

Annual Report
2009



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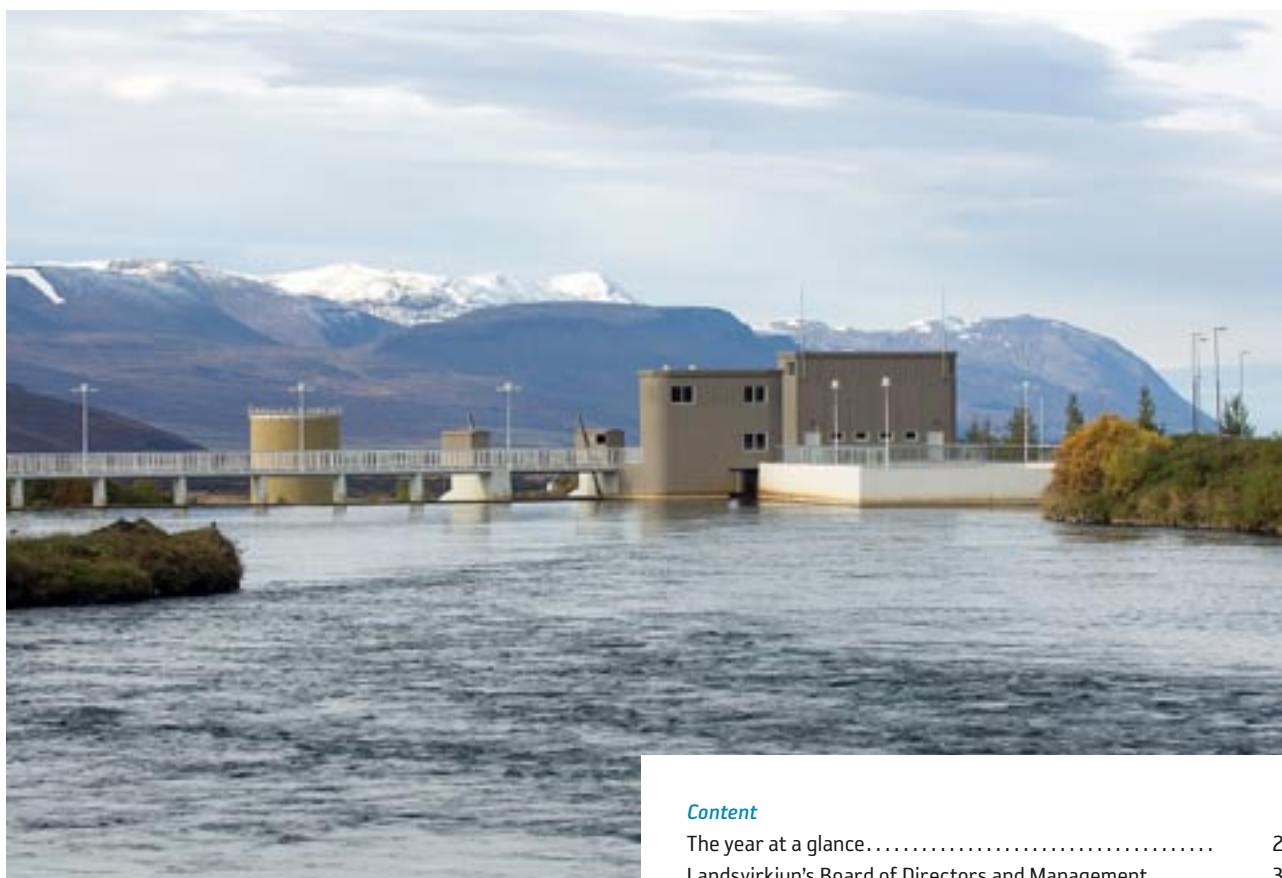
VIJV: page 15

DESIGN: PIPAR/TBWA

PRINTING: Svansprent

SUPERVISION: Kristjana Thorey Guðmundsdóttir

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Laxa II hydropower station. Reservoir and dam build in 1952.

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Highlights of the annual accounts

	2009	2008
Profit (loss)	193 millj. USD	(344.5) millj. USD
Cash gen. by operating activities ..	197 millj. USD	184.4 millj. USD
Liabilities.....	3,239 millj. USD	3,242 millj. USD
Owners' equity	1,564 millj. USD	1,377 millj. USD
Equity ratio	32.6%	29.8%

Electricity production, purchases and sales

	2009	2008
Total production.....	12,154 GWst	12,344 GWst
<i>With hydropower.</i>	11,687 GWst	11,867 GWst
<i>With geothermal power</i>	467 GWst	477 GWst
Electricity purchases	392 GWst	402 GWst
Sales to general market.....	2,181 GWst	2,416 GWst
Sales to power-intensive industries	10,365.3 GWst	10,330 GWst
Total sales – change between years	-1.6%	43.2%

The year at a glance

Landsvirkjun's net profit was US\$ 193 million in 2009 despite the difficulties in the global economy. Cash flow from operating activities was US\$ 197 million.



Krokslon waterfalls. A row of small waterfalls formed by overflow from the Sigalda reservoir (14km²).

Landsvirkjun and the School for Renewable Energy Science (RES) sign a cooperation agreement

(12 March) Landsvirkjun and RES signed a two-year energy research and education agreement. RES is an international school with focus on renewable energy sciences. Its primary objective is to utilise the extensive experience of Icelanders in this field.

Standard & Poor's downgrades Landsvirkjun's credit rating

(30 June) The credit rating agency Standard & Poor's changed its methodology for rating government-owned companies. As a result of this change in methodology ratings on Landsvirkjun's foreign loans fell from BBB- (watch list) to BB (stable outlook). Credit ratings on domestic obligations were downgraded from BBB+ (negative outlook) to BBB- (negative outlook).

Report on owner guarantees

(8 July) The EFTA Surveillance Authority (ESA) published a report in connection with the Authority's examination of the guarantees provided by Landsvirkjun's and Orkuveita Reykjavíkur's owners. The Authority found that the guarantees enjoyed by Landsvirkjun from its owners do not comply in all respects with the provisions of the EEA agreement

regarding state aid. However, the Authority determined that guarantees may be provided for the company's loans, provided that an appropriate fee is paid in exchange for the guarantee. Landsvirkjun currently pays a 0.25% guarantee fee on its loans in accordance with the Act on State Guarantees.

Karahnjúkar dam gains international recognition

(20 October) The Karahnjúkar dam received recognition at the 1st International Symposium on Rockfill Dams, held in Chengdu in China on 18–20 October. The dam is considered a Milestone Dam Project.

Moody's downgrades Landsvirkjun's credit rating

(11 November) Moody's Investor Service downgraded Landsvirkjun's credit ratings following a comparable downgrade of the Icelandic Treasury. The long-term ratings of Landsvirkjun's foreign loans were downgraded from Baa1 (negative outlook), to Baa3 (stable). The ratings for Landsvirkjun's short-term commitments fell from P-2 to P-3. As a result of these changes, Landsvirkjun has the same ratings as the Treasury. The stable outlook on Landsvirkjun's long-term debt indicates that no further ratings action is expected.

New CEO at Landsvirkjun

(9 November) Hordur Arnarson took over the post of CEO of Landsvirkjun at the beginning of November. Fridrik Sophusson who served as Landsvirkjun's CEO from 1998 stepped down in October 2009.

Certified safety controls

(14 December) Landsvirkjun was certified according to the safety standard, OHSAS 18001, occupational, health and safety. Three Icelandic companies have received this certification. Companies that operate according to the standard are required to continually work on improving their personnel's safety, health and well-being. The standard is intended to ensure that safety and healthcare issues are integral factors in the evaluation and decision-making processes involved in investing, execution, management and the purchasing of products and services.

The OHSAS 18001 standard is a part of Landsvirkjun's integrated management structure. The quality management standard ISO 9001 and the environmental control standard ISO 14001 are also fundamental to this management structure.

Landsvirkjun's net profits USD 193 million in 2009

Landsvirkjun's net profit was USD 193 million in 2009 which is a good result taking into account the difficulties in the global economy. Cash from operating activities amounted to USD 197 million. Total assets amounted to USD 4,803.5 million and Landsvirkjun's equity amounted to USD 1,564.5 million.

Full-time positions in 2009

In 2009, Landsvirkjun's permanent staff worked for a total of 179 man-years, one fewer than in the previous year.

Man-years worked by temporary staff were 48, the same as the year before. A total of 229 student interns were hired by Landsvirkjun in the summer of 2009.

Landsvirkjun's Board of Directors and Management Team

A new Board of Directors, appointed by the Minister of Finance, took office at the 2009 Annual General Meeting.



Above from left: Ingimundur Sigurpalsson, Sigurbjorg Gisladdottir vice-chairman, Stefan Arnorsson. Below: Bryndis Hlodversdottir chairman, Pall Magnusson.

Landsvirkjun's Board of Directors

Ms Bryndis Hlodversdottir *Chairman*
Ms Sigurbjorg Gisladdottir *Vice-Chairman*
Mr Ingimundur Sigurpalsson
Mr Pall Magnusson
Mr Stefan Arnorsson

Alternates:

Ms Anna Dora Saethorsdottir
Mr Birgir Jonsson
Mr Huginn Freyr Thorsteinsson
Ms Jona Jonsdottir
Ms Vigdis M. Sveinbjornsdottir

Executive Committee

CEO: Mr Friðrik Sophusson until 1 October, Mr Hordur Arnarson from 9 November
Office Manager and Deputy CEO: Mr Agnar Olsen

Heads of Divisions:

Energy: Mr Einar Mathiesen
Finance: Mr Stefan Petursson
Human Resources : Ms Sigthrudur Gudmundsdottir
Information Technology : Mr Bergur Jonsson
Marketing and Corporate Development: Mr Magnus Bjarnason from March 2010

Corporate Communications : Mr Thorsteinn Hilmarsson

Ms Ragna Sara Jonsdottir took over the position of Head of Corporate Communications in March 2010

Landsvirkjun at a turning point

Address by the Chairman of the Board of Directors

Landsvirkjun plans to be at the forefront in research and development of energy issues in Iceland with focus on power generation, marketing and utilisation of electrical power.



At present, Landsvirkjun stands at a turning point in its history, after almost 15 years of uninterrupted growth and the trebling of the company's energy production. In 2010, the focus will be on achieving a greater balance between construction, operations, finances and marketing. Landsvirkjun plans to be at the forefront in the development of energy issues in Iceland with focus on power generation, marketing and utilisation of electrical power. A part of this task will be a greatly increased focus on market and business development, corporate communications and branding.

Icelanders are among the few nations that have pure, renewable energy sources, whose desirability and value is growing constantly. These resources should be utilised for the domestic energy market and domestic industries, and possibly also for the export of electrical power via submarine cable to

Britain or mainland Europe. There are indications that the export of Icelandic renewable energy could prove profitable, as the price of electricity in Europe has risen considerably in the last few years.

Looking back at last year, it is evident that many remarkable things transpired, both in Landsvirkjun's external and internal environments. Landsvirkjun's 2009 results were good, despite the turbulence in the Icelandic economy. An important factor is the company's functional currency which is the US dollar, as over 70% of the revenue is in dollars. The collapse of the Icelandic krona, therefore, has a limited effect on the company's operations. The rising price of aluminium, low interest rates on foreign loans and the strengthening of the US dollar against the euro and other currencies have also benefited the company.

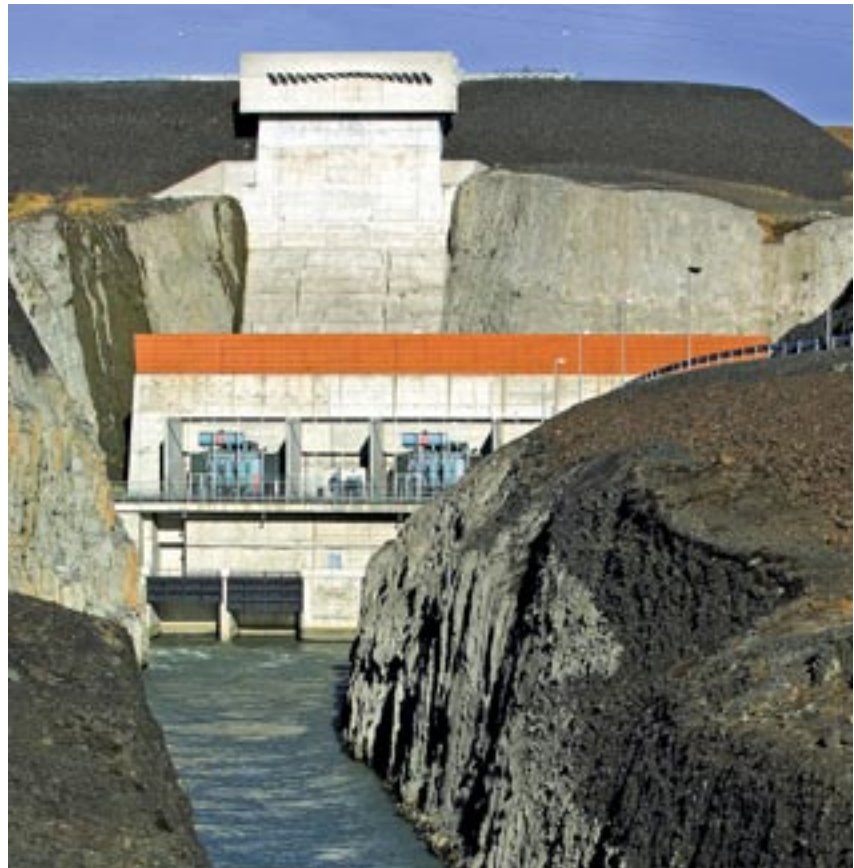
The operating profit of the Landsvirkjun group was USD 157.3 million, taking hedges into account, while total profit amounted to USD 193 million. These results were partly attributable to embedded derivatives related to aluminium prices in the company's sales agreements, as aluminium prices have risen considerably during the year. Cash from operating activities was USD 197 million. Total assets at year-end were USD 4.8 billion and equity was USD 1.56 billion or 32.6% of total assets. Under the current conditions, the main financial focus is to ensure the liquidity of Landsvirkjun so that the company can meet all its obligations over the next years. Landsvirkjun has sufficient liquidity to meet its obligations into the year 2012 through funds from operations and access to a revolving credit facility. At the end of the year, the company had liquid assets, including the revolving credit facility, totalling USD 476 million. In the next few years,

however, several large loans become due, which the company will need to refinance. Landsvirkjun's credit rating has fallen in line with the downgrade of the state's credit rating, which limits access to new funding and increases financial expenses. Under such circumstances, the company's ability to engage in new investments is very limited. One of Landsvirkjun's most urgent tasks, therefore, is to strengthen the company's standing with banks and investors. This is a prerequisite for maintaining access to credit on acceptable terms, which in turn is necessary for the company to be able to participate actively in the revival of the Icelandic economy.

The most prominent operational development during 2009 was the completion of the Karahnjúkar project. An informative publication about the power plant was released, which delves into various aspects of the operation and its effects on the community. A comprehensive database of the project's impacts can also be found on the website sjalfbaerni.is. Design work for the power plant at Budarhals was resumed, making it possible to issue an invitation to tender for the construction with short notice. Furthermore, research for power plants in the geothermal fields in north-east Iceland and hydroelectric power plants in south Iceland was conducted, in connection with, among other things, the second phase of Iceland's Master plan for Hydro and Geothermal Energy Resources.

Discussions resumed with Rio Tinto Alcan on the renewal of the previous power purchase agreement and for additional sales of electricity for increased production at the aluminium smelter in Straumsvík. Moreover, discussions were held with numerous parties that are looking into the possibility of establishing data centres or silicon plants in Iceland.

Work aimed at strengthening the internal structure and capacity of Landsvirkjun continued. During 2009, the company received a certification in accordance with the OHSAS 18001 standard on safety and work



Sultartangi hydropower station in operation since 1999.

environment. Previously, Landsvirkjun held a certification for the ISO 9001 standard for quality management, ISO 14001 for environmental management and ISO 27001 on information security.

This year, Landsvirkjun published its first report on greenhouse gas emissions resulting from the company's operations. Such publications will in the future be an ongoing part of the operation. The report includes an international comparison of the emission of greenhouse gases from various energy sources, clearly showing the strong position that Icelanders hold with hydropower and geothermal power.

A new Board of Directors was elected at the company's Annual General Meeting in April. The current Board Members are under-signed (Chairman), Sigurbjörg Gísladóttir (Vice-Chairman), Ingimundur Sigurpálsson,

Páll Magnússon and Stefan Arnórsson. On 1 October, Mr. Fridrik Sophússon retired as the CEO of the company, after almost eleven years with the company. He was succeeded by Mr. Hordur Arnarson, electrical engineer, who previously served as the CEO of high-tech company Marel for ten years.

As can be seen from the above, it is clear that 2009 was an eventful year, both here in Iceland and overseas. Diverse changes have resulted in Landsvirkjun facing new challenges. However, it is my belief that the company and its leadership will be successful in turning these challenges into opportunities, which will benefit both the company and the Icelandic nation.

Bryndis Hlodversdottir
Bryndis Hlodversdottir,
Chairman of the Board of Landsvirkjun.

New demands call for a new strategy

I think that we should aim for increased profitability. Our task at Landsvirkjun is to get the greatest value for the product and we intend to work effectively on this task in the near future, says Hordur Arnarson CEO.



Hordur Arnarson was appointed Landsvirkjun's CEO in November 2009. He is introducing certain changes for the company, which are driven by new circumstances in the international business environment in which Landsvirkjun operates, and by the need for reconciliation of energy utilisation in Iceland.

"When Landsvirkjun was originally established by the Icelandic state, the company's primary role was to construct power stations. As a result of this focus, the history of the company has been characterised by extensive construction projects. We plan to change the way of thinking in the company, shifting our focus from a construction-oriented company to a market-driven company. This means that we will focus more on profitability, which will be reflected in the company's operations, finances, sales and marketing. For example, we will focus on the better utilisation of our existing

operations, maximising output from existing power stations, both operationally and financially. Moreover, we plan to increase the flow of information, especially concerning the financial standing of the company. The confidential nature of the electrical power agreements has led to certain misunderstandings about the company's operations. Therefore, I feel it is important to publish information on power prices at the annual meeting of Landsvirkjun in 2010 with the aim to decrease the mystique surrounding this issue."

It has been suggested that confidentiality towards electricity buyers means that it is not possible to disclose energy prices, e.g. in Landsvirkjun's agreements with power-intensive industries. Is this argument no longer valid?

"We will continue to respect confidentiality towards individual customers as it relates

to electricity prices and other terms in the agreements. However, we plan to disclose information on the average prices of energy sales to power-intensive industries. Information on energy prices may be derived from various public informations. Therefore, these disclosures will not harm the business interests of Landsvirkjun or its customers, while they will help meet public demands for information."

Will this information confirm what the opponents of power-intensive industries maintain, that electrical power for aluminium smelters and other power-intensive plants is sold at rock-bottom prices?

