STEFNIR

# Stefnir Asset Management Company

# Financial Statements 30 June 2012

Stefnir hf.
Borgartun 19
105 Reykjavík

Reg. no. 700996-2479

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# Report and endorsement of the Board of Directors and the Managing Director

The purpose of Stefnir hf. is the day-to-day operation of undertakings for collective investments in transferable securities (UCITS), investment funds and institutional investors’ funds. Stefnir is Iceland’s largest fund manager with assets of ISK 340 billion under active management. The company manages the assets of several partnerships limited by shares that have been established around enterprise investment schemes. Stefnir is a subsidiary of Arion Bank hf. and Part A of the Financial Statements is part of the Consolidated Financial Statements of the Bank and its subsidiaries.

The Financial Statements of the company are divided in two: part A which includes the Financial Statements of Stefnir hf for the period 1 January og 30 June 2012, and part B which includes the Financial Statements of UCITS, investment funds and institutional investors' funds. It has been prepared according to the same accounting methods as last year. This presentation of the financial statement is in accordance with regulations on the financial statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority and the Financial Undertakings Act.

**Operations during the year**

The company returned a profit of ISK 626 million during the period according to the income statement. The company's equity at the end of the period was ISK 2,313 million according to the balance sheet. The capital ratio, calculated according to the Financial Undertakings Act, is 78.5%; the minimum ratio permitted by the Act is 8.0%.

At the beginning and end of the period, the company's share capital was ISK 43.5 million and was entirely owned by Arion Bank hf. and related companies.

**Highlights of the first half of 2012**

The company’s annual general meeting was held on 20 March 2012 and a decision was taken to pay a dividend of ISK 700 million to the shareholders of Stefnir. The board of directors of Stefnir remains unchanged from the last shareholders' meeting; Hrund Rudolfsdóttir is chairman, Snjólfur Ólafsson is vice chairman, Eggert Teitsson, Kristján Jóhannsson and Svava Bjarnadóttir are board members. Stefnir was recognized as the first Icelandic company to be “A model company in good corporate governance.” This honour is granted by the Center for Corporate Governance at the University of Iceland and is awarded on the basis of a number of factors, including a survey conducted by the auditing company KPMG ehf.

Stefnir has endeavoured to offer a wide selection of UCITS and investment funds in order to cater to the requirements of its investors. Stefnir now manages six government bond funds. In April 2012 the fund Stefnir – Liquidity Fund changed from being a UCITS into an investment fund. After a year in business, the fund clearly proved to be attractive to investors and was primarily investing in deposits of Icelandic financial companies. Stefnir believed, given the difference in size of financial companies which receive deposits and the consolidation taking place on the market, that the spreading of deposits among so many institutions could, in some cases, be contrary to the interests of unit holders. Investment funds have more flexible investment limits in deposits and therefore it was decided to change the operating format of the fund.

Returns on bonds during the first six months of the year were rather volatile. The year started off positively for indexed bonds; returns were rather good during the first quarter as the CPI increased and yields on indexed bonds fell. However, the year started off poorly for nominal bonds as the yield increased and returns were negative at the end of the first quarter. The situation turned around completely in the second quarter with nominal bonds showing excellent returns while indexed bonds struggled. The bond market has been highly volatile in the first six months of the year as returns on Stefnir bond funds clearly demonstrate.

International equities were also rather unpredictable in the first six months of the year. All markets made sharp gains during the first three months of 2012 but the second quarter was characterised by losses, particularly in Europe. The European debt crisis and political uncertainty were the main factors behind this. International equities funds managed by Stefnir were not left unscathed by these developments but nevertheless performed well against benchmark indices and competitors.

Domestic equities funds and balanced funds with a focus on domestic equities had an excellent first six months, with the Icelandic stock market making strong gains. It is clear that media coverage of new listings and greater investor confidence in Icelandic companies contributed to the growth of Icelandic equities funds and Stefnir's balanced funds.

# Report and endorsement of the Board of Directors and the Managing Director, cont.

Alternative investments have increased in recent quarters, particularly investments in Icelandic private equity and real estate. Limited partnerships run by Stefnir have undergone certain changes since the beginning of the year. In January SF III slhf. signed an agreement on acquiring an 82% stake in Jarðborarnir hf. and the new owners received their shares in March. The investment fund SÍA I delivered all its shares in Hagar hf. to its fund members; the shares were originally acquired through Búvellir slhf. The fund sold all its shares in Sjóklæðagerðin hf. in March. It owned a stake in the company through SF II slhf.

