Annual report 2000

Landsvirkjun
The National Power Company

Art in Energy Centres

In summer 2000 the Society of Icelandic Visual Artists held art exhibitions at two of Landsvirkjun's power stations (See inside back cover).

How should this be installed? Two of the artists and a Landsvirkjun employee at Laxá hydro station speculate.

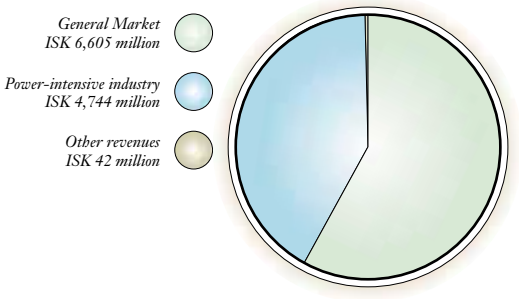
Is it art or is it nature? Young art critics at the Ljósifoss exhibition review a work by Gunnar Örn.

Different aspects of water depicted on a dam wall at Ljósifoss hydro station by Jóhanna Thórdardóttir.

Landsvirkjun's mission is to provide its customers with the best energy solutions to create the basis for a modern quality of life. Landsvirkjun's owners are the Icelandic State (50%), City of Reykjavík (45%) and Town of Akureyri (5%).

"Burst frame" by Gudjón Bjarnason encompasses the Ljósifoss station.

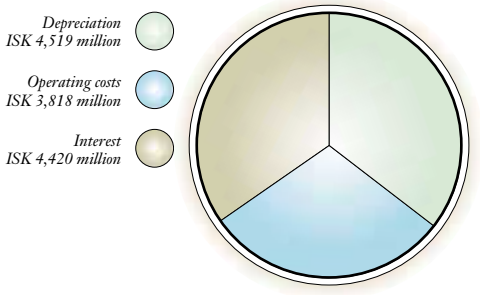
Operating revenues 2000 - ISK 11,391 m.



Highlights of the annual accounts (ISK)

	2000	1999
Net (loss) profit	(1,366 million)	1,924 million
Cash generated by operating activities	3,751 million	3,903 million
Liabilities	77.1 billion	66.7 billion
Owners' equity	34.5 billion	32.8 billion
Equity ratio	30.9%	33.0%

Operating expenses 2000 - ISK 12.757 m.



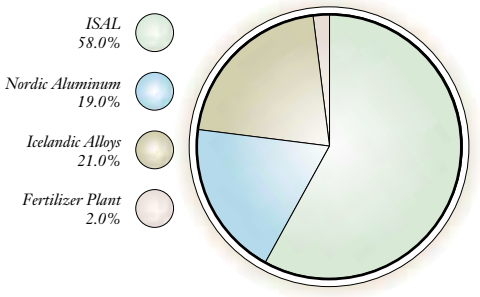
Electricity production, purchases and sales (GWh)

	2000	1999
Total production	6,579	6,314
Electricity purchases	655	464
Sales to general market	2,272	2,192
Sales to power-intensive industries	4,683	4,284
Sales increase	7.4%	15.9%

Electricity prices to the general market 2000

		Change from 1999	
	Avarege price	*Nominal price*	*In real terms*
Primary electricity	3.29 ISK/kWh	2.9%	-0.1%
Secondary electricity	0.53 ISK/kWh	-9.1%	-11.8%
Average price	2.91 ISK/kWh	1.6%	-1.4%

Breakdown of sales to power-intensive industries (GWh)



Landsvirkjun's credit rating on international markets

	Moody's	*Standard & Poor's*
Short term	P1	A1+
Long term	Aa3	A+

Overview

Getting ready for opening the exhibition in the underground caverns at Laxá.

On January 24, Landsvirkjun stopped curtailments of secondary electricity, thereby bringing to an end the two-year period of intermittent curtailments caused by hydrological shortages in the power system.

The second turbine at the Sultartangi station went on stream on January 31 as planned.

At the end of February, the Reydarál investor group decided to base its preparations for a proposed aluminium smelter in Reydarfjördur, East Iceland, on a start-up phase with twice the capacity of previous plans. This enabled Landsvirkjun to present new plans for harnessing the two glacial rivers north of Vatnajökull glacier, thereby opening the possibility of siting the reservoir at Kárahnjúkar instead of in the contraversial Eyjabakkar area.

The Landsvirkjun Board of Directors approved a new mission statement and vision for the company in April. A new organizational structure was subsequently introduced and finally ratified by the Board at the end of the year.

In June, Landsvirkjun presented proposals for an environmental impact assessment for the Kárahnjúkar hydro project. The most capable experts and institutions were commissioned to undertake the assessment, and extensive open public consultation and access was emphasized during the process. A website was opened where the public can follow the progress of the assessment process and submit remarks.

On June 17 and 21, powerful earthquakes, about 7 on the Richter scale, struck South Iceland but had negligible impact on the Landsvirkjun power system.

The company raised its wholesale tariff to local utilities by 2.9% on July 1, in accordance with the policy laid down by its owners.

In partnership with other power companies, Landsvirkjun organized an international seminar on Icelandic energy in the international context, at the Icelandic pavilion at the World Expo in Hanover on August 29.

On October 10, Landsvirkjun established a telecom company, Fjarski ehf. The new company will take over Landsvirkjun's existing telecommunications network and offer services as a telecom service provider.

Landsvirkjun was one of the main sponsors of Reykjavík – European City of Culture in the year 2000. Its main contribution to the cultural year was a series of art exhibitions, "Art in Energy Centres," held at the Laxá and Ljósifoss hydro stations in collaboration with the Society of Icelandic Visual Artists.

Number of employees

A total of 276 man-years were worked by full-time employees of Landsvirkjun in 2000, an increase of 11 from the previous year. Temporary employees worked 86 man-years in all, 21 less than in 1999.

Board of Directors

A new Board of Directors was appointed at Landsvirkjun's annual general meeting in April 2000, for a one-year term until April 6, 2001.

Appointed by the Minister of Industry and Commerce

Mr. **Jóhannes Geir Sigurgeirsson,** *Chairman*
Mr. **Árni Grétar Finnsson,** *Deputy Chairman*
Mr. **Sigfús Jónsson**

Appointed by the City Council of Reykjavík

Mr. **Helgi Hjörvar**
Mr. **Pétur Jónsson**
Mr. **Vilhjálmur Th. Vilhjálmsson**

Appointed by the Town Council of Akureyri

Mr. **Kristján Thór Júlíusson**

Management

Managing Director • **Mr. Fridrik Sophusson**

Deputy Managing Director • **Mr. Jóhann Már Maríusson**

Executive Management:

Finance and Marketing • **Mr. Örn Marinósson**

Transmission • **Mr. Thórdur Gudmundsson**

Energy • **Mr. Jóhann Már Maríusson**
• **Mr. Bjarni Bjarnason** (from March 1, 2001)

Human Resources • **Mrs. Sigthrúdur Gudmundsdóttir**

Information • **Mr. Bergur Jónsson**

Engineering and Construction • **Mr. Agnar Olsen**

Sculpture by Valgardur Gunnarsson.

Report by the Chairman and Managing Director

Solid position despite operating loss

Landsvirkjun's operating result for 2000 shows a sharp turnabout from 1999. Performance swung from a profit of almost ISK 2 billion then to a loss of ISK 1,366 million last year. This serves to underline once again how imprecise the profit for individual years is as a measure of the company's position. Profit needs to be viewed in the context of several years at a time. It is worth recalling here that a year ago we cautioned against reading too much into the excellent operating performance in 1999 with the qualification that "other things being equal, net profit cannot normally be expected to match the result produced this time around." The main factors at work in the operating result are that the company has substantial liabilities in international financial markets and is prone to interest and exchange rate trends there but lacks the scope for responding to them – not least when the real exchange rate of the Icelandic króna weakens. Consequently, Landsvirkjun's financial expenses increased by almost ISK 3 billion between 1999 and 2000, which is the main explanation for the company's operating loss.

