Hagar hf.

Consolidated Financial Statements
for Year Ended 29 February 2008
ISK

Hagar hf.
Skútuvogi 7
104 Reykjavík
Iceland

Reg. no. 670203-2120

Contents

Endorsement and Signatures by the Board of Directors and the CEO

The consolidated financial statements of Hagar hf. ("the Company") have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU. These are the Company's first IFRS consolidated financial statements. The Company's financial statements for the previous years have been prepared in accordance with the Financial Statements Act and Icelandic General accepted accounting principles in Iceland ("IS-GAAP"). The transition to IFRS resulted in an increase of equity of ISK 73 million as at 1 March 2007 and decrease of 61 million as at 1 March 2006. The financial statements comprise the consolidated financial statements of Hagar hf. and its subsidiaries ("the Group").

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

According to the income statement, profit of the Group for the year amounted to ISK 527 million. According to the balance sheet, equity at the end of the year amounted to ISK 8,808 million.

The Company's share capital amounted to ISK 1,218 million at the end of the fiscal year. Shareholders were 4 at the end of the fiscal year. Baugur Group hf. held a total of 95% of outstanding shares.

The Board of Directors proposes that no dividend shall be paid to shareholders.

Statement by the Board of Directors and the CEO

To the best of our knowledge the consolidated financial statements give a true and fair view of the consolidated financial performance of the Company for the fiscal year ended 29 February 2008, its assets, liabilities and consolidated financial position as at 29 February 2008 and its consolidated cash flows for the fiscal year ended 29 February 2008.

Further, in our opinion the consolidated financial statements and the endorsement by the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the annual consolidated financial statements of Hagar hf. for the year ended 29 February 2008 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements will be approved at the annual general meeting of Hagar hf.

Reykjavík, 29 May 2008.

The Board of Directors:

Jóhannes Jónsson

Jón Ásgeir Jóhannesson

Tinna Ólafsdóttir

CEO:

Finnur Árnason

Independent Auditor´s Report

To the Board of Directors and Shareholders of Hagar hf.

We have audited the accompanying consolidated financial statements of Hagar hf. and its subsidiaries (the "Group"), which comprise the balance sheet as at 29 February 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated 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 consolidated financial position of Hagar hf. as at 29 February 2008 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 29 May 2008.

KPMG hf.

Anna Þórðardóttir

Consolidated Income Statement
for the Year Ended 29 February 2008

	Note	2008/07	2006/07
Sales		52,210	46,513
Cost of goods sold		(38,488)	(34,645)
Gross profit		13,722	11,868
Other operating income	7	112	76
Salaries and salary-related expenses	8	(5,907)	(5,288)
Other operating expenses		(5,021)	(4,582)
Results from operating activities before depreciation and amortisatio		2,906	2,074
Depreciation and amortisation of operating assets	9	(992)	(856)
Results from operating activities		1,914	1,218
Finance income		471	1,182
Finance expenses		(1,779)	(1,659)
Net finance expense	10	(1,308)	(477)
Share of loss of equity accounted investees	14	(36)	(18)
Profit before income tax		570	723
Income tax expense	11	(43)	(172)
Net profit for the year		527	551
Earnings per share:			
Basic and diluted earnings per share of ISK 1		0.45	0.52

The notes on pages 9 to 32 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Consolidated Balance Sheet as at 29 February 2008

	Note	29/02/2008	28/02/2007
Assets			
Operating assets	12	4,532	4,113
Intangible assets	13	9,697	9,645
Investments in associates	14	1,004	82
Investments in other companies	15	3,905	2,484
Investments in bonds	28	518	448
Deferred tax assets	16	0	8
Total non-current assets		19,656	16,780
Inventories	17	3,657	3,063
Trade and other receivables	18	849	956
Trade receivable - customers' credit cards	18	3,112	2,667
Restricted cash	19	508	0
Cash and cash equivalents	19	213	150
Total current assets		8,339	6,836
Total assets		27,995	23,616
Equity			
Share capital	20	1,218	1,067
Share premium		6,536	3,975
Translation reserve		31	0
Retained earnings		1,023	1,496
Total equity		8,808	6,538
Liabilities			
Loans from credit institutions	22	610	1,792
Bonds	22	8,506	8,641
Incentives from operating leases	25	373	434
Deferred tax liabilities	16	37	0
Total non-current liabilities		9,526	10,867
Interest-bearing loans and borrowings	22	3,606	1,187
Trade and other payables, including derivatives	23	5,805	4,774
Provisions	24	250	250
Total current liabilities		9,661	6,211
Total liabilities		19,187	17,078
Total equity and liabilities		27,995	23,616

The notes on pages 9 to 32 are an integral part of these consolidated financial statements.

Financial Statements of Hagar hf. 29 February 2008 Amounts are in ISK million

Consolidated Statement of Changes in Equity for the Year Ended 29 February 2008

	Share capital	Share premium	Translation reserve	Retained earnings	**Total equity**
Changes in equity from 1 March 2006 to 28 February 2007					
Equity at 28 February 2006, IS-GAAP	1,015	3,611	0	2,320	6,946
Changes due to IFRSs adoption				(61)	(61)
Equity at 1 March 2006, IFRSs	1,015	3,611	0	2,259	6,885
Net profit for the year				551	551
Issued share capital	52	364			416
Dividend received recognised directly in equity				18	18
Dividends to shareholders				(1,332)	(1,332)
Equity at 28 February 2007, IFRSs	1,067	3,975	0	1,496	6,538
Changes in equity from 1 March 2007 to 29 February 2008					
Equity at 28 February 2007, IS-GAAP	1,067	3,975	0	1,423	6,465
Changes due to IFRSs adoption				73	73
Equity at 1 March 2007, IFRSs	1,067	3,975	0	1,496	6,538
Net profit for the year				527	527
Foreign currency diffrences for foreign operations			31		31
Issued share capital	151	2,561			2,712
Dividends to shareholders				(1,000)	(1,000)
Equity at 29 February 2008, IFRSs	1,218	6,536	31	1,023	8,808

The notes on pages 9 to 32 are an integral part of these consolidated financial statements.