At the end of June 2012 Stefnir established SRE II slhf. The objective of the entity is to invest in Icelandic commercial property and it has an investment capacity of ISK 16.4 billion. Investments have been made in two properties: Borgartún 37 which contains the headquarters of Nýherji and Sætún 10 which houses Advania. The company's shareholders include some of Iceland's largest pension funds and insurance companies

**Future events, risk factors and uncertainties in the second half of 2012**

Capital controls hamper the growth of the company's international funds; new investments are not possible and the Central Bank's actions relating to lifting the capital controls have pressured the Icelandic pension funds into selling assets in international UCITS.

SF1 slhf, a company operated by Stefnir, exercised a call option on 20.6% in Sjóvá-Almennar tryggingar hf at the beginning of August. SF1 slhf. owned 73% of Sjóvá after exercising the option. The stake was sold by ESÍ hf, a company set up to administer the Central Bank of Iceland's assets. SF1 slhf. is owned by pension funds and other institutional investors, including SÍA I and the institutional investor fund Stefnir ÍS-5.

In the autumn there are plans to establish SÍA II slhf, which will invest in Icelandic private equity. The fund will draw from the experience of SÍA I.

At the end of last year the funds OFAN VÍ and OFAN SVÍV were established. The purpose of the funds is to invest in loan agreements with Verzlunarskóli Íslands and the self-governing foundation SVÍV. The funds financed the loan agreements by issuing bonds and unit shares which have been sold to institutional investors. The bonds issued by the funds are in the process of being listed and are expected to be listed in the third quarter of 2012.

The board of directors of Stefnir draws attention to the fact that legal action has been brought against the company by the winding-up committee of Landsbanki Íslands hf. in respect of transactions made by funds under the company's management with Landsbanki Íslands, before and around the time of the collapse of the bank. Please refer to note 17 for further details.

**Endorsement of the board of directors and the Managing Director**

The Board of Directors and Managing Director of Stefnir hf. hereby attest the company's interim financial statement for the period 1 January to 30 June 2012 by signing below.

Reykjavík, 29 August 2012.

The Board of Directors:

Manging Director:

# Report on review of interm financial statements

**To the Board of Directors and Shareholder of Stefnir hf.**

We have reviewed the accompanying interim financial statements of Stefnir hf. for the 6 months ended 30 June 2012. The interim financial statement includes part A, which is the management company. Part A includes the Endorsement and Statement by the Board of Directors and the Managing Director, income statements, balance sheet, statement of cash flows and explanatory notes for the management company. Management is responsible for the preparation and presentation of these interim financial statements in accordance with Icelandic Financial Statements Act. Our responsibility is to express a conclusion on these interim financial statements based on our review.

**Scope of review**

We conducted our review in accordance with the International Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review nothing has come to our attention that causes us to believe that the accompanying Interim Financial Statements are not prepared, in all material respects, in accordance with Icelandic Financial Statements Act, the Financial Undertakings Act and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 29 August 2012.

Ernst & Young ehf.

Margrét Pétursdóttir

Margrét Pétursdóttir
State Authorized Public Accountant

# Statement of Income

## for the period 1 January to 30 June 2012

| | Note | 1.1. - 30.6. 2012 | 1.1. - 30.6. 2011 |
|---|---|---|---|
| **Operating income** | | | |
| Management and performance based fees | 4 | 1.114.900 | 694.339 |
| Net financial income | 10 | 51.726 | 39.173 |
| Net operating income | | 1.166.626 | 733.512 |
| **Operating expense** | | | |
| Salaries and related expense | 11 | 177.350 | 136.174 |
| Safe keeping commission | | 84.234 | 80.440 |
| Service fee to Arion bank hf. | | 17.559 | 25.469 |
| Other expense | | 93.919 | 102.701 |
| Operating expense | | 373.062 | 344.783 |
| **Earnings before tax** | | 793.564 | 388.729 |
| Income tax | 9, 12 | ( 167.986) | ( 77.746) |
| **Net earnings** | 15 | 625.578 | 310.983 |

