income statement when incurred. Derivatives used to hedge future transactions are recorded in the financial statements at the same time the transactions are entered into. The outstanding amounts of open contracts are shown in note 20.

CHANGES IN ACCOUNTING PRINCIPLES

7. The financial statements include, for the first time, consolidated financial statements for the company and its subsidiaries. Previously, the effects of the subsidiaries were shown using the equity method of accounting without consolidation.

   In conformity with the provisions of the Financial Reporting Act enacted in 2001, the company abandoned the inflation adjustments made in preparing the financial statements. The effects of inflation on the net monetary position

are not shown in the income statement. Fixed assets are no longer revalued annually based on the revaluation index reflecting changes in specific prices of the company's long-term assets. As of 2003, fixed assets are stated in terms of historical costs, meaning that retroactive changes were not made. If the company had used the methods of accounting for the effects of inflation on the income statement and balance sheet for the current year, net income would have been 14 million ISK and owners' equity would have been 1,600 million ISK lower than shown in the financial statements as at the end of 2003. To comply with the provisions of international accounting standards applicable to the abandonment of inflation accounting methods, the comparative figures for 2002 have not been changed.

In order to be consistent with regulations regarding the presentation of financial statements for companies on financial markets within the European Economic Area, the Company will use international financial reporting standards for financial statement purposes. Preparatory work for the implementation of the international standards will commence over the next months. The effects of those accounting changes on the financial statements have not yet been estimated.

FINANCIAL COSTS

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

	Group	*Parent*
Interest revenues	119	112
Tax on interest revenue	(11)	(11)
Interest expenses	(2,864)	(2,840)
Guarantee fee paid to owners	(208)	(208)
Exchange-rate gain	1,114	1,120
Capitalized interest costs	164	164
	(1,686)	(1,663)

PROPERTY, PLANT AND EQUIPMENT

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

Costs:	*Power-station*	*Sub-station*	*Power lines*	*Communi-cation equipment*	*Other assets*	*Total*
Balance Jan. 1, 2003	164,952	18,218	25,310	556	3,269	212,305
Increase 2003	1,993	534		97	191	2,815
Retired/sold		(1,157)		(3)	(36)	(1,196)
	166,945	17,595	25,310	650	3,424	213,924
Accumulated depreciation:						
Jan 1, 2003	76,338	8,979	13,578	83	1,391	100,369
Depreciation 2003	3,066	580	737	48	156	4,587
Retired/sold		(1,157)		(1)	(32)	(1,190)
	79,404	8,402	14,315	130	1,515	103,766
Book value at end of year	87,541	9,193	10,995	520	1,909	110,158

10. Depreciation in 2003 consists of the following (ISK million):

Power stations	3.066
Substations	580
Power lines	737
Telecommunicational assets	48
Other assets	156
Depreciation of assets in operation	4.587
Other	9
Capitalized depreciation	(11)
Research projects	690
	5.275

LONG-TERM INVESTMENTS

11. At the end of 2003, the company owned two subsidiary companies. During the year, the company acquired Icelandic Power Insurance Ltd. The consolidated financial statements for the company include those two subsidiaries.

The financial statements of Íslandsmidill hf. are not included in the consolidated financial statements of the company, since the effects of this subsidiary of the company's subsidiary on the consolidated financial statements are insignificant. The financial statements of Íslensk jardhitatækni ehf. are also excluded for the same reason.

The net income of these non-consolidated firms amounted to 17 million ISK and that amount has been credited to the income statement.

The following subsidiaries of the company are included in the consolidated financial statements:

	Percentage share	*Par value*	*Book value*
Fjarski ehf.	100%	250.0	247
Icelandic Power Insurance Ltd.	100%	USD 0.1	108
			355

Investments in other companies amounted to 10.3 million ISK during the year. The acquisition of new shares in Enex hf. cost 6.6 million ISK and Íslensk jardhitatækni hf. cost 3.7 million ISK.

