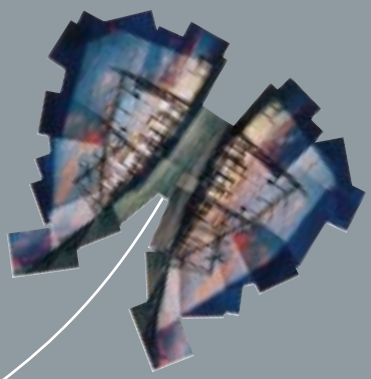
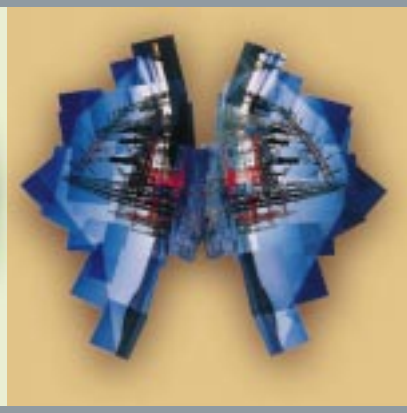


ANNUAL REPORT



1998

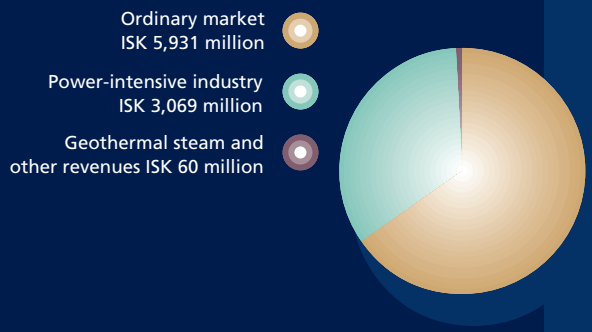
CULTURE AND NATURE

Landsvirkjun
The National Power Company

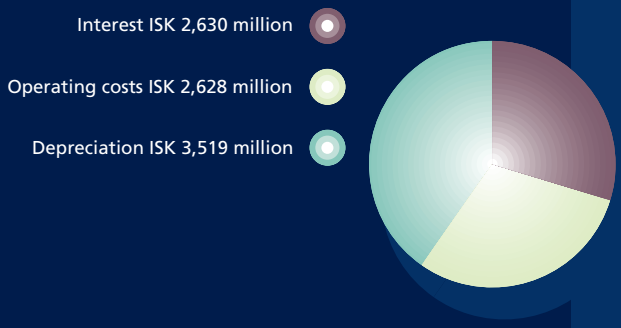
Landsvirkjun produces, distributes and sells wholesale electricity to local public utilities and, under special agreements, to power-intensive industries. Its task is to promote greater utilization of Iceland´s energy resources and ensure that electricity supply is always sufficient to meet demand. Landsvirkjun´s present ownership is divided among the Icelandic State (50%), City of Reykjavík (45%) and Town of Akureyri (5%).

Landsvirkjun's net profit for 1998 was ISK 283 million which is considerably lower than in the previous year. However, substantial cash was generated by operating activities, or ISK 3,370 million, which is similar to the two preceding years. Investment during the year amounted to ISK 9.5 billion, to meet greatly increased electricity sales to power-intensive industries.

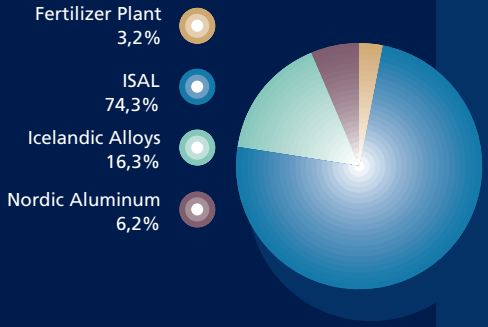
Operating revenues 1998 ISK 9,060 million



Operating expenses 1998 ISK 8,777 million



Breakdown of sales to power-intensive industries



Highlights of the annual accounts

	1998	1997
Net profit	**283 million**	1,717 million
Cash generated by operating activities	**3,370 million**	3,433 million
Liabilities	**59.4 billion**	51.0 billion
Pension obligation	**1.0 billion**	0.9 billion
Owners' equity	**30.2 billion**	29.6 billion
Equity ratio	**33.3 %**	36.3 %

Electricity production, purchases and sales

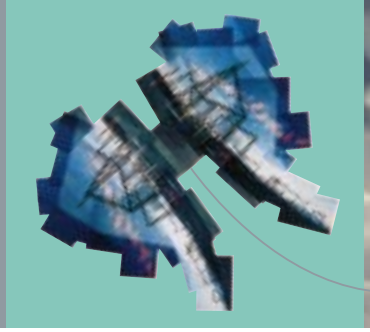
	1998	1997
Total production	5,811 GWh	5,203 GWh
Electricity purchases	92 GWh	–
Sales to ordinary market	2,118 GWh	2,136 GWh
Sales to power-intensive industries	3,471 GWh	2,823 GWh

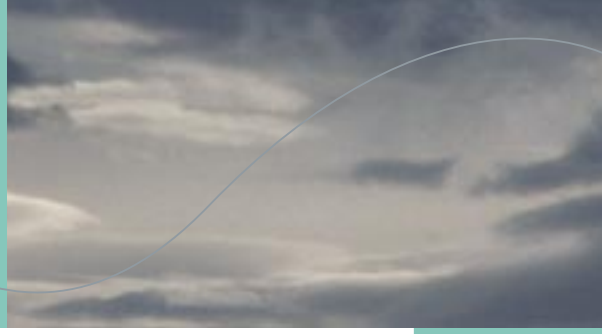
Electricity prices to the ordinary market 1998

	Average price	Change from 1997 Nominal price	In real terms
Primary electricity	3.14 ISK/kWh	3.8%	0,2%
Secondary electricity	0.50 ISK/kWh	10.1%	6,2%
Average price	2.80 ISK/kWh	8.4%	4,7%

Landsvirkjun's credit rating on international markets

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





OVERVIEW

The Nordic Aluminum (Nordural) smelter at Grundartangi officially went on stream on June 8th 1998, and with its rated capacity of 60 thousand tpy the smelter will eventually use up to 930 GWh annually.

Landsvirkjun signed a Euro Medium-Term Note programme in May, the first Icelandic borrower to do so.

On June 25, the Ministry of Industry and Commerce and Landsvirkjun made an agreement whereby MIL (the joint Ministry of Industry and Landsvirkjun Energy Marketing Agency) was renamed Invest in Iceland Agency – Energy Division. The aim behind this move is to coordinate promotion of Iceland for foreign investors as effectively as possible.

Hydrological conditions were extremely difficult during the year. Reservoirs did not fill up, the groundwater level was low and flow in rivers was poor. As a result, delivery of secondary electricity to power-intensive industries had to be curtailed and the price of secondary electricity to the ordinary market raised from September 1. These actions were in accordance with provisions in contracts with power-intensive industrial buyers and in the Landsvirkjun tariff. Curtailments of this kind had not been made since 1981.