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Consolidated Statement of Cash Flows for the Year Ended 29 February 2008

	Note	2008/07	2006/07
Cash flows from operating activities:			
Net profit for the year		527	551
Adjustments for non-cash transactions	27	1,888	1,854
Working capital provided by operating activities		2,415	2,405
Net change in operating assets and liabilities		203	141
Cash from operations before interest and taxes		2,618	2,546
Interest received		56	182
Interest paid		(796)	(931)
Net cash provided by operating activities		1,878	1,797
Cash flows from investing activities:			
Acquisition of intangible assets	13	(110)	(116)
Acquisition of operating assets	12	(1,398)	(934)
Acquisition of subsidiaries, net of cash acquired		0	(258)
Acquisition in shares in other companies		(397)	(103)
Restricted cash, change		(508)	0
Proceeds from sale of operating assets		49	47
Proceeds from forward sale of investments in other companies		1,000	0
Dividends received		85	18
Receivables and securities, changes		45	3,964
Net cash provided by investing activities		(1,234)	2,618
Cash flows from financing activities:			
Dividends paid		(1,000)	0
Proceeds from borrowings		351	800
Repayment of borrowings		(912)	(5,753)
Short term borrowings, changes		980	456
Net cash used in financing activities		(581)	(4,497)
Net increase in cash and cash equivalents		63	(82)
Cash and cash equivalents at 1 March		150	232
Cash and cash equivalents at 29 February		213	150
Investment and financing activities without cash flow effect:			
Acquisition of associates		2,712	0
Issued share capital		(2,712)	0
Dividends		0	(1,332)
Bonds		0	1,723
Investments in companies		0	(2,189)
Proceeds from the issue of share capital and sale of own shares		0	416
Current liabilities		0	133
Current receivables		0	1,249
Purchased goodwill		0	(4)
Long-term debt		0	4

The notes on pages 9 to 32 are an integral part of these consolidated financial statements.

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Notes to the Financial Statements

Notes to the Consolidated Financial Statements

1. ## Reporting entity

Hagar hf. (the "Company") is a limited liability company incorporated and domiciled in Iceland. The address of the Company's registered office is Skútuvogi 7, Reykjavík, Iceland. The consolidated financial statements of the Company as at and for the year ended 28 February 2008 comprise the Company and its subsidiaries (together referred to as the "Group" and individually as "Group entities")) and the Groups' interest in associates. The main activity of the Group is retail.

2. ## Basis of preparation

a. ***Statement of compliance***

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

The Company's Board of Directors approved the financial statements on 29 May 2008.

These are the Group's first financial statements prepared according to International Financial Reporting Standards and IFRS 1, Introduction of International Financial Reporting Standards, has been applied.

The preparation of the Group's financial statements according to IFRSs leads to changes in accounting methods from the Group's last financial statements which were prepared according to Icelandic GAAP. The accounting methods described here below have been applied in a unitary way for those periods included in these financial statements. Furthermore, they have also been applied in the preparation of the opening balance sheet according to IFRS. Note 32 contains information on the effects of the changes upon the implementation of the IFRS on the Group's financial position and performance. The note includes reconciliation of the Group's equity and return for comparative periods, on the one hand according Icelandic GAAP and on the other, according to IFRSs.

b. ***Basis of measurement***

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- derivative financial instruments
- financial instruments are measured at fair value through profit or loss

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

c. ***Functional and presentation currency***

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

d. ***Use of estimates and judgements***

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods effected.

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

2. Basis of preparation, cont.:

d. *Use of estimates and judgements, cont.:*

- Note 13 – measurement of the recoverable amounts of cash-generating units
- Note 23 – measurement of share-based payments
- Note 24 – provision and contingencies

3. Significant accounting policies

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

a. *Basis of consolidation*

i) *Subsidiaries*

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

ii) *Associates*

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

iii) *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.

b. *Foreign currency*

i) *Foreign currency transactions*

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for difference arising on the retranslation of foreign operation, which are recognised directly in equity, (see (ii) below).

3. Significant accounting policies, cont.:

i) *Foreign currency transactions, cont.:*

The foreign exchange difference from Group's forward exchange contracts used to hedge currency risk from trade payable denominated in a foreign currency is included in cost of goods sold.

c. *Financial instruments*

(i) *Non-derivative financial instruments*

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

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

Cash and cash equivalents comprise cash balances and call deposits.

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

Held-to-maturity investments

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

Financial assets at fair value through profit or loss

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

Other

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

(ii) *Derivative financial instruments*

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

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

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

c. ***Financial instruments, cont.:***

(ii) *Derivative financial instruments, cont.:*

Economic hedges

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

(iii) *Share capital*

Ordinary shares

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

Repurchase of share capital (treasury shares)

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is net of any tax effects, and is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as a increase in equity, and the resulting surplus or deficit on the transaction is included or deducted from share premium.

d. ***Operating assets***

(i) *Recognition and measurement*

Items of operating assets are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

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

(ii) *Subsequent costs*

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

(iii) *Depreciation*

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

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

(iii) *Depreciation, cont.:*

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

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

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

e. ***Intangible assets***

(i) *Goodwill*

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

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries. In respect of business acquisitions that have occurred since 1 January 2003, goodwill represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess is negative (negative goodwill), it is recognised immediately in profit or loss.