The company's other investments are as follows in ISK (million):

	Percentage share	*Par value*	*Book value*
Enex hf.	17.9%	15.9	42
Farice hf.	1.3%	0.4	1
Hecla SAS	30.0%	EUR 0.03	3
Íslandsmidill hf.	57.2%	33.0	75
Íslensk jardhitatækni ehf.	74.0%	0.4	4
Íslensk orka hf.	26.9%	44.7	0
Netorka hf.	15.7%	5.2	9
Sipenco Gmbh	25.0%	CHF 0.06	3
Tengir hf.	38.2%	15.3	15
Tetra Ísland hf.	29.4%	168.8	0
Vindorka hf.	6.2%	12.4	0
Vistorka hf.	6.2%	3.2	20
			172
Allowance account			(40)
			132

The company has not used the equity method of accounting for the above investments despite its holdings being greater than 20% due to the fact that those investments would have had an insignificant influence on the financial statements. The company's investment in Íslensk orka hf., Tetra Ísland hf. and Vindorka hf. has been written off.

An allowance account in the amount of 40 million ISK was set up at the end of 2003 due to the uncertainty of the financial position of the companies involved, most of which are high risk projects.

OWNERS' EQUITY

12. The capital account consists of the following (ISK million):

Balance at January 1st. 2003	39,979
Cash dividend	(350)
Net profit	1,551
	41,180

Based on an agreement dated 1981, with reference to subsequent amendments to that agreement, the capital contributions amounted to ISK 14 billion in terms of year-end prices in 1995. The capital contributions restated to reflect changes in price levels to the end of 2003 amounted to ISK 19,607 million. The partnership agreement stipulates that dividends must be 5.5% of the restated capital contributions and the balance for accrued dividend. Cash payments for dividends are based on certain operating indicators, i.e. profit before depreciation and interest charges on long-term debt. Undistributed accrued dividends amounted to ISK 7,843 million at the end of 2003 and the maximum amount that can be paid in the year 2003 based on the requirements of the partnership agreement is ISK 358 million. Accordingly, the owners' equity consists of the following balances (ISK million):

Restated capital contributions	19,607
Undistributed accrued dividends	7,843
	27,450
Retained earning	13,730
	41,180

PENSION OBLIGATIONS

13. The company's obligation to refund the indexation charges on retirement payments to current and former employees amounts to 1,691 million ISK at the end of 2003 based on actuarial estimate. The calculation takes into account estimates of future changes in compensation levels and price levels. The real discount rate is 3.5% and on average the increase in salaries in excess of price level changes projected at 1.5% annually. Assumptions on mortality rates and other relevant estimations are in conformity with the provisions of the regulation (no. 391/1998) governing such calculations for pension funds. The retirement age is 68 years for current employees and 65 years for non-employees with vested benefits; this is consistent with the relevant pension funds' regulations.

LONG-TERM LIABILITIES

14. Long-term liabilities are translated at the rate of exchange prevailing at the end of the year. They are in the following currencies (million):

	Foreign amount	ISK	Indexation exchange-rate (gain) losses
U.S. dollars	374.2	26,722	3,153
Euro	457.3	41,167	(1,994)
Icelandic króna		8,263	(204)
Japanese yen	5,017.5	3,350	(57)
Pounds sterling	67.4	8,558	230
Swiss francs		0	22
		88,060	1,150
Current maturities of long-term liabilities		2,953	
		85,107	

The nominal interest rates on outstanding debt range from 0.1% to 14.5%. The average nominal interest charges were 3,5% for the year 2003, or the same as for the previous year.

The owners of Landsvirkjun provide a guarantee of collection on the long-term liabilities of the company

15. The following is a maturity schedule as per loan agreements for long-term debt over the next five years:

2004	2,953
2005	4,216
2006	13,673
2007	1,204
2008	12,754
Later	53,260
	88,060

This payment schedule will change through refinancing measures in accordance with the company's policy of retirement of long-term debt.