A more stable criterion for the company's performance is cash generated by operating activities. Once again, the company generated substantial amounts for amortizing its loans or making investments. The amount was ISK 3,750 million in 2000 and has been in the range ISK 3-4 billion in recent years, irrespective of operating performance. This shows beyond all doubt that the company is well capable of handling the projects it has undertaken. It should also be pointed out that even though Landsvirkjun's sales to power-intensive industries rose sharply in 2000, they are also certain to increase on a major scale in the next few years.

Artist Ólöf Oddgeirsdóttir weaves her intergrated world wide web.

Current long-term contracts with power-intensive industrial manufacturers have been renewed during the past five years, and are structured so as to generate increased levels of income from electricity sales through the second half of the contract period. A turning point will be reached in 2005. This is an important consideration for evaluating Landsvirkjun's potential under the pending reforms which will bring Iceland's electricity sector into line with prevailing frameworks in most parts of the western world.

Windows of opportunity

In early spring, the Reydarál group announced a radical shift in its plans to construct an aluminium smelter in Reydarfjördur in East Iceland, when it decided to double the capacity of the start-up phase compared with its original proposals. This presented Landsvirkjun with an opportunity to review power supplies for the smelter by changing its plans for harnessing the rivers north of Vatnajökull glacier. Landsvirkjun seized this opportunity and emphasized that it would not only follow the spirit of the new law on environmental impact assessment but also exceed the official requirements for public access to information on the issue and channels for influencing it. A powerful expert team was assembled to undertake the most extensive and careful environmental impact assessment made in Iceland so far, which should be in line with international norms. As a result of this, public acceptance of these plans has markedly increased.

In autumn, US-owned Nordural also requested talks on further expansion to its aluminium smelter at Grundartangi. Interest had thereby emerged in a substantial build-up in power-intensive industries in both southwest Iceland and the eastern part of the country. This presents a good opportunity for Landsvirkjun, which on the basis of the government's industry strategy can organize phased development of the electricity system in both areas, if power contracts with the two parties can be finalized.

Deregulation of the electricity sector

For some time, Iceland has been preparing new legislation on the electricity sector. Underlying the new law are a European Union directive from 1992 and the government's stated objectives on the market economy. As described elsewhere in this report, Landsvirkjun's employees have been making great efforts to equip the company to tackle new times. The aim is to make the company more dynamic than ever and create more growth opportunities for it in a market-driven environment.

It is difficult to give a full account of what the company needs to achieve in order to operate successfully under changed conditions. However, it is important that clear rules for competition should be known from the outset. Here the government must give firm answers. It is also impossible to ignore the fact that 65% of Iceland's electricity production is utilized by power-intensive industries under long-term agreements with commitments on business terms and prices extending well into the second decade of this century. It must be kept in mind that the market in which competition is now being established only accounts for one-third of national electricity production. It is therefore obvious that Landsvirkjun must fulfil its obligations, which account for a very large share of production, irrespective of the new competitive market environment.

Thinking big

A dynamic power company is necessary for further growth on the power-intensive front, where great openings are at hand at the moment. A large and strong company, like Landsvirkjun, has in the past enabled Iceland to attract foreign investment in power-intensive industries and thereby fund building of power system which serves their needs while securing electricity at lower prices to the domestic market. This will also apply in the years to come.

Vision

We strive to make Landsvirkjun:

- A reliable and environment-friendly company, a leader in its field, which is prepared to tackle new challenges for the benefit of its customers, staff and owners.
- A flexible company which knows its customers' needs and fulfils them in accordance with individual requirements.
- A sought-after and diversified workplace where employees are able to develop their talents and initiative.
- A good asset in which initiative, know-how and financial strength are deployed to enhance its value still further.

Worldwide deregulation of the energy sector, like other fields of business, has led to mergers into larger and more efficient units for achieving results. The leadership of a dynamic power company is vital if Iceland intends to export its know-how and skill in energy project design, construction and management. Landsvirkjun has adopted new and progressive procedures and methodologies, and we intend to lead the way in channelling Icelandic know-how and drive towards new business opportunities which can be developed in the international energy sector. The first steps have been taken recently, and although they are small, they could be the start of greater things.

Chairman

Open house

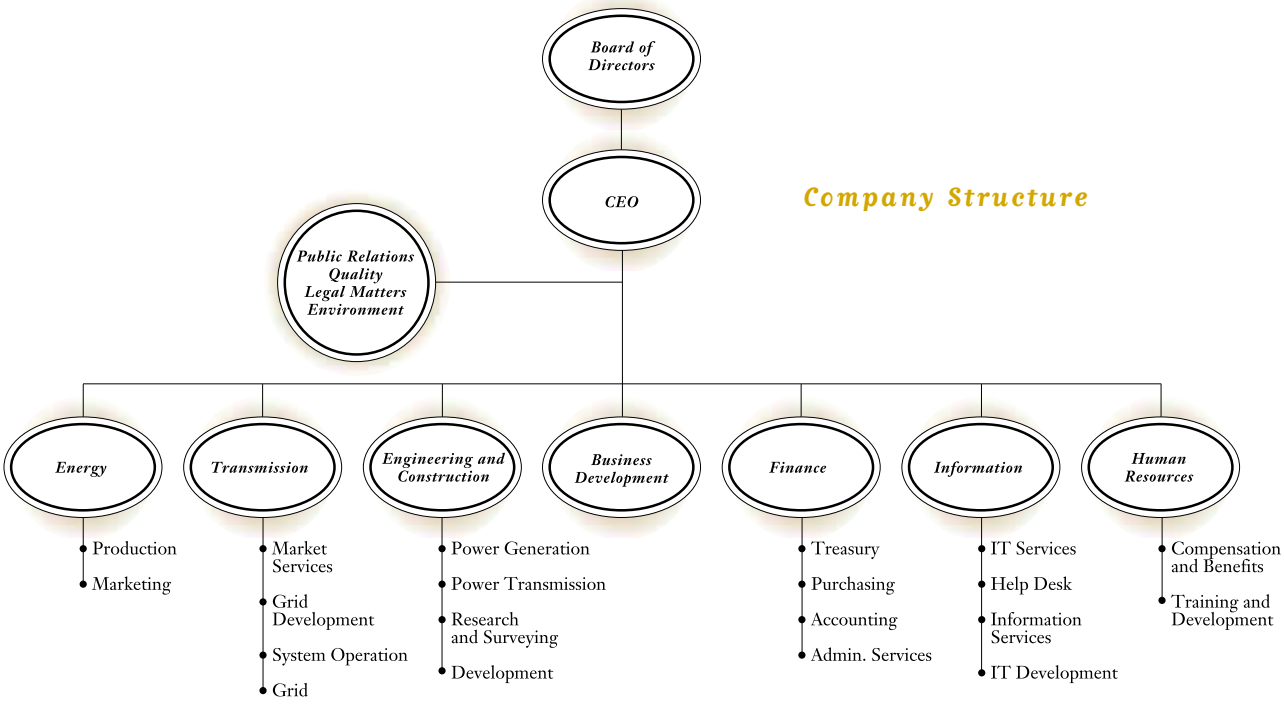
In recent times Landsvirkjun has focused on showing in practice that it is an open company with a strong responsibility towards the community. The general public should have easy access to find out about company activities. Accordingly, Landsvirkjun has introduced a policy of developing its facilities and their surroundings for tourism and outdoor leisure activities. The aim is to attract visitors and give them the chance to find out about what the company does. To promote these aims, two of Landsvirkjun's power stations hosted exhibitions last year, organized by the Society of Icelandic Visual Artists. Landsvirkjun now sponsors the National Museum of Iceland which will organize an impressive exhibition at Ljósifoss power station in summer 2001. Elsewhere, cooperation is under way locally on tourism and outdoor leisure activities. The plan is to establish Landsvirkjun's power stations and their vicinity as interesting places to visit. One aspect of these efforts is to highlight the distinctive features of electricity production in Iceland for visitors from other countries. Environment-friendly and sustainable hydropower and geothermal energy play a key role there. Iceland's energy production could prove to be an important contribution towards the image of pure and unspoilt nature which has been the main theme for promotion of tourism in Iceland in recent years.