On September 4, a cornerstone was laid at the Krafla Station to mark the commissioning of its second turbine, bringing production up to the full 60 MW capacity for which it was originally designed.

In October, Landsvirkjun began purchasing electricity from the Reykjavík District Heating Utility's geothermal power station at Nesjavellir under a 20-year agreement. The electricity is being purchased to serve the Nordural smelter and meet general increases in electricity consumption in Iceland.

Also in October, work was completed on the Há-ganga reservoir.

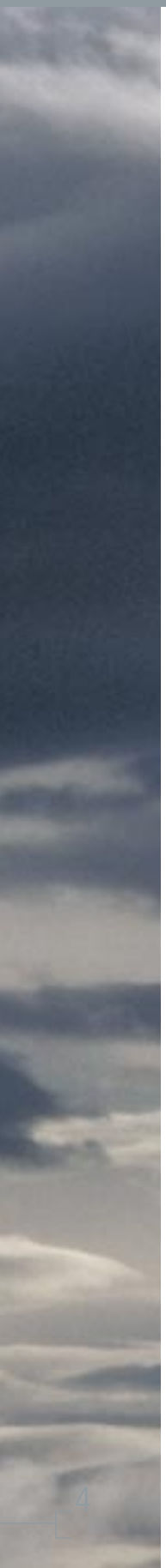
On December 15, the Búrfell Line 3A, a new 220 kV high-voltage transmission line from the Búrfell Station to the Greater Reykjavík Area, was put on stream.

At the end of the year Halldór Jónatansson retired as Managing Director after serving in that post since 1983. At the beginning of 1999, Fridrik Sophusson, former Minister of Finance, took over as Landsvirkjun's Managing Director.

Year 2000 compliance. Computers and digitally controlled equipment are an important element in the operation of electricity systems. Landsvirkjun has been systematically engaged in resolving Year 2000 compliance problems since the beginning of 1998, with the aim of ensuring unimpaired delivery of electricity to its customers. Details of the progress of the Y2K programme can be found on Landsvirkjun's website, www.lv.is.

Number of employees. A total of 369 man-years were worked at Landsvirkjun during 1998, an increase of twenty-four from the previous year.

REPORT BY THE CHAIRMAN AND THE MANAGING DIRECTOR



The new agreements signed with power-intensive industrial buyers over the period 1995 to 1997 continued to make a substantial contribution towards increased electricity sales, as they did in the previous year. Landsvirkjun's sales to power-intensive industries increased by almost 23% in 1998 compared with the year before. This was offset by hydrological conditions in the second half of the year which proved to be the most difficult in the company's history, resulting in the need to curtail secondary electricity deliveries to power-intensive industries from September 1 onwards and raise the price of secondary electricity to the ordinary market in order to curb demand. Both moves were in accordance with contractual provisions and delivery terms for these categories of electricity, and were implemented in order to ensure that Landsvirkjun could fulfil its obligations to deliver primary electricity. If hydrological conditions had been more favourable, sales to power-intensive industries would have increased even further and no contraction would have taken place in sales to the ordinary market. The drop of almost 1% in sales to the ordinary market can be entirely attributed to low water levels, since primary electricity sales to it grew by 4.3%.

Since Landsvirkjun bases virtually all its production on harnessing the natural water cycle, climatic fluctuations can occasionally be expected to cause production to fall to minimum levels. This fact is known and the electricity system is designed to take it into account, and secondary electricity is sold on terms which give scope for curtailments in response to natural fluctuations.

Besides the hydrological problems, currency developments in the latter half of the year and low world aluminium prices meant that operating profit was not consistent with the large increase in sales. However, these are temporary effects which do not give a true picture of the company´s long-term operational profitability.

Landsvirkjun has recently been undertaking extensive development of the electricity system in order to meet its greatly increased commitments. At the same time, the present system has been operating at maximum load. Landsvirkjun's employees have thus been under considerable strain both because of new construction projects and system operation under difficult conditions. In this respect the company has benefited from its capable employees, along with training and preparations from the prior years. Internal work will continue to focus on efforts to achieve greater operational efficiency and more effective working methods. Among other things, company procedures have been benchmarked against those of many of the most efficient electricity producers in the western world. Environmental, safety, and quality management issues have also been highlighted, with the aim that Landsvirkjun will be a model company in all these areas.

All the construction projects now in progress at Landsvirkjun are in line with budgets and timetables. The company therefore has every reason to expect that its new facilities and upgrades of older ones will enter operation at the right time and will begin boosting production and handling greater transmission as the load grows. Two of three new power contracts for power-intensive industrial projects have already gone into effect and all that remains of the new production facilities is Icelandic Alloys' third furnace at Grundartangi, which is scheduled to go on stream in October 1999. Landsvirkjun's main projects during the past year included construction of the Búrfell line 3A, completion of the Háganga reservoir, boosting of turbines at the Búrfell Station, reconstruction of the Sog Stations and completion of the Krafla Station. Good progress was made on the Sultartangi Station which will enter service towards the end of 1999. Landsvirkjun invested a total of ISK 9.5 billion in new construction projects during the year.

ISAL and Nordural were responsible for the increase in Landsvirkjun's electricity sales to power-intensive industries. The share of power-

intensive industries in total electricity sales increased as a result, and Landsvirkjun's revenues became even more linked to world aluminium prices. In 1998, Landsvirkjun commissioned a study of the ways in which its profitability will be increasingly exposed to fluctuations in world aluminium prices in the next few years, and explored possible action to ensure stable revenues in spite of them. Landsvirkjun has secured access to consultancy in this field with the aim of building up in-house knowhow and skills to manage this risk. Another study commissioned during the year revealed that electricity generation for power-intensive industries and their operation over the past 30 years have yielded a net macroeconomic benefit to Iceland equivalent to ISK 90 billion. In light of this, there is every reason for Iceland to continue to consolidate this sector of the economy.

The energy sectors in neighbouring countries are being rapidly restructured and it is clear that a new framework will take shape in Iceland too in the near future. Landsvirkjun therefore faces the major tasks of formulating a policy and organizational structure which will serve the company in the new climate. Changes are already beginning to emerge within the energy sector. In 1998, Landsvirkjun began contractual purchases of electricity from the Reykjavík District Heating Utility steam generation station at Nesjavellir. In response to an EU directive, preparations are being made for the in-house separation of electricity production and transmission, and production by other Icelandic parties than Landsvirkjun can be expected to increase still further. The Sudurnes District Heating Utility in southwest Iceland plans to launch electricity production with a new 30 MW turbine unit at its Svartsengi Station in autumn 1999.