STATEMENT OF CASH FLOWS

16. Cash flow from operating activities is a good indicator of the company's ability to repay liabilities. The statement of cash flows is particularly useful when comparative figures for several years are presented. For this purpose the following table shows the cash flows from operating activities for the last four years (ISK million):

	Group	Parent company		
	2003	2002	2001	2000
Net profit (loss)	1,551	5,729	(1,839)	(1,366)
Reconciling adjustments:				
Depreciation and assets written of	5,437	5,261	5,487	4,562
Exchange-rate adjustments, net	(1,129)	(4,817)	1,413	521
Working capital provided by operations	5,859	6,173	5,061	3,717
Changes in components of working capital				
Decrease (increase) in current assets	(168)	176	37	(390)
Increase (decrease) in current liabilities	(90)	83	444	424
Cash provided by operation	5,601	6,432	5,542	3,751
Cash provided by operation as a percentage of long-term liabilities	6.4%	8.3%	6.1%	5.0%

OTHER NOTES

17. Semi-annual summary

The Group's operations are specified as follows semi-annually:

	1.1.-30.6.	*1.7.-31.12.*	*Total*
Operating revenues	6,684	6,326	13,010
Operating expenses excluding depreciation	2,151	2,347	4,498
Depreciation	2,551	2,724	5,275
Financial costs	(481)	2,167	1,686
	4,221	7,238	11,459
Net profit	2,463	(912)	1,551
Net cash provided by operating activities	3,153	2,388	5,601

18. The group paid ISK 1,847 million in salaries to employees; related expenses and pension payments amounted to ISK 470 million or in total ISK 2,317 million.

Remuneration to the Board of Directors and Executive Management amounted to ISK 89.8 million.

19. General administrative expenses of the parent company consist of the following:

Corporate office	247
Finance	190
Human resources	76
Information technology	119
Pension payments	149
Provision for shares and written-off assets	162
Marketing unit	49
Common costs	55
	1,047

20. The company has entered into foreign exchange forward contracts, options and swaps to hedge against the effects of exchange rate fluctuations and changes in the world prices of aluminium and interest rates. The effects of those hedges are recorded during the hedging period.

The company primarily uses forward exchange contracts to protect revenue flow and debt obligations. At the end of 2003 the following market values of the contracts outstanding were as follows (thousand):

Receivables		*Obligations*	
USD	15,000	EUR	15,000
ISK	502,700	USD	6,000
JPY	15,844,634	GBP	10,000

The company has entered into contracts to take a position to buy or sell foreign currencies and the effects of those contracts are entered in the financial statements.

At the end of 2003 the company has entered into forward contracts regarding future revenue flows linked to the world market price of aluminium. In this fashion, the company has entered into contracts for 80% of aluminium-linked revenues for 2004, 35% of such revenues for 2005, 20% and 12% for 2006 and 2007, respectively. Additionally, the company has made call and put options to secure a share in price increases and to protect against price decreases.

21. In conformity with the provisions of new energy laws, the company has prepared a segmental analysis of its operations. The analysis is based on rules for the allocation of common costs and expenses. The segmental presentation of the income statement for the parent company is as follows:

	Production	*Transmission*	*Total*
Operating revenues	9,133	3,172	12,305
Operating expenses	6,541	2,566	9,107
Income from operation (ebit)	2,592	606	3,198
Return on assets employed	2.92%	2.92%	2.92%

In 2003 there were no specific tariffs for transmission. Thus, operating revenues are split to provide the same return on assets employed in each segment. In this analysis, the cost of energy purchases and certain other expenses have been netted from revenues before they are split between the two segments.

22. During the year, construction of the hydropower project at Kárahnúkar was started after contracts for delivery of electrical power were entered into with Fjardaál, a subsidiary of Alcoa. The power station's capacity will be 690 MW and transmission lines will be erected to Reydarfjörður. The current estimate is for the first generating unit to commence operation in 2007. Further information on the project can be found at the power projects' website, www.karahnjukar.is. At the end of 2003 the accrued construction cost amounts to 16.3 billion ISK.

Doing the laundry in 1960.

The photographs in this report belong to the National Museum of Iceland. They commorate the advance of electricity into Icelandic society in the 20th century. Landsvirkjun thanks the National Museum and its employees for their assistance.