Managing Director

Organization

A large section of the Landsvirkjun staff have recently taken part in strategic and organizational planning aimed at strengthening the company and equipping it better to tackle new conditions in the future. In spring 2000, the Landsvirkjun Board of Directors approved a new strategy for the company and a new organizational structure went into effect at the same time, which was ratified by the Board at the end of the year.

Company Structure



Energy

The Energy division produces and sells energy under the optimum arrangement for fulfilling the requirements of Landsvirkjun's customers. It emphasises economical energy procurement and production system operations within the framework imposed by a responsible environmental policy.

Transmission

The role of the Transmission division is the operation, maintenance, development and management of Landsvirkjun's transmission system. After foreseeable reforms in the electricity market in Iceland, its role will be to lay the foundation for efficient electricity trading by granting access to a first-rate electricity transmission system.

Engineering and Construction

The Engineering division handles project management and consultancy for the preparation and construction phases of electricity projects. Its aim is to ensure customers the best possible solutions in accordance with their needs, by offering extensive know-how and experience in harnessing of renewable energy sources.

Business Development

The role of the Business Development division is to create conditions for taking advantage of the expertise, knowledge and opportunities within Landsvirkjun and outside it, with the aim of broadening the base of company activities.

Finance

The role of the Finance division is to manage the company's finances and provide its management with services which increase operational efficiency.

Information

The Information division provides the company with services in acquiring, organising, processing and communicating information effectively.

Human Resources

The Human Resources division leads policy-making and focused management designed to enable the company to draw on the best available human resources at any time and develop them for the benefit of employees and the company alike.

Corporate Office

The Corporate Office handles issues involving the company policy, in particular communication, legal matters and quality and environmental management. It safeguards the interests of the company as a whole through promotional work, reliable information and correct initiatives and responses.

Business development

Landsvirkjun's redefined mission and strategy underline that the company will engage in a wider range of projects than before. The statutory role of Landsvirkjun will clearly change in the near future when the energy sector structure is brought into line with European Union directives and the government's aims for deregulation and competition in the energy sector. In response, the company has already begun participation in various innovative ventures and projects.

Shares in other companies

Landsvirkjun has recently established various companies and become a shareholder of others. An amendment to the parliamentary act on Landsvirkjun has increased its scope in this respect. Nonetheless, Landsvirkjun is still subject to considerable restrictions on its general expansion. The following is an outline of the companies in which Landsvirkjun is involved.

Enex hf

The purpose of the company (previously named Jardhiti ehf) is development, research, processing and harnessing of all types of energy resources, and energy distribution and sale. It emphasises export of Icelandic geothermal know-how and technology. Landsvirkjun owns a share of just over 15% in the company.

Fjarski ehf.

At the end of the year, Landsvirkjun's telecom network was transferred to a separate wholly owned company. Landsvirkjun's telecom staff will continue to handle operation of the network, on a contractor basis, to ensure financial independence from other company activities. Its purpose is to provide Landsvirkjun and other companies with telecom services for data transmission via microwave and optical fibre networks.

Íslensk orka ehf.

The purpose of the company is to harness geothermal energy and other underground resources at Bakkahlaup in Öxarfjördur, North Iceland. Landsvirkjun holds a 26% share in the company.

L4 Solutions Inc – Management Champions

L4 Solutions was established in February 2000 to develop customised management software solutions for electricity transmission and distribution companies. Software applications process data captured from existing systems. Landsvirkjun holds a share of just under 40% in this company, which is registered in the USA with a head office in Philadelphia.

Stikla hf

This company's core activity is to set up and operate a new wireless telecom network based on the TETRA standard. Stikla's service area is planned to extend to all parts of Iceland by the end of 2001. Landsvirkjun owns a one-third share in this company, which was established in February 2000.

Vindorka hf.

The purpose of this company is further development of a new, revolutionary concept for harnessing wind power, towards construction and global market sales of wind-powered electricity stations. Landsvirkjun owns just over 10% of shares in the company.

EcoEnergy hf

EcoEnergy was founded in February 1999 and is a holding company owning a majority of shares in NýOrka, which is engaged in research for establishing a hydrogen fuel community in Iceland. Landsvirkjun owns a stake of just under 8% in EcoEnergy and is the third-largest shareholder.

International projects

Legislative amendments now authorize Landsvirkjun to operate as a consultant in other countries. Landsvirkjun has employees with a diverse range of know-how in the fields of energy-related research, finance, operations and project management, and the company also enjoys a strong financial position. All these factors create international windows of opportunity for Landsvirkjun. Although this is a new field and still at the pilot stage, Landsvirkjun took part in several projects in Africa and South America during the year in partnership with Icelandic and overseas consulting companies.

Technology based on competence

While Landsvirkjun has vast physical assets in the form of power stations and transmission systems, the know-how and experience of its employees is no less crucial for the company's ability to grow and flourish in the future. A good company provides its employees with systematic training necessary for its operations, supports individuals in their personal development and the cultivation of their abilities, and encourages them to seek further knowledge. Landsvirkjun is determined to be a leader in addressing all aspects of modern human resource management on these principles. The company and its employees alike benefit from this policy. Work is in progress on laying the foundation for systematic continuous education, by charting the skills required for all jobs and defining the need for training, as well as seeking to give all employees maximum opportunity to develop their talents in their work.

Operations

Transmission

Electricity system management was benchmarked during the year, as part of an international project covering 20 countries which also addressed development of benchmarking methodologies. Landsvirkjun emerged as one of the best performers in terms of system management.

It has been decided to purchase a new energy management system for the Landsvirkjun dispatch centre from Alstom of France which is scheduled to enter operation in 2002. Replacing a system from 1989, it will form a foundation for changes in Landsvirkjun's activities when deregulation goes into effect.

The need for new transmission infrastructure was assessed, based on the power consumption of an aluminium smelter at Reydarfjördur with a production capacity of up to 400 thousand tonnes p.a. Other system studies addressed the general development of the transmission network over the coming years, and the conceivable expansion of the Nordural smelter at Grundartangi.

There were 136 breakdowns in the electricity system in 2000 compared with 93 in 1999. System outage showed some increase and measured 40.2 minutes for all areas except the West Fjords. If the West Iceland transmission line is included, system outage time totalled 60.6 minutes.