As more producers enter the field and some form of competition is established in the energy market, it is important to size up the position of Landsvirkjun's activities and its prospects. The company has been in a dominant position and will doubtless maintain it provided that it gives priority to efficiency, organization and good service. Greater competition is likely to prompt the government to take over various energy-related research which Landsvirkjun has been undertaking, and the social role which Landsvirkjun has to some extent performed through price equalization and discounts on electricity for space heating can also be expected to be transferred to the state.

A considerable amount of discussion has taken place about Landsvirkjun's plans for harnessing glacial rivers in connection with proposed power-intensive industrial projects in East Iceland. A new energy sector framework in the future can be expected to produce a clearer division of tasks and thereby a more focused dialogue on such issues. The government's leadership role in policy-making will become more apparent and Landsvirkjun will assume a clearer role in hydropower development and electricity production.

Landsvirkjun needs to maintain its initiative in the energy sector and cater for its customers, guided by the principle of good service, in order to continue to grow and flourish. In 1998 the government began work on new legislation authorizing new hydro projects, which parliament approved before the spring 1999 recess. This legislation authorizes Landsvirkjun to construct hydropower stations at Vatnsfell and Búdarháls, South Iceland, and a geothermal steam generating station at Bjarnarflag, North Iceland. The most immediate project is the Vatnsfell Station, utilizing a diversion canal between Lake Thórisvatn and Krókslón reservoir above Sigalda power station, which will need to go on stream over the period 2001 to 2004, depending upon how demand develops. For this reason, Landsvirkjun will be taking measures to enable construction work at Vatnsfell to begin as early as 1999.

Harnessing of hydro and geothermal power for electricity production is a cost-effective and environment-friendly way to meet a modern society's energy needs. Few nations are fortunate in having been able to utilize this energy on the scale seen in Iceland. In recent years we have managed to import expertise in design and construction in the power sector, which in turn has enabled us to assist other nations with environment-friendly development of their own energy resources. Although it is important to boost such activities, at the same time we should attend to the great potential for further development which exists within Iceland itself. The bulk of Landsvirkjun's present electricity production already serves export industries, and further harnessing of Iceland's energy resources in the near future is primarily based on continuing to do so. Along with discussions with new prospective customers who are weighing up whether it is feasible to set up new aluminium production facilities in Iceland, it is important to consider expanding the power-intensive industries which are already in operation.

Chairman

Managing Director

A new Board of Directors was appointed at Landsvirkjun's annual general meeting in April 1998 for a one-year term, until April 23, 1999.

Board of Directors:

Appointed by the Ministry 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:
- ***Ms. Kristín Einarsdóttir***
- ***Mr. Pétur Jónsson***
- ***Mr. Vilhjálmur Th. Vilhjálmsson***

Appointed by the Town Council of Akureyri:
- ***Mr. Jakob Björnsson***

Management:

Managing Director:
- ***Mr. Halldór Jónatansson,*** *through December 1998*
- ***Mr. Fridrik Sophusson,*** *from January 1999*

Deputy Managing Director:
- ***Mr. Jóhann Már Maríusson***

Director Finance and Marketing:
- ***Mr. Örn Marinósson***

Director Operations:
- ***Mr. Thórdur Gudmundsson***

Director Engineering and Construction:
- ***Mr. Agnar Olsen***

OPERATIONS

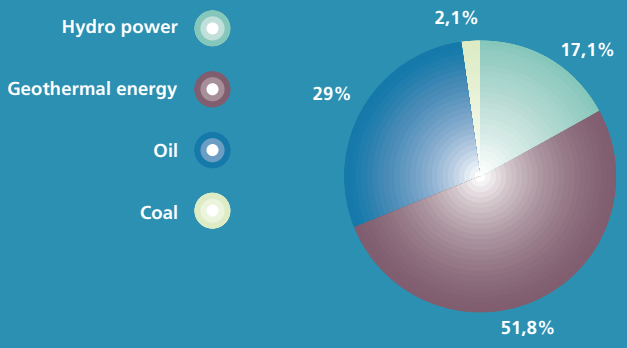
Operation of the Power System

The results of various enhancements and work on existing hydro production facilities became apparent last year. Modifications to the Krafla Station yielded good results and production reached the full capacity of 60 MW for which it was originally designed. Boosting of the Búrfell Station turbines from 210 to 270 MW was completed and upgrading of electrical equipment under the programme is now at its final stage.

Further processing of the results of benchmarking led to substantial economies during the year and even more gains are aimed for in the years to come. In particular, benchmarking has pinpointed the potential for streamlining in the grid system, where attention has now been focused. One part of these efforts has involved maintenance and improvements to

Landsvirkjun's Power System

Primary energy use in Iceland 1998



Landsvirkjun's Power Stations

	Commissioned	Installed capacity	
Hydropower stations			**897 MW**
Búrfell	1969	105 MW	
	1971	35 MW	
	1972	70 MW	
	1997	40 MW	
	1998	20 MW	**270 MW**
Hrauneyjafoss	1981	70 MW	
	1982	140 MW	**210 MW**
Blanda	1991	50 MW	
	1992	100 MW	**150 MW**
Sigalda	1977	50 MW	
	1978	100 MW	**150 MW**
Írafoss	1953	31 MW	
	1963	17 MW	**48 MW**
Laxá	1939	2 MW	
	1944	3 MW	
	1953	9 MW	
	1973	9 MW	
	1993	5 MW	**28 MW**
Steingrímsstöd	1959	13 MW	
	1960	13 MW	**26 MW**
Ljósifoss	1937	9 MW	
	1944	6 MW	**15 MW**
Geothermal stations			**63 MW**
Krafla	1977	30 MW	
	1997	30 MW	**60 MW**
Bjarnarflag	1969	3 MW	**3 MW**
Fossil fuel stations			**42 MW**
Straumsvík	1969	30 MW	**35 MW**
Akureyri	1983	7 MW	**7 MW**
Total installed capacity			**1002 MW**

the high-voltage gear at transformer stations, using condition monitoring. The aim is to extend the economical service life of high-voltage gear at the substations while still ensuring maximum operational security.

The number of breakdowns at Landsvirkjun's power stations, substations and high-voltage transmission lines was similar to the previous year. Outage increased for the second consecutive year, however, and measured 41.2 minutes for all other areas than the West Fjords, compared with 19.6 minutes in 1997. If the West Iceland transmission line is included, system outage time amounted to 125.7 minutes, compared to 90.1 minutes the year before.

Production, Purchases and Sales

Landsvirkjun's production increased by 11.7% and amounted to 5,811 GWh. This is equivalent to 92.6% of Iceland's total 6,275 GWh electricity production during the year. Landsvirkjun's hydro production was 5,382 GWh (95.8% of the national total) and its geothermal stations produced 429 GWh (65.5%). Furthermore, Landsvirkjun purchased 92 GWh of electricity from the Reykjavík District Heating Utility.