Subsequent measurement

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

(ii) *Other intangible assets*

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

(iii) *Subsequent expenditure*

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

(iv) *Amortisation*

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets, other than goodwill, from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

Software	5 years

f. ***Leased assets***

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

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

3. Significant accounting policies, cont.:

g. *Inventories*

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

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

h. *Impairment*

(i) *Financial assets*

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

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

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss.

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

(ii) *Non-financial assets*

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the “cash-generating unit”). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

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

(ii) *Non-financial assets*

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

i. ***Employee benefits***

(i) *Defined contribution plans*

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

(ii) *Short-term benefits*

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

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

(iii) *Share-based payment transactions*

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

j. ***Provisions***

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

k. ***Revenue***

Goods sold

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

Services

Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

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

l. ***Lease payments***

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

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

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

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

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

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

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

n. ***Income tax***

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

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

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets.

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

3. Significant accounting policies, cont.:

o. *Earnings per share*

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which could be issued.

p. *New standards and interpretations adopted in the year ended 29 February 2008*

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures became mandatory for the Group's 2007-2008 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Group.

IFRIC 7 – 10 became mandatory for the Group's 2007-2008 financial statements but their adoption had no impact on the Group's financial statements for the year ended 29 February 2008.

q. *New standards and interpretations not yet adopted*

A number of new standards, amendments to standards and interpretations are not yet effective for the period ended 29 February 2008, and have not been applied in preparing these consolidated financial statements:

IFRS 8 Operating Segments introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Group's 2009-2010 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's management in order to assess each segment's performance and to allocate resources to them. Currently the Group presents segment information in respect of its business segments and presents one segment, retail. Under the management approach, the Group will present segment information in respect of retail.

IAS 1 Presentation of Financial Statements (revised in 2007) replaces IAS 1 Presentation of Financial Statements (revised in 2003) as amended in 2005. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either in a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the statement of changes in equity. IAS 1 (revised in 2007), which becomes mandatory for the Group's 2009-2010 financial statements if endorsed by the EU, is expected to impact the presentation of the Group's income statement and statement of changes in equity.

Revised IAS 23 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If endorsed by the EU, the revised IAS 23 will become mandatory for the Group's 2009-2010 financial statements and will not have any impact on the consolidated financial statements.

The amendments to IFRS 2 Share Based Payment – Vesting Conditions and Cancellations (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Group's 2009 financial statements, with retrospective application required. The Group has not yet determined the potential effect of IFRS 2 (revised in 2008) on the consolidated financial statements.

3. ## Significant accounting policies, cont.:

q. ***New standards and interpretations not yet adopted, cont.:***

IFRS 3 Business Combinations (revised in 2008) and amended IAS 27 Consolidated and Separate Financial Statements introduce changes to the accounting for business combinations and for non-controlling (minority) interest. The most significant changes from IFRS 3 (2004) and IAS 27 (2003) are the following:
• IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations achieved by contract alone;
• The definition of a business combination has been revised to focus on control;
• The definition of a business has been amended;
• Transaction costs incurred by the acquirer in connection with the business combination do not form part of the business combination transaction;
• Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
• Disposals of equity interests while retaining control are accounted for as equity transactions;
• New disclosures are required.

IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions* requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Group's 2008-2009 financial statements, with retrospective application required. The Group has not yet determined the potential effect of the interpretation.

IFRIC 12 *Service Concession Arrangements* provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Group's 2008-2009 financial statements if endorsed by the EU, is not expected to have any effect on the consolidated financial statements.

IFRIC 13 *Customer Loyalty Programmes* addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13, which becomes mandatory for the Group's 2009-2010 financial statements if endorsed by the EU. The Group has not yet determined the potential effect of the interpretation.

IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Group's 2008-2009 financial statements if endorsed by the EU, with retrospective application required. It is not expected to have any effect on the consolidated financial statements.

4. Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

a. *Operating assets*

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

b. *Intangible assets*

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

c. *Inventories*

The fair value of inventories acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

d. *Investments in financial assets at fair value through profit or loss*

As indicated in note 3 c (i), the Group’s financial assets at fair value through profit or loss are measured at fair value in the balance sheet. For some of these fanancial assets quoted market prices are readily available. However, certain financial assets, for example unquoted securities, are fair valued using valuation techniques, including reference to the current fair values of other instruments that are substantially the same, subject to the appropriate adjustments.

Fair value estimates are made at a specific point in time, based on market conditions and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement (e.g. interest rates, volatility, estimated cash flows etc.) and therefore, cannot be determined with precision.

d. *Trade and other receivables*

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

e. *Derivatives*

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

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

4. Determination of fair values, cont.:

g. *None derivatives financial liabilities*

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

f. *Share-based payment transactions*

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

5. Financial risk management

a. *Overview*

The Group has exposure to the following risks from its use of financial instruments:

Credit risk
Liquidity risk
Market risk.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies, and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

b. *Credit risk*

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and investment securities.

(i) Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

At the reporting date there were no significant concentrations of credit risk.