Power production, Purchases, Sales and Marketing

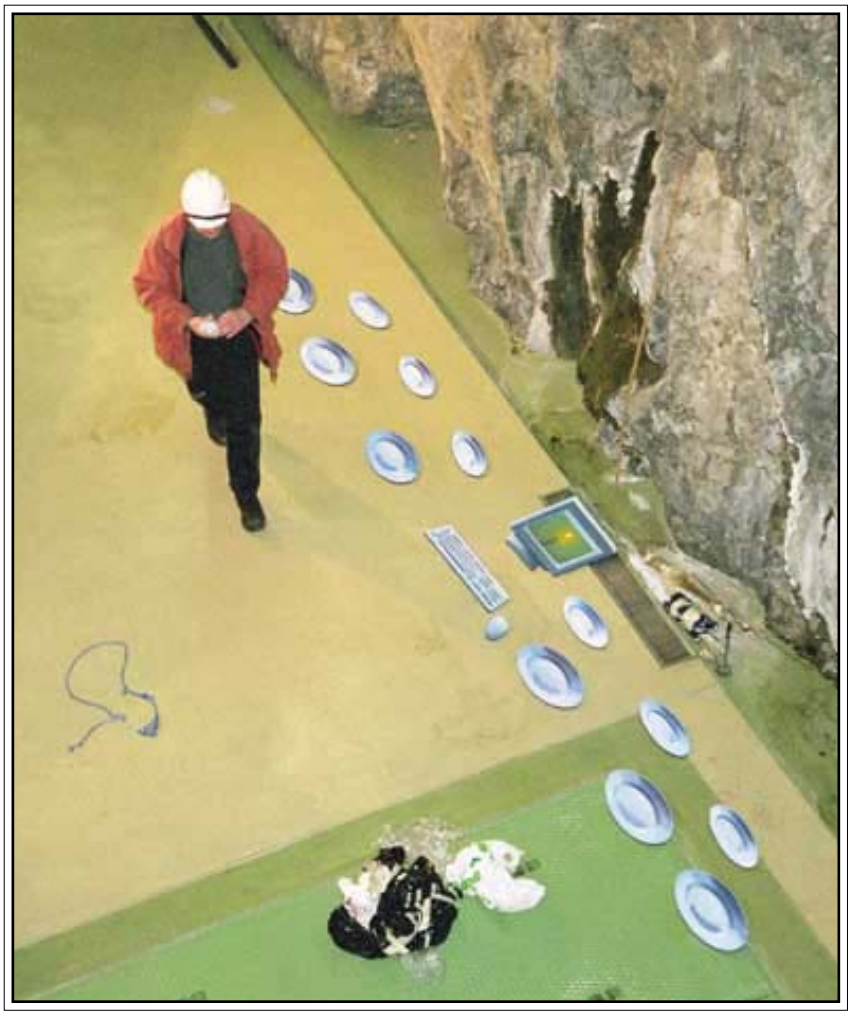
Accessibility to all turbines in the Landsvirkjun system averaged 93% during the year, a highly satisfactory rate given the scale of construction projects in progress at our power stations. A target of 99% average accessibility to all turbines has been set for the winter of 2001.

Landsvirkjun's production increased by 4.2% to 6,579 GWh, which is just under 85.7% of Iceland's total electricity production of 7,679 GWh.

Landsvirkjun's hydro production was 6,108 GWh (just over 96% of the national total) and its geothermal stations produced 470 GWh (35.5%). Furthermore, Landsvirkjun purchased a total of 655 GWh of electricity from Reykjavík Energy and Sudurnes District Heating Co.

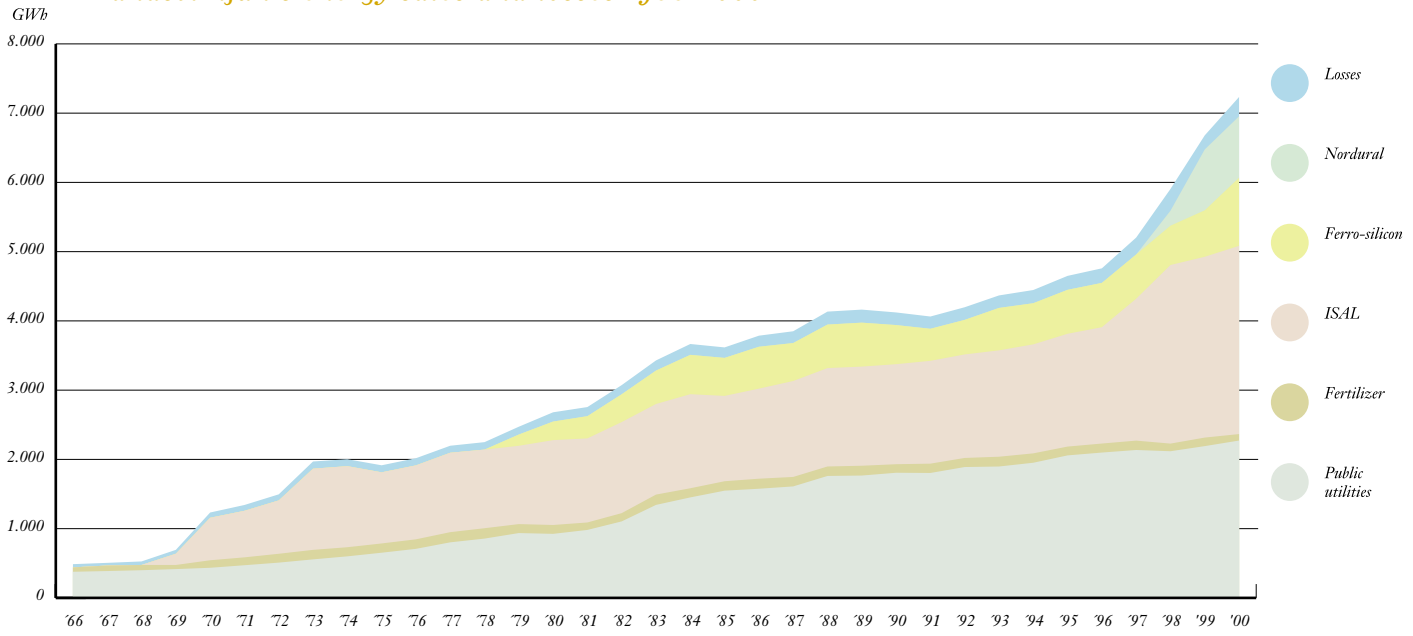
Sales amounted to 6,956 GWh and losses and own use to 279 GWh, or 3.8%. Sales of primary electricity in the general market increased by 2.4%, and total general market sales including secondary electricity rose by 3.6%. Sales to power-intensive industries grew by 9.3%, accounted for partly by the fact that the third furnace at the Icelandic Alloys ferro-silicon plant was in operation for its first full year, and partly by the lower level of secondary electricity curtailments compared with the preceding two years. Total sales by Landsvirkjun increased by 7.4% from the year before.

For the two years prior to 2000, unfavourable hydrological conditions forced Landsvirkjun to curtail secondary



"Supper" by Sigurdur Örlygsson about to be served up on the cavern wall at Laxá.

Landsvirkjun's energy sales and losses 1966-2000



Thousands of guests visited the art exhibitions at our power stations.

electricity supplies to customers. This period of intermittent curtailments came to an end on January 24. On July 1, 2000, Landsvirkjun's wholesale tariff to local utilities was raised by 2.9%.

In early 2000, the Reydarál group abandoned its plans to construct a 120 thousand tonne p.a. aluminium smelter in Reydarfjördur, but requested talks with Landsvirkjun instead on a power contract for a smelter of up to 390 thousand tonnes at the same site. Talks were in progress for most of the year and a final decision is expected to be announced in the New Year of 2002, which would enable the smelter and Kárahnjúkar station to start up in 2006.

Talks were launched with Nordural on further expansion of its aluminium smelter at Grundartangi. The company's present operating licence authorizes it to expand to 180 thousand tonnes p.a., and Nordural has put forward requests for an expansion of up to 300 thousand tonnes.

Environment

New legislation and a new regulation on environmental impact assessment entered into effect in 2000. From the outset, Landsvirkjun decided to take full and active advantage of the benefits of the new legislation, which in particular gives developers easier access to suggestions and remarks from outside parties at an early stage.

Environmental management continued to be a major priority in all aspects of company activities. Workgroups were set up at individual workplaces and divisions aimed at detailing implementation of environmental work, prioritizing projects and preparing preliminary auditing of environmental management under the ISO 14001 standard.

Landsvirkjun's Power Stations

Hydropower stations	**1017 MW**
Búrfell	270 MW
Hrauneyjafoss	210 MW
Blanda	150 MW
Sigalda	150 MW
Sultartangi	120 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	**1122 MW**

Development and construction

The cavern walls at Laxá were integrated into a work by Gudrún Kristjánsdóttir.

During the year, research was conducted for the Búdarháls hydro project (110 MW), planned in the Thjórsá-Tungnaá watershed where Landsvirkjun already operates four of its largest power stations. Work included trial drilling for siting of the headrace tunnel and powerhouse. Towards the end of the year rock samples were drilled in preparation for the Núpur project (130 MW), which is planned for the lower river Thjórsá.