Total electricity production at Landsvirkjun in 1998 was equivalent to 17.7% of primary energy consumption in Iceland during the year.

Sales amounted to 5,589 GWh and losses and own use to 314 GWh, or 5.3%. Sales in the ordinary market contracted by 0.9%, which is attributable to a 26.1% reduction in sales of secondary electricity, as a result of Landsvirkjun's measures to counter adverse hydrological conditions. Primary electricity sales, on the other hand, grew by 4.3%, reflecting the general upswing in the Icelandic economy. Sales to power-intensive industries increased by 22.9%. This massive growth was the result of the expansion to the ISAL smelter at Straumsvík and start-up of the new Nordural smelter at Grundartangi. Total sales by Landsvirkjun increased by 12.7% compared with the previous year.

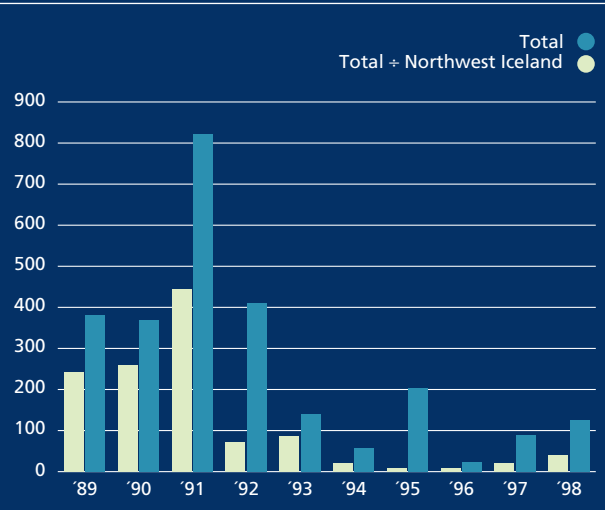
The Environment

At the beginning of 1998, work began on building up Landsvirkjun's environmental management system on the basis of the environmental policy approved by the board of directors in the previous year. It has been decided that Landsvirkjun will aim for environmental management accreditation to the ISO 14001 standard.

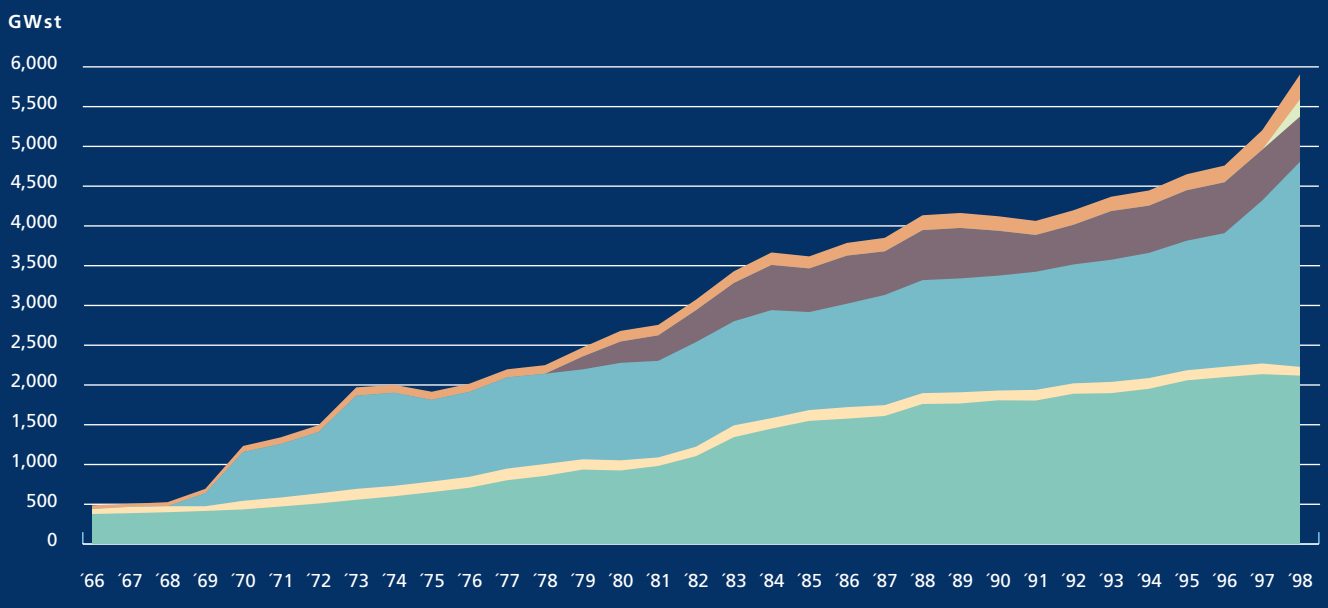
Environmental representatives have been appointed in all of the company's operational units and will be in charge of forming an environmental task force in each unit. These groups will then work on environmental studies and corrective action in their respective fields of activity, in accordance with the company's environmental management plan of action.

Since positive attitude is a vital component of any successful environmental work, priority has been given to employee training at the start of the environmental programme. One of the most extensive environmental management training projects ever undertaken in Iceland has been launched. It began towards the end of the year with a training course for Landsvirkjun's environmental representatives, and will be followed by a two-day course for management and all other employees.

System outage in minutes



Landvirkjun's energy sales and losses 1966-1998



DEVELOPMENT

Research and Development

Long-term studies were continued for possible future hydro projects in the glacial rivers north of Vatnajökull, focusing in particular on the river Jökulsá á Brú. In preparation for design of the proposed Kárahnúkar project, extensive geological research was conducted at the proposed dam site and part of the tunnel route from there to the powerhouse.

Preliminary structural studies, geological mapping and groundwater research were undertaken for the conceivable diversion of the upper reaches of Skaftá river into Tungnaá via a reservoir in Lake Langisjór. This project would thereby increase the flow of water to all of Landsvirkjun's largest hydro stations situated in the Thjórsá river basin, South Iceland.

The Minister of Industry issued a harnessing permit for the Fljótsdalur project in 1991, after which an official planning procedure took place. A number of responses from the public were received concerning the proposed arrangement, which Landsvirkjun took into account to a considerable extent. At the end of 1991, however, the project was shelved, after the prospective electricity buyer postponed plans for constructing an aluminium smelter at Keilisnes. Current legislation on environmental impact assessments includes a provision that it does not apply to projects already authorized before its entry into effect in May 1994. Nonetheless, in the middle of 1998 the Landsvirkjun board decided to have an environmental impact report made for the project, among other things to examine whether the premisses had changed since 1991. Work on the report has focused in particular on acquiring more detailed data and information than was available when construction began at Fljótsdalur in 1991.

Towards the end of 1998 it was decided to begin design of tender documents for the Vatnsfell hydro project, South Iceland, which is planned to be completed between 2001 and 2004. Landsvirkjun intends to advertise the solicitation during the first half of 1999, but a final decision to go ahead with the project will depend on contracts for increased electricity sales.