"No. It is actually a topic for endless discussion as to whether profitability is ever considered satisfactory. Aluminium smelters are reliable and important customers of electrical power companies. They need a rich and constant supply of energy and make

long-term agreements that are well suited both for them as well as the energy sellers. Some people do indeed assert that the price of energy to power-intensive industries in Iceland is so low that it must be subsidised, but that is not the case. The question we should be asking ourselves is: Are we selling electricity to power-intensive industries at the “correct” price? I think that we should make greater demands for profitability. Our task at Landsvirkjun is to get the highest value for our product, and we intend to work very hard on this task in the near future. That being said, I am not undermining the work of those responsible for the company's previous agreements, and in no way am I devaluing them or their work. However, it is a fact that the international environment has changed dramatically in the last five to six years, and we need to take this into account in our areas of focus. Energy prices have risen in international markets, especially in Europe where an active market for electricity has been formed by linking together the continent's energy grids. Carbon taxes have been imposed on most energy sources other than hydroelectric power. Our customers operate in this environment, and the comparison with developments overseas provides Landsvirkjun with opportunities which should be utilised. Renewable energy sources, hydroelectric and geothermal power, improve the competitive advantage and strengthen the company's position, especially in the long run.”

It is sometimes suggested in the public debate that Icelanders have reached the limit in their power-plant projects and have even already allocated most of the hydroelectric power that can be readily harnessed. Do you agree with that?

“I think we have a few untapped power-plant options, mostly smaller power plants. A framework programme on power-plant options is being prepared, and then it will be up to the authorities to decide whether and where to construct new power stations. Landsvirkjun should not have political opinions on power-plant options, but rather it should investigate individual options, evalu-



Burfell station came in operation 1969. The front wall of the power station is decorated with a mural by the Icelandic sculptor Sigurjon Olafsson.

ate their efficiency and submit professional data to the authorities for consideration during their decision making process. In the long run, I think that as the profitability of power plants increases, the willingness to harness renewable sources of electricity increases. It does not, however, mean that money can buy everything. All nature is precious and some boundaries will never be crossed, whatever the profitability. However, it is important that there is a reasonable acceptance of power plants and energy utilisation.”

Is there “reasonable acceptance” of the power plants in the lower stretch of the River Thjorsa?

“There is probably not enough acceptance of the harnessing plans in the lower stretch of the River Thjorsa at this point in time, but one of our tasks in the near future will be to work towards reconciliation of the operations, both with increased communication and interaction with a diverse group of stakeholders. Nevertheless, I realise that there will never be complete acceptance of everything that Landsvirkjun does, and there will always be some groups in the community that disagree with the authorities about the set of tasks given to the company at any

given time. However, we will strive to create constructive dialogue, guided by mutual respect, with stakeholders and others that have opinions on our tasks.”

Does this mean that there will be a reduction in Landsvirkjun's operations?

“I wouldn't use those words specifically, but rather that in a different environment, Landsvirkjun's focus will change. We will engage in operations within the framework established for us by the authorities, and we will place increased focus on the role of Landsvirkjun in research and development and innovation within the energy sector. We plan to create value with the knowledge and technology that reside within the company. Our export of knowledge was successful in 2009, and 2010 looks promising. Canada is one example of a country in which we have worked extensively and been successful. This operation has a strong and beneficial derivative effect for the Icelandic energy sector and contributes to its development and increased competitiveness. For example, we contribute by providing other companies with opportunities through Landsvirkjun's operations abroad, and annually allocate considerable funds to research and innovation in the field of renewable energy.”

Sales and marketing

The diversification of Landsvirkjun's customer base has grown and the company hopes to further diversify its electricity purchasers in coming years.



Steingrímsstöð hydropower station came in operation 1959.

Income from electricity sales amounted to USD 251.5 million in 2009 compared to USD 388.4 million in the previous year. Income from electricity sales decreased by USD 136.9 million, or 35%. This is primarily due to a decrease in income in the domestic market when measured in USD, due to the fall of the Icelandic krona, and a decrease in income from aluminium companies due to lower aluminium prices in the global market, as electricity prices to aluminium companies are linked to global aluminium prices. Revenues from aluminium hedges for the year 2009 amounted to USD 42.5 million.

During the past year, Landsvirkjun had talks with many potential new customers. The company reached agreements with Becromal, which began operating a high voltage capacitor foil plant in 2009, and Verne Holdings, which plans to operate a data centre at Keflavik Airport. Thus, the diversification of Landsvirkjun's customer base has grown and the company hopes to further diversify its electricity purchasers in coming years.

Wholesale market

The wholesale market for electricity is relatively stable. However, the number of wholesale sellers of electricity can be expected to grow resulting in increased competition in the future.

At the beginning of each year, contracts for the majority of wholesale transactions for the coming year are finalised. Existing contracts are either adapted to the needs of customers or new contracts are negotiated if requested.

Landsnet (which operates the Icelandic transmission system) had planned to establish a spot market for electricity, but this work was postponed due to the economic situation in Iceland. Landsvirkjun is involved in an advisory group that was established to prepare and develop the spot market. Landsvirkjun entered into a one-year contract with Landsnet to sell electricity to the grid, due to transmission losses during the year. Landsvirkjun's production capacity is currently fully utilised. As a result, the company

did not enter into any new contracts for the sale of secondary electricity during 2009 and it does not expect to enter into new contracts for secondary electricity in 2010. Secondary power is delivered on interruptible terms and is typically priced lower than other power. Secondary electricity is sold to users who can handle energy curtailment up to an agreed level, and who may, in such cases, choose to temporarily use other energy sources.

Wholesale electricity prices in Iceland are competitive with prices in Europe. In the Nordic countries, the status of water reserves largely dictates prices, while in Central Europe the price of fossil fuels, such as coal and gas, play the main role in price formation. In the Nordic countries, trading in electrical power mainly takes place on the spot market, Nord Pool. The line graph shows the development of short-term wholesale prices from Landsvirkjun as compared to the price development on the Nord Pool market in 2009. Prices are shown in EUR/MWh.

Power-intensive industries and high-technology markets

Alcoa Fjarðal currently utilises all the electricity that can be produced in the Fljotsdalur power plant, including 40 MW that the company receives in accordance with a special annex agreement. Originally, the aluminium plant was expected to produce 322,000 tonnes a year, but its actual capacity is 346,000 tonnes. The energy needed to support the increased capacity could be sourced from Fljotsdalur, as the plant's energy production was 7% higher than projected by the designers of the Karahnjúkar project.

In February, an agreement was signed with Nordural Grundartangi for increased sales of electricity. The agreement calls for an immediate increase of 25 MW and 212 GWh and an additional 25 MW in phases from 2010 to 2012. A new power station will need to be constructed to enable delivery of electricity in the latter 25 MW phase. Such increased electricity sales are dependent on permits being granted for the construction.

In April, the electricity sales agreement with Becromal Iceland was expanded. Becromal began operations in Krossanes in Eyjafjörður in August 2009, approximately one year later than planned when the original electricity sales agreement was negotiated. The factory is being brought into service in phases. At the end of 2009, the plant was operating at a quarter of its output and the plant is expected to be at full capacity by the end of 2010.

In October, Landsvirkjun finalised an electricity sales agreement with Verne Holdings, which plans to operate a data centre at Keflavík airport. Delivery of electricity is planned in 2010.

The company has been in discussions with Rio Tinto Alcan regarding the supply of electricity for a potential 40,000 tonnes increase in the capacity of the Straumsvík aluminium smelter. If the parties reach an agreement and the necessary permits are issued, Landsvirkjun intends to secure the increased electricity supply by constructing a new power station at Budarhals. This would result in an increase in electricity sales to the aluminium plant of 75 MW and 650 GWh a year.

In addition, Landsvirkjun has been involved in discussions with various parties planning to construct a silicon-refining plant, a data centre, a fertiliser plant and a silicon metal plant in Iceland. The company also participated in the discussions between representatives of Theistareykir and parties interested in buying electricity from geothermal power stations in the north of Iceland. Those discussions did not lead to a definite conclusion, as the financial crisis has had widespread effects on the potential for development in the field of power-intensive and high-technology industries.

In October a letter of intent was signed between the state and the municipalities of Nordurthing, Skutustadahreppur and Thingeyjarsveit on cooperation in the field of energy research, energy utilisation and

employment development in the region. The parties agree on the importance of utilising the geothermal power in the Thingeyjarsýsla area for extensive economic development in the area. A task committee was appointed, consisting of, among others, representatives from Landsvirkjun and Theistareykir.

Green certificates

In 2009, all of Landsvirkjun's power stations were re-certified by the German company TÜV SÜD. The certification confirms that the electricity produced by Landsvirkjun is derived from renewable power sources. This certification has been used to sell green certificates, which serve as guarantees of origin and are derived from a European Union directive. Trade in green certificates is intended to stimulate the use of renewable/green energy sources within the EU. One certificate is issued per MWh of electricity produced. Landsvirkjun sells green certificates in the EU voluntary market.

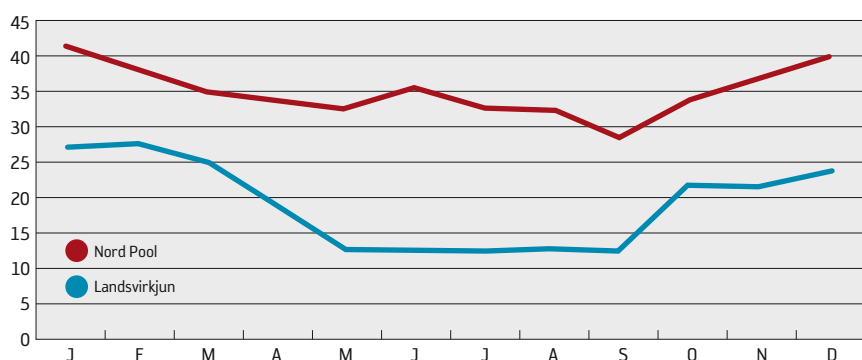
The electricity market in Europe

Climate change and electricity consumption was the subject of discussions within the European Union in 2009. The EU has established the following targets intended to reduce greenhouse gases by 2020:

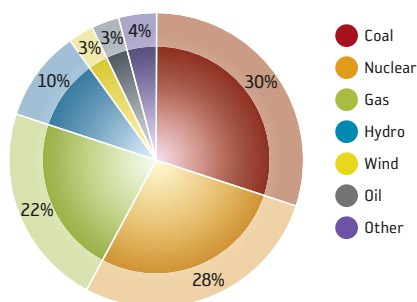
- 20% of electrical power must be produced from renewable energy sources.
- Greenhouse gas emissions must be reduced by 20%.
- Electricity use must be reduced by 20%.

In order to achieve these goals, electricity produced from renewable sources in the EU must be doubled from 2007 levels.

Landsvirkjun's short-term wholesale price trend in 2009 in EUR/MWh



Energy sources for electricity production in the European Union in 2007.



Operation of power stations

Landsvirkjun was certified according to a safety standard in the field of safety and work environment control, OHSAS 18001.

Landsvirkjun operates eleven hydroelectric power stations and two geothermal power stations in Iceland. The power stations are operated with a focus on efficiency, reliability and cohabitation with the environment and with society.

There were no setbacks or serious unforeseen events at any of Landsvirkjun's power stations this year. There were three minor work-related accidents that led to employee absences from work this year, but they were not serious. At the end of the year, 301 days had passed since the last accident-related absence, and the H-index of the energy division was measured as 7.03 (The H-index is an international scale and specifies the number of accidents resulting in absence from work. Landsvirkjun's H-index refers to 200.000 working hours. H-index is the total number of accidents resulting in absence from work divided by the total number of hours worked by all employees in the company, multiplied by 200.000.).

Landsvirkjun operates a coordinated and certified quality, environmental and safety management system based on ISO 9001, ISO 14001 and OHSAS 18001, and an internal electrical safety management system (RÖSK), which fulfils the demands of the Iceland Fire Authority on electrical safety management.

There were 81 unplanned outages in Landsvirkjun's power stations, compared to 70 in the previous year. Landsvirkjun has set itself the goal of all units being available for operation 99% of the year, excluding scheduled maintenance periods. This goal was not fully achieved in 2009, when the machines were available 98.8% of the time.

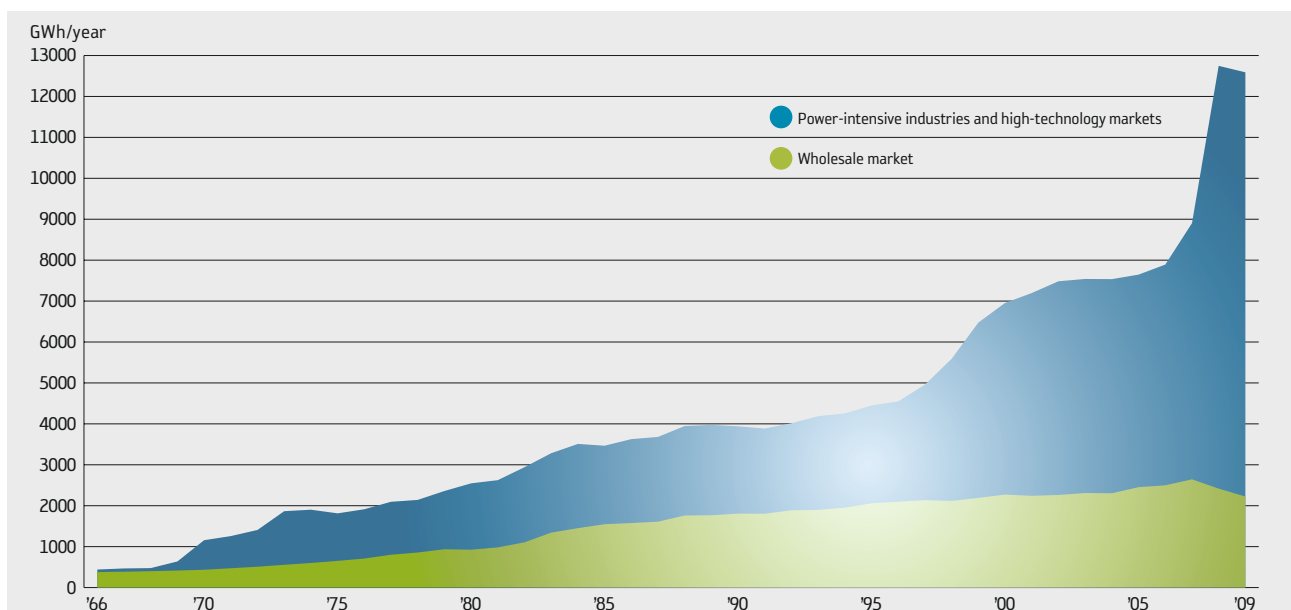
The Energy Division performed 60 maintenance and improvement tasks during the year, the largest of which were for projects in the Thjorsa region. Of these, the most extensive tasks involved maintenance of the dam, intake headrace, intake facilities and pipes at Sigalda Power Station.

For this reason, the Station was taken out of service from the beginning of July to the middle of August. One of the two new transformers for Sultartangi Power Station was delivered from the manufacturer in South Korea in August, and was commissioned in October. The other transformer arrived in Iceland in March 2010.



Repair work in Ljosifoss hydropower station, the oldest station on the river Sag (1937).

Landsvirkjun's electricity sales 1966–2009

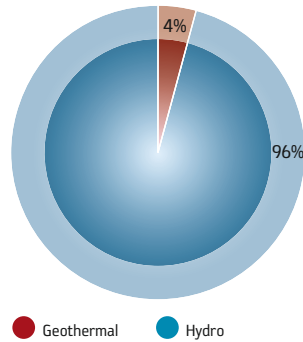


Electrical power production

A total of 73% of electricity in Iceland is produced with hydro power and 27% with geothermal power. Landsvirkjun's share in electricity production is 96.0% for hydro power and 10.8% for geothermal power.

The amount of electricity produced by Landsvirkjun that was transmitted through the Landsnet national grid came to 12,154 GWh in 2009, a decrease of 1.5% from the previous year. Hydropower accounted for approximately 96% of electricity production, and geothermal power for about 4%, as can be seen in the chart on the right.

Landsvirkjun's energy production 2009



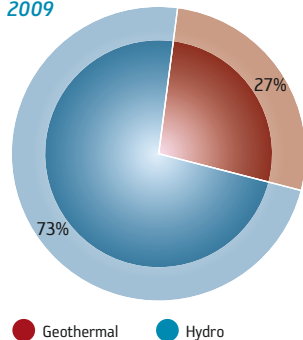
Landsvirkjun currently operates eleven hydropower plants, two geothermal plants and one fossil-fuel plant for emergency use.

Landsvirkjun's power stations

	Power MW	Activated
Fljotsdalur	690	2007
Burfell	270	1969
Hrauneyjafoss	210	1981
Sultartangi	120	1999
Sigalda	150	1977
Blanda	150	1991
Vatnsfell	90	2001
Irafoss	48	1953
Laxa I	5	1939
Laxa II	9	1953
Laxa III	14	1973
Steingrimsstod	26	1959
Ljosifoss	15	1937
Hydropower	1,797	
Krafla	60	1977
Bjarnarflag	3	1969
Geothermal	63	
Total:	1,860	
Straumsvik	35	1969
Reserve power	35	

In addition, Landsvirkjun purchased 392 GWh of electricity from other energy companies for resale to power-intensive industries. Landsvirkjun's total energy portfolio in 2009 were 12,546 GWh, 1.6% less than in 2008. The column chart below shows Landsvirkjun's total energy portfolio in 2005–2009.

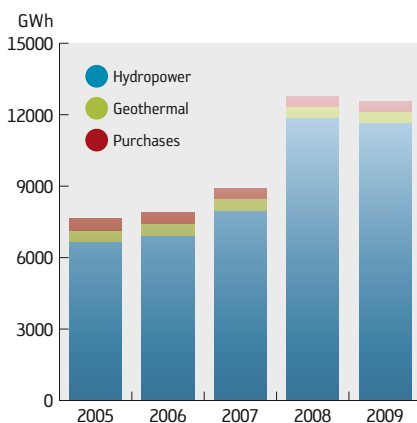
Division of energy production in Iceland 2009



Landsvirkjun's electricity sales amounted to 12,546 GWh during the year. Sales of primary electricity to public utilities decreased by 5.4%, but remained the same to power-intensive industries. Total electricity production in Iceland was 16,839 GWh. Landsvirkjun's share was approximately 73%, a 3% reduction from the previous year. The chart on the right shows the division of energy production by energy sources.

A total of 73% of electricity in Iceland is produced with hydroelectric power and 27% with geothermal power. Landsvirkjun's share in electricity production is 96.0% for hydroelectric power and 10.8% for geothermal power.

Landsvirkjun's total energy portfolio 2005–2009



Blanda reservoir, 56 square kilometers.

Research

In 2009, data was compiled, on potential power projects that Landsvirkjun is exploring, and submitted for evaluation in the second stage of Iceland's Master plan for Hydro and Geothermal Energy Resources.

Landsvirkjun participates in various research projects every year, the goal of which is to lay solid foundations for the company's future development and to maximise operational security for its power system. In 2009, data was compiled, on potential power projects that Landsvirkjun is exploring, and submitted for evaluation in the second stage of Iceland's Master plan for Hydro and Geothermal Energy Resources. The submitted power project options included 10 hydro-power projects, two diversion projects, and 6 geothermal areas with a total generation capacity of about 14.7 TWh/year.