5. Financial risk management, cont.:

c. *Liquidity risk*

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group has made agreements on overdraft facilities. No unused loan facilities is at 29 February 2008 (2007: ISK 800 million).

d. *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will effect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

(i) Currency risk

The Group is exposed to currency risk on purchases and borrowings that are denominated in a currency other than ISK. The currencies in which these transactions primarily are denominated are Swedish krona(SEK), japanese yen(YEN), U.S Dollars(USD), Euro (EUR) and Sterling (GBP).

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

(ii) Interest rate risk

A 27% og the Groups's borrowings carry variable interest rates.

(iii) Other market value risk

Other market value risk is limited as investments in shares and bonds are an insubstantial part of the Group's operations.

e. *Capital management*

The Board's policy is to maintain a strong capital base to sustain future development of the business. The Company's Board of Directors monitors the level of dividends to shareholders.

The Company's Board of Directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. Return on equity was 7% in the year ended 29 February 2008 and 8% in the year ended 28 February 2007.

There were no changes in the Company's approach to capital management during the year and the Company is not obliged to comply with external rules on minimum equity.

6. Segment reporting

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

7. Other income

Other income specifies as follows:	2007/08	2006/07
Concession rent	39	14
Sold services	73	62
	112	76

8. Salaries and related expenses

Salaries and related expenses are as follows:

Salaries	5,054	4,595
Related expenses	853	693
Total salaries and related expenses	5,907	5,288
Number of employees	1,627	1,617

Salaries paid to the Board of Directors and Management amounted to ISK 216 million in 2007/08 (2006/07: ISK 212 million).

9. Depreciation and amortisation

Depreciation and amortisation are specified as follows:	29/02/2008	28/02/2007
Depreciation of operating assets, see note 12	934	814
Amortisation of intangible assets, see note 13	58	42
Depreciation and amortisation recognised in the income statement	992	856

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10. ## Finance income and expense

Financial income and financial expenses are specified as follows:	2007/08	2006/07
Interest income of bank deposits and account recievables	24	29
Interest income and indexation of bonds	101	443
Net foreign exchange gain	10	0
Net gain on the sale of shares in companies and loan write-downs	0	350
Provision for expected claims	0	200
Dividend	141	0
Net changes in fair value of financial assets at fair value through profit or loss	0	101
Changes in fair value of derivatives	195	59
Total finance income	471	1,182
Interest expenses and indexation	(1,457)	(1,569)
Net foreign exchange gain (loss)	0	(90)
Net changes in fair value of financial assets at fair value through profit or loss	(322)	0
Total finance expense	(1,779)	(1,659)
Net finance expense	(1,308)	(477)

11. ## Income tax expense

Reconciliation of effective tax rate		2007/08		2006/07
Profit for the year		527		551
Income tax for the year		43		172
Profit before income tax		570		723
Income tax according to current tax rate	18.0%	103	18.0%	130
Other Items	(10.5%)	(60)	5.8%	42
Effective tax rate	7.5%	43	23.8%	172

12. ## Operating assets

Operating assets and their depreciation is specified as follows:	Buildings	Fixtures and equipment	Total
Cost			
Balance at 1 March 2006	40	8,096	8,136
Acquisitions through business combinations	0	157	157
Acquisitions during the period	0	934	934
Transfered to intangible assets (note 32)	0	(229)	(229)
Other disposals	0	(39)	(39)
Balance at 28 February 2007	40	8,919	8,959
Depreciation and impairment losses			
Balance at 1 March 2006	1	4,087	4,088
Depreciation	2	812	814
Transfered to intangible assets (note 32)	0	(56)	(56)
Balance at 28 February 2007	3	4,843	4,846

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12. **Operating assets, cont.:**

	Buildings	Fixtures and equipment	Total
Carrying amounts			
At 1 March 2006	39	4,009	4,048
At 28 February 2007	37	4,076	4,113
Cost			
Balance at 1 March 2007	40	8,919	8,959
Acquisitions during the period	0	1,398	1,398
Other disposals	(5)	(454)	(459)
Balance at 29 February 2008	35	9,863	9,898
Depreciation and impairment losses			
Balance at 1 March 2007	3	4,843	4,846
Depreciation	1	933	934
Other disposals	0	(414)	(414)
Balance at 29 February 2008	4	5,362	5,366
Carrying amounts			
At 1 March 2007	37	4,076	4,113
At 29 February 2008	31	4,501	4,532

Change in estimates

A expected useful lives of certine fixtures was decreased during the year ended 29 February 2008 due to a planned renovation and change in location of stores.

Official Real Estate Value and Insurance Value

Insurance value, official real estate value and carrying value at the end of February 2008, is as follows:

	29/02/2008	28/02/2007
Official real estate value	37	43
Insurance value of buildings	41	49
Carrying value of buildings	31	37
Insurance value of fixtures and equipment	9,225	7,416
Carrying value of fixtures and equipment	4,501	4,076

Leased operating assets

The Group leases operating assets under a number of finance lease agreements. These leases provide the Group with the option to purchase the equipment at a beneficial price. The leased equipment secures lease obligations (see note 22). At 28 February 2008 the net carrying amount of leased equipment was ISK 115 million (2007: 309 million).