A comprehensive and ambitious programme was arranged for the Kárahnjúkar hydro project environmental impact assessment. In July a proposal for the EIA was sent to the State Planning Agency, which delivered its opinion on the plan in August. From the outset, a major priority was open public presentation of the project. This is the most extensive environmental impact assessment ever conducted in Iceland. All necessary research for the assessment was completed in the autumn and the EIA report is expected to be submitted to the State Planning Agency at the end of March 2001.

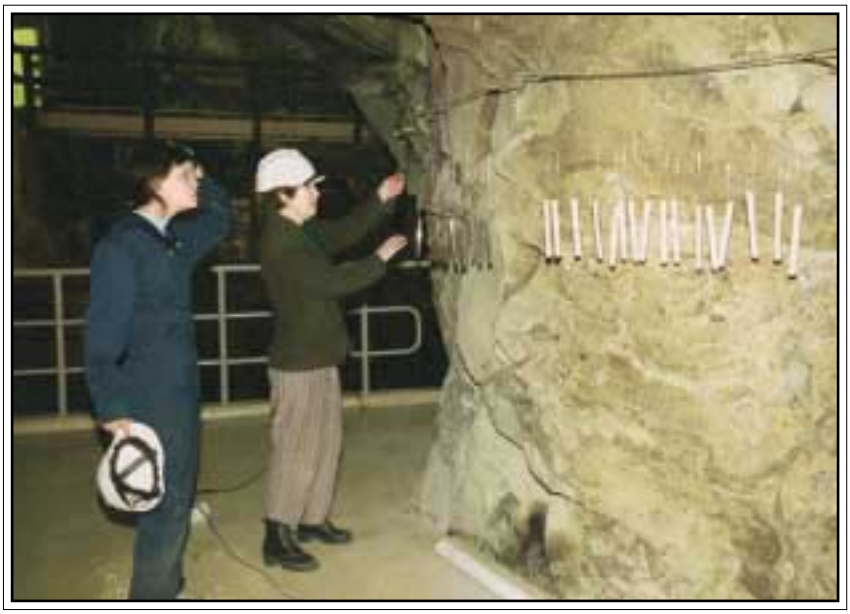
Preparations were launched for an EIA for the Búdarháls project. After the mandatory public presentation of the proposed project, the State Planning Agency approved Landsvirkjun's proposed plan for conducting the EIA, and an assessment report will be delivered in the early months of 2001. A proposed plan for an EIA for a 40 MW expansion to the Krafla geothermal station, North Iceland, was submitted to the State Planning Agency towards the end of 2000. Nearby, research was also conducted in connection with environmental impact assessment of a 40 MW geothermal power plant at Bjarnarflag.

At the end of March, full-scale work was launched on designing and preparing the Kárahnjúkar project, East Iceland. This process was prompted by interest from the Reydarál group in constructing a much larger smelter in Reydarfjördur than had originally been discussed. A wide range of research was undertaken in the summer in connection with the project design phase. The largest-scale studies involved drilling a 51-metre tunnel to investigate rock strata beneath the Kárahnjúkar dam site and drilling at the proposed tunnel mouth. Tenders were invited across the European Economic Area to select consultants for designing tender documents for the actual project and construction blueprints.

Construction work at the Sultartangi station (120 MW) was completed during the year. The second turbine at the station went on stream on January 31, as scheduled from the start of the project.

Continuous construction work has been in progress at the site of the Vatnsfell hydro station (90 MW) since work was launched in summer 1999, and the project moved into full swing in spring 2000. Construction activity peaked during the year. On-site installation of mechanical and electrical hardware also began, but will mainly take place in 2001. The first turbine will be ready to go on stream on October 15, 2001 and the second one two months later.

Finance



Artist Kristín Jónsdóttir instals part of her work "Sources".

Landsvirkjun produced a loss on its operations amounting to ISK 1,366 million in 2000, after consecutive years of profit since 1996.

Income statement

Operating revenues amounted to ISK 11,391 million in 2000, compared with ISK 10,144 million the previous year. This represents an increase of ISK 1,247 million, or 12.3%. Sales to local utilities grew by ISK 333 million (5.3%), as a result of both greater sales volume and the tariff increase. Sales to power-intensive industries increased by ISK 906 million, or 23.6%. This large growth is explained by greater sales volume, a rise in contractual electricity prices to match higher aluminium prices, and the depreciation of the Icelandic króna. Landsvirkjun's revenues from sales to power-intensive industries are denominated in foreign currencies and linked to world market prices for aluminium.

Operating expenses before depreciation were ISK 3,818 million, as against ISK 2,927 million in 1999. Reasons for the increase include an ISK 288 million rise in the pension fund commitment, an increase of ISK 269 million in purchases of power, and general rises in the price level. In volume terms, purchases of power increased by 40% compared with the previous year; prices are denominated in foreign currency and linked to world aluminium prices, since this sourced electricity is resold to power-intensive industries. Another factor at work was that the Sultartangi station went into operation during the year. Depreciation in 2000 totalled ISK 4,519 million compared with ISK 3,812 million in 1999. This increase of ISK 707 million results from revaluation of assets and the inclusion of the Sultartangi station and other new assets. Landsvirkjun's profit before net financial costs was ISK 3,054 million, down by ISK 352 million from the previous year.

Financial costs rose from ISK 1,481 million in 1999 to ISK 4,420 million in 2000, an increase of ISK 2,939 million. The explanation for this large increase primarily lies in the 9.9% depreciation of the króna from the beginning to the end of the year, while interest rates in international markets also rose considerably. Average nominal interest rates on Landsvirkjun's long-term liabilities were 6.3% during the year. The real annual interest rate, measured in terms of Landsvirkjun's own index, was 6.6%. By comparison, the real annual interest rate was 2.6% in 1999 and 4.8% on average over the period 1987 to 2000.

Balance sheet and cash flows

Landsvirkjun's total assets grew by ISK 12 billion in the course of the year and the book value of equity by ISK 1.7 billion, while liabilities increased by ISK 10.3 billion. Total assets at the end of the year amounted to ISK 111.6 billion. Liabilities amounted to ISK 77.1 billion and equity ISK 34.5 billion. The equity ratio at the end of 2000 was 30.9%, compared with 33% at the end of 1999.

Although price and exchange rate developments have a decisive impact on Landsvirkjun's operating performance, they have relatively little effect on cash flows. Cash generated by operating activities amounted to ISK 3,751 million, which is ISK 152 million less than the 1999 figure of ISK 3,903 million. Investments during the year totalled ISK 6,400 million, as against ISK 8,899 million the year before. Net borrowing was ISK 2,688 million.

Risk management

Landsvirkjun applies active risk management to hedge against foreign exchange and interest rate risks. Hedging has produced good results and the company still enjoys very low nominal interest terms, or 6.3%, despite rises in foreign interest rates. However, the company has great difficulty in hedging against exchange rate risks on its foreign borrowing, since the Icelandic money market is not large enough for conversion of liabilities from foreign to domestic currency on a substantial scale.

Markets

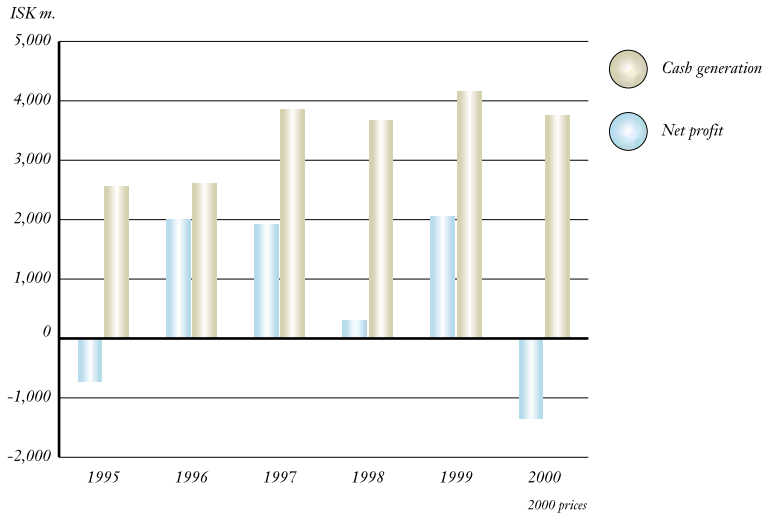
In recent years, Landsvirkjun has been aiming to increase the weighting of the Icelandic króna in the composition of

its total liabilities. However, conditions were very tight in the domestic bond market and in the company's opinion it was not possible to launch a bond issue there with acceptable interest terms. Another factor that Landsvirkjun bore in mind was that by making a large issue it could have thrown the market into even greater disequilibrium than already prevailed there.