The Iceland Deep Drilling Project

For around a decade now, Landsvirkjun, Orkuveita Reykjavíkur and Hitaveita Sudurnesja (currently HS Orka) have been exploring the possibility of finding and exploiting geothermal fluid in a supercritical condition (at more than 375°C) deep underground within the current production areas. In the later stages of this exploration, the

National Energy Authority, Alcoa and, most recently, StatoilHydro have become members of the Iceland Deep Drilling Project. The Project has also received grants from international research funds.

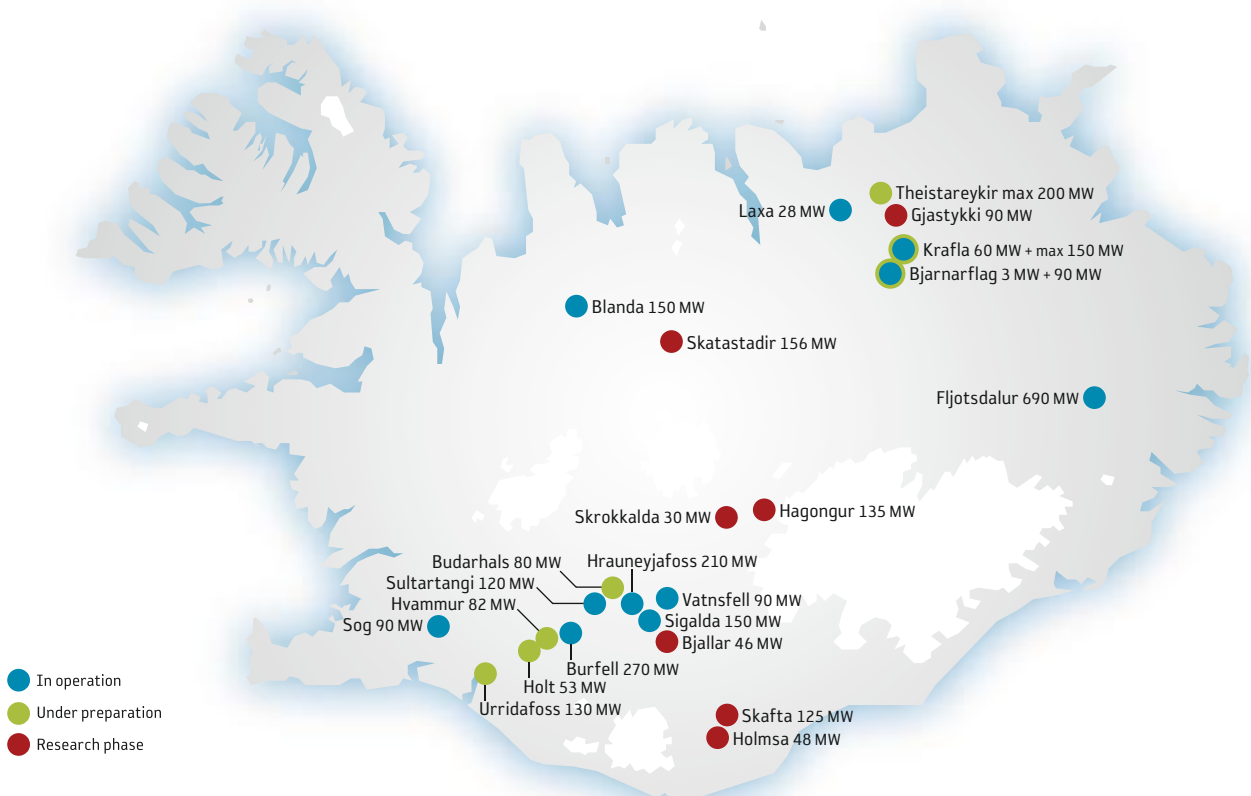
For research purposes the first IDDP borehole was found location at Vitismor within the Krafla geothermal area. This area has been researched extensively and there were indications of magma being present at shallow depths. The planned borehole depth was 4.5 km. Repeatedly at around 2,100 m numerous problems occurred including, lost circulation, caving, getting stuck, twist offs, fishing jobs, cement jobs, a failed coring attempt, and three sidetracks. Then on June 24th the drill bit became stuck in a silica-rich magma. Circulation was not lost and the bit was freed 24 hours later. A decision was made not to attempt drilling deeper, and instead a production casing was cemented inside the anchor casing. Although the IDDP-1 borehole is not as deep as planned

and the hydraulic pressure aimed for was not obtained, the downhole temperature is probably very high. There are, therefore, various options that can be studied for the exploitation of the borehole for energy production. The borehole is expected to be ready for pressure testing during the first part of 2010. The results of research of the geothermal fluid will be used over the next few years to design and develop an experimental power plant.

Energy issues and climate change

If forecasts of global climate change materialise, glacial runoff will increase as a result of expedited glacial melting. Work is underway on revising the statistical exploration data (discharge models and discharge data) that Landsvirkjun uses in its production planning for the current power system and in evaluating prospective power project options. Work on adopting new discharge models that include modelled climate data is in progress. Forecasts on changes in

Power stations and power projects



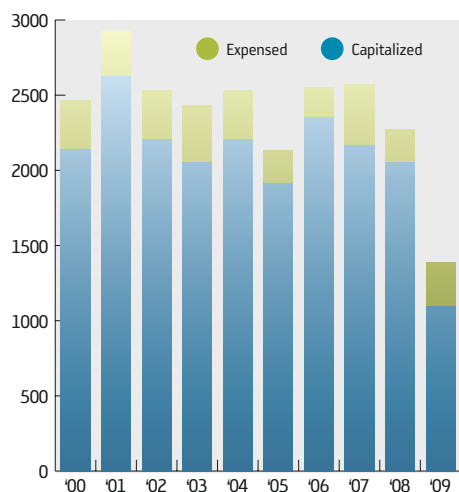
precipitation and temperature are applied to modify historical discharge data and make them represent present and future runoff conditions.

It is important for Landsvirkjun to be well aware of the potential impacts and risks associated with climate change, while at the same time taking advantage of any opportunities it presents. Runoff to Landsvirkjun's power plants may be expected to increase on average by 20% until 2050 as a result of climate change, compared with current runoff figures.

Research and construction preparations for power projects create jobs

Since 2000, Landsvirkjun has been spending on average ISK 2,400 million (at 2009 price levels) a year on research, engineering design and supervision for preparation and construction of new power projects, on the renewal of older facilities and on research and monitoring of existing operating areas. Landsvirkjun's total spending has encouraged the development and accumulation of knowledge and experience in Icelandic engineering firms and in the institutions involved in environmental and hydrological research.

Landsvirkjun payments to consultants and research institutes (ISK million)



(2009 price level)



Krafla geothermal power station has been operating at its full installed capacity of 60 MW since 1999.



Theistareykir is considered one of the three largest geothermal areas in North East Iceland.

Construction work preparations

In 2009 Landsvirkjun commenced preparatory work for Budarhals hydropower project.



Budarhals hydropower project, the construction will continue in summer 2010.

Landsvirkjun has decided to commence preparatory work on the Budarhals hydropower plant in the summer of 2010. Tendering for the work was opened on 11 March 2010, and construction is to begin in May.

At the same time as Landsvirkjun presented its decision to commence preparatory work at Budarhals, the company announced that the principal phases of the power-plant construction work would be put out to tender later in 2010, provided that agreements could be reached on financing and energy sales.

The National Planning Agency approved Budarhals Power Station in May 2001, following an environmental impact assessment. Landsvirkjun subsequently received all the appropriate permits for the construction.

Hydropower projects in the south of Iceland

Three power projects are planned in the lower stretch of the River Thjorsa: the Hvammur, Holt and Urridafoss projects. All the projects have undergone environmental impact assessments and have been approved.

The power stations are located in four municipalities: Rangarthing ytra and Asahreppur to the east of the river, and Skeid and Gnipverjahreppur and Floahreppur to the west of the river. They have not all, as yet, confirmed their municipal plans for the three power projects.

Studies on the biology, hydrology and environment in the project area have been carried out, including annual monitoring of runoff and fluvial sediments in the River Thjorsa, monitoring of groundwater near the River Thjorsa, and monitoring of the biodiversity of the River, with a special focus on the migratory behaviour of salmon and fry.

Geothermal power plants in north-east Iceland

In 2009, Landsvirkjun and Theistareykir continued their preparatory work for the exploitation of the geothermal areas in the two Thingeyjarsýsla districts. This was in spite of the expiry in autumn 2008 of the Memorandum of Understanding between Alcoa, Landsvirkjun and Theistareykir to explore the possibilities for exploitation of energy for an Alcoa 250,000 tonnes capacity aluminium smelter at Bakki. Preparations for an environmental impact assessment and other studies continued, while the number of costly exploratory drillings was reduced.

At the end of the year, Landsvirkjun purchased an approximately 32% shareholding in Theistareykir from Nordurorka, subject to due diligence.

In 2009, drilling was completed on one exploratory geothermal well in the Krafla area. This confirmed that exploitable fluids are to be found above depths of 2,000 metres. Earlier pilot holes had revealed that special measures would be needed to produce energy-rich fluids below the 2,000 metre level due to the risk of corrosion. No geothermal exploratory wells were drilled at Bjarnarflag and at Theistareykir, although drilling there during 2006–2008 produced excellent results.

The monitoring of small earthquakes continued, as did measurements of resistivity and gas emissions. Various regular measurements of the liquids from the wells were also taken, and investigations were carried out into the possible impacts of re-injected geothermal brine and liquid brine runoff from geothermal power stations on the groundwater systems in the Krafla area and at Bjarnarflag.

Work on the environmental impact assessment of the Krafla II power station continued, together with assessments of Theistareykir Power Station, the power lines and the Alcoa aluminium smelter at Bakki in the Nordurthing district. At the same time, work was underway on a joint environmental impact assessment for the power stations, power lines and the aluminium smelter, in the wake of a ruling issued by the Minister for the Environment in July 2008. Uncertainties concerning procedures generated in the wake of the ruling delayed the assessment substantially in 2009. An assessment was also being carried out on the environmental impact of up to three exploratory holes in Gjastykki. The opinion of the National Planning Agency is expected during the first half of 2010.

The status of power stations and preparations is as follows:

- Landsvirkjun operates a 60 MW power station at Krafla. Proposals have been made to increase its capacity by up to 150 MW.
- Landsvirkjun operates a 3 MW power station at Bjarnarflag. Environmental impact assessment has been carried out and approved for a new 90 MW power plant at this site. Geothermal steam has already been acquired for the first stage of its development.
- Landsvirkjun owns a 32% shareholding in Theistareykir, which is conducting research into the geothermal area at Theistareykir. A power station of up to 200 MW is planned, and geothermal steam has already been obtained for the first stage.
- Research is being conducted into the geothermal area at Gjastykki.

Karahnjukar Hydropower Project

Landsvirkjun is proud of its environmental policy. On the Karahnjukar project sites, the finishing and clean-up work has been greater in scale than on any comparable project in Iceland.



Halsón reservoir for the Fljotsdalur hydropower station is 57 square kilometers.

Finishing and clean-up work 2009

Various finishing and site clean-up work was carried out at the Karahnjukar construction site in 2009. Landsvirkjun is proud of its environmental policy and has made cleaning up and re-vegetating the environment at its construction sites a priority. On the Karahnjukar project sites, the finishing and clean-up work has been greater in scale than on any previous project in Iceland. During the summers of 2008 and 2009 major effort was put into the removal of debris (such as piping, concrete and other foreign bodies) and the smoothing and evening out of quarries, dumps and work sites in order to return the environment as closely as possible to its former condition. The work is being executed in close cooperation with the Environment Agency of Iceland and the plan is to complete it in 2010.

Istak contractors carried out finishing work in the powerhouse area, and a Final Acceptance Certificate for the powerhouse civil structures was issued in August 2009.

In the Fljotsdalur valley, the contractor Islandsgardar performed the finishing work around the central and staff building and cleaned up the construction area.

Work at the site of the Karahnjukar dam

Istak completed construction of the taildam in Hafrahvammur Canyon below the Karahnjukar dam in accordance with a 2008 contract. The taildam creates a pool below the Hverfandi waterfall (spillway water) for the purpose of reducing the spillwater impacts and hence the risk of rock erosion in the canyon. Further work performed by Istak included installing the base for an outdoor work of art, installation of tourist facilities, and road improvements and finishing work. Approximately 70 people worked for Istak during the summer of 2009 on the site, and the works were completed by early December.

In September, a final inspection of the Karahnjukar dam and the headrace tunnels was performed, thus completing the two-

year guarantee period of the work by the contractor Impregilo.

Sudurverk contractors worked on improvements and on the finishing work at Desjara and the Saudardalur dams, and in September a Final Acceptance Certificate was issued for both dams.

Orkuvirki-Austurafl contractors worked on electrical installations and equipment in various gate structures and in the access tunnels. The company's employees, together with the staff of Landsvirkjun Power, also worked on alterations of the on-site electricity grid used during the construction period to bring it to a condition suitable for power plant operation. The distribution voltage was reduced from 33 kV to 11 kV for the major part of the system, additional transmission cables were installed and permanent equipment was set up. Orkuvirki-Austurafl had up to 10 employees in the area until the beginning of December.



Fljotsdalur hydropower station started operation in November 2007.

Mitigating measures

In 2009, various mitigating measures were carried out in the Halslón Reservoir area. Experiments were also conducted, in cooperation with the State Soil Conservation Service, on methods for preventing the drifting of airborne dust and sand. The task involved, among other things, the creation of erosion protection on the eastern shore of Halslón.

Sand traps, which had been damaged by wave action, were rebuilt and protected from erosion. The Sand traps were arranged and constructed taking into account factors specific to each location. The teams experimented with different arrangements of erosion protection measures, and time will tell which are the most appropriate.

Recently tendered jobs

Several finishing jobs were put out to tender in 2009, including Contract KAR-27, which was negotiated with the contractors Ylur and Heradsfjörður, and Contract KAR-28 for an outdoor artwork, Hringidan (Vortex), with accompanying stonework, which was undertaken by Lystigardur. The former contract will be completed in the summer of 2010, while the latter has already been completed.

Work at the Hraunaveita diversion area Istak began working again at the Hraunaveita diversion area in the latter part of May, as soon as the snow had cleared. Approximately 40 people were there for much of the summer working on Contract KAR-25 for the Keldua dam, Keldua spillway, Grjóta spillway and the bottom outlet installation in the Ufsarstífla dam. Istak was also involved in cleaning up the area and removing construction and camp facilities. The filling of the Keldua Reservoir began in mid-July. The Reservoir was full for the first time in early November.

All electro-mechanical equipment has proved to work well

The gate contractors Montavar and ATB Riva Calzone carried out the final finishing work and testing of the equipment in cooperation with VA-Tech Andritz. All gate equipment had been brought into its final operating mode by end of September.

At Fljotsdalur Power Station, VA-Tech Andritz was engaged in slight improvements to the turbine runners and the transverse maintenance gates in the draft tubes. Efficiency tests on generating unit No. 1 proved that the improvements of the runners had been

quite successful. The turbines now achieve maximum efficiency in the best operating range of the units.

In autumn 2009, the annual check was carried out on the Fljotsdalur generating units. Units 2 to 6 were commissioned in November 2007, while unit 1 was commissioned in February 2008. VA-Tech Andritz participated in these checks with the Station's operation staff. Very little sand abrasion was seen on the runners, an indication that abrasion estimates were correct. The generator inspection revealed that minor repairs are necessary to the rotor pole accessories, something that is planned for 2010.

Overall, it can be concluded that all of the equipment has proved reliable with no unexpected incidents during the two years that it has been in operation.

Fljotsdalur Power Station was in full operation throughout the whole year of 2009 and experienced no significant operational problems. The total energy production of the Station was just under 4,800 GWh, which is somewhat more than was anticipated in the initial Station's design.

Final Acceptance Certificates for the greater part of Contract KAR-36, Penstocks and Gates, were issued to the contractor, DSD-Stahlbau, in July.

International award

In October the Karahnjúkar dam received an award as an International Milestone Dam Project at a symposium held in Chengdu in China. Björn Stefánsson, civil engineer and Managing Director at Landsvirkjun Power, accepted the award and gave a presentation on the dam and the Karahnjúkar project. The symposium was attended by 450 guests from approximately 30 countries.

The Karahnjúkar dam is one of the tallest dams of its type in the world and the highest of its kind in Europe.

Finance

Return on equity in 2009 was 14% and the company's equity ratio was 32.6%. Landsvirkjun's liquidity position is good and the company can meet all obligation into 2012 without any refinancing.



Laxa II hydropower station.

Landsvirkjun's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. Landsvirkjun's functional currency is USD.

The year's results

The group's profit in 2009 amounted to USD 193 million, whereas in the previous year it had made a loss of USD 344.5 million. This improvement in net income is largely explained by changes in financial items, especially fair-value changes of embedded derivatives in connection with the company's electric power sales agreements. Return on equity in 2009 was 14%, whereas it was negative by 21.5% in 2008. Cash from operating activities amounted to USD 197 million, compared to USD 184.4 million in 2008. Cash and cash equivalents at year-end 2009 amounted to USD 194.2 million. This is an increase of USD 70 million from the previous year. It should be noted that the positive fair-value changes in embedded derivatives are largely unrealised, a fact which should be taken into consideration in the evaluation of the company's results.

The 2009 results are in general satisfactory. Aluminium prices were very low during Q1 in 2009, which had a negative impact on income from energy sales to aluminium companies. The aluminium hedges that the company had put in place, however, were extremely successful, so the impact on cash flow was limited. Moreover, interest rates in all major markets were low, which again had a positive effect on results and cash flow. The company's key financial indicators (i.e. return on equity and equity ratios) were stronger than in the previous year. The same may be said of interest coverage, which was 2.94x in 2009, while it was 1.67x in 2008. Furthermore, net debt/EBITDA was 10.4x in 2009, while the corresponding figure in 2008 was 9.6x. In calculating these key indicators, realised hedges are regarded as a part of operating income.

Landsvirkjun expects its business to continue to improve and plans to further strengthen the above ratios. However, it should be noted that short-term and long-term aluminium prices can have a considerable impact on the company's results and cash flow.

Income statement

The group's operating revenues amounted to USD 299.8 million in 2009, a decrease of 33.7% from the previous year. The decrease in operating income is mainly explained by the lower energy prices to aluminium smelters due to the fall in aluminium prices, as well as by the fact that income from energy sales in the domestic market has decreased in US dollar terms as a result of the depreciation of the Icelandic krona. Realised hedges in connection with electric power sales contracts are recorded under financial items in accordance with IFRS. Hedges credited to Landsvirkjun from counterparties amounted to USD 42.5 million in 2009, while USD 54.8 million were expensed to counterparties in 2008. Landsvirkjun regards realised hedges as a part of its income. As a result, the reduction in income between years is 13.8% when hedges are taken into account.

The group's operating expenses amounted to USD 185 million in 2009, compared to USD 206 million in the previous year. Depreciation and impairment of fixed assets weigh the most in operating expenses, at USD



Vatnsfell hydropower station came in operation 2001.

114.3 million in 2009 compared with USD 105.5 million in 2008, an increase of 8.3% year on year. Other operating expense items decreased by approximately 30% between 2008 and 2009.

As a result, the group's EBIT fell by USD 131.2 million in 2009 compared with the previous year. However, this amount is approximately USD 33.9 million when realised hedges are taken into account. The company's EBITDA fell by USD 122.4 million between years, although this figure is approximately USD 25.1 million when realised hedges are taken into account.