Amounts are in ISK million

13. ## Intangible assets

The Group's intangible assets are specified as follows:

	Lease rights	Software	Goodwill	Total
Cost				
Balance at 1 March 2006	120	0	8,723	8,843
Acquisitions during the period	0	0	671	671
Transfered to intangible assets (note 32)	0	229	0	229
Balance at 29 February 2007	120	229	9,394	9,743
Amortisation and impairment losses				
Balance at 1 March 2006	0	0	0	0
Amortisation	12	0	30	42
Transfered to intangible assets (note 32)	0	56	0	56
Balance at 29 February 2007	12	56	30	98
Carrying amounts				
At 1 March 2006	120	0	8,723	8,843
At 29 February 2007	108	173	9,364	9,645
Cost				
Balance at 1 March 2007	120	229	9,394	9,743
Acquisitions during the period	28	82	0	110
Balance at 29 February 2008	148	311	9,394	9,853
Amortisation and impairment losses				
Balance at 1 March 2007	12	56	30	98
Amortisation	12	37	9	58
Balance at 29 February 2008	24	93	39	156
Carrying amounts				
At 1 March 2007	108	173	9,364	9,645
At 29 February 2008	124	218	9,355	9,697

Impairment tests

Goodwill was tested for impairment by comparing their carrying amounts to their value in use. The main assumptions consist of discount rate of 13.7%-14,7%, and revenue growth of 7%.

For the purpose of impairment testing on goodwill, goodwill is allocated to the Group's unit which represent the lowest level within the Group, at which the goodwill is monitored for internal management purpose.

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13. **Intangible assets, cont.:**

For the purpose of impairment testing on goodwill, value in use is determined by discounting the future cash flows generated from the continuing use of each unit and was based on the following key assumptions:

Cash flows were projected based on actual operating results and the 5-year business plan. Cash flows were extrapolated for determining the residual value using a constant growth rate which was consistent with the long-term average growth rate for industry. Management believes that this forecast period was justified due to the long-term nature of the business. The anticipated annual revenue growth included in the cash flow projections was 7% for the years 2008 to 2012. An after-tax discount rate of 13,7-14,7% was applied in determining the recoverable amount of the units. The discount rate was estimated based on an industry average weighted average cost of capital, which was based on a possible range of debt leveraging of average 33,5% at a marked interest rate of 9,3%.

The value assigned to the key assumptions represent management's assessment of future trends in the business and are based on both external sources and internal sources (historical data).

14. **Investments in associates**

The Company's share of loss in its associates for the year amounted to ISK 36 million (2006/07: ISK 18 million).

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

	Ownership	Carrying amount at 29/02/2008	Ownership	Carrying amount at 28/02/2007
Max ehf., Iceland	51%		51%	
P/f SMS, Faroe Islands	50%		-	-
		1,004		82

Summary of financial information for associates at 31 December 2007, not adjusted for the percentage ownership held by the Group:

	29/02/2008	28/02/2007
Assets	2,465	313
Liabilities	(1,233)	(150)
Revenue	4,545	304
Expenses	(4,603)	(340)
Net loss	(58)	(36)

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

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

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15. Other investments

Financial assets designated at fair value through profit or loss

The Group's investment in other companies designated at fair value through profit or loss is specified as follows:

	Share	Carrying amount at 29/02/2008	Carrying amount at 28/02/2007
Húsasmiðjan hf., Iceland	45%		
FL Group hf., Iceland	0.40%		
BYR sparisjóður, Iceland			
Investment in other companies			
		3,905	2,484

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

In Agust 2007, the Company entered into a forward sale contract where 37.9 million shares in FL Group were sold forward. The Company will receive any gain or loss from the shares against paying interest and bear foreign currency risk from the contract until the settlement of the contract. The net fair value of the forward sale contract is classified as derivatives and is recorded with other payables and amounted to ISK 706 million at 29 February 2009. Gain or loss from the contract is classified as finance income or loss on a net basis.

16. Deferred tax assets and liabilities

The deferred tax assets and liabilities are specified as follows:

	29/02/2008	28/02/2007
Deferred tax assets at 1 March	8	170
Acquisitions during the year	0	(5)
Calculated income tax for the year	(43)	(159)
Other items	(2)	2
Deferred tax (liability) assets at the end of the year	(37)	8

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16. ## Deferred tax assets and liabilities, cont.:

The Company's deferred income tax asset is attributable to the following balance sheet items:

	29/02/2008	28/02/2007
Intangible assets	(33)	(20)
Operating assets	(315)	(373)
Trade and other receivables	2	11
Trade and other payables, including derivatives	153	54
Carrying amount of losses carried forward	156	336
Deferred tax asset	(37)	8

Movement in temporary differences during the year:

	Balance 01/03/2007	Recognised in profit or loss	Balance 29/02/2008
Intangible assets	(20)	(13)	(33)
Operating assets	(373)	58	(315)
Investments in associates	3	(3)	0
Trade and other receivables	8	(6)	2
Loans and borrowings	54	99	153
Carrying amount of losses carried forward	336	(180)	156
Net tax asset	8	(45)	(37)

Carry forward tax losses at year-end amounted to ISK 820 million. Due to uncertainty regarding the utilisation of tax asset arising from carry forward tax losses it is not recognised in full. A ISK 129 million of the carry forward tax losses are recognised in the income tax assets. Carry forward losses not used to offset taxable income within ten years expire. Carry forward tax losses can be used as follows:

	29/02/2008	28/02/2007
Loss for the year 1999, to be used before end of 2009	23	23
Loss for the year 2001, to be used before end of 2011	17	17
Loss for the year 2002, to be used before end of 2012	35	35
Loss for the year 2003, to be used before end of 2013	28	116
Loss for the year 2004, to be used before end of 2014	26	693
Loss for the year 2005, to be used before end of 2015	820	1,194
	949	2,078
Carry forward tax losses not recognised	(129)	(129)
Carry forward tax losses recognised in in income tax assets or liabilities	820	1,949

17. ## Inventories

Inventories are specified as follows:

Groceries	1,983	1,770
Speciality goods	1,630	1,250
Goods in transit	44	43
Total inventories	3,657	3,063

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18. Trade and other receivables

Trade and other receivables are specified as follows:

	29/02/2008	28/02/2007
Trade receivables	652	719
Other receivables	225	282
Allowance for bad debt	(28)	(45)
Trade and other receivables	849	956
Customers credit cards	3,112	2,667
Total trade and other receivables	3,961	3,623

The Company has pledged its credit card receivables in the amount of ISK 1.185 million (2007: 1.130).