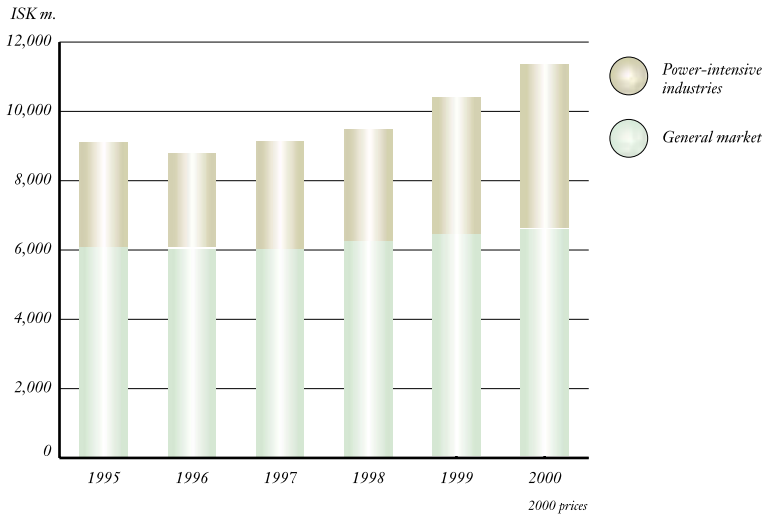
Although conditions in the domestic bond market were fairly tough, the situation in foreign markets was quite different. Landsvirkjun's funding activities went very smoothly and focused solely on borrowings under its EMTN programme. The facility was renewed and expanded from USD 500 million to USD 1,000 million in May. Northern European investors continued to play the main role in company funding, but borrowings were also made in Japan, the UK and the Czech Republic, the first Icelandic bond issue in that market.

Generally speaking the aluminium market was in good shape during the year and the outlook is that aluminium prices will remain high for the time being. This is not least because of uncertainties in the electricity market on the US west coast, where many aluminium companies have been cutting back production with a corresponding upward impact on world prices. Uncertainty about the state of the US economy, on the other hand, could serve to bring down aluminium prices in the course of the year. Landsvirkjun is launching action to hedge against the impact of aluminium price fluctuations on its income flow. The company identifies a need to address aluminium price risks, especially in light of the greater weighting that aluminium prices will have in its income flow in the coming years.

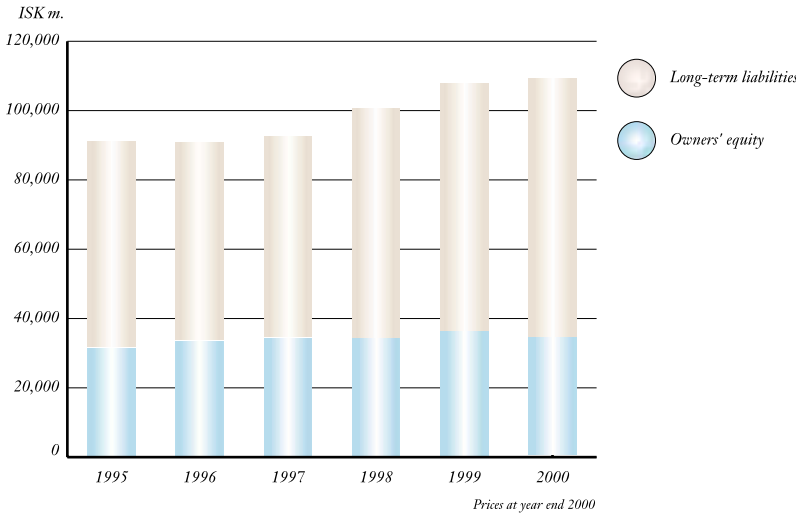
Cash generation and net profit



Composition of revenues



Long-term liabilities and owners' equity



Financial statements 2000

DIRECTORS' REPORT

The company showed a net loss from its operations in 2000 after a four-year profit period. The net loss amounted to ISK 1,366 million compared with a profit of ISK 1,924 million in 1999. The change from the previous year can for the most part be explained by higher net real interest costs which were 6.6% in 2000 compared to 2.6% in 1999. Operating revenues in 2000 increased by ISK 1,247 million from 1999, operating expenses increased by ISK 1,598 million and net financial costs increased by ISK 2,939 million. Cash generated by operating activities was ISK 3,751 million in 2000 compared to ISK 3,903 in 1999.

Investments amounted to ISK 6,412 million compared to ISK 8,910 million in 1999. New long-term borrowings exceeded repayments of long-term debts by ISK 2,688 million in 2000 compared with ISK 6,619 million in the previous year.

Landsvirkjun is a partnership, jointly owned by the State Treasury, with a 50% interest, the City of Reykjavík, which holds 44.525%, and the Town of Akureyri which owns a 5.475% interest. The company is an independent legal entity having independent finances and accounting.

The Board of Directors will at the annual meeting propose a dividend payment to the owners for 2000 in conformity with the provisions of the Act on Landsvirkjun an the Partnership Agreement between the owners. According to the said regulation the Board's proposal will amount to ISK 285 million should the Board's proposal be approved.

The Board of Directors and the Managing Director hereby confirm the 2000 Financial Statements by means of their signature.

Reykjavík, March 2, 2001

Board of Directors: Jóhannes Geir Sigurgeirsson

Árni Grétar Finnsson — Helgi Hjörvar

Sigrídur Hjartar — Sigfús Jónsson

Kristján Thór Júlíusson — 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, 2000, 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 statements 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, 2000, 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 2, 2001

Jón Eiríksson
Ólafur Nílsson

KPMG Endurskoðun hf.

Income statement 2000

	Note	2000	1999
OPERATING REVENUES			
Power sales - Local utilities		**6,605,734,268**	6,271,913,749
Power sales - Power-intensive industries		**4,743,725,974**	3,837,414,647
		11,349,460,242	10,109,328,396
Sale of steam from geothermal wells		**23,383,300**	21,930,235
Other income		**18,407,962**	13,188,178
Total operating revenues		**11,391,251,504**	10,144,446,809
OPERATING EXPENSES	1		
Energy		**1,840,721,045**	1,365,828,908
Transmission		**595,084,396**	484,937,440
Engineering and construction		**199,699,176**	196,667,969
Cost of general research		**211,746,845**	173,845,173
General administrative expenses	12	**970,611,548**	705,425,815
Depreciation	1,4	**4,519,006,186**	3,811,720,123
Total operating expenses		**8,336,869,196**	6,738,425,428
Operating profit		**3,054,382,308**	3,406,021,381
FINANCIAL COSTS	2		
Interest revenues		**(236,167,044)**	(185,799,899)
Interest expenses		**4,270,254,420**	3,465,324,572
Exchange-rate losses (gains)	1	**6,894,603,122**	(2,710,754)
Gain on net monetary position	1	**(6,508,118,000)**	(1,795,223,000)
		4,420,572,498	1,481,590,919
(NET LOSS) NET PROFIT		**(1,366,190,190)**	1,924,430,462