Interest expenses in 2009 amounted to USD 92.5 million, compared with USD 177.7 million in 2008. Interest rates on all major currencies have decreased substantially in recent years, and Landsvirkjun has benefited from having floating rates on the major part of its debt portfolio. The average nominal interest rates on long-term loans were approximately 2.46% in 2009, compared with approximately 4.51% the previous year.

Financial income in excess of financial expenses totalled USD 95.1 million in 2009,

while financial expenses in excess of financial income amounted to approximately USD 660.6 million the year before. The difference of USD 755.7 million can largely be attributed to fair-value changes in embedded derivatives relating to the company's electric power sales contracts with aluminium smelters, which move in line with world market prices for aluminium. Other derivatives and foreign exchange differences also have an effect. In 2009, the exchange rate difference was negative by USD 48.8 million, while it was negative by USD 128.6 million in 2008. Fair-value changes in embedded derivatives were positive by USD 253.3 million in 2009, while they were negative by USD 497.2 million in 2008.

In 2009, expensed income tax amounted to USD 16.9 million, while in 2008 credited income tax amounted to USD 70 million. In December 2009, the Icelandic Parliament (Althingi) approved an increase in the rate of income tax from 23.5% to 32.7% for partnerships, and from 15% to 18% for limited liability companies. The effects of this change have been recorded in the consolidated financial statements.

Balance sheet

The group's total assets amounted to USD 4,803.5 million at year-end 2009, and are divided into non-current assets (USD 4,438.7 million) and current assets (USD 364.8 million). In the previous year, total assets were USD 4,619.2 million. In 2009, the company's capitalised embedded derivatives increased by USD 184 million.

At the end of 2009, Landsvirkjun's equity amounted to USD 1,564.5 million. The company's equity ratio was 32.6%, as compared to 29.8% at the end of the previous year. Equity increased by approximately USD 187.7 million from the previous year. The difference is largely attributable to the year's profits, which amounted to USD 193 million.

The company's long-term liabilities, including next year's instalments, amounted to a total of USD 3,018.1 million at the end of 2009, compared to USD 2,975.3 million in the previous year. The liability components of derivative agreements amounted to USD 129.2 million at year-end 2009, compared to USD 145.6 million at year-end 2008.

Statement of cash flows

During 2009, cash flow from operating activities was USD 197 million. Cash income was USD 311.2 million, compared to USD 456 million in the previous year. Paid operating expenses amounted to USD 68.2 million in 2009, compared to USD 112.5 million in the previous year. Thus cash from operating activities, excluding financial items, increased by approximately USD 100.5 million year-on-year. Net cash outflow due to financial expenses amounted to USD 45.9 million in 2009, as compared to USD 159.1 million in 2008. This amount includes an inflow from realised hedges of USD 45.3 million in 2009, as opposed to an outflow of USD 60.4 million in 2008.

Paid capital expenditure in 2009 for non-current assets amounted to USD 120.5 million, compared to USD 374.8 million the previous year. The bulk of investments were related to the final phase of the Karahnjúkar

project. Loans were paid off to the tune of USD 4.6 million, while borrowings in 2008 amounted to USD 168.6 million. No dividends were paid out to owners in 2009, while dividends amounting to USD 7.8 million were paid the year before.

Financing

Landsvirkjun's liquidity position at the beginning of 2009 was good, as funding objectives were achieved in 2008 despite deteriorating market access. Borrowings in 2009 amounted to a total of USD 195.7 million, as compared to USD 450 million in 2008. In total, four private placements were issued during the year, three in ISK and one in USD. The term of the ISK bonds was six months; one bond is due within the year, while the other two are due in May 2010. The USD bond amounted to 45 million with a term of seven years. The terms on these loans were below the credit default swap spread of the Icelandic state at the time of issuance. They were issued under the company's EMTN programme. Moreover, the company's subsidiary, Landsnet (Icegrid), issued bonds amounting to ISK 5 billion for a term of 25 years, which were particularly well received in the domestic market.

After the collapse of the Icelandic banking system in 2008, access to international

debt markets, which had been substantial in previous years, was effectively cut off. The company, therefore, temporarily reduced investments to meet these unexpected new external circumstances and to ensure a good liquidity position for the rest of the year. Due to this uncertainty in the Icelandic economy, the credit rating agency S&P's placed Landsvirkjun on credit watch on 8 May 2008 with a negative outlook. In its reasoning, the agency focused on the uncertainty surrounding whether or not the Icelandic state would intervene in a timely manner if the company encountered financial difficulties. In response, and to reduce the concerns of S&P's and other international agencies, Landsvirkjun, the Ministry of Finance and the Central Bank of Iceland agreed to a Contingent Credit Facility. In the event that Landsvirkjun does not have sufficient funds to meet interest payments or instalments, the Facility provides for the Central Bank of Iceland to supply the company with foreign currency in return for Icelandic krona or bonds. The Facility covers up to USD 300 million, and the expiry date of the agreement is 1 July 2011.

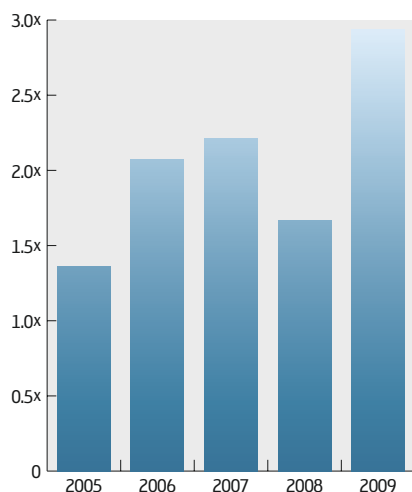
In 2003, Landsvirkjun syndicated a USD 200 million Revolving Credit Facility with its relationship banks. This loan facility was intended to be available to draw on if

international bond markets were to close temporarily, as has often happened in recent decades. In 2005, the loan was refinanced, the Facility increased to USD 400 million and the term extended to 2012. Landsvirkjun is now benefiting from the RCF and at year-end the undrawn amount was USD 282 million.

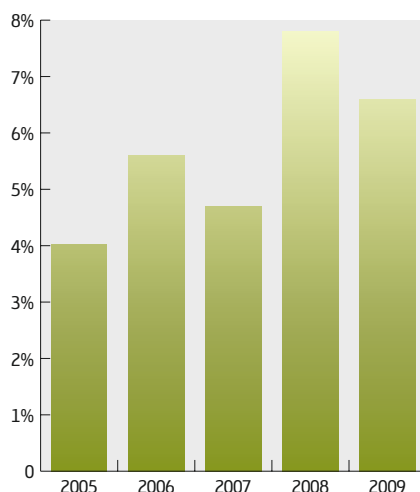
A part of Landsvirkjun's strategy has for a long time been to focus on refinancing risk and aims to distribute loan maturities evenly over a long period of time. Landsvirkjun acted in accordance with this strategy in its financing of the Karahnjúkar project. The company is, therefore, well prepared for challenging market conditions for the foreseeable future. Landsvirkjun anticipates that its good liquidity position, cash from operations and its revolving credit facility will ensure that the company can meet all existing liabilities into the year 2012, provided that no new major investment projects are undertaken. There remains a great deal of uncertainty in the economy, which makes new funding difficult. It is hoped that conditions will begin to improve by mid-year 2010 and that conventional markets will become accessible again. It is unlikely, however, that loan terms will be similar to what they were before the financial crisis, although Landsvirkjun now benefits from having issued long-term bonds on very favourable terms.

Financial ratios including realized aluminium hedges

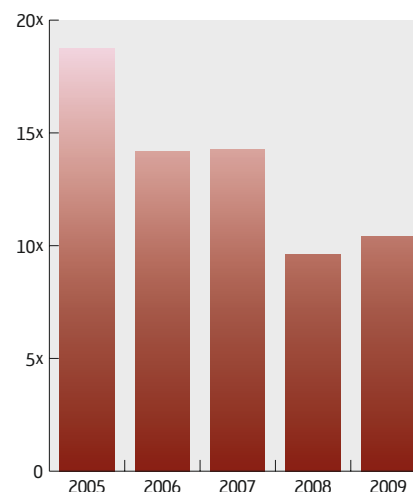
Interest coverage (EBITDA/interest expense)



FFO/net debt



Net debt/EBITDA



Risk Management

Despite limited access to new hedges, the company's risk levels, as regards to changes in aluminium prices, interest rates and currencies, are within acceptable limits.



Krafla geothermal station. Constructions started 1974 and electricity production began in 1978.

Landsvirkjun places great emphasis on effective financial risk management, and plans its risk management accordingly. Landsvirkjun's Board of Directors formulates risk management strategies and defines acceptable risk levels in each risk category. Decision making and supervision of risk management are at the responsibility of the Risk Management Committee, which consists of the CEO, the Deputy CEO and the Head of Finance. The CEO is the chairman of the Risk Management Committee.

The Head of Risk Management is responsible for day-to-day risk management. The main objective of Risk Management is to analyse and manage Landsvirkjun's exposure to risk. Risk Management is entrusted with the task of securing the company's operating performance by reducing operational fluctuations that arise due to changes in exchange rates, interest rates and aluminium prices. Risk Management regularly presents reports to the Risk Management Committee and Landsvirkjun's Board, which assess the company's risk profile and the performance of Risk Management.

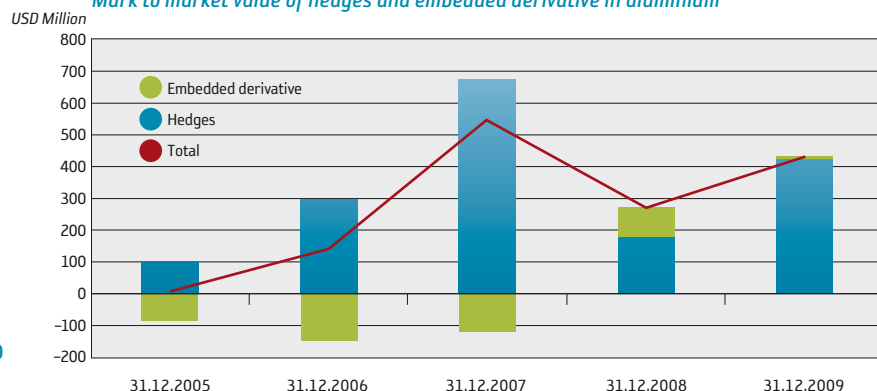
The year 2009

Landsvirkjun's access to new hedges was limited due to the financial crisis and circumstances in Iceland. The company's risk level (as regards to fluctuations in aluminium prices, interest rates and currencies) is, however, within acceptable limits, as the company continues to benefit from hedges made in previous years. The company's liquidity position is strong and construction activity is limited.

The focus has been on reducing the company's liquidity risk, and this has been taken into account in new derivatives agreements. The duration of new agreements has been shortened and use of options has increased. Moreover, hedges with credit support agreements (CSA) have not been made.

Derivatives contracts with rating triggers were settled in 2008 and 2009, and the company's ISDA contracts were re-exam-

Mark to market value of hedges and embedded derivative in aluminium



ined. Contracts containing rating trigger provisions have been renewed without those provisions, thereby ensuring equal treatment for all of Landsvirkjun's counterparties.

Landsvirkjun's financial risk

The goal of effective risk management is to reduce uncertainty in the company's cash flows and financial standing that is due to financial risk, and to seek operating results in accordance with stated objectives. The main financial risks for Landsvirkjun relate to changes in world aluminium prices, currency risk, interest rate risk and liquidity risk. Counterparty risk is also regarded as a financial risk. Risks relating to counterparties have been limited through the quality requirements the company makes.

Aluminium-related risk

Most of Landsvirkjun's income is dependent on global aluminium prices, and there for considerable risk is related to possible decreases in aluminium prices. In order to reinforce that part of the company's income, Risk Management may hedge up to 100% of next year's aluminium-price risk, and proportionally less for the following nine years. This authorisation has partly been utilised with derivative contracts aimed at reducing the effects of aluminium price downturns on operating income. Such contracts consist, in most cases, in fixing aluminium prices at a certain level. These measures resulted in considerable income in 2009, as the average aluminium price was quite low.

Embedded derivatives

Landsvirkjun's electric power sales and purchase contracts, with their linkage to aluminium prices, form embedded derivatives that are recorded in the company's financial statements. The embedded derivatives of electric power sales contracts are capitalised in the balance sheet at fair value on the balance sheet date and, in a similar way, electric power purchases are entered as liabilities. The net fair-value changes in electric power sales and purchase contracts during the year are recognised in the profit and loss account under financial income and financial expenses.

Landsvirkjun changed the criteria for the evaluation of embedded derivatives in the company's 2009 financial statement. Under the new criteria, account is taken of provisions relating to the purchase obligations of electric power purchasers. No actual fair-value changes in excess of what the company has defined as an effective market are assumed. The definition of an effective market is based on the forward price of aluminium as published by the LME exchange with a duration of 123 months. The altered criteria are in full accordance with IFRS and reflect the company's cautious approach. The effects of the above changes result in an approximately USD 240 million reduction in the company's performance before taxes.

Information on embedded derivatives and derivatives contracts for aluminium may be found in Note 52 in the financial statements.

Foreign exchange risk

Foreign exchange risk is defined as the risk of financial loss due to adverse changes in currency exchange rates. Landsvirkjun's foreign exchange risk relates to cash flows, financial assets and liabilities, as well as to all general transactions in currencies other than its functional currency. Risk Management is authorised to use forward agreements and options to ensure a fixed rate of cash flow against the functional currency for up to three years.

The company's functional currency is the United States dollar (USD). As a result, foreign exchange risk is created from the net cash flow and the open position of the balance sheet in currencies other than USD. The company income flow is largely in USD. Other income is in ISK and NOK. However, the foreign exchange risk in these currencies is limited, as cash flows in ISK are balanced and income in NOK is proportionately very small. Payment risk due to amortisations and interest in EUR over the next few years has been limited by hedging.

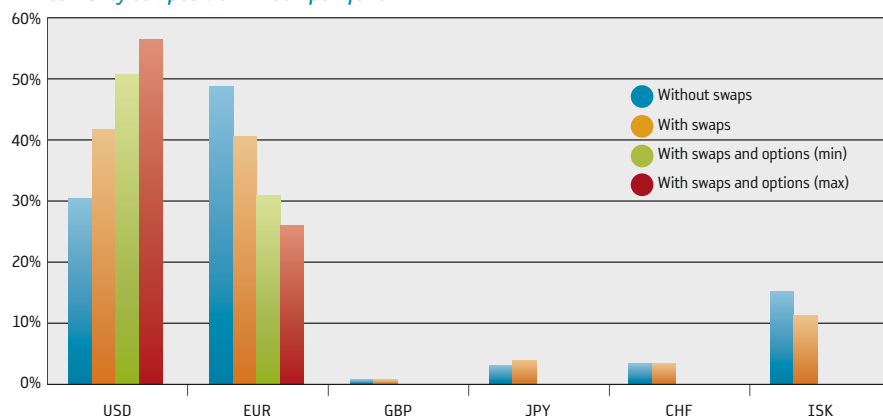
Landsvirkjun's accounting risk, which is linked to exchange rate volatility, is largely a result of a debt position in EUR, which for the most part consists of long-term loans. Moreover, risk related to JPY, CHF and GBP for outstanding loans is limited. The open position of the loan portfolio with respect to USD is approximately 21% of the company's assets, which is in excess of the preferred long-term position of the company.

Further information on the company's foreign exchange risk may be found in Note 53 in the financial statements.

Interest rate risk

Landsvirkjun's interest rate risk is due to interest-bearing assets and liabilities with fixed or variable interest rates. Interest-bearing financial liabilities are significantly higher than interest-bearing financial assets, and it is in the company's interest to minimise interest expenses.

Currency composition in loan portfolio





Thorsvatn reservoir is the biggest lake in Iceland, 86 square kilometers.

At year-end 2009, the proportion of loans with variable interest was 84%, as compared to 80% at year-end 2008. This has benefited the company, as interest rates have been low and, so have Landsvirkjun's financial expenses.

Landsvirkjun has entered into interest rate swap agreements aimed at reducing the company's interest expenses and risk over a longer period. The fair value of the contracts is recognised in the company's income statement as the hedge relationship between the agreements, and the underlying loans has not been defined.

Further information on the company's interest risk may be found in Note 54 in the financial statements.

Liquidity risk

Liquidity risk is defined as the risk of the company having insufficient liquid funds to meet payment obligations on time. The risk is formed by inconsistencies in the terms of financial liabilities and the cash flow that the

company's assets provide. Given the size of the balance sheet compared with its income, the company has always been very aware of its liquidity risk. The company counters this risk by ensuring a reasonable distribution of maturity dates, good access to loan facility and by securing its cash position. In the light of uncertainties in the economic outlook and limited access to funds, the company has reviewed all aspects of its business and temporarily reduced investment levels for the purpose of securing its liquidity position.

The company's liquidity position is monitored by Risk Management, which regularly analyses the cash flow and cash position, taking existing commitments into account. The analysis takes into account the different currencies that Landsvirkjun works with, and in particular the limitations of the Icelandic krona as a payment currency for overseas commitments.

Landsvirkjun, the Central Bank of Iceland and the Ministry of Finance have entered into a contingent credit facility to the ef-

fect that the Central Bank of Iceland will provide the company with foreign currency in exchange for krona or bonds. However, the company must fully exhaust all other financing options before such measure is implemented. The agreement amount is a maximum of USD 300 million, and is effective until June 2011. Moreover, Landsvirkjun has been granted an exemption from the Central Bank of Iceland's currency restrictions on lending and borrowing, guarantees and derivatives trading, and obligatory deposits of foreign currency.

Landsvirkjun's liquid funds are largely in foreign currencies in overseas bank accounts and banking transactions have been normal. The company's cash flow is healthy and obligations in all currencies have been met without difficulties.

At year-end 2009, Landsvirkjun's cash and cash equivalents amounted to approximately USD 194 million, and the company had access to an undrawn loan facility of USD 282 million. In total, the company had secured access to liquid funds amounting to USD 476 million. Taking into account the estimated cash flow from operations, the company has secured sufficient liquid funds to last into the year 2012.

Further information on the company's liquidity position is available in Note 55 in the financial statements.

Counterparty risk

Landsvirkjun's counterparty risk arises first and foremost as a result of the company's electric power contracts with industrial users and derivatives negotiated for hedging purposes. Although the amounts involved are considerable, risk is limited by the company's requirements for counterparty quality.

Further information on counterparty risk may be found in Note 56 in the financial statements.