19. Cash and cash equivalents

Cash	213	39
Bank balances	0	111
Cash and cash equivalents in the statement of cash flows	213	150

20. Equity

Issued capital

In millions of shares	2007/08	2006/07
On issue at 1 March	1,067	1,015
Issued share capital	151	52
On issue at 29 February	1,218	1,067

The Company holds own shares amounting to a nominal amount of ISK 0,2 million, own shares are deducted from equity. One vote is attached to each ISK one share. Issued capital at year-end amounted to ISK 1.218 million and is all paid for.

Share premium

Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Company. According to Icelandic Companies Act 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

Translation reserve

Foreign exchange differences arising on translation of financial statements of foreign associates are recognised directly in a separate component of equity.

20. Equity, cont.:

Dividends

The following dividends were declared and paid by the Company:

Dividends paid is as follows:	2007/08	2006/07
Dividends paid ISK 0.82 per share 2007/08 (ISK 1,25 per share 2006/2007)	1,000	1,332

The Board of Directors proposes that no dividend shall be paid to shareholders in 2008/09.

21. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Parent by the weighted average outstanding number of shares during the year and shows the earnings per each share.

Basic and diluted earnings per share	2007/08	2006/07
Net profit for the year attributable to equity holders of the parent	527	551
Weighted average number of ordinary shares:		
Share capital at the beginning of the year	1,067	1,015
Issued share capital	109	26
Weighted average number of ordinary shares	1,176	1,041
Basic and diluted earnings per share	0.45	0.53

22. Interest-bearing loans and borrowings

Interest-bearing loans and borrowings are specified as follows:

Non-current liabilities		
Secured bank loans	427	1,483
Unsecured loan from shareholder	0	675
Finance lease liability	183	179
Total loans from credit institutions	610	2,337
Unsecured bond issues	8,506	8,096
	9,116	10,433

Current liabilities		
Current portion of secured bank loans	1,236	439
Current portion of loan from shareholder	675	0
Current portion of finance lease liability	7	40
Unsecured bank facility	1,688	708
	3,606	1,187

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22. **Interest-bearing loans and borrowings, cont.:**

Terms and conditions of outstanding loans were as follows:	Weighted average interest rate	29/02/2008 Carrying amount	28/02/2007 Carrying amount
Debt in ISK, indexated	5.60%	11,531	10,479
Debt in EUR	5.79%	240	217
Debt in USD	6.74%	136	139
Debt in SEK	5.31%	405	424
Debt in JPY	2.38%	122	110
Debt in CHF	4.09%	288	251
Non-current loans and borrowing, including current portion		12,722	11,620
Current portion of non-current loans and borrowings		(3,606)	(1,187)
Total loans and borrowings		9,116	10,433

Contractual repayments of non-current borrowings are specified as follows:	2008/09	2007/08
Repayments in 2007/08	0	1,187
Repayments in 2008/09	3,606	2,537
Repayments in 2009/10	8,876	7,588
Repayments in 2010/11	34	287
Subsequent	206	21
Total	12,722	11,620

Finance lease liabilities

Finance lease liabilities are payable as follows:	Future minimum lease payments	Interest	Present value of minimum lease payments
Less than one year	7	19	27
Between one and five years	29	80	109
More than five years	85	230	315
	121	329	451

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23. **Trade and other payables, including derivatives**

Trade and other payables are specified as follows:	29/02/2008	28/02/2007
Trade payables	3,842	3,417
Other payables	1,202	1,237
Share-based payments obligation	34	0
Derivatives - forward sale contract	707	0
Derivatives - foreign exchange option contract	(42)	58
Incentives from operating leases (see note 26)	62	62
Total trade and other payables, including derivatives	5,805	4,774

In May and June 2007, the Company entered into share-based option contracts with its executives. The contracts, which are cash settled, are exercisable at end of May 2010. The total liability is estimated to ISK 127 million whereof ISK 34 million are recorded as salary related expenses for the period and as a liability at 29 February 2008.

24. **Provisions and contingencies**

In February 2006, the Company sold its subsidiary Skeljungur hf. Under the sale agreement the Company has an obligation to pay any compensationary damages that may be imposed on Skeljungur hf. as a result of litigations from former customers of Skeljungur hf. due to its violation of the Icelandic Competition Law. The company has already been indicted by several of its customers. The District Court of Reykjavík has ruled against the company and ordered it to pay conpensationary damages. Skeljungur hf. has appealed the verdict. The conclusion of this case is uncertain. No charge was recognised in the income statement for the year ended 29 february 2008 (2006/07: ISK 200 million). At year-end the provision amounted to ISK 250 (2007: ISK 250 million).

25. **Operating leases**

Non-cancellable operating lease rentals are payable as follows:

	29/02/2008	28/02/2007
Less than one year	30	58
Between one and five years	2,123	1,554
More than five years	14,529	12,267
	16,682	13,879

The Company leases buildings for its operations. The longest term of lease is until 2021. At the end of February, the obligation in relation to these leases amounted to ISK 16,682 million (2007: 13,879 million). The Company has also entered into operating lease agreements regarding machinery, equipment and operating assets.