*Stefnir hf. Financial statements 30 June 2012* *Amounts are in ISK thousands*

# Statement of Financial Position
## as at 30 June 2012

| | Note | 30.06.2012 | 31.12.2011 |
|---|---|---|---|
| **Assets** | | | |
| Securities with variable income | | 1.283.447 | 1.035.038 |
| Securities with fixed income | | 73.366 | 76.884 |
| Total Securities | 5, 13 | 1.356.814 | 1.111.922 |
| Receivable from Arion Bank hf. | | 294.009 | 108.953 |
| Accounts receivables | 7 | 335.057 | 273.833 |
| Total Receivables | | 629.065 | 382.786 |
| Tax assets | 9, 16 | 51.175 | 209.888 |
| Other assets | | 25.208 | 9.749 |
| Cash and cash equivalents | 8 | 541.196 | 1.039.777 |
| Total Other Assets | | 617.579 | 1.259.414 |
| **Total Assets** | | 2.603.458 | 2.754.121 |
| **Equity** | | | |
| Share capital | | 43.500 | 43.500 |
| Statutory reserve | | 10.875 | 10.875 |
| Retained earnings | | 2.259.122 | 2.333.545 |
| Total Equity | 15 | 2.313.497 | 2.387.920 |
| **Liabilities** | | | |
| Payable to Arion Bank hf. | | 196.415 | 204.116 |
| Accounts payable | | 2.163 | 21.640 |
| Other liabilities | | 91.383 | 140.446 |
| Total liabilities | | 289.961 | 366.202 |
| **Total Liabilities and Equity** | | 2.603.458 | 2.754.121 |

*Amounts are in ISK thousands*

# Statement of Cash Flows

## for the period 1 January to 30 June 2012

| | Note | 1.1. - 30.6 2012 | 1.1. - 30.6 2011 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net earnings | 15 | 625.578 | 310.983 |
| Non-cash items included in net earnings: | | | |
| Valuation changes of securities | | ( 37.075) | ( 8.385) |
| Expensed tax | | 167.986 | 77.745 |
| Changes in operating assets and liabilities | | ( 337.979) | 167.062 |
| Net cash from operating activities before taxes | | 418.510 | 547.405 |
| Income tax paid | | ( 9.273) | 0 |
| Net cash from operating activities | | 409.236 | 547.405 |
| **Investing activities** | | | |
| Change in Securities with variable income | | ( 213.540) | ( 161.654) |
| Change in Securities with fixed income | | 5.723 | ( 368) |
| Investing activities | | ( 207.817) | ( 162.022) |
| **Finance activities** | | | |
| Dividend paid | 15 | ( 700.000) | ( 500.000) |
| Finance activities | | ( 700.000) | ( 500.000) |
| **Net decrease in cash and cash equivalents** | | ( 498.581) | ( 114.616) |
| **Cash and cash equivalents at the beginning of the year** | | 1.039.777 | 847.747 |
| **Cash and cash equivalents at the end of the period** | 8 | 541.196 | 733.131 |

*Stefnir hf. Financial statements 30 June 2012* *Amounts are in ISK thousands*

# Notes to the Financial Statements

**Accounting policies**

**1. General information**

Stefnir hf. is a limited liabilty entity and operates in accordance with Act. 2/1995 on Limited Liabilty Companies and Act. 161/2002 on Financial Undertakings. The address of Stefnir's registered office is at Borgartún 19, Reykjavík and its ID no. is 700996-2479.

Stefnir is að subsidiary of Arion Bank hf., ID no. 581008-0150, Borgartún 19, Reykjavík.

**2. Basis of preparation**

The Interim Financial Statements of Stefnir hf., A-part, are prepared in accordance with law on Financial Statements, law on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS. The Financial Statements are prepared on the historical cost basis except for Securities that are valued at fair value. The Financial Statements are presented in Icelandic króna (ISK), rounded to the nearest thousand unless otherwise stated. The company is a subsidiary of Arion bank hf. The Interim Financial Statements of Stefnir hf. are part of the Consolidated Interim Financial Statements for the parent company with information on operations and financial position of the Consolidated company.

**3. Use of estimates and judgements**

The preparation of Financial Statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, contingent liabilities as well as income and expenses in the Financial Statements presented. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the Financial Statements.

**4. Management and performance based fees**

The company earns asset management fees for the operations of Stefnir's Securities Funds, Investment Funds and Professional Investors' Funds. The fee is a fixed percentage of the net assets of each fund and includes the following operating expenses of the funds; salaries of the employees of the operating company, marketing and management. Fees are also earned from the operation of special purpose entites that have been established for enterprise investments. Additionally the company earns fees for the asset management of foreign funds that are in custody of foreign entities. Performance fees are earned if certain conditions are met.

**5. Securities**

**a. Securities with variable income**

Securities owned by the company are trading assets. Fund units are measured at buy price at year end. Listed fund units are measured at market value at end of June.