Financial statements 2009



Key figures

Management's presentation of the operation of Landsvirkjun

	2009	2008	2007	2006
Operation *				
Operating revenues	299,788	452,027	368,824	343,511
Realised aluminium hedges, income (expenses).....	42,526	(54,759)	(59,447)	(50,963)
Total operating revenues.....	342,314	397,268	309,377	292,548
Operating expenses	(70,655)	(100,512)	(105,800)	(102,805)
EBITDA	271,659	296,756	203,577	189,743
Depreciation and impairment loss	(114,321)	(105,532)	(81,960)	(76,932)
EBIT	157,338	191,224	121,617	112,811
Financial items	52,602	(605,804)	505,085	(212,470)
Income tax	(16,944)	70,048	(167,444)	277,230
Profit/(loss) of the year	192,996	(344,532)	459,258	177,571
Balance Sheet				
Total assets	4,803,522	4,619,220	5,142,303	4,279,794
Equity.....	1,564,487	1,376,792	1,600,145	1,143,272
Liabilities	3,239,035	3,242,428	3,542,158	3,136,522
Cash Flow				
Funds from operation (FFO)	186,869	223,007	135,886	151,377
Cash flow from operation	197,023	184,350	138,522	146,789
Investment activities	(120,533)	(374,797)	(532,526)	(731,967)
Financing activities	(4,572)	168,586	506,937	601,544
Liquidity				
Cash and cash equivalents at year end	194,248	124,993	179,578	74,963
Undrawn revolving credit facility	281,600	350,000	350,000	350,000
Total liquidity	475,848	474,993	529,578	424,963
Key ratios				
Return on equity	14.0%	-21.5%	40.2%	18.3%
Equity ratio	32.6%	29.8%	31.1%	26.7%
EBITDA/interest expenses	2.94x	1.67x	2.21x	2.07x
FFO / net liabilities **	6.6%	7.8%	4.7%	5.6%
FFO / interest expenses	2.02x	1.25x	1.47x	1.65x
Net liabilities / EBITDA	10.39x	9.60x	14.26x	14.18x
Credit rating at year end				
Standard & Poor's	BB	BBB-	A+	A+
Moody's	Baa3	Baa1	Aaa	Aaa
Other criterion for Landsvirkjun (parent company)				
Installed power at year end (MW)	1,860	1,860	1,860	1,170
Sales in Gwh	12,546	12,746	8,903	7,892
No. of employees based on full time employment	179	180	212	208
Sales per employee	70	71	42	38
Research and development	23,601	48,363	32,877	18,448
Accident frequency: H200***	1.1	0.4	0.7	n.a.

* Hedges, income (expenses) related to electric power sale agreements have been transferred from financial items to operating income.

** Net liabilities are long term loans including current maturities less cash.

*** H200 is the number of absence accidents per each 200,000 working hours.

Amounts are in USD thousand

Endorsement by the Board of Directors and CEO

Landsvirkjun's objective is to operate in the energy sector and to engage in other business and financial operations according to the decision of the Board of Directors at each time. The Company's consolidated financial statements include, in addition to the parent company, five subsidiaries, Landsnet hf., Fjarski ehf., Hraunaveita ehf., Icelandic Power Insurance Ltd. and Landsvirkjun Power ehf., in addition to three subsidiaries of Landsvirkjun Power ehf.

The financial statements of Landsvirkjun for the year 2009 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The functional currency of the Company is USD and amounts in the financial statements are rounded to the nearest thousand USD.

The Group's operating income amounted to USD 299.8 million in the year 2009 compared to USD 452 million in the previous year. Income thus decreased by USD 152.2 million which is mainly explained by lower energy price to aluminium companies due to decrease in the world market aluminium price and the decreased income on energy sale in the domestic market between years in USD due to the depreciation of the ISK. Realised aluminium hedges amounted to USD 42.5 million in the year 2009 but in the previous year the amount of USD 54.8 million was expensed related to such hedges. Taking realised hedges into account, the decrease in income from the previous year amounted to USD 54.9 million. Operating expenses amounted to USD 185 million in 2009 compared to USD 206 million in 2008. The Company's operating profit thus amounted to USD 114.8 million in 2009 compared to USD 246 million the previous year. When taking into account the aforementioned hedges, operating profit decreases modestly and amounts to USD 157.3 million compared to USD 191.2 million the previous year.

Financial income in excess of financial expenses amounted to USD 95.1 million in the year 2009, but in the year 2008 financial expenses in excess of financial income amounted to USD 660.6 million. The change between years amounts to USD 755.7 million. The main reason for this significant difference between years is that the value of embedded derivatives increased by USD 253.3 million in the year 2009 but decreased by USD 497.2 million in the year 2008. Foreign exchange difference is negative in the year, which is mainly explained by changes in EUR against the USD. Profit on fair value changes in derivative agreements is mostly unrealised which must be taken into account in the analysis of the Company's

results. Realised aluminium hedges amounted to USD 42.5 million in the year 2009 compared to expensed hedges to the amount of USD 54.8 million the prior year as previously mentioned. Interest expenses decreased by USD 85.2 million between years due to a decrease in floating interest rates during the year, but Landsvirkjun some time ago made the decision to maintain for some time floating rates on the main part of its loan portfolio. According to the income statement, profit amounted to USD 193 million compared to a USD 344.5 million loss in the previous year.

Landsvirkjun has entered into derivative agreements in order to manage risk. Agreements have been made due to interest rate risk and foreign currency risk. In addition, derivative agreements have been made in order to hedge risk due to fluctuations of aluminium prices in the global market as part of income is based thereon. Positive fair value of aluminium hedges amounted to USD 5 million at year end 2009. Fair value of other derivative agreements at year end 2009 was negative by USD 67.7 million. Fair value of embedded derivatives in Landsvirkjun's electric power sales agreements with aluminium companies after deducting the fair value of embedded derivatives in electric power purchase agreements is positive and their fair value is measured at USD 423 million at year end 2009.

Landsvirkjun has granted Landsnet hf. loans on market terms to the amount of USD 377.7 million and those transactions have been eliminated in the consolidated financial statements. The majority of the loans were granted in connection with the establishment of Landsnet and the spinning off of the company from Landsvirkjun.

Equity at year end 2009 amounted to USD 1,564 million compared to USD 1,377 million at year end 2008 according to the Balance Sheet and the Company's Board of Directors proposes that the profit of the year be recognised as increase in equity. The Company's Board of Directors proposes that no dividends be paid but otherwise refers to the notes to the financial statements and statement of equity for further changes in equity.

The financial position of the Company is adequate as is its liquidity position due to cash balance and an undrawn Revolving Credit Facility signed in the year 2005. Landsvirkjun is no longer exposed to construction risk after the Karahnjúkar power station was taken into use and the Company has not made any commitments on new power projects. It is the

opinion of the management of Landsvirkjun that the Company is able to meet its obligations into the year 2012 though no access to new capital will become available during that time. The Company is working on refinancing and its management is confident that it will be concluded within that time. The Company will not undertake any further major investments unless financing is secured.

The city of Reykjavik and the town of Akureyri provide a guarantee of collection together with the State for all obligations of Landsvirkjun, entered into before the end of year 2006. From the beginning of year 2007, the State and Eignarhlutir ehf. provide a guarantee of collection for all of Landsvirkjun's obligations entered into after that date. The Company's payments due to guarantees for long-term loans amounted to USD 7.2 million in the year 2009.

Statement of the Board of Directors and the Managing Director

According to the best knowledge of the Board of Directors' and the Managing Director, the financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the Managing Director that the financial statements give a fair view of the Company's assets, liabilities and financial position as at December 31, 2009 and the Company's results and changes in cash in the year 2009.

Furthermore, it is the opinion of the Board of Directors and the Managing Director that the financial statements and the Endorsement by the Board of Directors for the year 2009 give a fair view of the Company's results, financial position and development and describe the main risk factors faced by the Company.

The Board of Directors and the Managing Director hereby confirm these consolidated financial statements with their signature.

Reykjavik, 19 March 2010.

The Board of Directors:

Bryndis Hlodversdottir
Sigurbjorg Gísladóttir
Ingimundur Sigurpálsson
Páll Magnússon
Stefan Arnórsson

CEO:

Hordur Arnarson

Independent Auditor's Report

To the Board of Directors and owners of Landsvirkjun

We have audited the accompanying financial statements of Landsvirkjun, which comprise the balance sheet as at December 31, 2009, and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles

used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Landsvirkjun as at December 31, 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavik, 19 March 2010.

KPMG hf.

Reynir S. Gylfason

Arni Claessen

Income Statement for 2009

	Notes	2009	2008
Operating revenues			
Power sales		251,492	388,368
Transmission		44,329	53,268
Other income	25	<u>3,967</u>	<u>10,391</u>
		<u>299,788</u>	<u>452,027</u>
Operating expenses			
Energy production costs		112,103	120,710
Transmission costs		31,474	36,435
Cost of general research		11,868	8,073
Other operating expenses	28	<u>29,531</u>	<u>40,826</u>
		<u>184,976</u>	<u>206,044</u>
Operating profit		<u>114,812</u>	<u>245,983</u>
Financial income and (financial expenses)			
Interest income		5,907	15,390
Interest expenses		(92,493)	(177,742)
Net income (expenses) on financial assets and liabilities		(102,923)	57,815
Fair value changes of embedded derivatives	52	253,304	(497,167)
Realised aluminium hedges	52	42,526	(54,759)
Associated companies	35	(11,193)	(4,100)
	29	<u>95,128</u>	<u>(660,563)</u>
Profit (loss) before taxes		<u>209,940</u>	<u>(414,580)</u>
Income tax	30	(16,944)	<u>70,048</u>
Net profit (loss) for the year		<u>192,996</u>	<u>(344,532)</u>
Attributable to:			
Owners of the parent company		188,801	(293,384)
Subsidiaries minority interest		<u>4,195</u>	<u>(51,148)</u>
		<u>192,996</u>	<u>(344,532)</u>

Notes 1 to 60 are an integral part of these financial statements.

Amounts are in USD thousand

Statement of Comprehensive Income for the year 2009

	2009	2008
<i>Profit (loss) for the year</i>	<u>192,996</u>	<u>(344,532)</u>
Operating items moved to equity		
Translation difference due to functional currency	(1,827)	(52,037)
Revaluation of non-current assets	0	212,998
Income tax on revaluation of non-current assets	0	(31,950)
Change in tax ratio	(3,474)	0
Total operating items moved to equity	<u>(5,301)</u>	<u>129,011</u>
<i>Total Comprehensive Income (loss) for the year</i>	<u>187,695</u>	<u>(215,521)</u>
Profit (loss) attributable to:		
Owners of the parent Company	185,492	(208,360)
Subsidiaries minority interest	2,203	(7,161)
	<u>187,695</u>	<u>(215,521)</u>

Notes 1 to 60 are an integral part of these financial statements.

Balance Sheet as at 31 December 2009

Assets	Notes	2009	2008
Non-current assets			
Property, plant and equipment	31	3,737,504	3,789,129
Projects under construction		12,441	12,243
Intangible assets	32	141,523	138,077
Derivative financial instruments	34	431,822	287,513
Associated companies	35	2,367	13,342
Shares in other companies	36	248	127
Long-term notes receivable		334	246
Deferred tax asset	38	112,472	133,409
Total non-current assets		4,438,711	4,374,086
Current assets			
Inventories	39	4,159	4,269
Accounts receivables and other receivables	40	108,858	98,374
Derivative financial instruments	34	57,546	17,498
Cash and cash equivalents	41	194,248	124,993
Total current assets		364,811	245,134
Total assets		4,803,522	4,619,220
Equity and liabilities			
Equity			
Owners' contributions	42	586,512	586,512
Revaluation account	43	110,556	116,268
Translation difference	43	(34,702)	(33,670)
Other equity		878,621	686,384
Equity of the owners of the parent company		1,540,987	1,355,494
Minority interest		23,500	21,298
Total equity		1,564,487	1,376,792
Long-term liabilities			
Long-term debt	44	2,750,923	2,789,261
Accrued pension liabilities	46	21,978	22,118
Obligation due to demolition	47	4,663	3,936
Derivative financial instruments	34	96,113	123,971
		2,873,677	2,939,286
Current liabilities			
Accounts payable and other payables	48	65,115	95,537
Current maturities of long-term debt	45	267,197	186,008
Derivative financial instruments	34	33,046	21,597
		365,358	303,142
Total liabilities		3,239,035	3,242,428
Total equity and liabilities		4,803,522	4,619,220

Notes 1 to 60 are an integral part of these financial statements.

Amounts are in USD thousand

Statement of Equity from January 1, 2008 to December 31, 2009

	<i>Owners' contribution</i>	<i>Revaluation account</i>	<i>Translation difference</i>	<i>Other equity</i>	<i>Equity attributable to the owners of the company</i>	<i>Minority interest</i>	<i>Total equity</i>
Changes in equity year 2008							
Equity at January 1 2008 ..	586,512	0	(687)	985,861	1,571,686	28,459	1,600,145
Translation difference			(32,982)		(32,982)	(19,055)	(52,037)
Revaluation of non-current assets		138,831			138,831	74,167	212,998
Income tax effect of revaluation		(20,825)			(20,825)	(11,125)	(31,950)
Loss of the year				(293,384)	(293,384)	(51,148)	(344,532)
Total loss of the year		118,006	(32,982)	(293,384)	(208,360)	(7,161)	(215,521)
Depreciation transferred ..		(1,738)		1,738	0		0
Dividends paid				(7,831)	(7,831)		(7,831)
Equity at 31 December 2008	586,512	116,268	(33,670)	686,384	1,355,494	21,298	1,376,792
Changes in equity year 2009							
Equity at January 1 2009 ..	586,512	116,268	(33,670)	686,384	1,355,494	21,298	1,376,792
Translation difference			(1,033)		(1,033)	(794)	(1,827)
Change in tax ratio		(2,276)			(2,276)	(1,198)	(3,474)
Profit of the year				188,801	188,801	4,195	192,996
Total profit of the year		(2,276)	(1,033)	188,801	185,492	2,203	187,695
Depreciation transferred ..		(3,436)		3,436	0		0
Equity at 31 December 2009	586,512	110,556	(34,702)	878,621	1,540,987	23,500	1,564,487

Notes 1 to 60 are an integral part of these financial statements.

Statement of Cash Flows for 2009

	2009	2008
Operating activities		
Cash received from customers	311,182	455,977
Cash expenses	(68,249)	(112,499)
From operation excluding interest	242,933	343,478
Interest income received	4,632	17,049
Interest expenses and foreign exchange difference paid	(95,884)	(115,800)
Hedge disbursements	45,342	(60,377)
Cash flow from operating activities	197,023	184,350
Investing activities		
Karahnjukar project - hydropower station	(30,236)	(189,457)
Transmission	(21,303)	(12,084)
Development costs	(14,997)	(55,134)
Purchased shares	(1,791)	(11,334)
Sold shares	68	0
Other capital expenditure	(13,377)	(15,220)
Assets sold	94	8,119
Unpaid construction cost, change	(14,075)	(70,646)
	(95,617)	(345,756)
Other receivables, change	(24,916)	(29,041)
Investing activities	(120,533)	(374,797)
Financing activities		
Cash dividends	0	(7,831)
New loans	195,698	449,882
Currency swaps	4,818	54,425
Amortization of long-term debt	(205,088)	(288,535)
Short term loans, change	0	(39,355)
Financing activities	(4,572)	168,586
<i>Increase (decrease) in cash</i>	71,918	(21,861)
<i>Effect of exchange difference on cash and cash equivalents</i>	(2,663)	(32,724)
<i>Cash and cash equivalents at the beginning of the year</i>	124,993	179,578
<i>Cash and cash equivalents at end of year</i>	194,248	124,993
Financing and investing activities not affecting cash flow:		
Assets available for sale	0	(12,560)
Finance lease agreements	0	12,560

Notes 1 to 60 are an integral part of these financial statements.

Amounts are in USD thousand

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7. Net income (exp.) on financial assets/liabilities	34	37. Subsidiaries	45
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Notes

Reporting entity

1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavík. Landsvirkjun operates on the basis of the Act on Landsvirkjun no. 42/1983. The Company's main objective is to engage in operations in the energy sector. The financial statements include the consolidated financial statements of the Company and its subsidiaries.

2. Basis of preparation

Significant accounting policies used in the preparation of these financial statements are identified below.

a. *Statement of compliance*

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

The Company's Board of Directors approved the presentation of the financial statements on 19 March 2010.

b. *Basis of measurement*

The financial statements have been prepared on the historical cost basis except for the following assets and liabilities, which have been measured at fair value: derivative financial instruments, long term receivables, transmission, telecommunications system, trading financial assets and liabilities and shares in other companies.

Fixed operating assets of the subsidiaries, Landsnet hf. and Fjarski ehf., were revalued in the year 2008.

Fixed assets and asset groups available for sale are recognised at the lower of the book value and the net fair value.

c. *Presentation and functional currency*

The financial statements are presented in USD, which is the parent Company's functional currency. All financial information presented in USD has been rounded to the nearest thousand, unless otherwise stated.

d. *Use of estimates and judgements*

The preparation of financial statements in conformity with the IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised and the effect of the changes are entered in the periods that the changes are made and in subsequent periods if the change also affects those periods.

Information on management's estimates and decisions made in relation to the application of accounting methods that significantly affect the financial statements are presented in the following notes:

- note 31 property, plant and equipment
- note 32 intangible assets
- note 34 derivative financial instruments
- note 46 pension fund obligation
- note 52 aluminium price risk

Significant accounting methods

Accounting policies set out below have been consistently applied to all periods presented in these financial statements, and to all companies within the group.

3. Basis of consolidation

a. Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Financial statements of subsidiaries have been taken into account. When the Company's share of losses exceeds its interest in a subsidiary, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the subsidiary. In case of a profit on the operation of a subsidiary in a subsequent period, a share in their profit is not recognised until a share in a loss has been fully set off.

b. Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Company's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

c. Subsidiaries with other functional currency

Assets and liabilities of a subsidiary with other functional currency than the parent company are translated to USD at the exchange rate ruling at the accounting date. Income and expenses of that operation are translated to USD at the average exchange rate of the period. The exchange rate difference arising from the translation is entered as a specific item under equity. Amounts in the statement of cash flows are translated to USD at the average exchange rate of the period. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of cash flows.

4. Associated companies

Associated companies are those companies in which the Company has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity, including any other possible voting power.

The financial statements include the Group's share in the income and expenses of associated companies according to the method of association, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds the book value of an associated company the book value is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the associated company. If in subsequent periods there is a profit on the operation of associated companies, the share in the profit is not recognised until previous share in losses has been balanced.

5. Operating revenues

Revenues from sales and transmission of electricity consists of sales supplied to power intensive industries and public utilities based on delivery during the period. Other service income is also recognised when earned or upon delivery.

6. Interest income and expenses

Interest income and expenses are recognised in the income statement as they accrue using the effective interest method. Interest income and expenses include bank rates, premium, realised interest rate swaps and other difference arising on initial book value of financial instruments and amounts on the date of maturity using the effective interest method.

Effective interest is the imputed rate of interest used in determining the current value of estimated cash flow over the estimated useful life of a financial instrument or a shorter period if applicable, so that it equals the book value of the financial asset or liability in the balance sheet. When calculating effective interest rate the Company estimates cash flow taking into account all contractual aspects of the financial instrument.

7. Net income (expenses) on financial assets and liabilities

Net income (expenses) on financial assets and liabilities include profit and loss on current assets and liabilities and all redeemed and unredeemed fair value changes, dividends and changes in foreign exchange difference. Dividend income is recognised in the income statement when distribution of dividends has been approved.

8. Foreign currency transactions

Transactions in foreign currencies are recognised at the exchange rate ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are recognised at the exchange rate ruling at the end of the period. The foreign currency gain or loss thereon is recognised in the income statement. Non-monetary assets and liabilities measured at cost value in a foreign currency are translated to USD at the exchange rate ruling at the date of the transactions. Tangible assets and liabilities recognised in foreign currencies at fair value are translated to USD at the exchange rate ruling at the date of determination of fair value.