The remaining incentives from operating leases amounting to ISK 435 million will be recognised in profit or loss on a straight-line basis over next seven years.

Amounts are in ISK million

26. Financial instruments

Credit risk

Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	Notes	2007/08	2006/07
Investments in other companies	15	3,905	2,484
Trade receivables and other receivables	18	849	956
Trade receivables - customers credit cards	18	3,112	2,667
Restricted cash	19	508	0
Cash and cash equivalents	19	213	150
		8,587	6,257

The maximum exposure to credit risk for trade receivables at the reporting date by customer was:

Credit cards receivables	3,112	2,667
Other receivables	849	956
	3,961	3,623

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

Balance at the beginning of the year	45	844
Receivables written off	(12)	(21)
Changes in provision during the period	1	(778)
Balance at year end	34	45

Liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments:

29 February 2008

Non-derivative financial instruments	Carrying amount	Contractual cash flows	Less than one year	1 - 2 years	2- 5 years	After 5 years
Loans and borrowings	10,871	(12,131)	(3,283)	(8,786)	(26)	(36)
Finance lease liabilities	191	(420)	(26)	(54)	(84)	(256)
Trade and other payables	5,805	(5,805)	(5,805)			
Overdraft	1,688	(1,688)	(1,688)			
	18,555	(20,044)	(10,802)	(8,840)	(110)	(292)

28 February 2007

Non-derivative financial instruments	Carrying amount	Contractual cash flows	Less than one year	1 - 2 years	2- 5 years	After 5 years
Loans and borrowings	11,620	(12,675)	(1,568)	(3,283)	(7,798)	(26)
Finance lease liabilities	217	(484)	(60)	(54)	(84)	(286)
Trade and other payables	4,774	(4,774)	(4,774)			
Overdraft	708	(708)	(708)			
	17,319	(18,641)	(7,110)	(3,337)	(7,882)	(312)

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26. **Financial instruments, cont.:**

Currency risk

Exposure to currency risk

The Group's exposure to foreign currency risk, based on notinal amounts, was as follows:

29 February 2008	EUR	USD	CHF	SEK	JPY
Loans and borrowings	2,407	2,079	4,590	38,049	193,422
Balance sheet risk	2,407	2,079	4,590	38,049	193,422

28 February 2007	EUR	USD	CHF	SEK	JPY
Loans and borrowings	2,411	2,079	4,606	44,571	194,908
Balance sheet risk	2,411	2,079	4,606	44,571	194,908

The following significant exchange rates applied during the year:

	Average rate		Reporting date spot rate	
	2007/08	2006/07	2007/08	2006/07
EUR	88.74	90.02	99.80	88.79
USD	63.47	70.75	65.63	67.33
CHF	54.08	56.85	62.72	55.05
SEK	9.55	9.76	10.64	9.56
JPY	0.55	0.61	0.63	0.57

A 10 percent weakening of the Icelandic Kronas against the above currencies at 29 February 2007 would have drcreased profit after tax by ISK 98 million (2006: ISK 94 million). This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2006/07.

Interest rate risk

Interest-bearing financial liabilities are as follows at the year end:	2007/08	2006/07
Financial instruments with fixed interest rate		
Financial liabilities	9,297	9,531
Financial instruments with floating interest rate		
Financial liabilities	3,425	2,089

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26. ## Financial instruments, cont.:

Fair value

Fair value versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	29 February 2008 Carrying amount	29 February 2008 Fair value	28 February 2007 Carrying amount	28 February 2007 Fair value
Investments in other companies	3,905	3,905	2,484	2,484
Trade and other receivables	849	849	956	956
Cash and cash equivalents	213	213	150	150
Loans and borrowings	(11,034)	(10,634)	(10,913)	(10,513)
Overdraft	(1,688)	(1,688)	(707)	(707)
Derivatives - forward sale contract	(707)	(707)	0	0
Derivatives - foreign exchange option contract	42	42	(58)	(58)
Trade and other payables	(5,140)	(5,140)	(4,716)	(4,716)
	(13,560)	(13,160)	(12,804)	(12,404)

The basis for determining fair values is disclosed in note 4.

27. ## Statement of cash flows

Adjustments for non-cash transactions specified as follows:

	29/02/2008	28/02/2007
Gain on sale of assets	(10)	(3)
Depreciation	992	856
Indexation and foreign exchange rate difference	683	915
Share of loss in associates	36	18
Financial assets designated at fair value through profit or loss	(322)	(101)
Derivatives, changes	607	58
Incentives from operating leases, changes	(62)	(62)
Income tax	(35)	172
Other items	(1)	1
	1,888	1,854

28. ## Related parties

Identity of related parties

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

Related party transactions

Unsecured loans to directors issued during the year ended 29 February, 2008 amounted to ISK 518 million (ISK 448 million at 28 February 2007). The loans were made in connection to directors' share purchase. The loans are interest-bearing and carry a floating interest rate of 15% at fiscal year end. The bonds are repayable in full in January 2012.

Among other receivables is a claim on Baugur Group hf. in the amount of ISK 16 million (ISK 67 million at 28 February 2007). Baugur Group hf. has granted the Company a subordinated loan amounting to ISK 675 million. The loan will mature on 30 November 2008.