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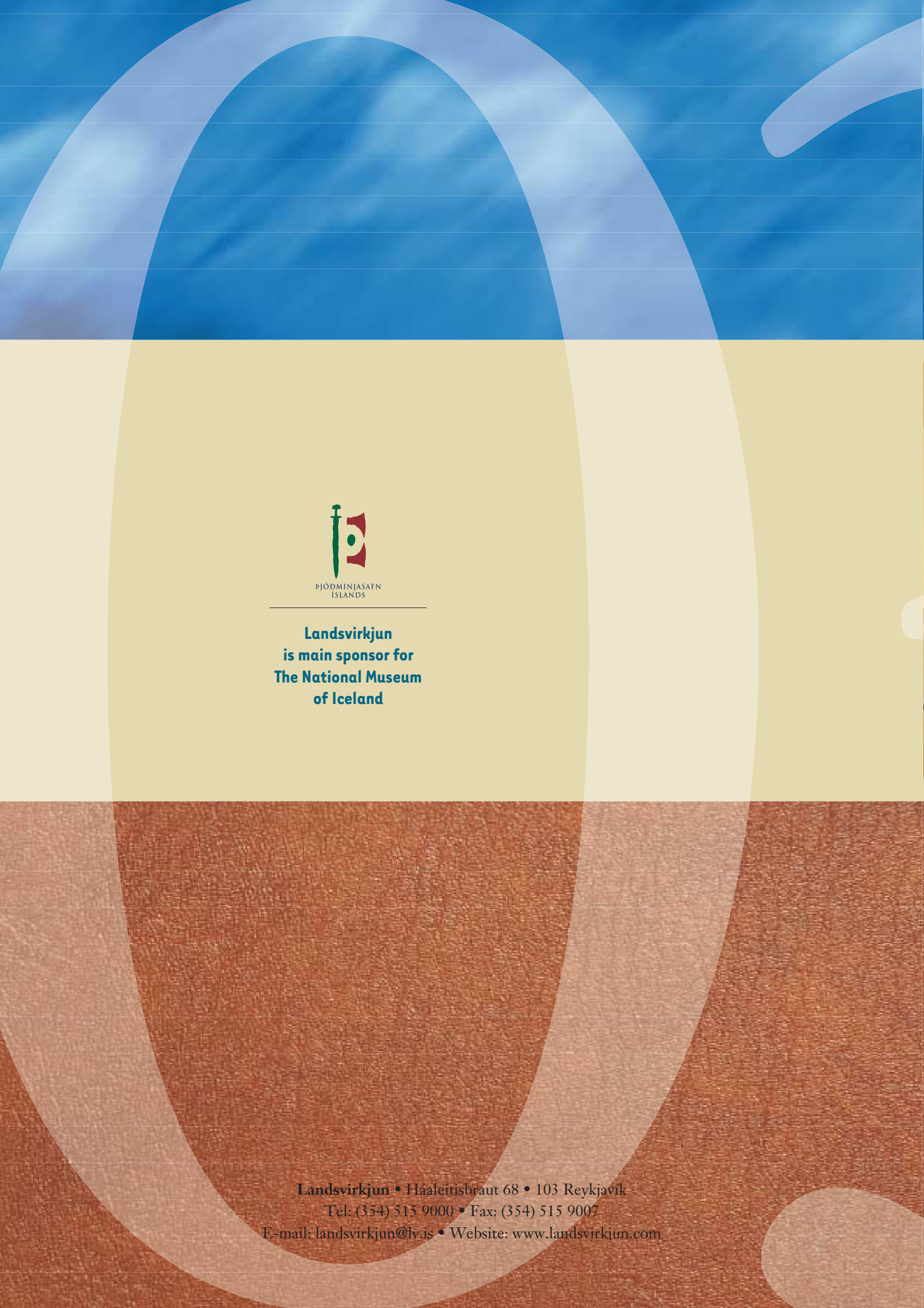
Fish processing out doors under electric lights, nort Iceland 1936.



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Landsvirkjun is main sponsor for The National Museum of Iceland

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