9. Impairment

a. Financial assets

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

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

Impairment loss on financial assets is recognised in the income statement. Accumulated loss on available for sale financial assets, previously recognised among equity, is recognised in the income statement when the impairment loss has been incurred.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised in the statement of comprehensive income.

b. Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Impairment tests are carried out at least once a year on intangible assets with undetermined useful life.

Impairment loss is recognised when the book value of the asset or its cash generating unit exceeds its recoverable amount. A cash generating unit is the smallest distinguishable asset group that generates cash, which is mostly independent from other units or unit groups. Impairment loss is expensed in the income statement and later proportionally as reduction in the book value of other assets pertaining to the unit.

The recoverable amount of non-financial assets or its cash generating unit is the greater of its sales value or its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

10. Income tax

Income tax on the results for the year consists of current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against the asset.

A deferred tax asset is recognised in the financial statements. Its calculation is based on the difference in balance sheet items, according to the tax return, on the one hand, and the consolidated financial statements on the other. The difference thus arising is due to the fact that the tax assessment is based on other premises than the Group's financial statements and is in main respect a temporary difference as expenses are in general entered in the financial statement in an another period than in the tax return.

11. Intangible assets

Intangible assets are recognised at cost value, less impairment loss and amortization.

Expenditure for general research cost is expensed in the period it incurs. Development cost for future power projects is capitalised among fixed assets. The development cost is only capitalised if there is probability of future economic benefit and the Company intends and is able to conclude, use or sell it. The cost is not depreciated at this stage but account is taken for possible impairment loss if a project changes.

Water and geothermal rights are capitalised in the balance sheet at cost value as intangible assets with unlimited useful life.

Other intangible assets are stated at cost less accumulated amortization and impairment loss.

Subsequent cost is only capitalised if it increases the estimated future economic benefit of the asset it relates to. All other cost is expensed in the income statement when incurred.

Depreciation is calculated on a straight line basis, based on the estimated useful lives of intangible assets from the date that they become applicable. Estimated useful life is specified as follows:

Software	25%	4 years
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12. Fixed assets

Fixed assets are initially measured at cost.

The Group's transmission and telecommunication systems are recognised at a revalued cost in the balance sheet, which is their fair value less depreciation from the date of revaluation in 2008. The revaluation of those assets will be carried out on a regular basis. All value increase due to the revaluation is recognised in the revaluation account among equity after income tax effect. Depreciation of the revalued cost is recognised in the income statement. Upon sale or disposal of an asset, the part of the revaluation account pertaining to the asset is transferred to retained earnings.

Other operating assets are capitalised at cost less accumulated depreciation and impairment.

Initial value of fixed assets includes the estimated cost of demolition following their use. Estimated demolition cost of power lines has been measured at discounted value based on the useful life and an obligation in relation thereto has been recognised among long-term liabilities. An increase in the obligation due to the discounted value is expensed through the income statement in addition to depreciation of demolition cost.

Cost value consists of all cost incurred due to the acquisition of the asset. Cost value of fixed assets constructed in own account is the aggregate cost of construction, such as cost of material and salaries in addition to all other cost the Company incurs in making the asset operative.

If single items of fixed assets have different estimated useful lives they are divided in accordance with their different useful lives.

Interest expense on loans used to finance the cost value of projects are capitalised at the time of construction. Interest is not calculated on development cost. After the assets have been taken into use, interest expense is recognised in the income statement.

Depreciation

Depreciation is calculated as a fixed annual percentage based on the estimated useful lives of the operating assets.

Depreciation method, estimated useful life and residual value are reassessed at each accounting date.

Depreciation ratios and useful life are specified as follows:

	<i>Depreciation</i>	<i>Useful life</i>
Power stations:		
Powerhouses and other structures	1.67%	60 years
Machinery	2.5–6.67%	15–40 years
Dams and waterways	1.67–3.33%	30–60 years
Thermal stations	1.67–6.67%	15–60 years
Substations	2.5%–5%	20–40 years
Power lines	2.00%	50 years
Office buildings	2.00%	50 years
Equipment	10–25%	4–10 years
Vehicles	10–20%	5–10 years
Optical fibre	5.00%	20 years
Masts	7.00%	15 years
Telecommunication buildings	6.00%	17 years
Other telecommunication equipment	14–15%	7 years

13. Financial instruments

a. Non-derivative financial instruments

Non-derivative financial instruments consist of investments in shares and bonds, accounts receivable, other receivables, cash and cash equivalents, borrowings, accounts payable and other short-term liabilities.

Non-derivative financial instruments are recognised at fair value at initial recognition. In case of financial instruments, not measured at fair value through income statement, all direct transaction cost is entered as increase in the fair value at their initial recognition, with the exceptions described here below. Following an initial registration non-derivative financial instruments are recognised as follows.

Financial instruments are entered in the consolidated financial statements when the Company becomes a part of contractual provisions of the relevant financial instrument. Financial assets are derecognized if the Company's contractual right to cash flow due to the asset expires or the Company transfers the assets to another party without holding back control or almost all the risk and gain involved in the ownership. Conventional purchase and sale of financial assets are recognised at the transaction date, i.e. the date the Company enters into obligation to purchase or sell the asset. Financial obligations are derecognized from the consolidated financial statements if the obligations of the Company defined in an agreement are paid, expire, disallowed or are invalidated.

Cash and cash equivalents consist of cash, short term market securities and demand deposits.

Note no. 6 includes information on accounting methods used for financial income and expenses.

Financial assets and liabilities at fair value through income statement

A financial instrument is recognised at fair value and fair value changes through income statement in case of current financial assets or if it is, at initial registration, determined as financial instrument at fair value through income statement. A financial instrument is denominated at fair value through income statement if the Company manages such investments and decisions of purchase and sale are based on their fair value. Financial assets and liabilities at fair value through income statement are recognised at fair value in the balance sheet and fair value changes are recognised in the income statement. Direct transaction cost is entered in the income statement as it incurs.

Other financial instruments

Other non-derivative financial instruments are recognised at amortised cost value using the effective interest method, less impairment loss, if any.

Off-setting of financial assets and liabilities

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when the legal right exists on off-setting and the Company intends to account for financial assets and liabilities by off-setting.

b. Derivative financial instruments

The Company enters into derivative financial instruments to hedge its foreign currency, interest rate and aluminum price risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related and another instruments with the same provisions as the embedded derivative would be defined as derivative and the hybrid contract is not stated at fair value in the income statement.

Derivative financial instruments are recognised initially at fair value. Attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in the income statement as part of net income (expenses) on financial assets and liabilities.

Separable embedded derivatives

Fair value changes of embedded derivatives separable from the host contract are recognised when the fair value change takes place, see notes on risk management.

14. Fair value measurement

Some of the Company's accounting standards and notes require that the fair value be measured, both for financial assets and liabilities and other assets and liabilities. The fair value has been determined due to assessments and/or notes according to the following methods. Where applicable, further information is made available on methods used to find the fair value of assets and liabilities in the note relevant to the asset or the liability in question.

The fair value of financial assets and liabilities listed in an active market is the same as their listed value. Evaluation methods are applied to all other financial instruments in calculating their fair value. A financial asset or liability is considered to be listed on an active market if the official price can be obtained from a stock exchange or another independent party and the price reflects real and regular market transactions between unrelated parties.

Evaluation methods can involve the use of recent transaction prices between unrelated parties. The methods take note of the value of other financial instruments similar to the instrument in question, and methods are used to determine the discounted cash flow or other evaluation methods that can be applied in order to measure in a reliable way the real market value. When applying evaluation methods all factors that market parties would use in price assessment are used and the methods are in accordance with generally accepted methods for rating financing instruments. The Company verifies its evaluation methods on an ongoing basis and tests them by using prices obtained from transactions in an active market with the same instrument, without adjustments or changes, or based on information from an active market.

The most reliable verification of the initial fair value of derivative financial instruments is the purchase value, unless the fair value of the instrument can be verified by comparison with other recent listed market transactions with the same instrument, or based on an evaluation method where variables are exclusively based on market data. When such market data can be obtained the Company recognises profit and loss at the initial recognition date of the instruments.

15. Fixed assets

Fair value of revalued property, plant and equipment has been determined on the basis of the discounted cash flow of the asset in question.

16. Inventories

Inventories are stated at the lower of the cost value or the net sales value. Cost value of inventories is based on "the First In First Out method" and includes cost incurred upon the purchase of the inventories and in bringing them to the sales location and in a saleable state.

17. Cash and cash equivalents

Cash and cash equivalents consist of cash, short term market securities and demand deposits.

18. Equity

The Group's equity is divided into owners' contribution, revaluation account, translation difference, other equity and minority interest. The parent company's initial capital amounts to USD 587 million.

19. Employees' benefits

a. Defined contribution plan

Cost due to contribution to defined benefit plans is expensed in the income statement when incurred.

b. Defined benefit plan

The Company's obligation due to defined benefit plans is calculated by estimating the future value of defined pension benefits accrued by current and former employees in current or previous periods. The benefits are discounted in order to determine their present value. An actuary has calculated the obligation on the basis of a method, which is based on accrued benefits. Changes in the obligation are recognised in the income statement when incurred.

20. Obligations

Obligations are recognised when the Company has entered into obligations due to past events, it is likely that they will be settled and they can be reliably measured. The obligation can be assessed on the basis of estimated cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

21. Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (operating segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and returns that are different from those of other segments. The Group's main segment is based on operating segments. Geographical segments are not disclosed as almost the entire operation of the group is carried out in Iceland.

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

Segment operating results, assets and liabilities consist of items that can be directly linked to each segment, in addition to the items that can be reasonably divided into segments. Items not classified with single segments are mainly investments and related income, borrowings and related cost, collective assets and related cost, in addition to deferred income tax.

22. Reporting standards

The Group applies revised IAS 1 Presentation of Financial Statements (2007), which became effective as of 1 January 2009. As a result, the Group presents in the consolidated statement an income statement and a statement of comprehensive income. Comparative figures have been changed accordingly. The change only affects the presentation of the financial statements.

The Group applies IFRS 8 Operating segments, which became effective as of 1 January 2009. The Group's operating segments are presented in accordance with information used by management in its evaluation thereof and they have changed from the previous year.

The Group has adopted International Financial Reporting Standards, amendments thereto and interpretations confirmed by the EU at year end 2009 and that apply to its operation. The Group has not adopted standards, amendments to standards or interpretations entering into effect after year end 2009, which may be adopted earlier. The effect thereof on the Group's financial statements have not been fully determined but are considered to be insubstantial.

23. Management's evaluation and assumption in relation to the application of accounting methods

The Group's management makes judgements, estimates and assumptions that may affect items in the Group's balance sheet for the next period. The management reevaluates on an ongoing basis its judgements and estimates based on previous experience and other relevant factors, such as estimated future events when decisions on judgements and estimates are made.

Fair value of derivative agreements

The fair value of derivative agreements not listed in effective markets is determined by using evaluation methods, which are reviewed on an ongoing basis by qualified independent employees. All evaluation models used must be approved and tested in order to ensure that the results reflect the documents used. Management's evaluation pertains mainly to embedded derivatives. Further information on the evaluation of derivative agreements is included in note 52.

24. Statement of segments

Segment information is presented by sectors. The primary segment statement is presented according to the nature of the operation and is based on the Group's organisation and internal disclosure.

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

Segment operating income includes the segments pertaining directly to specific segments and the items that can be logically divided between the segments. Assets and liabilities of the Group are in the same manner divided between segments based on the beforementioned premises.

Landsvirkjun Group's operating segments are specified as follows:

Electricity production

The operation of the parent company falls under the segment electricity production but Landsvirkjun's objectives according to law is to operate in the energy sector and operate other business and financial operations according to the decision of the Board of Directors at each time. Landsvirkjun's electricity production is based on hydroelectric- and geothermal power. Landsvirkjun sells all its electricity production to retail consumers and in great quantity to industrial users. Furthermore, the operation of Icelandic Power Insurance Ltd. falls under this segments but the purpose of the company is to take care of insurances of Landsvirkjun's power stations.

Electricity transmission

The operation of Landsnet hf. falls under the segment electricity transmission, but the company was established in August 2004 on the basis of the Energy Act approved by the Parliament in spring 2003. The purpose of Landsnet hf. is to operate electricity transmission and system management in Iceland according to provisions of Chapter III of the Energy Act no. 65/2003 and may thus not carry on other operation than that is necessary in order to carry out its obligations according to the Energy Act.

Other segments

Other segments include the operation of the companies Fjarski ehf. and Landsvirkjun Power ehf. together with Landsvirkjun Power ehf.'s subsidiaries. The purpose of Fjarski ehf. is to own and operate a telecommunications system throughout the country and to rent access thereto in addition to other related operation. Landsvirkjun Power ehf. takes care of sale of technical and operational advisory services to third parties and manages general research work, harnessing researches and projects for Landsvirkjun and related companies.

Almost all the operation of the Group is based in Iceland.

	<i>Electricity production</i>	<i>Electricity transmission</i>	<i>Other segments</i>	<i>Adjustments</i>	<i>Total</i>
Operating segments year 2009					
Income from third party	252,831	44,382	2,575		299,788
Income within the Group	15,767	63,183	6,752	(85,702)	0
Segment income	268,598	107,565	9,327	(85,702)	299,788
Segment operating expenses	(116,342)	(32,067)	(7,948)	85,702	(70,655)
EBITDA	152,256	75,498	1,379		229,133
Depreciation and impairment loss	(94,617)	(19,258)	(799)	353	(114,321)
Segment earnings, EBIT	57,639	56,240	580	353	114,812
Segment assets 2009	4,664,694	585,451	13,815	(462,805)	4,801,155
Shares in associated companies	1,553	401	413		2,367
Total assets 2009	4,666,247	585,852	14,228	(462,805)	4,803,522
Segment liabilities 2009	3,102,368	519,223	4,888	(387,444)	3,239,035
Total liabilities 2009	3,102,368	519,223	4,888	(387,444)	3,239,035
Investments	66,970	27,447	657	(1,085)	93,989
Operating segments year 2008					
Income from third party	395,993	53,483	2,551		452,027
Income within the Group	17,153	69,745	8,668	(95,566)	0
Segment income	413,146	123,228	11,219	(95,566)	452,027
Segment operating expenses	(144,041)	(42,002)	(10,035)	95,566	(100,512)
EBITDA	269,105	81,226	1,184		351,515
Depreciation and impairment loss	(82,576)	(22,563)	(704)	311	(105,532)
Segment earnings, EBIT	186,529	58,663	480	311	245,983
Segment assets 2008	4,509,047	571,818	13,495	(488,482)	4,605,878
Shares in associated companies	12,270	400	672		13,342
Total assets 2008	4,521,317	572,218	14,167	(488,482)	4,619,220
Segment liabilities 2008	3,144,622	512,032	5,416	(419,642)	3,242,428
Total liabilities 2008	3,144,622	512,032	5,416	(419,642)	3,242,428
Investments	311,948	30,129	1,994	(1,530)	342,541

Amounts are in USD thousand

25. Other income

Other income is specified as follows:

	2009	2008
Service sale, rent and other income	3,967	10,391

26. Salaries and salary related expenses

Total number of employees is specified as follows:

Average number of employees during the year full-time equivalents	376	357
Full-time equivalent units at year-end	318	317

27. Total salaries of employees are specified as follows:

Salaries	23,206	32,775
Pension premium payments	2,756	3,736
Defined pension benefit payments	1,192	1,662
Increase in pension obligation	603	3,876
Other salary related expenses	3,103	2,623
	30,860	44,672

Salaries are divided as follows in the income statement:

Energy production costs	11,386	14,490
Transmission costs	8,210	11,276
Cost of general research	0	201
Other operating expenses	11,264	18,705
	30,860	44,672

Fridrik Sophusson resigned as the Managing Director (CEO) of the Company in October 2009 and Hordur Arnarson was appointed as Managing Director (CEO).

Salary of the Board of Directors, Managing Director, Deputy and Executive Directors are specified as follows:

Salaries of the Board of Directors of the parent company	76	115
Salaries of Boards of Directors of three subsidiaries	92	131
Salaries and benefits of the CEO of the parent company, Fridrik Sophusson	215	244
Salaries and benefits of the CEO of the parent company, Hordur Arnarson	32	0
Salaries of the Deputy CEO and Directors of the parent company	676	950
Salaries and benefits of the CEO and Directors of subsidiaries	907	1,070

28. Other operating expenses

Other operating expenses are specified as follows:

Corporate office	2,902	3,627
Finance	2,953	4,051
Human resources	921	1,171
Information technology	2,167	2,903
Engineering and construction	296	516
Pension	1,625	5,255
Other shared cost	2,060	2,284
	12,924	19,807
Other cost - relating to subsidiaries	11,020	13,978
Assets available for sale, impairment	2,595	4,148
Depreciation	2,992	2,893
	29,531	40,826

Auditors' fees are specified as follows:

Auditing of financial statements	220	266
Reviewing of interim financial statements	53	100
Other services	70	58
	343	424

29. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

	2009	2008
Interest income	5,907	15,390
Interest expenses	(85,260)	(178,060)
Guarantee fee paid to owners	(7,233)	(6,970)
Capitalised interest costs	0	7,288
Total interest expenses	(92,493)	(177,742)
Exchange rate difference	(48,834)	(128,612)
Fair value changes of derivatives	(53,655)	186,284
Fair value changes of shares	(438)	(13)
Sales profit on shares	4	156
Net income (expenses) on financial assets and liabilities	(102,923)	57,815
Fair value changes of embedded derivatives	253,304	(497,167)
Aluminium hedges, income(expenses)	42,526	(54,759)
Effects through associated companies	(11,193)	(4,100)
Financial income and (expenses)	95,128	(660,563)

30. Income tax

Income tax is specified as follows:

Change in income tax asset	(20,937)	26,860
Current tax	(101)	(361)
Liability due to revaluation recognised in equity	3,518	30,751
Foreign exchange difference	575	12,694
Other items	0	105
Recognised as income (expense) in the income statement	(16,944)	70,048

Change in income tax asset is specified as follows:

Change in temporary difference	(58,378)	14,483
Effect of changed income tax ratio	32,148	(10,345)
Carry forward loss utilised	5,868	35,416
Foreign exchange difference	(575)	(12,694)
Change in deferred tax asset	(20,937)	26,860

Effective tax rate

	2009	2008
Profit (loss) for the year	192,996	(344,532)
Income tax for the year	16,944	(70,048)
Profit (loss) before income tax	209,940	(414,580)
Income tax acc. to the parent company's current tax rate	23.5% 49,336	23.5% (97,426)
Effect of different tax rates within the Group	-0.5% (1,008)	-3.5% 14,435
Effect of change in tax rate	-17.0% (35,659)	-2.5% 10,345
Non-deductible cost	0.1% 154	-0.7% 3,074
Other items	2.0% 4,121	0.1% (476)
Effective income tax	8.1% 16,944	16.9% (70,048)

31. Property, plant and equipment

Property, plant and equipment, their initial value and depreciation is specified as follows:

<i>Cost value</i>	<i>Power stations</i>	<i>Transmission</i>	<i>Communicat. equipment</i>	<i>Other assets</i>	<i>Total</i>
Total value at 1.1.2008	4,413,840	686,724	12,734	77,057	5,190,355
Effect of exchange rate changes	0	(406,714)	(6,546)	(19,411)	(432,671)
Additions during the year	143,159	10,484	1,210	5,771	160,624
Revaluation of fixed assets	0	230,338	2,715	0	233,053
Assets from construction	264,421	0	0	0	264,421
Sold and disposed of	0	0	0	(607)	(607)
Total value at 31.12.2008	4,821,420	520,832	10,112	62,810	5,415,174
Effect of exchange rate changes	0	(17,024)	(332)	(765)	(18,121)
Additions during the year	39,237	3,413	530	11,338	54,518
Assets from construction	0	17,644	0	0	17,644
Moved to assets available for sale	0	0	0	(3,424)	(3,424)
Sold and disposed of	(32,822)	0	0	(1,031)	(33,853)
Total value at 31.12.2009	4,827,835	524,865	10,310	68,928	5,431,938
<i>Depreciation</i>					
Total value at 1.1.2008	1,477,090	34,474	5,579	21,550	1,538,693
Depreciation of the year	77,697	19,422	700	2,780	100,599
Revaluation of depreciation	0	20,054	0	0	20,054
Effect of exchange rate changes	0	(27,921)	(2,923)	(1,935)	(32,778)
Sold and disposed of	0	0	0	(524)	(524)
Total value at 31.12.2008	1,554,787	46,030	3,357	21,871	1,626,044
Depreciation of the year	83,796	16,886	779	2,587	104,048
Effect of exchange rate changes	0	(1,664)	(116)	(97)	(1,877)
Sold and disposed of	(32,822)	0	0	(957)	(33,779)
Total value at 31.12.2009	1,605,761	61,252	4,020	23,404	1,694,436
<i>Book value</i>					
1.1.2008	2,936,750	652,250	7,155	55,507	3,651,660
31.12.2008 og 1.1.2009	3,266,633	474,802	6,756	40,939	3,789,129
31.12.2009	3,222,074	463,614	6,291	45,524	3,737,504

Official assessment of fixed assets and insurance value

The official assessment of the Company's real estates amounted to USD 268 million at year end 2009. Insurance value of the Company's assets amounts to USD 3,607 million.