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

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29. **Group entities**

At 29 February 2008 the Company's subsidiaries were six. The subsidiaries included in the condensed consolidated financial statements are the following:

	Place of registration and operation	Ownerhip interest 29/02/2008	28/02/2007
Bananar ehf.	Iceland	100%	100%
DBH á Íslandi ehf.	Iceland	100%	100%
Ferskar kjötvörur ehf.	Iceland	100%	100%
Íshöfn ehf.	Iceland	100%	100%
Noron ehf.	Iceland	100%	100%
Res ehf.	Iceland	100%	100%

30. **Uncertainty**

In November 2007, the Competition Authority searched the premises of the Company as a result of a complaint made against the company regarding possible violations of competition law. The Competition Authority has not concluded its investigation and it is uncertain what, if any, effect this investigation will have on the company's operation and financial position.

31. **Financial Ratios**

The Group's primary financial ratios are as follows:

Balance Sheet:	29/02/2008	28/2/2007
Current ratio - Current assets/current liabilities	0.9	1.1
Equity ratio - equity/total capital	31.5%	27.7%
Internal value of share capital	7.2	6.1

Amounts are in ISK million

32. Explanation of transition to IFRSs

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

As stated in note 2(a), these are the Groups' first consolidated financial statements prepared in accordance with IFRSs, as adopted by the EU.

The consolidated financial statement for the fiscal year 1 March to 29 February 2008 are prepared in accordance with the accounting policies specified in note 3 on significant accounting policies. This also applies to comparative information for the year ended 28 February 2007 and the preparation of an opening IFRS balance sheet at 1 march 2006 (the Group's date of transition).

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

Changes in equity from IS-GAAP to IFRSs:

		Equity
Equity according to IS-GAAP at 28 February 2007		6,465
Equity according to IFRS's at 1 March 2007		6,538
Change in equity from IS-GAAP to IFRSs		73
Adjustments at 1 March 2006:		
Intangible assets	IAS 38	(74)
Income tax	IAS 12	13
Total changes due to transit to IFRS at 1 March 2006		(61)
Changes in profit for the year 1 March 2006 to 29 February 2007:		
Amortization of intangible assets	IAS 38	74
Lease rights	IAS 38	(12)
Fair value of investments in other companies	IAS 39	101
Income tax effects	IAS 12	(29)
Total changes due to IFRS in the year 2006-2007		134
Change in equity from IS-GAAP to IFRSs		73

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

Intangible assets

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

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32. Explanation of transition to IFRSs, cont.:

Investments in other companies

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

Intangible assets

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

Income tax

Total income tax effect is that equity decreases by ISK 29 million at 28 February 2007.

Changes from IS-GAAP to IFRS

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

Income Statement for the year 1 March 2006 to 29 February 2007, change from IS-GAAP to IFRS

According to IS-GAAP		Change in valuation	Change in presentation	IFRS	
Sales	46,513			46,513	Sales
Cost of goods solds	(34,645)			(34,645)	Cost of goods solds
Other operating income	76			76	Other operating income
Salaries- and salary related expense	(5,288)			(5,288)	Salaries- and salary related expense
Other operating expense	(4,582)			(4,582)	Other operating expense
Depreciation	(918)	62		(856)	Depreciation
Net financial expenses	(1,128)	101	2,209	1,182	Finance income
			(1,659)	(1,659)	Finance expenses
Net gain on the sale of shares in companies and loan write-downs	550		(550)	0	
Share of profit of associated companies	(18)			(18)	Share of loss of equity accounted investees
Income tax	(143)	(29)		(172)	Income tax
Net profit for the year	417	134	0	551	**Profit for the year**

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32. Explanation of transition to IFRSs, cont.:

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

According to IS-GAAP 28 February 2007		Change in valuation	Change in presenta-tion	IFRSs 1 March 2007	
Assets					**Assets**
Non-current assets:					
Operating assets	4,282		(169)	4,113	Operating assets
Intangible assets	9,488	(12)	169	9,645	Intangible assets
Investments in associates	82			82	Investments in equity accounted investees
Investments in other companies	186	101	2,197	2,484	Investments in other companies
Bonds	448			448	Bonds
Deferred tax asset	24	(16)		8	Deferred tax assets
Non-current assets	14,510	73	2,197	16,780	Non-current assets
Current assets					
Inventories	3,063			3,063	Inventories
Accounts receivable	674		282	956	Accounts receivable
Other receivables	282		(282)	0	Other receivables
Accounts receivable - customers' credit cards	2,667			2,667	Accounts receivable -customers' credit cards
Short-term investments in listed companies	2,197		(2,197)	0	
Cash and cash equivalents	150			150	Cash and cash equivalents
Current assets	9,033	0	(2,197)	6,836	Current assets
Total assets	23,543	73	0	23,616	**Total assets**
Equity					**Equity**
Share capital	1,067			1,067	Share capital
Share premium	3,975			3,975	Share premium
Retained earnings	1,423	73		1,496	Retained earnings
Equity	6,465	73	0	6,538	Total equity
Subordinated loan	675		(675)	0	
Equity and subordinated loan	7,140	73	(675)		
Long-term debt					
Loans from credit institutions	2,226		(434)	1,792	Loans from credit institutions
Bonds	7,966		675	8,641	Bonds
	0		434	434	Incentives from operating leases
Total liabilities	10,192	0	675	10,867	Non-current liabilities
Current liabilities					
Interest-bearing borrowings	1,249		(62)	1,187	Interest-bearing borrowings
Trade and other payables	4,712			4,712	Trade and other payables
			62	62	Incentives from operating leases
Provisions	250			250	Provisions
	6,211	0	0	6,211	Current liabilities
Total liabilities	16,403	0	675	17,078	Total liabilities
Total equity and liabilities	23,543	73	0	23,616	**Total equity and liabilities**

Financial Statements of Hagar hf. 29 February 2008 Amounts are in ISK million