**b. Securities with fixed income**

A bond that is listed on regulated securities market which is active and price generating is measured at market price at each time. The expression “active and price generating” means that the closing price of the bond is not based on old trades, trading with an insignificant portion of the total issuance or does not reflect the fair value of the bond as valued by specialists. If the issuer of a bond is expected to default, the bond is valued at the expected recoverable amount taking into account priority order of claims.

A bond where the issuer is deemed viable but is not listed on an active and price generating securities market is measured at present value of future cash flow. The choice of yield curve used for each bond is based on general risk and the circumstances on the market at the end of the period.

For a bond where the issuer is not deemed viable the methods described above are deviated from and the bond is measured at expected recovery value and no interest income is realised. The estimate of expected recovery value takes into account the experience of the recovery from similar issuers, the financial statements of the issuer and statements issued by it. If the issuer is in administration, has defaulted or stated that payments of the bond will not be made the expected recovery is measured 0-1% and the bond entered into a collection process. If new information is received from issuers that have previously been fully provisioned for, the bond is re-valued, which might change the valuation of the bond to higher value. Due to significant uncertainty about the valuation of bonds the final recovery might vary considerably from the valuation at end of June.

**6. Foreign currency transactions**

Transactions in foreign currencies are translated to Icelandic króna at exchange rates at the dates of transactions. Assets and liabilities denominated in foreign currency are translated at exchange rate at the end of June. Net foreign assets at 30 June amount to ISK 997 millions and are specified as follows:

| | EUR | USD | GBP | SEK |
|---|---|---|---|---|
| Assets | 821.771 | 60.014 | 114.708 | 203 |
| Liabilities | ( 3) | 0 | 0 | 0 |
| Net balance 30.06.2012 | 821.768 | 60.014 | 114.708 | 203 |
| Net balance 31.12.2011 | 901.884 | 65.171 | 111.248 | 200 |

**7. Receivables**

Recivables are measured at nominal value

**8. Cash**

Cash consists of cash and deposits whth credit institutions.

**9. Tax assets**

The deferred income tax asset has been calculated and entered in the Statement of Financial Position. The calculation is based on the difference between Statement of Financial Position items as presented in the tax return on the one hand, and in the Financial Statements on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because of time difference in impairment of securites and foreign exchange gain and loss are distributed over three years in the tax return. A deferred tax asset due to prvious years' losses has been accounted for.

**10. Net financial income**

Net financial income is specified as follows:

| | 1.1. - 30.6 2012 | 1.1. - 30.6 2011 |
|---|---|---|
| Valuation change in securities assets | 33.382 | ( 25.744) |
| Foreign exchange gain (loss) | 12.890 | 59.202 |
| Interest income | 5.491 | 5.803 |
| Interest expense | ( 37) | ( 88) |
| Net financial income | 51.726 | 39.173 |

**11. Personnel**

Salaries and related expenses are specified as follows:

| | | |
|---|---|---|
| Salaries | 140.915 | 112.842 |
| Salary related expenses | 36.435 | 23.331 |
| Salaries and related expenses | 177.350 | 136.174 |

Number of employees is as follows:

| | | |
|---|---|---|
| Employees at the end of the period | 17 | 16 |
| Average number of employees during the period | 17 | 16 |

**12. Income tax**

| | | |
|---|---|---|
| Current year | 158.713 | 77.746 |
| Prior year correction | 9.273 | 0 |
| Total Income tax expense | 167.986 | 77.746 |

*Stefnir hf. Financial statements 30 June 2012* *Amounts are in ISK thousands*

**13. Securities**

Securities with variable income are specified as follows:

| | 30.06.2012 | 31.12.2011 |
|---|---|---|
| Fund units issued by funds operated by Stefnir hf. | 1.085.343 | 852.108 |
| Fund units issued by others | 151.094 | 147.868 |
| Shares in investment companies | 47.011 | 35.063 |
| | 1.283.447 | 1.035.038 |

Securities with fixed income are specified as follows:

| | 30.06.2012 | 31.12.2011 |
|---|---|---|
| Listed on NASDAQ OMX Iceland: | | |
| Issued by public entities | 11.810 | 13.920 |
| Unlisted: | | |
| Issued by public entities | 5.263 | 5.521 |
| Isued by others | 56.293 | 57.442 |
| | 73.366 | 76.884 |
| Securities total | 1.356.814 | 1.111.922 |

**14. Related parties**

Stefnir hf. has a related party relationship with the parent company, Arion Bank hf. and its subsidiaries and associates, funds under management, The Board of Directors and key management personnel at Stefnir.

No unusual transaction took place with related parties in the reporting period. Transaction with related parties have been conducted on an arm's length basis.