All amounts are in ISK

Balance sheet as at december 31, 2000

Assets

	Note	2000	1999
PROPERTY, PLANT AND EQUIPMENT	1.3		
In operation			
Power stations		**143,708,245,402**	124,009,357,359
Transformer stations		**16,362,349,105**	14,305,384,978
Power lines		**23,634,164,140**	21,374,745,969
Vehicles, equipment and dredger		**930,370,665**	825,538,717
Office building and equipment		**1,723,415,245**	1,842,445,676
		186,358,544,557	162,357,472,699
Less: Accumulated depreciation		**86,855,178,008**	75,285,559,659
Total in operation		**99,503,366,549**	87,071,913,040
Construction and research			
Development costs		**1,882,013,570**	1,409,648,112
Projects under construction		**5,216,282,840**	6,293,101,105
Total construction and research		**7,098,296,410**	7,702,749,217
Shares and long-term notes receivable			
Shares	5	**122,347,292**	70,021,539
Long-term notes receivable		**21,122,391**	31,906,236
Total shares and long-term notes receivable		**143,469,683**	101,927,775
Total property, plant and equipment		**106,745,132,642**	94,876,590,032
CURRENT ASSETS			
Accounts receivable - trade		**1,687,284,943**	1,321,700,608
Accounts receivable - other		**176,883,227**	149,647,891
Accrued interest receivable		**10,579,744**	11,760,064
Inventories (oil)		**27,861,600**	29,628,000
Cash		**2,948,711,411**	3,160,086,128
Total current assets		**4,851,320,925**	4,672,822,691
Total assets		**111,596,453,567**	99,549,412,723

All amounts are in ISK

Liabilities and owners' equity

	Note	2000	1999
OWNERS' EQUITY	6		
Owners' contribution		**20,707,646,000**	19,205,502,000
Retained earnings		**13,796,634,625**	13,643,292,495
		34,504,280,625	32,848,794,495
OBLIGATIONS			
Accrued pension obligation	7	**1,256,588,000**	1,056,560,000
LONG-TERM LIABILITIES			
Long-term liabilities	8	**59,903,274,619**	57,376,587,570
CURRENT LIABILITIES			
Accounts payable		**1,147,572,324**	812,215,960
Accrued interest payable		**1,042,364,771**	903,584,391
Current maturities of long-term liabilities	9	**13,742,373,228**	6,551,670,307
Total current liabilities		**15,932,310,323**	8,267,470,658
Total liabilities		**77,092,172,942**	66,700,618,228
Total liabilities and owners' equity		**111,596,453,567**	99,549,412,723

All amounts are in ISK

Statement of cash flows in 2000

	Note	2000	1999
OPERATING ACTIVITIES	10		
Cash received from customers		**10,997,658,402**	9,887,706,907
Interest income		**237,347,364**	174,039,835
Cash expenses		**(3,486,422,946)**	(2,806,750,008)
Cash payment for interest costs		**(3,998,012,217)**	(3,352,042,003)
		3,750,570,603	3,902,954,731
INVESTING ACTIVITIES			
Vatnsfell project		**(2,512,624,933)**	(1,079,648,713)
Sultartangi project		**(868,644,797)**	(4,262,062,931)
Refurbishment of Búrfell station		**(301,766,976)**	(370,234,122)
Refurbishment of Sog stations		**(444,596,473)**	(358,916,412)
Extension of Krafla station		**(319,457,533)**	(666,351,451)
Refurbishment of Straumsvík thermal station		**(196,531,082)**	(203,711,399)
Transformer stations and power lines		**(669,657,792)**	(827,112,307)
Research and development		**(704,105,281)**	(303,572,562)
Other capital expenditure		**(394,360,323)**	(838,503,324)
		(6,411,745,190)	(8,910,113,221)
Decrease in long-term notes receivable		**11,623,752**	11,568,242
		(6,400,121,438)	(8,898,544,979)
FINANCING ACTIVITIES			
New long-term liabilities		**6,897,041,827**	16,245,276,025
Amortization of long-term liabilities		**(4,208,556,709)**	(9,626,797,097)
Cash dividend		**(250,309,000)**	(234,805,000)
		2,438,176,118	6,383,673,928
(Decrease) increase in cash during the period		**(211,374,717)**	1,388,083,680
Cash at beginning of year		**3,160,086,128**	1,772,002,448
Cash at end of year		**2,948,711,411**	3,160,086,128

All amounts are in ISK

Notes to financial statements

ACCOUNTING POLICIES

1 The financial statements are prepared in conformity with the provisions of the Financial Reporting Act and the related regulations on the form and content of financial statements. The methods used in preparing the financial statements are in all material respects consistent with those of the previous year.

The following is a summary of the accounting policies used in preparing the accounts:

- The original cost of property, plant and equipment is revalued to year-end prices. For this purpose the original cost is divided into two parts. One part, representing local Icelandic cost, is estimated as one-third of the total original cost, while the other part, representing foreign cost, is estimated as two-thirds of the original cost. The local portion is revalued according to changes in the Icelandic index of construction cost, whereas the foreign portion is revalued on the basis of changes in the exchange value of the Icelandic króna in relation to the SDR, as adjusted for foreign inflation. The revaluation factor in accordance with this calculation is 10.2% for the current year.
- Depreciation of fixed assets in the income statement is shown at mid-year prices, while accumulated depreciation in the balance sheet is shown at year-end prices.
- The fixed assets of the company are depreciated on a straight-line basis as follows:

		Estimated useful life
Power plants:		
Construction expenditure, etc.	1.67%	60 years
Machinery	3.33%	30 years
Dams and waterways	1.67%	60 years
Thermal stations	4.00%	25 years
Transformer stations	3.33%	30 years
Power lines	2.78%	36 years
Office buildings	2.00%	50 years
Equipment	12 - 20%	4 - 8 years
Vehicles	20.00%	5 years
Research projects	12.50%	8 years

- Indexation on local debt and foreign exchange differences are expensed in the income statement. To counterbalance such revaluation a price-level gain on the net monetary liabilities of the company is calculated. The price-level gain is calculated based on the net liabilities of the company at the beginning of the year, taking into consideration changes in that position during the year. The result of this calculation is that the net profit (loss) reported is stated at mid-year prices.
- Interest is capitalized during construction. Once the respective assets are operational the interest cost is expensed.
- Expenditures for general research are expensed as incurred. Development costs for future power projects are capitalized. Interest costs on these development costs, however, are not capitalized. These costs will be amortized over a period of 8 years, if no firm commitment has been issued to complete the projects. This policy was decided upon with reference to the risk and uncertainty associated with the future benefits of such costs. Additionally, the viability of one future project can change the likelihood of another power project being materialized. Previously, capitalized development costs were either written off when the projects were abandoned or were added to the cost of construction for the projects that were implemented.
- The income statement is issued in accordance with the new organisation chart of Landsvirkjun which came into force in the middle of the year but the figures for last year are not in every respect comparable because of changes in assignments.

FINANCIAL COSTS

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

Interest revenues	(263)
Tax on interest revenues	27
Interest expenses	4,331
Guarantee fee paid to owners	159
Exchange-rate losses on long-term liabilities	7,029
Exchange-rate gain on short-term items	(134)
Gain on net monetary position	(6,508)
	4,641
Capitalized interest costs	(220)
	4,421

The net real interest cost, to the amount of ISK 4,421 million, is approximately 6.6% on the average outstanding long-term loans for the year 2000, compared to 2.6% for the year 1999.
The average for the years 1987-2000 is 4.8%. The net real interest cost in percentages is computed by comparing total interest cost and exchange-rate differences with the revaluation factor used by the company, as explained in note 1.

