Hagar hf.

Condensed Consolidated
Interim Financial Statements
1 March - 31 August 2011
ISK

Hagar hf.
Hagasmára 1
201 Kópavogur
Iceland

Reg. no. 670203-2120

Contents

Endorsement and Signatures of the Board of Directors and the CEO

The condensed consolidated interim financial statements of Hagar hf. ("the Company") for the period 1 March to 31 August 2011 have been prepared in accordance with International Financial Reporting Standards (IFRSs) for interim financial statements (IAS 34). The interim financial statements comprise the consolidated interim financial statements of Hagar hf. and its subsidiaries, together referred to as the "Group".

On 12 October 2011, the Company refinanced its loans with Arion banki hf. The loans have a final repayment date on 5 October 2015. The Company can request for an extension of the final repayment date of four years.

According to the statement of comprehensive income, profit of the Group for the period amounted to ISK 1,025 million. According to the balance sheet, equity at the end of the period amounted to ISK 4,807 million.

The Company's share capital amounted to ISK 1,172 million at the end of the period. Shareholders were four at the beginning of the period and twelve at the end of the period. Eignabjarg ehf., a company owned by Arion bank hf., held 63,5% of outstanding shares and Búvellir slhf., a company owned by several pension funds and other professional investors, held 35,3%. The intention of shareholders is to list the Company's shares on Nasdaq OMX Iceland later this year.

Statement by the Board of Directors and CEO

To the best of our knowledge it is our opinion that the condensed consolidated interim financial statements give a true and fair view of the consolidated financial performance of the Company for the six month period ended 31 August 2011, its assets, liabilities and consolidated financial position as at 31 August 2011 and its consolidated cash flow for the period then ended in accordance with International Financial Standards (IFRSs) for interim financial statements (IAS 34).

The Board of Directors and the CEO have today discussed the condensed consolidated interim financial statements of Hagar hf. for the period 1 March to 31 August 2011 and confirm them by means of their signatures.

Reykjavík, 28 October 2011

The Board of Directors:

Árni Hauksson

Kristín Friðgeirsdóttir

CEO:

Independent Auditor's Report

To the Board of Directors and Shareholders of Hagar hf.

We have audited the accompanying condensed consolidated interim financial statements of Hagar hf., which comprise the consolidated balance sheet as at 31 August 2011, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flows statement for the period 1 March to 31 August 2011, 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 condensed consolidated interim financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of condensed consolidated interim financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the condensed consolidated interim financial statements. The procedures selected depend on the auditor's judgment, 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 consolidated 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 condensed consolidated interim financial statements are prepared, in all material respects, in accordance with IAS 34 “Interim Financial Reporting”.

Reykjavík, 28 October 2011

KPMG ehf.

Consolidated Statement of Comprehensive Income for the six months ended 31 August 2011

	Note	2011 1.3.-31.8.	2010 1.3.-31.8.
Sales	15	33.711	33.807
Cost of goods sold		(25.685)	(25.328)
Gross profit		8.026	8.479
Other operating income		55	49
Salaries and salary-related expenses		(3.037)	(3.092)
Other operating expenses		(2.856)	(3.020)
Results from operating activities before fine, depreciation and amortisation		2.188	2.416
Fine to the Competition Authority		0	(270)
Depreciation and amortisation of operating and intangible assets	7	(596)	(459)
Results from operating activities		1.592	1.687
Finance income		210	201
Finance expenses		(441)	(1.257)
Net finance expense	8	(231)	(1.056)
Profit before income tax		1.361	631
Income tax		(336)	(161)
Comprehensive income for the period		1.025	470

Earnings per share:

Basic and diluted earnings per share of ISK 1		0,87	0,40

The notes on pages 9 to 12 are an integral part of these financial statements.

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Consolidated Balance Sheet as at 31 August 2011

	Note	31.8.2011	28.2.2011
Assets			
Operating assets		4.418	4.638
Intangible assets	6	7.998	8.172
Non-current assets		12.416	12.810
Inventories	9	4.614	3.936
Trade and other receivables		675	541
Trade receivable - customers' credit cards		3.987	3.455
Cash and cash equivalents		1.825	1.088
Current assets		11.101	9.020
Total assets		23.517	21.830
Equity			
Share capital		1.172	1.172
Share premium		1.272	1.272
Retained earnings		2.363	1.168
Total equity		4.807	3.612
Liabilities			
Loans and borrowings	10	10.694	483
Incentives from operating leases		174	196
Deferred tax liabilities		365	151
Non-current liabilities		11.233	830
Loans and borrowings	10	677	11.497
Trade and other payables	11	6.527	5.618
Provisions		273	273
Current liabilities		7.477	17.388
Total liabilities		18.710	18.218
Total equity and liabilities		23.517	21.830

The notes on pages 9 to 12 are an integral part of these financial statements.