32. Intangible assets are specified as follows:

<i>Cost value</i>	<i>Capitalised development cost</i>	<i>Water and geothermal rights</i>	<i>Software</i>	<i>Total</i>
Total value at 1.1.2008	93,760	40,568	5,691	140,019
Effect of foreign exchange rate changes	(6,599)	0	(1,650)	(8,249)
Additions during the year	55,134	0	1,685	56,819
Total value at 31.12.2008	142,295	40,568	5,726	188,589
Effect of foreign exchange rate changes	(379)	0	(95)	(474)
Additions during the year	22,277	0	829	23,105
Sold and disposed of	0	0	(432)	(432)
Moved to assets in construction/ in operation	(8,939)	0	0	(8,939)
Total value at 31.12.2009	155,254	40,568	6,028	201,850

	Capitalised development cost	Water and geothermal rights	Software	Total
Amortization and impairment loss				
Total value at 1.1.2008	43,515	0	2,389	45,904
Amortization during the year	0	0	824	824
Impairment loss during the year	4,108	0	0	4,108
Effect of foreign exchange rate changes	(10)	0	(315)	(325)
Total value at 31.12.2008	47,613	0	2,898	50,511
Amortization during the year	0	0	897	897
Impairment loss during the year	9,375	0	0	9,375
Sold and disposed of	0	0	(432)	(432)
Effect of foreign exchange rate changes	(4)	0	(22)	(26)
Total value at 31.12.2009	56,984	0	3,341	60,325
Book value				
1.1.2008	50,245	40,568	3,302	94,113
31.12.2008 og 1.1.2009	94,682	40,568	2,828	138,077
31.12.2009	98,270	40,568	2,687	141,523

33. The Group's depreciation and impairment is specified as follows:

	2009	2008
Power stations	83,796	77,697
Transmission	16,886	19,422
Telecommunication equipment	779	700
Other assets	2,587	2,780
Depreciation of assets in operation	104,048	100,600
Impairment loss on development cost	9,375	4,108
Amortization of software	897	824
	114,321	105,532

The Group's depreciation and impairment is divided as follows by sectors:

Energy production costs	84,386	78,258
Transmission costs	17,569	20,273
Cost of general research	9,375	4,108
Other operating expenses	2,991	2,893
	114,321	105,532

34. Derivative financial instruments in the balance sheet are specified as follows:

Assets:

Embedded derivatives in electricity sales agreements	446,569	195,944
Aluminium hedges	36,050	98,032
Currency swaps	3,335	11,035
Interest rate swaps	1,911	0
Other derivatives	1,503	0
	489,368	305,011

Derivative financial instruments are divided as follows:

Long-term component of derivative agreements	431,822	287,513
Short-term component of derivative agreements	57,546	17,498
	489,368	305,011

Liabilities:

Embedded derivatives in electricity sales agreements	23,562	26,242
Aluminium hedges	31,157	0
Currency swaps	53,118	63,396
Interest rate swaps	12,379	10,754
Other derivatives	8,943	45,176
	129,159	145,568

Derivative financial instruments are divided as follows:

Long-term component of derivatives	96,113	123,971
Short-term component of derivatives	33,046	21,597
	<u>129,159</u>	<u>145,568</u>

35. Shares in associated companies recognised according to the equity method within the Group are specified as follows:

2009

	Share	Share in return	Book value
Eignarhaldsfelagid Farice ehf.	29.5%	(6,175)	0
Theistareykir ehf.	32.0%	(382)	1,524
Netorka hf.	40.8%	74	430
Hecla SAS	29.4%	198	413
Sipenco GmbH	29.6%	(25)	0
		<u>(6,310)</u>	<u>2,367</u>

In addition, the Company's holding in Eignarhaldsfelagid Farice ehf. has been written down by USD 4.9 million due to impairment losses in relation to the financial restructuring of Eignarhaldsfelagid Farice ehf. Landsvirkjun entered into an agreement on the acquisition of Nordurorka ehf.'s 32% in Theistareykir ehf. at year end 2009 subject to certain conditions and the agreement has therefore not been recognised in the financial statements, see note 59.

2008

	Share	Share in return	Book value
Eignarhaldsfelagid Farice ehf.	29.5%	(1,668)	10,986
Theistareykir ehf.	32.0%	(2,074)	1,251
Netorka hf.	40.8%	83	436
Hecla SAS	30.0%	81	209
Sipenco GmbH	25.0%	(38)	0
Isturk	30.0%	(44)	0
HydroKraft Invest hf.	50.0%	(440)	460
		<u>(4,100)</u>	<u>13,342</u>

36. Shares in other companies are specified as follows:

	2009		2008	
	Share	Book value	Share	Book value
Neydarlinan hf.	7.9%	400	7.9%	414
Orkuvordur ehf.	11.1%	240	9.0%	165
DMM Lausnir ehf.	17.8%	286	17.8%	295
Vistorka hf.	12.0%	283	13.2%	292
Other companies (6/4)		<u>645</u>		<u>162</u>
Total shares in other companies		1,854		1,328
Fair value changes of shares		<u>(1,606)</u>		<u>(1,201)</u>
		<u>248</u>		<u>127</u>

Shareholding has been decreased by the impairment loss, or by USD 1.6 million, due to an uncertainty on the future standing of individual companies, but some of the companies are established around high-risk innovative projects.

37. Landsvirkjun's subsidiaries are specified as follows:

	2009	2008
	Share	Share
Fjarski ehf.	100.0%	100.0%
Hraunaveita ehf.	100.0%	100.0%
Icelandic Power Insurance Ltd.	100.0%	100.0%
Landsnet hf.	64.7%	64.7%
Landsvirkjun Power ehf.	100.0%	100.0%

38. Tax asset

In December 2009, the Icelandic Parliament, Althingi, decided to increase the income tax ratio from 23.5% to 32.7% for partnerships and from 15% to 18% for limited liability companies as of 1 January 2010. The change comes into effect in the tax assessment in the year 2011. The effect thereof has been recognised in the financial statements and the increase in deferred tax asset amounts to USD 32.1 million.

Changes in the tax asset during the year is specified as follows:

	2009	2008
Calculated tax asset at the beginning of the year	133,409	106,797
Calculated income tax	(16,944)	70,048
Current income tax	101	258
Liability due to revaluation of fixed assets transferred to equity	(3,482)	(31,950)
Foreign exchange loss and translation difference due to tax asset	(612)	(11,744)
Deferred tax asset at year-end	112,472	133,409

The Company's deferred tax asset is specified as follows:

Carry forward taxable loss	57,021	50,550
Non-current assets and intangible assets	176,262	140,516
Derivative financial instruments	(137,447)	(52,423)
Other items	17,547	7,460
Translation difference due to tax asset	(910)	(12,694)
Deferred tax asset at year-end	112,472	133,409

The Group's carry forward losses may be utilised for 10 years from when it is incurred.

Carry forward loss of the year 2006, usable until the year 2016	44,952	46,490
Carry forward loss of the year 2007, usable until the year 2017	0	7,528
Carry forward loss of the year 2008, usable until the year 2018	136,059	156,962
Carry forward loss of the year 2009, usable until the year 2019	40,191	0
Carry forward loss at year end	221,202	210,980

Deferred tax asset is calculated on all carry forward loss where it is considered likely that it will be utilised against future taxable profit.

Carry forward loss is recognised in Icelandic krona and therefore the exchange rate of the USD affects carry forward loss at each year end.

39. Inventories

Inventories are specified as follows:

Oil	290	294
Spareparts and consumables	3,869	3,975
	4,159	4,269

40. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:

Accounts receivables	44,542	52,949
Other short term receivables	54,742	37,013
Assets available for sale	9,574	8,412
	108,858	98,374

At year-end 2009, 97% of accounts receivables were under 30 days old.

41. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

Bank deposits	194,248	113,940
Market securities	0	11,053
	194,248	124,993

42. Equity

The parent company is a partnership owned by the State and Eignarhlutir ehf. The State owns a 99.9% share in the Company and Eignarhlutir ehf. holds 0.1%. The Company is an independent taxable entity. The Group's equity ratio at year end 2009 was 32.6% but was 29.8% at year end 2008.

43. The revaluation account consists of revaluation of fixed assets of subsidiaries after income tax effect. Translation difference is the foreign exchange difference arising due to Landsvirkjun's subsidiaries with other functional currencies.

44. Liabilities

Long-term debt is specified as follows by currencies: .

	2009			2008	
	Maturity date	Average interests	Remaining balance	Average interests	Remaining balance
Liabilities in ISK, indexed	2009-2034	4.0%	438,023	3.9%	333,592
Liabilities in ISK, unindexed	2009		0	6.8%	3,902
Liabilities in CHF	2012-2022	1.5%	96,233	2.5%	93,487
Liabilities in EUR	2009-2028	1.8%	1,465,843	2.7%	1,431,944
Liabilities in GBP	2014-2016	11.4%	15,270	11.4%	13,433
Liabilities in JPY	2009-2013	1.0%	85,052	1.1%	175,483
Liabilities in USD	2009-2026	1.7%	917,699	2.2%	923,428
			3,018,120		2,975,269
Current maturities of long-term debt			(267,197)		(186,008)
Total long-term debt			2,750,923		2,789,261

Interest terms on the parent company's loans are from 0.7-14.5%. Nominal interests for the period were on average approximately 2.46% compared to approximately 4.51% the previous year.

The city of Reykjavik and the town of Akureyri provide together with the State a guarantee of collection for all obligations of Landsvirkjun, entered into before the end of year 2006. From the beginning of year 2007 the State and Eignarhlutir ehf. provide such a guarantee for all of Landsvirkjun's obligations entered into after that date.

45. According to loan agreements, current maturities of long-term debt are as follows:	2009	2008
2009	-	186,008
2010	267,197	197,618
2011	293,232	285,758
2012	235,317	197,725
2013	156,492	146,759
2014	167,137	-
Later	1,898,745	1,961,401
	3,018,120	2,975,269

46. Pension fund obligation

The Company's obligation to refund the indexation charges on retirement payments to current and former employees, which hold pension rights with state and communal pension funds amounted to USD 22 million at year end 2009 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest in excess of price increase are assessed at 3.5% and salary increase in excess of price increase is assessed at 1.5% per year on average. Premises on life expectancy and death rate are in accordance with provisions of Regulation no 391/1998 on obligatory pension benefits and operation of pension funds. The retirement age is 68 years for current employees and 65 years for non-employees with vested benefits and this is consistent with the relevant pension funds' regulation.

Change in the obligation is specified as follows:	2009	2008
Balance at 1.1.	22,118	38,153
Expensed during the period	1,624	5,255
Payments during the period	(1,022)	(1,379)
Effect of foreign exchange rate differences	(742)	(19,911)
Balance at 31.12.	21,978	22,118

Pension fund obligation, 5 year statement:	2009	2008	2007	2006	2005
Present value of the obligation	21,978	22,118	38,153	35,168	31,419

47. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:	2009	2008
Balance at 1.1.	3,936	7,212
Expensed during the period	497	324
Increase in obligation	366	0
Effect of foreign exchange rate differences	(136)	(3,601)
Balance at 31.12.	4,663	3,936

In accordance with IFRS, the initial value of fixed operating assets shall include estimated cost of their demolition after their use. Estimated demolition cost of power lines has been assessed and discounted on the basis of the useful life. In return, an obligation has been written up among long-term liabilities. An increase in the obligation is expensed in the income statement amounting to the discounted value in addition to depreciation of the demolition cost.

48. Accounts payable and other payables

Accounts payable and other payables are specified as follows:

Accounts payable	28,033	41,095
Accrued interest	21,041	35,874
Other short term liabilities	16,042	18,567
	65,115	95,537

49. Related parties

Definition of related parties

Associated companies and key management are among the Company's related parties.

Transactions with related parties

Sale of goods and services

Associated companies	40	596
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Cost

Associated companies	27	41
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Interest income

Associated companies	1,358	676
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Accounts receivables and other receivables

Associated companies	23,580	21,928
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Accounts payable and other payables

Associated companies	2	9
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Receivables from an associated company is mainly due to a loan to Eignarhaldsfelagid Farice ehf.

50. Risk management

The Company's Board of Directors has approved a risk management policy, which is based on the following factors:

- That risk is defined and its origin is known
- That generally accepted methods are used in evaluating the risk
- That effective management is applied in accordance with authorisations
- That effective monitoring on risk factors is ensured
- That information provided to the risk committee and the Board of Directors is accurate and provided on a regular basis

Landsvirkjun's risk management strategy defines a benchmark in each risk category with respect to hedging limits. The Company's Board of Directors receives on an ongoing basis an overview of the Company's risk position and results of risk management.

Decisions and the supervision of how hedging is implemented are entrusted to a risk management committee. The risk management committee consists of the Managing Director, his deputy and the Financial Director. The Managing Director is the chairman of the risk management committee. The Head of Risk Management is responsible for risk management on a daily basis.

The objectives of risk management are to analyse, manage and monitor Landsvirkjun's risks in order to stabilise operating return by reducing operating fluctuations due to exchange rate, interest rate and aluminium price changes. Financial risk is divided into market risk, liquidity risk and counterparty risk.

The Company's market risk consists mainly of three risk categories:

- Risk due to fluctuations in world market price of aluminium
- Interest rate risk due to the Company's liabilities
- Foreign exchange risk due to liabilities and income in foreign currencies

51. Market condition in 2009

Landsvirkjun's access to new hedges this year was limited due to the international financial crisis and the situation in Iceland. The Company's risk exposure due to changes in aluminium price, interest and foreign currency rates is though within reasonable limits as the Company has hedges from previous years. Cash position is strong and capital expenditure is at minimum level.

Risk management has had to adapt to changed environment and hedging activities have changed accordingly. Emphasis is placed on reducing liquidity risk in relation to derivative agreements, contractual terms have changed and use of options increased.

Derivative agreements with Rating Triggers were closed in the years 2008 and 2009. ISDA agreements have been renewed without such provisions and equality has been maintained towards Landsvirkjun's counterparties.

52. Aluminium price risk

The Company is exposed to substantial risk due to possible future aluminium price fluctuations. The Company has thus entered into derivative agreements in order to secure its income base and reduce fluctuations. Such agreements consist in most cases of fixing aluminium price at a certain level. The Company therefore loses income if aluminium price increases considerably, but at the same time guarantees better cash flow should the price of aluminium decrease in the markets. Risk management may hedge up to 100% of aluminium price risk for next year and proportionally less over the next 10 years but is not limited by minimum hedges. Part of the aforesaid derivative agreements was realised with profit in the year 2009. The Company aims at increasing hedges next year in order to reduce risk due to possible aluminium price changes as the Company's hedges from the year 2011 and onwards are limited. At the end of December, fair value of the hedges in question was positive by USD 5 million but the agreements are effective over the next five years.

The accompanying tables show the changes in the fair value of aluminium hedges due to changes in aluminium price and/or interest rates, but the effect of volatility is insubstantial. The amounts are in USD thousand before taxes.

2009

		Aluminium Price		
		-10%	0%	10%
Interest rate	-1%	21,766	575	(21,071)
	0%	20,903	0	(21,344)
	1%	20,065	(558)	(21,608)

2008

		Aluminium Price		
		-10%	0%	10%
Interest rate	-1%	27,558	3,058	(22,057)
	0%	23,884	0	(24,483)
	1%	20,355	(2,936)	(26,811)

Embedded derivatives

Landsvirkjun has defined the part of electric power sales and purchase agreements related to aluminium price as embedded derivatives, which are recognised in the Company's financial statements. Embedded derivatives in electric power sales agreements are capitalised in the balance sheet at fair value on the reporting date and in a comparable way electric power purchase agreements are charged. Fair value changes of the agreements during the year are recognised in the Company's income statement among financial income and expenses.

In evaluating the value of embedded derivatives generally accepted evaluation methods are used where market values are not available. Fair value of the agreements is calculated on the basis of the forward price of aluminium, discounted at USD zero-coupon rates allowing for volatility.

The fair value of embedded derivatives is specified as follows:

	2009	2008
Fair value of embedded derivatives at the beginning of the year	169,702	665,158
Foreign exchange rate effect	0	1,712
Fair value changes during the year	253,305	(497,167)
Fair value of embedded derivatives at year end	423,007	169,702

Division of embedded derivatives is specified as follows:

Long term components of embedded derivatives	374,946	183,667
Short term component of embedded derivatives	48,061	(13,965)
Total embedded derivatives	423,007	169,702

The following tables show the change in the fair value of embedded derivatives in the case of changes in aluminium price and/or interest rates, but the effect due to volatility is insubstantial. The amounts are in USD thousand before taxes.

2009		Aluminium Price			2008		Aluminium Price		
		-10%	0%	10%			-10%	0%	10%
Interest rates	-1%	(145,312)	20,728	184,529	Interest rates	-1%	(218,097)	21,031	261,766
	0%	(158,659)	0	156,415		0%	(217,534)	0	219,117
	1%	(171,157)	(19,424)	130,061		1%	(217,161)	(17,944)	182,833

Landsvirkjun has made changes in the assumptions for evaluation of embedded derivatives in the financial statements as of 2009. It is the opinion of Landsvirkjun's management that the assumptions are in accordance with IFRSs and that they reflect Landsvirkjun's precautionary view. The changes are as follows:

The assumptions for take or pay obligations of electric power buyers are implemented and calculations are now based on the minimum purchase of 77% - 85%. Previously the calculations were based on a 100% energy use of buyers over the term of the agreements.