PROPERTY, PLANT AND EQUIPMENT

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

	Power stations	*Transformer stations*	*Power lines*	*Other assets*	*Total*
Costs:					
Balance Jan. 1, 2000	124,009	14,305	21,374	2,669	162,357
Increase 2000	6,471	567	73	159	7,270
Revaluation 2000	13,228	1,490	2,187	280	17,185
Retired/sold	0	0	0	(454)	(454)
	143,708	16,362	23,634	2,654	186,358
Accumulated depreciation:					
Jan. 1, 2000	57,289	6,948	9,677	1,371	75,285
Depreciation 2000	2,636	679	669	135	4,119
Revaluation 2000	5,985	745	1,022	147	7,899
Retired/sold	0	0	0	(448)	(448)
	65,910	8,372	11,368	1,205	86,855
Book value at end of year	77,798	7,990	12,266	1,449	99,503

4 Depreciation in 2000 consists of the following (ISK million):

Power stations	2,636
Transformer stations	679
Power lines	669
Other assets	135
Depreciation of assets in operation	4,119
Other	9
Research projects	391
	4,519

5 Landsvirkjun established in the year 2000 a wholly owned subsidiary, named Fjarski ehf Landsvirkjun also established, along with other parties, a limited liability company named Stikla hf, and a limited company named L4 Solutions Inc. In the year 2000 Landsvirkjun increased its share in Vindorka hf with a purchase of shares with a nominal value of ISK 0.7 million for ISK 16.7 million. Landsvirkjun decided to write down the book value of its stake in Íslensk orka hf in an effort to secure that the value of the shares is not overstated.
Landsvirkjun's holdings consist of the following (ISK million):

	Share	*"Nominal value"*	*"Book value"*
Fjarski ehf	100.0%	5.0	5.0
Stikla ehf	33.3%	50.0	50.0
Vindorka hf	11.5%	10.3	50.0
VistOrka hf	2.1%	1.0	1.0
Íslensk orka ehf	26.9%	44.7	1.0
L4 Solutions Inc	39.9%	0.2*	15.3
			122.3

*million USD

OWNERS' EQUITY

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

	According to financial statements	At prices as of year-end
Balance at January 1, 2000	32,849	36,203
Cash dividend	(250)	(263)
Revaluation of assets	9,779	-
Gain on net monetary position	(6,508)	-
Net loss	(1,366)	(1,436)
	34,504	34,504

Based on the partnership agreement dated 1981 with reference to subsequent amendments to that agreement, the capital contributions amounted to ISK 14 billions in terms of year-end prices in 1995. The capital contributions restated to reflect changes in price levels to the end of 2000 amounted to ISK 16,698 million.

The partnership agreement stipulates that dividends shall be 5.5% of the restated capital contributions and the balance for accrued dividends. 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 4,010 million at the end of 2000 and the maximum amount that can be paid in the year 2001 based on the requirements of the partnership agreement is ISK 285 million. Accordingly, the owners' equity consists of the following balances:

Restated capital contributions	16,698
Undistributed accrued dividends	4,010
	20,708
Retained earnings	13,796
	34,504

OBLIGATIONS

7 The accrued pension obligation of the company, based on actuarial estimates, amounted to ISK 1,257 million at the end of 2000.

LONG-TERM LIABILITIES

8 Long-term liabilities are translated at the rate of exchange prevailing at the end of the period. They are in the following currencies (millions):

	Foreign amount	*ISK*	*%*	*Indexation exhange-rate losses (gains)*
U.S. dollars	398.0	33,803	45.9%	4,778
Euro	162.7	12,864	17.5%	711
Icelandic króna	-	8,172	11.1%	331
Japanese yen	8,771.0	6,489	8.8%	233
German marks	130.8	5,287	7.2%	402
Pounds sterling	35.6	4,502	6.1%	325
Swiss francs	16.6	860	1.2%	158
Norwegian kroner	174.0	1,669	2.2%	91
		73,646	100.0%	7,029
Current maturities of long-term liabilites		13,742		
		59,904		

The nominal interest rates on outstanding debt are from 0% to 14.5%. The average nominal interest charges were 6.3% for 2000 as compared with 5.8% for 1999.

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

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

2001	13,742
2002	2,584
2003	36,024
2004	5,622
2005	4,508
Later	41,166

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

10 Cash flow from operating activites is a good indicator of the company's ability to repay its 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):

	2000	1999	1998	1997
Net operating profit (loss)	(1,366)	1,924	283	1,716
Reconciling adjustments:				
Depreciation	4,562	3,812	3,519	3,232
Exchange rate adjustments net	521	(1,798)	(398)	(1,730)
Working capital provided by operations	3,717	3,938	3,404	3,218
Changes in components of working capital				
Decrease (increase) in current assets	(390)	330	(374)	147
Increase (decrease) in current liabilities	424	(365)	340	68
Cash provided by operation	3,751	3,903	3,370	3,433
Cash provided by operation as a percentage of total liabilities	5.0%	6.0%	5.6%	6.7%

OTHER ITEMS

11 The company paid ISK 1,533 million in salaries to employees, which consist of the following

Energy	582
Transmission	320
Engineering and construction	150
Corporate office	69
Finance, information and human resources	191
Marketing agency	22
Capitalized amount	31
	1,365
Related expenses	203
Pension payments	288
	1,856

Remuneration to the board of directors and executive management amounted to ISK 62 million.
The company had 276 permanent and 86 temporary employees in 2000.

12 General administrative expenses consist of the following:

Corporate office	197
Finance	205
Human resources	84
Information	59
Pension payments	288
Shares in Íslensk orka hf	44
Marketing unit	37
Common costs	57
	971

13 A dispute between the company and the owners of the water rights of the Blanda river was settled by arbitration in 1992. The amount awarded to the landowners was ISK 92 million. Additionally, the company had to pay all legal fees in connection with the arbitration. In accordance with the decision of the arbitration tribunal, payment of ISK 51 million is to be deferred until such time that a dispute regarding the ownership of the moorland around Blanda river has been resolved. The accrued amount with interest costs was ISK 88 million at the end of 1997.
That year the Supreme Court of Iceland ruled that the counties in the vicinity have only limited ownership rights which do not include the water rights for the disputed land. With reference to this ruling, and based on a contract from 1982 between the Government and Landsvirkjun, the Government has made claims for the unpaid balance for the water rights. The District Court of Reykjavík awarded the Government the right for this claim in a ruling last autumn. Landsvirkjun appealed and litigation before the Supreme Court is to take place at the end of March 2001. The unpaid balance has not been posted to the financial statements.

Art in Energy Centres

We want the public to learn about our environment-friendly power system totally based on sustainable energy sources. We have therefore adopted the policy of encouraging tourism and outdoor leisure activities in the vicinity of our power stations. We also try to make sure that our stations become points of interest that tourists want to visit. In summer 2000 we welcomed the Society of Icelandic Visual Artists into two of our oldest hydro stations to hold exhibitions. These exhibitions proved to be one of the most popular events of the cultural programme for Reykjavík – European City of Culture 2000. By popular demand, we will continue the exhibition at the Laxá station, North Iceland, in summer 2001. The photos in this report show preparations and the resulting exhibitions last summer.

From an introduction to the exhibitions by Jón Proppé, critic:

"The power stations are a symbol of the intransigence with which the Icelanders have built their community on this almost uninhabitable land far away in the northern ocean. But art also speaks of how they have overcome obstacles and tamed the destructive forces that ruled the land from its creation until a few northerners had the mad idea that they could make their home there. Both are testimony to a creative and resourceful nation in close and intimate contact, born of deep respect, with nature."

One of our many guests enjoys culture and nature at Ljósifoss hydro station.

Design: Nonni og Manni
Photography: Marisa Navarro Arason
Printing: Oddi
Supervision: Þorsteinn Hilmarsson
Sculpture on cover:
The waterflute by artist Hafsteinn Austmann
Sculpture now owned by the City of Reykjavík

Landsvirkjun is main sponsor for The National Museum of Iceland

Landsvirkjun and the National Museum have taken up wide-ranged cooperation involving research as well as public relations. In summer 2001, the Museum will stage a large exhibition of Icelandic wood carving at Landsvirkjun's visitor centre at the Ljósifoss hydro station an hour's drive east of Reykjavík.

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