Constructions

Continuous construction work on Sultartangi hydro project has been going on at the site since its commencement in spring 1997 and went into full swing in spring 1998. Activity there was at a peak during the year and almost two-thirds of construction work was completed by the end of the year. Work involving the mechanical and electrical equipment began and the main part of installation work will take place in 1999. The station's two turbines will go on stream in November 1999 and January 2000.

The Háganga reservoir increasing water storage in the lake Thórisvatn drainage area was completed in October 1998. It involved damming the Kaldakvísl river at Sydri-Háganga to create a reservoir with a storage capacity of 320 Gl from summer to winter. Work began in summer 1997 and 60% was completed that autumn. The reservoir began filling in mid-summer, and at the end of October water started flowing from it into lake Thórisvatn.

MARKETING AND FINANCE

Marketing

Electricity purchases by power-intensive industries increased by 648 GWh, or 23%, compared with 1997, despite a 153 GWh curtailment of secondary electricity during the last third of the year. Had the curtailment not been made, sales would have grown by 28.4%. The main factor at work was a 530 GWh increase in sales to ISAL in 1998, which was the first full year of operations for the third potroom at the Straumsvík smelter. Sales of electricity to the Nordural smelter at Grundartangi also began during the year. By the end of the year Nordural had reached half of its rated production capacity, and expects to achieve full capacity by spring 1999.

On June 1, 1998 an agreement took effect between the Ministry of Industry and Commerce, Landsvirkjun and the Trade Council of Iceland, involving a change in the status of the Icelandic Energy Marketing Agency (MIL) and the Invest in Iceland Bureau. These agencies are now brought under joint management and both act under the Invest in Iceland name. MIL has been renamed Invest in Iceland Agency – Energy Marketing Division and the Invest in Iceland Bureau is now the Invest in Iceland Agency – General Investments. The Agency's role is to attract foreign investors to Iceland, and the aim behind the merger is to strengthen and coordinate promotion of Iceland for foreign investors.

Landsvirkjun took part in talks which the Icelandic government and local authorities in East Iceland held with Hydro Aluminium of Norway on the conceivable construction of an aluminium smelter in Reydarfjördur with a production capacity of 120 thousand tpy in the first stage, and a possible second stage with a 240 thousand tpy capacity. The company collaborated with Hydro on a prefeasibility study for this project. Talks also took place with the power-intensive industrial companies already operating in Iceland to discuss possible increases in power sales to them in the future. Consultation continued with the parties who have been involved in recent years in studies of the possibility of exporting electricity from Iceland via submarine cable.

Financial Results

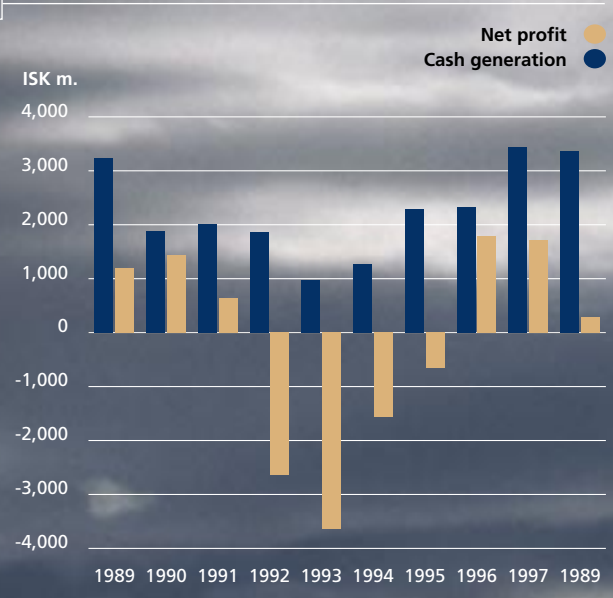
Financial market conditions were highly favourable for Landsvirkjun for most of last year. The exchange rate of the Icelandic króna appreciated steadily against other currencies, at the same time as interest rates in the long-term bond market decreased. During the year, the company made two domestic bond issues to a total amount of ISK 3,750 million. Landsvirkjun signed a Euro Medium-Term Note programme in May, the first Icelandic borrower to do so, and did several favourable trades under the programme in June and July. However, international financial markets went into upheaval in the autumn, and the króna began to depreciate at the same time. Credit supply became significantly tighter in international markets and the exchange rate of the Yen also rose sharply over a very short period. This development had a negative impact on Landsvirkjun's financing activities during the last few months of the year.

Although price level and exchange rate changes have had a decisive impact on Landsvirkjun's net income, they have only had a small impact on cash flows. Cash generated from operating activities amounted to ISK 3,370 million, the company's second-best result ever in this respect and only marginally lower than the record figure from the year before. Investments during the year totalled ISK 9,500 million, the highest level in real terms apart from 1968, 1982 and 1983. Net borrowing amounted to ISK 7,300 million.

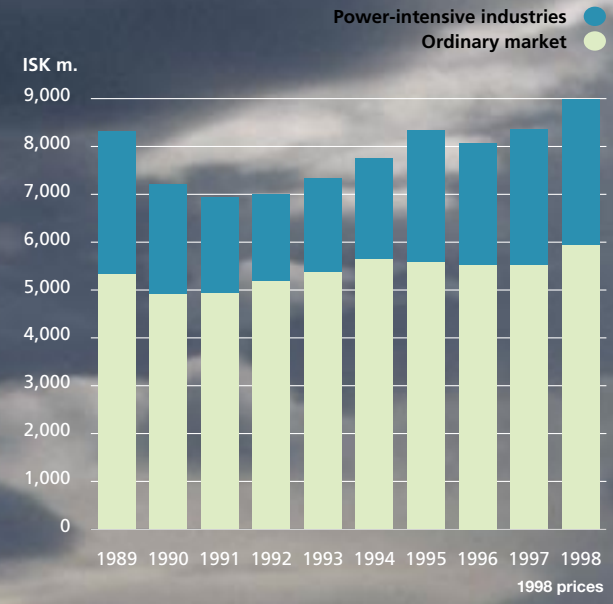
At the end of the year, total assets stood at ISK 90.6 billion. Liabilities amounted to ISK 59.4 billion, pension fund obligations ISK 1.0 billion and equity ISK 30.2 billion. Investment in connection with new power sales agreements increased the company's long-term liabilities by almost ISK 8 billion during the year, thereby reducing the equity ratio from 36.3% to 33.3%.

Further confirmation of Landsvirkjun's creditworthiness in domestic and foreign markets was made during the year. Moody's confirmed its credit rating and Standard & Poor's confirmed its short-term credit rating and changed its outlook on the long-term credit rating from A+ "stable" to A+ "positive," which is a sign of growing confidence for the near future. Furthermore, Standard & Poor's confirmed its AA+ rating for Landsvirkjun's borrowings in the domestic market.