As before, an active market is defined up to 123 months and is based on prices of the LME. However, the management opinion is that aluminium price expectations in ten years will reflect the evaluation of Landsvirkjun's management as when the agreements were made and therefore fair value changes will not arise after active market. Previously, the calculations were based on a flat curve based on the last forward aluminium price throughout the term of the agreements.

The calculations are now limited to the revision time of electric power sales agreements in terms of time. Previously, revision time was limited in all other cases than for Fjardaal, which was limited to the life term of the agreement.

The main reasons for the above mentioned changes are:

Where Landsvirkjun's electric power sale to aluminium factories has not been insured in excess of take or pay it is the Company's view that this shall be taken into account in the evaluation of embedded derivatives.

It is the opinion of Landsvirkjun's management that there is no reason to believe that the aluminium price for a longer time than 123 months is different from the basic assumptions in electric power sale agreements. It is therefore not an actual fair value change after the period of an active market.

The effect of changed assumptions in the fair value of embedded derivatives is specified as follows:

	2009	2008
Fair value of embedded derivatives based on previous assumptions	660,962	169,702
Fair value change due to changed period length	(151,482)	(55,471)
Fair value changes due to assumptions on purchase obligation	(86,473)	(18,577)
Fair value of embedded derivatives based on new assumptions	423,007	95,654
Fair value changes based on previous assumptions ('09: before - '08: before)	491,260	
Fair value changes based on new assumptions ('09: now - '08: now)	327,353	
Fair value changes in the financial statements ('09: now - '08: before)	253,304	

Fair value is recognised in the Company's financial statements according to an evaluation based on new assumptions in the year 2009 but according to previous assumptions in the year 2008.

53. Foreign exchange risk

Foreign currency risk is the risk of loss due to unfavourable changes in foreign exchange rates. Landsvirkjun's foreign exchange risk is due to the payment flow, financial assets and liabilities in addition to all general transactions in other currencies than the functional currency.

The Company's functional currency is the USD and therefore a foreign exchange risk arises from net cash flow and opening balance in the balance sheet in other currencies than the USD. The Company's income flow is mainly in USD. Other income is in ISK and NOK but foreign exchange risk due to those currencies is limited due to netting in the cash flow in ISK and income in NOK is relatively low. Currency risk due to amortization and interest payments in EUR over the next years has been limited with derivative agreements. Risk management has the authority to hedge foreign currency cash flows against the functional currency for up to three years in advance with forward agreements and options.

The Company's reporting risk related to exchange rate changes arises mainly due to its debts in EUR, which are mainly long term loans. There is also limited risk related to the JPY, CHF and GBP due to outstanding loans. The open balance in the loan portfolio against the USD is around 21% of assets which is in excess of the Company's desirable long term balance. The reason for imbalance in the currency composition in the balance sheet is among others due to the closing of swaps in order to ensure liquidity and the Company's limited access to new hedges. The following table shows Landsvirkjun's open balance in other currencies than the functional currency.

The Group's foreign exchange risk is specified as follows in nominal value (USD thousand):

2009

	EUR	ISK	JPY	Other currencies
Accounts receivables and other receivables	30,219	24,135	0	7,228
Cash	7,862	70,369	324	5,377
Derivatives	682,625	159,628	(26,922)	0
Bonds	(1,465,842)	(437,689)	(85,052)	(111,503)
Accounts payable and other payables	(10,401)	(42,408)	(1,627)	(1,951)
Risk in balance sheet	(755,537)	(225,965)	(113,277)	(100,849)

2008

Accounts receivables and other receivables	30,717	20,023	0	2,295
Cash	4,912	36,544	3	409
Derivatives	1,010,550	107,190	(22,931)	(3,864)
Bonds	(1,431,944)	(337,494)	(175,483)	(106,920)
Accounts payable and other payables	(30,802)	(45,269)	(2,859)	(3,993)
Risk in balance sheet	(416,567)	(219,006)	(201,270)	(112,073)

Exchange rate of the main currencies against the USD, (usd/currency) for the years 2009 and 2008 is specified as follows:

	Average rate		Rate at year end	
	2009	2008	2009	2008
EUR	0.72	0.69	0.69	0.71
GBP	0.64	0.55	0.62	0.69
CHF	1.08	1.09	1.03	1.06
JPY	93.31	102.03	92.41	90.22
NOK	6.24	5.71	5.76	6.99
ISK	123.59	88.07	124.90	120.87

Sensitivity analysis

The strengthening of the USD by 10% against the following currencies at December 31, would have increased the Group's profit by the following amounts after 23.5% income tax. The analysis is based on that all variables, especially interest rates, remain unchanged. The analysis was made in the same way for the year 2008.

	Profit after tax		Equity	
	2009	2008	2009	2008
EUR	61,361	95,600	61,361	95,600
ISK	3,711	23,168	3,711	23,004
JPY	8,116	18,000	8,116	18,000

The weakening of the USD by 10% against the aforementioned currencies would have the same effect in the opposite direction, provided that all other variables would remain unchanged.

The fair value of currency swaps was negative by USD 50 million at the end of December 2009. The underlying principal amount is USD 398 million. The fair value of forward currency agreements was positive by USD 1.4 million and the underlying principal amount was USD 90 million. The fair value of forward currency agreements was negative by USD 9 million and the underlying principal amount was approx. USD 371 million.

54. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's liabilities carry both fixed and floating interest rates and interest rate derivatives are used in order to hedge against risk. Interest bearing financial liabilities are higher than interest bearing financial assets and the Company's risk consists therefore of possible increase in interests and increased interest expenses.

At the end of December, the proportion of loans with floating interest rates was 84% compared to 80% at year end 2008. Changes in interest rate by one percent would have led to a change in interest expenses by USD 29 million in the year 2009 (USD 26 million in the year 2008). The Company's financial instruments with fixed interests are not sensitive to interest rate changes. At year end 2009, the estimated market value of the Company's long term liabilities was USD 118 million lower than their book value (USD 149 million lower in the year 2008).

Landsvirkjun has entered into interest rate swaps, which are aimed at fixing interest rates and reducing the Company's risk exposure. The agreements are not denominated as hedges and fair value changes are thus recognised in the income statement. At the end of December 2009 the fair value of interest rate swaps was negative by USD 10 million and the underlying principle amounted to USD 140 million. The following table shows the effect of the interest rate increase and fluctuation in the fair value of the derivatives. The analysis decreases the interest rates only by 0.2% in which case rates will be 0%. The amounts are in USD thousand.

		Interest rates			
		-0.2%	0%	1%	2%
Volatility	-1%	224	1,406	6,182	9,434
	0%	(1,190)	0	4,966	8,477
	1%	(2,549)	(1,364)	3,701	7,440

Interest rate changes in the US have considerable effect on the value of embedded derivatives with Landsvirkjun and the effect is greater as aluminium price increases. Sensitivity analysis of embedded derivatives at year end is included in note 52, which states the effect changes in interest rates and aluminium prices have on embedded derivatives in the Company's electric power agreements.

55. Liquidity risk

Liquidity risk consists of the risk of losses should the Company not be able to keep its obligations at maturity date. In order to limit such risk, the Company's liquidity balance is monitored by analysing the flow of revenues and expenses and the maturity dates of financial assets and liabilities. Effective liquidity management ensures sufficient access to cash at each time. At the end of December 2009, the Company's cash and cash equivalents amounted to USD 194 million and undrawn revolving credit facility was USD 282 million, or in total USD 476 million. Taken into consideration cash flow from operation the Company believes that access to liquid assets is ensured into the year 2012.

In order to further reinforce Landsvirkjun's liquidity balance the Company has signed a contingent credit facility with the Ministry of Finance and the Central Bank of Iceland. The Central Bank has according to the agreement the obligation to provide the Company with foreign currency and Landsvirkjun has to hand over to the bank Icelandic krona or bonds in exchange but though only to the extent that the Company has previously fully tried other financing resources. The amount of the agreement is a maximum of USD 300 million and expires on 1 July 2011.

In order to ensure access to capital and maintain flexible funding possibilities Landsvirkjun has used different loan types. In the past years, financing has mostly taken place through a Euro Medium Term Note Program (EMTN). At year end the balance of loans under the EMTN was USD 1.93 billion but the total amount that the Company can borrow under the program is USD 2.5 billion.

The Company's risk related to refinancing is reduced with an even maturity profile of outstanding loans. Weighted average life of the loan portfolio was 7.5 years at year end and the proportion of loans with maturity within 12 months was 8.9%.

Contractual payments due to financial instruments, including interest rates, are specified as follows:

2009

	<i>Book value</i>	<i>Contractual cash flow</i>	<i>Within one year</i>	<i>1 - 2 years</i>	<i>2 - 5 years</i>	<i>More than 5 years</i>
Non-derivative financial instruments						
Long-term loans	(3,018,120)	(3,615,600)	(305,252)	(332,348)	(682,438)	(2,295,562)
Trade receivables	108,858	108,858	108,858			
Trade payables	(65,115)	(65,115)	(65,115)			
	<u>(2,974,377)</u>	<u>(3,571,857)</u>	<u>(261,509)</u>	<u>(332,348)</u>	<u>(682,438)</u>	<u>(2,295,562)</u>
Derivative financial instruments						
Currency swaps	(58,653)	(82,437)	667	(1,637)	(81,467)	
Interest rate swaps	(10,468)	(21,468)	(4,289)	(3,874)	(8,229)	(5,076)
Forward agreements	1,431	1,660	0	1,660		
Aluminium derivatives	4,893	1,758	(11,590)	2,356	10,993	
Embedded derivatives	423,007	497,417	48,230	49,645	161,721	237,821
	<u>360,210</u>	<u>396,930</u>	<u>33,018</u>	<u>48,150</u>	<u>83,018</u>	<u>232,745</u>

2008

Non-derivative financial instruments

Long-term loans	(2,975,269)	(3,766,341)	(267,387)	(275,446)	(831,726)	(2,391,782)
Trade receivables	98,374	98,374	98,374			
Trade payables	(95,537)	(95,537)	(95,537)			
	<u>(2,972,432)</u>	<u>(3,763,504)</u>	<u>(264,550)</u>	<u>(275,446)</u>	<u>(831,726)</u>	<u>(2,391,782)</u>

Derivative financial instruments

Currency swaps	(97,105)	(64,537)	1,049	(10,635)	(67,596)	12,645
Interest rate swaps	(10,754)	(12,598)	(1,309)	(1,246)	(3,738)	(6,305)
Forward agreements	(432)	(447)	(447)			
Aluminium derivatives	98,032	125,638	18,669	23,712	60,478	22,779
Embedded derivatives	169,702	438,669	(14,061)	(2,233)	75,642	379,321
	<u>159,443</u>	<u>486,725</u>	<u>3,901</u>	<u>9,598</u>	<u>64,786</u>	<u>408,440</u>

56. Counterparty risk

Counterparty risk is the risk that a counterparty to an agreement does not comply with provisions of the agreement. Landsvirkjun's counterparty risk arises first and foremost due to the Company's energy contracts and derivatives entered into for hedging purposes, but such contracts are only entered into with financial companies. Though the amounts involved are considerably high, the risk is limited with the Company's requirements for counterparty quality. Landsvirkjun has set a benchmark for derivatives which involves that no derivative agreements are made with financial companies that have a lower rating than A- from Standard and Poor's or a comparable rating from other recognised credit rating agencies. If credit rating is not available a special insurance agreement is made between parties limiting Landsvirkjun's risk. Before energy contracts are made the financial standing of the relevant companies and their parent companies are thoroughly reviewed, if applicable.

The Company's counterparty risk is specified as follows at year end:

	<u>31/12/2009</u>	<u>31.12.2008</u>
Derivative financial instruments	489,368	305,011
Other long-term receivables	334	246
Accounts receivables and other receivables	108,858	98,374
Cash	194,248	124,993
	<u>792,808</u>	<u>528,624</u>

57. Fair value

Comparison of fair value and book value

The fair value and book value of financial assets and liabilities in the balance sheet is specified as follows:

	2009		2008	
	Book value	Fair value	Book value	Fair value
Shares in other companies	248	248	127	127
Derivative agreements	360,210	360,210	159,443	159,443
Bonds	334	334	246	246
Trade and other receivables	108,858	108,858	98,374	98,374
Cash and cash equivalents	194,248	194,248	124,993	124,993
Interest bearing long-term liabilities	(3,018,120)	(2,899,707)	(2,975,269)	(2,826,473)
Trade and other payables	(65,115)	(65,115)	(95,537)	(95,537)
	<u>(2,419,337)</u>	<u>(2,300,924)</u>	<u>(2,687,623)</u>	<u>(2,538,827)</u>

Note 14 includes further information on measurement of fair value.

Interest rates in the evaluation of fair value

Inter bank rates and swap rates were used without premium for the relevant currencies as at the reporting date when discounting the estimated cash flow.

Interest rates are specified as follows:

	2009	2008
Embedded derivatives in electric power sales agreements (USD)	0.24 - 4.62%	1.31 - 2.70%
Interest bearing long term liabilities	0.24 - 4.23%	0.75 - 4.30%

Fair value classification:

The table here below shows financial instruments recognised at fair value according to price evaluation method. The methods are defined as follows:

Level 1: available price in an active market for the same type of assets and liabilities

Level 2: assumptions based on other variables than available price in an active market (level 1) that can be obtained for assets and liabilities, directly (for example price) or indirectly (derived from prices)

Level 3: assumptions for fair value of assets and liabilities are not based on market data

2009	Level 2	Level 3	Total
Embedded derivatives		423,007	423,007
Other derivatives	(62,797)		(62,797)
Shares in other companies		248	248
	<u>(62,797)</u>	<u>423,255</u>	<u>360,458</u>

2008

Embedded derivatives		169,702	169,702
Other derivatives	(10,259)		(10,259)
Shares in other companies		127	127
	<u>(10,259)</u>	<u>169,829</u>	<u>159,570</u>

58. Classification of financial instruments

According to the International Financial Reporting Standard IAS 39 Financial instruments: recognition and measurement, financial assets and liabilities are divided into defined groups. The classification affects how the evaluation of the relevant financial instrument is measured. Those groups to which the Company's financial assets and liabilities pertain and their basis for evaluation are specified as follows:

- Trading assets and liabilities – are recognised at fair value through profit and loss
- Financial assets and liabilities – are denominated at fair value and recognised at fair value through profit and loss
- Loans and receivables – are recognised at amortised cost
- Other financial liabilities – are recognised at amortised cost

Financial assets and liabilities are divided into the following groups of financial instruments:

	<i>Trading assets and liabilities</i>	<i>Financial assets and liabilities at fair value through profit and loss</i>	<i>Loans and receivables</i>	<i>Financial liabilities recognised at amortised cost</i>	<i>Book value</i>
2009					
Shares in other companies		248			248
Bonds			334		334
Derivatives	489,368				489,368
Accounts receivables and other receivables			108,858		108,858
Cash			194,248		194,248
Total assets	489,368	248	303,440	0	793,056
Interest bearing liabilities				3,018,120	3,018,120
Derivatives	129,158				129,158
Accounts payable and other payables			65,115		65,115
Total liabilities	129,158	0	65,115	3,018,120	3,212,393
2008					
Shares in other companies		127			127
Bonds			246		246
Derivatives	305,011				305,011
Accounts receivables and other receivables			98,374		98,374
Cash			124,993		124,993
Total assets	305,011	127	223,613	0	528,751
Interest bearing liabilities				2,975,269	2,975,269
Derivatives	145,568				145,568
Accounts payable and other payables			95,537		95,537
Total liabilities	145,568	0	95,537	2,975,269	3,216,374

59. Other issues

On August 22, 2007, a special evaluation committee issued a ruling on a settlement amount for water rights due to Kárahnjúkar power station and the division between owners. The total amount amounted to in excess of USD 13.2 million. Most owners of water rights in Jokuldalur and three in Fljotsdalur announced that they would not accept the ruling of the committee and filed a case in court on February 22, 2008. Forty cases were confirmed in the District Court of Austurland on January 15, 2008. The parties involved are owners of one third of the water rights.

In the year 2007, Landsvirkjun and Landsnet hf. entered into two currency swaps with domestic financial institutions, which consist in a change from ISK to USD. Due to the weakening of the ISK in the year 2008, unrealised foreign exchange loss was created, which has been recognised as negative fair value to the amount of USD 39 million in the group's financial statements. A claim was made to the bankruptcy estate of one financial institution due to default in payments but the other agreement has been terminated. The agreements' fair value is recognised in the Group's financial statements as the final result on the settlement of the agreements is not concluded but the Company does not agree to the aforementioned fair value evaluation given the current situation.


The Company has capitalised water rights amounting to USD 40.6 million, whereof water rights related to Kárahnjúkar weigh the most. With law no. 58/2008 on the change of law on the resource and energy sector, which entered into effect on 1 July 2009, restrictions are set for the State, municipalities and companies owned by them on the endorsement of ownership of water rights for waters containing harnessable power in excess of 10 MW. The State and municipalities are though allowed to give to companies owned by them the right of use of the resources for up to 65 years at a time. Upon the adoption of this law, the Prime Minister shall nominate a committee to discuss the arrangement of leasing of water and geothermal heat rights owned by the State. The committee shall in its work discuss on lease amount, lease term, renewal of lease agreements and other issues related to parties' rights and obligations. The committee shall submit proposals in the first half of year 2010.

The ownership of Landsvirkjun in Theistareykir ehf. is 32% and the owners have provided a guarantee on the company's loans. The owners carry responsibility in proportion to their ownership and Landsvirkjun total guarantee amount due to those loans at year end 2009 amounts to USD 1.6 million. Landsvirkjun acquired in addition Nordurorka hf.'s 32% share in Theistareykir ehf. at the end of December 2009 with certain conditions to be fulfilled in the first half of year 2010. Following the acquisition, Landsvirkjun will own 64% in the company. The price for the share is USD 4.5 million following a due diligence and additional USD 11 million when energy production begins in the area of Theistareykir ehf., though not until after ten years. Landsvirkjun's share at year end, 32%, is recognised according to the equity method in the financial statements. Theistareykir ehf. will become a subsidiary of Landsvirkjun and a part of the Group when the conditions have been fulfilled.

On 8 July 2009, the EFTA Surveillance Authority (ESA) issued a ruling in relation to the institution's research on the arrangement of Landsvirkjun's owners' guarantee. ESA's opinion is that the unlimited guarantee that Landsvirkjun enjoys with its owners is not fully in accordance with provisions of the EEA agreement on state aid. However, ESA believes that a guarantee can be provided for loans, provided that a reasonable fee is paid for the guarantee. ESA's ruling is in the form of appropriate measures to the Icelandic Government and the Government has announced that ESA's decision will be reacted to by presenting bills of law that will meet with ESA's comments on the present arrangement. The bills of law concern an amendment to the law on Landsvirkjun.

60. Subsequent events

Nothing has come forth after the balance sheet date which would require adjustments or changes to the financial statement for the year 2009.



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