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Consolidated Statement of Changes in Equity for the six months ended 31 August 2011

	Share capital	Share premium	Translation reserve	Retained earnings	Total equity
Changes in equity from 1 March to 31 August 2010:					
Equity at 1 March 2010	1.172	1.272	31	44	2.519
Comprehensive income for the period				470	470
Equity at 31 August 2010	1.172	1.272	31	514	2.989
Changes in equity from 1 March to 31 August 2011:					
Equity at 1 March 2011	1.172	1.272	0	1.168	3.612
Share-based transaction (see note 13)				170	170
Comprehensive income for the period				1.025	1.025
Equity at 31 August 2011	1.172	1.272	0	2.363	4.807

The notes on pages 9 to 12 are an integral part of these financial statements.

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Consolidated Statement of Cash Flows for the six months ended 31 August 2011

	Note	2011 1.3.-31.8.	2010 1.3.-31.8.
Cash flows from operating activities:			
Net profit for the period		1.025	470
Adjustments for:			
Depreciation and amortisation	7	596	459
Net finance expense	8	231	1.056
Share-based expense	13	170	0
Income tax		336	161
Incentives from operating leases and other items		(37)	25
Working capital provided by operating activities		2.321	2.171
Net change in operating assets and liabilities		(310)	(943)
Cash from operations before interest and taxes		2.011	1.228
Interest received		40	23
Interest paid		(429)	(758)
Net cash provided by operating activities		1.622	493
Cash flows to investing activities:			
Acquisition of operating assets		(206)	(270)
Acquisition of intangible assets		0	(7)
Proceeds from sale of operating assets		10	59
Net cash used in investing activities		(196)	(218)
Cash flows to financing activities:			
Proceeds from borrowings		0	367
Repayment of borrowings		(689)	(344)
Short term borrowings, changes		0	(450)
Net cash used in financing activities		(689)	(427)
Net increase (decrease) in cash and cash equivalents		737	(152)
Cash and cash equivalents at 1 March		1.088	475
Cash and cash equivalents at 31 August		1.825	323

The notes on pages 9 to 12 are an integral part of these financial statements.

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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 Hagasmári 1, Kópavogur, Iceland. The condensed consolidated interim financial statements of the Company as at and for the six months ended 31 August 2011 comprise the Company and its subsidiaries, together referred to as the "Group" and individually as "Group entities". The main activity of the Group is retail.

2. Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting* .

They do not include all of the information required for a complete set of consolidated annual financial statements and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended 28 February 2011.

The condensed consolidated interim financial statements were approved by the Board of Directors on 28 October 2011.

3. Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 28 February 2011.

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.

4. Estimates

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

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 28 February 2011.

5. Segment reporting

The Group does not present business segments as its operation is only in retail and in Iceland.

6. Goodwill

Impairment tests

Goodwill arising on business combinations is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indications that goodwill may be impaired. Goodwill acquired in a business combination is allocated to groups of cash-generating units according to the level at which management monitor that goodwill.

As there was indication that goodwill might be impaired at 31 August 2011 it was tested for impairment. According to the impairment tests impairment loss is ISK 150 million for one cash-generating unit and is recognised in profit and loss.

7. Depreciation and amortisation

Depreciation and amortisation is specified as follows:	**2011 1.3.-31.8.**	**2010 1.3.-31.8.**
Depreciation of operating assets	421	363
Impairment of goodwill	150	60
Amortisation of intangible assets	25	36
	596	459

8. Finance income and expense

Finance income and finance expense are specified as follows:		
Interest income	40	23
A final settlement with Skeljungur hf.	0	123
Adjustment of provision	170	47
Net foreign exchange gain	0	8
Total finance income	210	201
Interest expense and indexation	(441)	(1.128)
Net changes in fair value of financial assets at fair value through profit or loss	0	(129)
Total finance expense	(441)	(1.257)
Net finance income and expense	(231)	(1.056)

9. Inventories

Inventories are specified as follows:	**31.8.2011**	**28.2.2011**
Groceries	2.798	2.319
Speciality goods	1.515	1.317
Goods in transit	301	300
Total inventories	4.614	3.936
Inventory write-down at the end of the period	109	115

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10. Loans and borrowings

Loans and borrowings are specified as follows:

	31.8.2011	28.2.2011
Non-current loans and borrowings		
Secured bank loans	10.491	283
Other loans	203	200
Total loans and borrowing	10.694	483
Current loans and borrowings		
Current portion of secured bank loans	664	11.485
Current portion of finance lease liability	13	12
Total loans and borrowing	677	11.497

Terms and conditions of outstanding loans were as follows:

	Weighted average interest rate	Carrying amount	Carrying amount
Debt in ISK, indexed	10,0%	216	499
Debt in ISK, un-indexed	6,3%	11.155	11.481
Non-current loans and borrowing, including current portion		11.371	11.980
Current portion of non-current loans and borrowings		(677)	(11.497)
Total non-current loans and borrowings		10.694	483

Contractual repayments of loans and borrowings are specified as follows:

Repayments in 1 year or less	677	11.497
Repayments in 1 - 2 years	10.506	16
Repayments in 2 - 3 years	13	16
Repayments in 3 - 4 years	13	16
Repayments in 4 - 5 years	13	16
Subsequent	149	419
Total	11.371	11.980

In accordance with the requirements of IFRSs, the repayment of the Company's loan with Arion Banki hf. is shown as due in October 2012, although an agreement was reached in October 2011 to extend the due date to October 2015, as explained below.

On 12 October 2011, the Company refinanced it's long-term loans with Arion Banki hf. in the amount of ISK 11,155 million. The contractual repayments of the loans after the refinancing is ISK 54 million per month as previously. The final maturity date of the loans are on 5 October 2015, on which ISK 8,520 million is due. At that time the Company can request that the loans be extended for further four years. The Weighted average interest rate on un-indexed loans after the refinancing is REIBOR + 1.94%.

11. Trade and other payables

Trade and other payables are specified as follows:

	31.8.2011	28.2.2011
Trade payables	4.836	4.161
Other payables	1.521	1.277
Taxes payable	126	126
Incentives from operating leases	44	54
Total trade and other payables	6.527	5.618

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Notes, cont.:

12. Related parties

a. *Identity of related parties*

The Company has a related party relationship with its parent company, associates, directors and executive officers. Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. The Company's ultimate Parent Company is Arion banki hf.

b. *Related party transactions*

Payable to related parties at period-end, was as follows:	**31.8.2011**	**28.2.2011**
Arion banki hf. (included in loans and borrowings)	(11.155)	(11.481)

Transactions between the Group and related parties in the Statement of Comprehensive income, was as follows:

	2011	**2010**
	1.3.-31.8.	**1.3.-31.8.**
Interest income from Arion banki hf.	37	15
Fees paid to Arion banki hf.	0	(2)
Interest expense to Arion banki hf.	(409)	(358)

13. Share-based transaction

During the period, Eignabjarg ehf. which is the parent company of Hagar hf. finished an agreement with key management personnel (KMP) of Hagar hf. that entitles them to receive shares in Hagar hf. without any reimbursement. This agreement was a settlement related to an earlier agreement made between Eignabjarg and KMP which KMP agreed to terminate against this reimbursement. The nominal value of shares amounts to 17.0 million. At the signing of the agreement, 7.7 million shares were delivered to KMP. The remaining shares in the nominal amount of 9.4 million will only be delivered to KMP if they remain in service at 31 July 2012. The shares will be delivered to KMP during the period 15 January - 31 July 2012. In addition Eignabjarg ehf. will reimburse KMP all tax payments levied on them due to this agreement.

Due to this agreement between Eignabjarg ehf. and the Company's KMP, the Company expensed ISK 170 million as salary and salary-related expenses through profit and loss with a corresponding positive entry in equity. The fair value of the agreement at the agreement date amounts to 344.3 million ISK and the Company will account for the remaining amount in the same manner during the second half of the year.

The Company will incur no cost or cash outflow as a result of this agreement, as Eignabjarg will fulfil all obligations to KMP under the agreement. The expense entry in profit and loss does not have any effect on the Company's income tax.

14. Group entities

At 31 August 2011 the Company's subsidiaries were eight. The subsidiaries included in the condensed consolidated interim financial statements are the following:

	Place of registration and operation	**Ownership interest 31.8.2011**	**Ownership interest 28.2.2011**
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%
Sólhöfn ehf.	Iceland	100%	100%
Eignarhaldsfélagið Dagar ehf.	Iceland	100%	100%
Hagar verslanir ehf.	Iceland	100%	100%

15. Change in group entities

On 31 August 2010, Rekstrarfélag Tíu-ellefu ehf., a company at that time owned by Eignabjarg ehf., took over the operations of the retail stores of 10-11. The operating results of 10-11 are included in the prior year results.

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