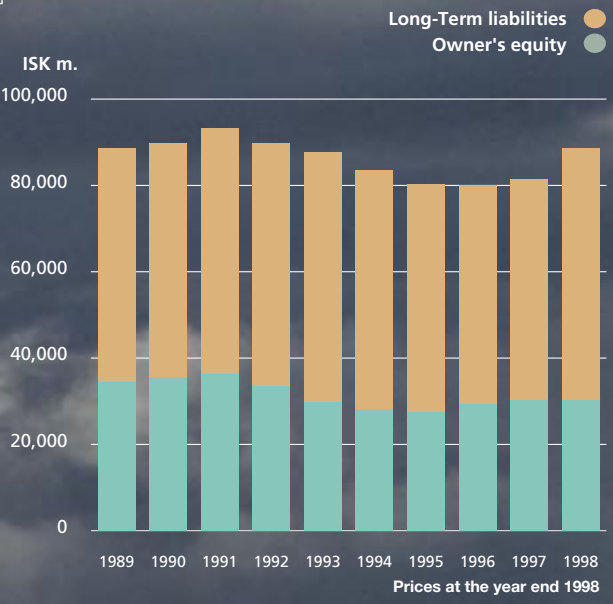
Cash generation and net profit



Composition of revenues



Long-term liabilities and owner's equity



DIRECTORS' REPORT

The company had a net profit from its operations in 1998 as in the previous two years, after a four year lossmaking period. The net profit for 1998 amounted to ISK 283 million compared with a net profit of ISK 1,717 million in 1997. The decrease in net profit from the previous year can for the most part be explained by higher net real interest costs which were 5.2% in 1998 compared to 2.3% in 1997. Operating revenues in 1998 increased by ISK 648 million from 1997, operating expenses increased by ISK 614 million and net financial costs increased by ISK 1,468 million. Cash generated by operating activities was ISK 3,370 million in 1998 compared to ISK 3,433 million in 1997.

Investments amounted to ISK 9,497 million, compared to ISK 5,606 million in 1997. New long-term borrowings exceeded repayments of long-term debt by ISK 7,302 million in 1998 compared with ISK 1,848 million in the previous year. This change in the net debt position can for the most part be explained by investment expenditures in the respective years.

The company has taken measures to ensure that the reliability of the power system in Iceland will not be compromised during the millennium change.

Landsvirkjun is a partnership, jointly owned by of 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 1998 in conformity with the provisions of the Act on Landsvirkjun and the Partnership Agreement between the owners. According to said regulation, dividend will amount to ISK 235 million should the Board's proposal be approved.

The Board of Directors and the Managing Director hereby confirm the 1998 Financial statements by means of their signature.

Reykjavík, February 26, 1999

Board of Directors: Jóhannes Geir Sigurgeirsson,
Árni Grétar Finnsson, Jakob Björnsson
Kristín Einarsdóttir, Pétur Jónsson
Sigfús Jónsson, Vilhjálmur Þ. Vilhjálmsson

Managing Director: Friðrik Sophusson

AUDITOR'S REPORT

To the Board of Directors of Landsvirkjun.

We have audited the accompanying balance sheet of Landsvirkjun as of December 31, 1998, 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, 1998, 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, February 26, 1999.

Jón Eiríksson
Ólafur Nilsson
KPMG Endurskoðun hf.

INCOME STATEMENT 1998

	Note	1998	1997
OPERATING REVENUES			
Power sales - Local utilities		**5,930,841,704**	5,508,953,745
Power sales - Power-intensive industries		**3,069,496,609**	2,847,933,069
Total power sales		**9,000,338,313**	8,356,886,814
Sale of steam from geothermal wells		**32,529,437**	33,266,465
Other income		**27,263,751**	21,916,836
TOTAL OPERATING REVENUES		**9,060,131,501**	8,412,070,115
OPERATING EXPENSES			
Operation of power stations		**935,938,516**	813,442,553
Purchase of power		**77,140,236**	-
Cost of transmission and distribution		**197,839,802**	295,219,285
System operation		**192,780,653**	167,635,254
General administrative expenses	12	**862,799,170**	682,028,236
Cost of general research		**190,839,806**	186,376,168
Operating taxes	13	**171,056,427**	157,366,847
Depreciation	1,6	**3,519,216,749**	3,231,671,794
		6,147,611,359	5,533,740,137
FINANCIAL COSTS	3		
Interest revenues		**(92,063,673)**	(69,269,573)
Interest expenses		**3,098,103,306**	2,944,917,795
Exchange-rate losses (gains)		**603,104,064**	(18,861,269)
Gain on net monetary position	1	**(979,259,000)**	(1,695,258,000)
		2,629,884,697	1,161,528,953
TOTAL EXPENSES		**8,777,496,056**	6,695,269,090
NET PROFIT		**282,635,445**	1,716,801,025

All amounts are in ISK

BALANCE SHEET AS AT DECEMBER 31, 1998

ASSETS

	Note	1998	1997
PROPERTY, PLANT AND EQUIPMENT	1,5		
In operation			
Power stations		**114,439,279,685**	109,969,755,759
Transformer stations		**12,701,526,636**	11,078,311,181
Power lines		**20,271,388,493**	17,372,034,885
Vehicles, equipment and dredger		**825,719,557**	764,639,357
Office building and equipment		**1,667,371,006**	1,589,485,221
		149,905,285,377	140,774,226,403
Less: Accumulated depreciation		**69,655,609,958**	65,183,838,361
Total in operation		**80,249,675,419**	75,590,388,042
Construction and research			
Fljótsdalur project and extension of Búrfell		**1,416,462,123**	1,041,176,553
Other investments		**5,750,850,316**	3,088,626,513
Total construction and research		**7,167,312,439**	4,129,803,066
Long-term notes receivable		**42,425,249**	32,510,826
Total property, plant and equipment		**87,459,413,107**	79,752,701,934
CURRENT ASSETS			
Accounts receivable - trade		**1,064,899,080**	882,217,821
Accounts receivable - other	4	**306,806,874**	82,503,637
Inventories (oil)		**30,220,000**	14,652,635
Cash		**1,772,002,448**	826,410,752
		3,173,928,402	1,805,784,845
Total assets		**90,633,341,509**	81,558,486,779

All amounts are in ISK

LIABILITIES AND OWNERS' EQUITY

	Note	1998	1997
OWNERS' EQUITY			
Owners' contribution	7	**18,015,879,000**	16,904,900,000
Retained earnings		**12,194,609,671**	12,697,537,765
		30,210,488,671	29,602,437,765
OBLIGATIONS			
Accrued pension obligation	8	**1,035,374,000**	931,000,000
LONG-TERM LIABILITIES			
Long-term liabilities	9	**57,317,023,587**	49,534,914,824
CURRENT LIABILITIES			
Accounts payable		**1,085,266,662**	647,322,091
Accrued interest payable		**985,188,589**	842,812,099
Total current liabilities		**2,070,455,251**	1,490,134,190
Total liabilities		**59,387,478,838**	51,025,049,014
Total liabilities and owners' equity		**90,633,341,509**	81,558,486,779