Transactions with related parties 1 January to 30 June 2012:

| | Revenue | Expense | Receivables/ Assets | Liabilities |
|---|---|---|---|---|
| Arion bank consolidated | 506.070 | 107.424 | 850.810 | 196.415 |
| Units in funds | 609.354 | | 148.641 | 27.051 |
| | 1.115.424 | 107.424 | 999.451 | 223.465 |

**15. Equity**

**a.** Total share capital amounts to ISK 43.5 million at year end.  One vote is associated with every one króna share.

**b.** Changes in eqity are specified as follows:

| | Share capital | Statutory reserve | Retained earnings | Total |
|---|---|---|---|---|
| Equity 1.1.2011 | 43.500 | 10.875 | 2.159.937 | 2.214.312 |
| Dividend paid | | | ( 500.000) | ( 500.000) |
| Net earnings | | | 673.608 | 673.608 |
| Equity 31.12.2011 | 43.500 | 10.875 | 2.333.545 | 2.387.920 |
| | | | | |
| Equity 1.1.2012 | 43.500 | 10.875 | 2.333.545 | 2.387.920 |
| Dividend paid | | | ( 700.000) | ( 700.000) |
| Net earnings | | | 625.578 | 625.578 |
| Equity 30.06.2012 | 43.500 | 10.875 | 2.259.122 | 2.313.497 |

*Stefnir hf. Financial statements 30 June 2012* *Amounts are in ISK thousands*

**15. Equity, cont.**

**c.** Equity at end of June is ISK 2,313 thousands or 88.9% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 78.5%, exceeding the minimum legal requirement of 8%. The ratio is calculated as follows:

| | **30.06.2012** | **31.12.2011** |
|---|---|---|
| Total equity | 2.313.497 | 2.387.920 |
| Tax assets | ( 51.175) | ( 209.888) |
| Total own funds for solvency purposes | 2.262.322 | 2.178.032 |
| Total capital requirements are specified as follows: | | |
| Credit risk | 150.730 | 130.020 |
| Market risk | 79.735 | 78.424 |
| Capital requirement | 230.465 | 208.444 |
| Capital adequacy ratio | 78,5% | 83,6% |

**16. Tax liability/asset**

Changes in deferred tax assets and liabilities are specified as follows:

| | | |
|---|---|---|
| Tax assets at the beginning of the year | 209.888 | 28.143 |
| Reassessment of taxes for the years 2009-2011 | 0 | 326.731 |
| Income tax recognised in profit or loss | ( 158.713) | ( 145.794) |
| Other changes | 0 | 808 |
| Deferred tax asset at the end of the period | 51.175 | 209.888 |

Tax assets are attributable to the following:

| | | |
|---|---|---|
| Tax loss carried forward | 11.407 | 165.714 |
| Securities | 39.057 | 39.057 |
| Deferred foreign exchange gain and loss | ( 1.221) | 3.185 |
| Other items | 1.932 | 1.932 |
| Deferred tax asset at the end of the period | 51.175 | 209.888 |

In 2011 tax authorities made amendments to Stefnir's 2009 Tax form for operations in 2008. The amendment concerned impairment of securities assets that was deemd unauthorised at that time. The amendment does not have material impact on the amount of the impairment, but postpones it to the years 2009 and 2011. The tax asset at the beginning of 2011 is affected by the amendment as explained in the above table. Amended income tax assesment for the year 2009 was paid 2011.

**17. Other information**

The winding-up committee of Landsbanki Íslands has brought legal action against Stefnir in Reykjavík District Court. The legal action is based on the winding-up committee's demand to rescind Landsbankinn's payment of money market deposits which matured early in October 2008 to two funds managed by Stefnir. The amount involved is ISK 450 million plus interest. Stefnir considers the winding-up committee's claims to be baseless and the case will be heard by Reykjavík District Court this coming autumn.

**18. Events after the balance sheet date**

In July the EFTA Surveillance Authority (ESA) concluded its formal investigation into the purchases of the assets of money market funds in the autumn of 2008. The investigation aimed to clarify whether the purchase by Arion Bank hf. of assets in the funds could be interpreted as state aid. The ESA concluded that it did constitute state aid but that it complied with Article 61(3)(b) of the EEA agreement. The board of directors is pleased that a definitive conclusion has been reached and that all uncertainty relating to the investigation has been eliminated.

**In the case of any discrepancy between the English and the Icelandic texts, the Icelandic versions shall prevail and questions of interpretation will be addressed solely in the Icelandic language.**

*Stefnir hf. Financial statements 30 June 2012* *Amounts are in ISK thousands*