All amounts are in ISK

STATEMENT OF CASH FLOWS IN 1998

	Note	1998	1997
OPERATING ACTIVITIES	10		
Cash received from customers		**8,687,199,154**	8,554,157,119
Interest income		**92,063,673**	71,672,830
Cash expenses		**(2,433,893,039)**	(2,222,047,348)
Cash payment for interest costs		**(2,975,132,208)**	(2,970,284,589)
		3,370,237,580	3,433,498,012
INVESTING ACTIVITIES			
Refurbishment of Búrfell stations		**(492,981,349)**	(653,566,275)
Refurbishment of Sog stations		**(426,858,856)**	(468,004,913)
Extension of Krafla station		**(680,397,508)**	(1,083,060,313)
Refurbishment of Straumsvík thermal station		**(100,421,724)**	-
Kvíslaveita - river diversion		**(71,692,271)**	(261,460,145)
Háganga - reservoir		**(377,539,351)**	(365,264,539)
Sultartangi project		**(3,886,117,594)**	(1,542,098,206)
Installation of series and shunt capacitors		**(823,475,905)**	(529,888,272)
Power lines		**(1,865,993,138)**	(452,537,940)
Other capital expenditure		**(771,712,857)**	(249,786,012)
		(9,497,190,553)	(5,605,666,615)
Decrease (increase) in long-term notes receivable		**(9,000,000)**	32,725,636
		(9,506,190,553)	(5,572,940,979)
FINANCING ACTIVITIES			
New long-term liabilities		**8,090,752,364**	3,868,503,028
Amortization of long-term liabilities		**(788,882,695)**	(2,020,851,634)
Cash dividend		**(220,325,000)**	(204,204,000)
		7,081,544,669	1,643,447,394
(Decrease) increase in cash during the period		**945,591,696**	(495,995,573)
Cash at beginning of year		**826,410,752**	1,322,406,325
Cash at end of period		**1,772,002,448**	826,410,752

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 in accordance with changes in the Icelandic index of construction cost, but 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 1.82% for the current year.
- Depreciation of fixed assets in the income statement is shown at mid-period prices, but 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	12.00%	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 income (loss) reported is stated at mid-period 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, however, on these development costs 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.

CHANGES IN ACCOUNTING PRINCIPLES

2 The company revised its estimate of the pension obligation. Based on provisions in laws and regulations regarding the financing of the pension fund for government employees, the pension fund will be reimbursed for payments as a result of salary increases in excess of the first pension payment to retirees. Previously, the obligation represented the present value of payments to those employees who had retired and the calculation was based on current salaries, but now the obligation represents the present value of future payments regardless of whether they are retired or not. The service charge for this obligation in the amount of 104 million is charged to operations but the present value of salary increases in the future for current employees is charged to the retained earnings account. Comparative figures have been changed to reflect this change in accounting estimate.

FINANCIAL COSTS

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

Interest revenues	(92)
Interest expenses	3,281
Exchange-rate losses on short-term items	18
Exchange-rate losses on long-term liabilities	585
Gain on net monetary position	(979)
	2,813
Capitalized interest costs	(183)
	2,630

The net real interest cost, to the amount of ISK 2,630 million, is approximately 5.2% on the average outstanding long-term loans for the year 1998, compared to 2.3% for the year 1997.

The average for the years 1987-1998 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.

ACCOUNTS RECEIVABLE

4 Accounts receivable are segregated into two accounts, one representing outstanding receivables from power sales to the company's customers and the other account is for other outstanding receivables, mainly a value-added tax due from the state treasury in the amount of ISK 218,7 million.

PROPERTY, PLANT AND EQUIPMENT

5 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, 1998	109,970	11,078	17,372	2,370	140,790
Increase 1998	2,434	1,402	2,550	114	6,500
Revaluation 1998	2,036	222	349	45	2,652
Retired/sold	(1)	0	0	(36)	(37)
	114,439	12,702	20,271	2,493	149,905
Accumulated depreciation:					
Balance Jan. 1,1998	50,284	5,557	8,112	1,246	65,199
Depreciation 1998	2,126	538	523	75	3,262
Revaluation 1998	942	107	154	23	1,226
Retired/sold	(1)	0	0	(31)	(32)
	53,351	6,202	8,789	1,313	69,655
Book value at end of year	61,088	6,500	11,482	1,180	80,250

6 Depreciation in 1998 consists of the following (ISK million):

Power stations	2,126
Transformer stations	538
Power lines	523
Other assets	75
Depreciation of assets in operation	3,262
Other	7
Research projects	250
	3,519

OWNERS' EQUITY

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

	According to financial statements	At prices as of year-end
Balance at January 1, 1998	30,353	30,907
Less: Accrued pension obligation at beginning of year	(751)	(760)
	29,602	30,147
Cash dividend	(220)	(223)
Revaluation of assets	1,524	-
Gain on net monetary position	(979)	-
Net profit	283	286
Balance at December 31, 1998	30,210	30,210

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 1998 amounted to ISK 15,750 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 2,265 million at the end of 1998 and the maximum amount that can be paid in 1999 based on the requirements of the partnership agreement is ISK 235 million. Accordingly, the owners' equity consist of the following balances:

Restated capital contributions	15,750
Undistributed accrued dividends	2,265
	18,015
Retained earnings	12,195
	30,210

OBLIGATIONS

8 The accrued pension obligation of the company, based on actuarial estimates, to retired employees amounted to ISK 243 million at the end of 1998. The obligation to make payments to current employees in the future based on assumptions of real salary increases was not recorded in last year's financial statements, but a note explained the obligation. Now the total obligation to make pension payments for the future salary increases is estimated and recorded. Based on actuarial estimate the present value of the total obligation amounts to ISK 1,035 million and the full amount is now shown as a separate liability in the balance sheet. The unrecorded obligation at the end of 1997 to make payments for future pensions based on projected salaries for current employees is estimated to be ISK 751 million and the amount is charged to the retained earnings account.

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

	Foreign amount	ISK	%	Indexation, exchange-rate losses (gains)
U.S.dollars	252,0	17,564	30.7%	(474)
German marks	210,8	8,774	15.3%	282
Icelandic króna	-	7,745	13.5%	91
Japanese yen	11,150,0	6,841	11.9%	639
Swiss francs	82,1	4,152	7.2%	126
Pounds sterling	35,0	4,034	7.0%	(84)
Dutch guilders	105,3	3,888	6.8%	102
French francs	182,9	2,270	4.0%	66
Norwegian kroner	223,1	2,049	3.6%	(163)
		57,317	100.0%	585

The nominal interest rates on outstanding debt are from 3.0% to 14.5%. The average nominal interest charges were 6.0% for 1998 as compared with 5.9% for 1997.
The following is a maturity schedule as per loan agreements for long-term debt over the next five years (ISK millions):

1999	8,344
2000	3,543
2001	10,059
2002	2,385
2003	4,937
Later	28,049

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

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

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):

	1998	1997	1996	1995
Net operating profit (loss)	283	1,716	1,742	(628)
Reconciling adjustments:				
Depreciation	3,519	3,232	3,137	3,172
Exchange rate adjustments net	(398)	(1,730)	(2,374)	(360)
Working capital provided by operations	3,404	3,218	2,505	2,184
Changes in components of working capital				
Decrease (increase) in current assets	(374)	147	0	(237)
Increase (decrease) in current liabilities	340	68	(236)	261
Cash provided by operation	3,370	3,433	2,269	2,208
Cash provided by operation as a percentage of total liabilities	5.58%	6.66%	4.61%	4.34%

OTHER ITEMS

11 The company paid ISK 1,438 million in salaries to employees of which ISK 1,399 million were charged to operations and the remaining ISK 39 million were capitalized. Salaries consist of the following:

Director's office and finance and marketing division	225
Operating division	925
Engineering division	142
Marketing unit	20
Capitalized amount	39
Pension payments	87
	1,438
Related expenses	199
	1,637

Remuneration to the board of directors and executive management amounted to ISK 51.9 million.
The company had 263 permanent and 106 temporary employees in 1998.

12 General administrative expenses consist of the following:

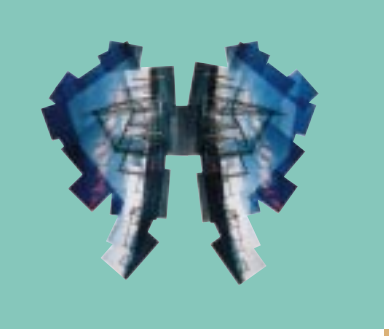
Director's office and finance and marketing division	288
Operating division	76
Engineering and construction division	187
Marketing agency	35
Common costs	277
	863

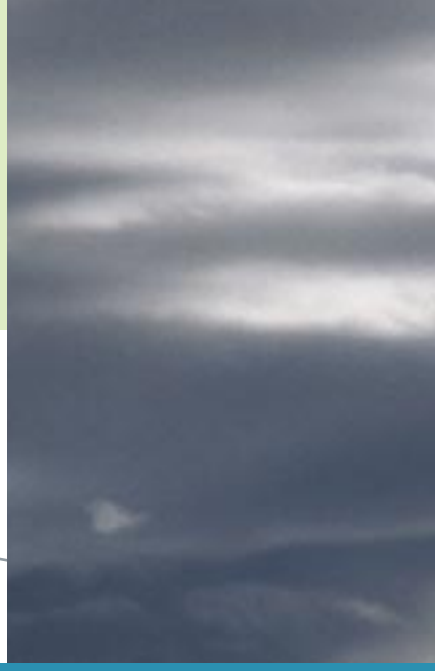
13 Operating taxes consist of the following (ISK million):

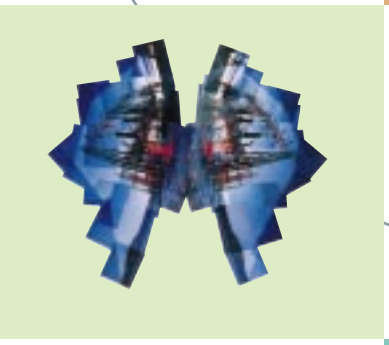
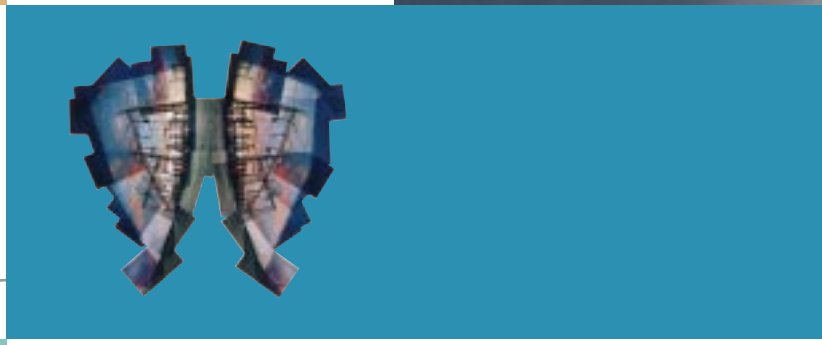
Guarantee fee paid to the owners	115
State Electrical Inspection charge	48
Fish Farm Fund charge	8
	171

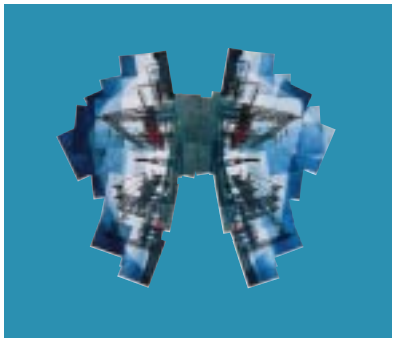
14 A dispute between the company and the owners of the water rights of the Blanda river was settled by arbitration in 1992. The amount awarded to the landowners was ISK 92 million. Additionally, the company had to pay all legal fees in connection with the arbitration. In accordance with the decision of the arbitration tribunal, payment of ISK 51 million is to be deferred until such time that the dispute regarding the ownership of the water rights has been resolved. The accrued amount with interest costs is ISK 88 million at the end of 1997.

The Supreme Court has decided that the municipalities around Blanda do not have a legitimate claim for the water rights. Based on that decision the government has made claims for the unpaid balance for the water rights. The unpaid balance has not been posted to the financial statements.





The photographs in this annual report are from a series of artworks by Illur (Illugi Eysteinsson). His works are based on photographs which he took in Landsvirkjun's substations. The wire structures of high-voltage masts and switchyards are awe-inspiring to some observers, and just awful to others; some people find them mundane and ponderous. Here the artist has let them take wing, to reflect the character of the electricity that passes through them and appears instantaneously in the form of light, warmth and motion.

Design: Nonni og Manni
Photography: SSJ
Printing: Oddi
Supervision and text: Thorsteinn Hilmarsson
Translation: Bernard Scudder

CULTURE AND NATURE

Landsvirkjun is a main sponsor for Reykjavík as European City of Culture in the year 2000. In this capacity, the company sponsors promotions of the nationwide cultural programme which will be held throughout the year under the theme “Culture and Nature”. Landsvirkjun is also sponsoring the Society of Icelandic Visual Artists to hold exhibitions in the Sog and Laxá power stations in summer 2000.

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