



Asset Management Company

Financial Statements 30 June 2014

Stefnir hf. - A hluti
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 Stefir hf. is to operate UCITS, investment funds and institutional investors' funds. The company also manages the assets of several partnerships limited by shares that have been established around enterprise investment schemes. Stefir is Iceland's largest fund manager with assets of approximately ISK 421 billion under active management. Stefir is a subsidiary of Arion Bank hf. and the A-part of the Interim Financial Statements is part of the Consolidated Financial Statements of the Bank and its subsidiaries.

The Interim Financial Statements of the company are divided in two: part A which includes the Interim Financial Statements of Stefir hf. and part B which includes the Interim Financial Statements of UCITS, investment funds and institutional investors' funds. The Interim Financial Statements have been prepared according to the same accounting methods as last year. The Interim Financial Statements have been prepared on accordance with the Annuals Account Act, the Financial Undertakings Act and the rules of the Financial Supervisory Authority on the accounts of UCITS management companies.

Operations during the year

The company reported earnings of ISK 437 million in the period according to the income statement. The company's equity at the end of the period was ISK 2 billion according to the balance sheet. The capital ratio, calculated according to the Act on Financial Undertakings, is 57%, the minimum being 8.0% according to the Act.

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 2013

The company's annual general meeting was held on 19 March 2014 and a decision was taken to pay a dividend of ISK 1 billion to the shareholders of Stefir. The board of directors of Stefir was elected at the meeting and comprises the following members: Hrunn Rudolfsdóttir, chairman, Kristján Jóhannsson, vice chairman, and Jökull Heiddal Úlfsson, Svava Bjarnadóttir and Thórdur Sverrisson who are board directors. Thórdur Sverrisson is a new boardmember replacing Snjólfur Ólafsson.

In 2012 Stefir was recognized as the first Icelandic company to be "A model company in good corporate governance." This honour was 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. The company is constantly working on maintaining and developing corporate governance and re-attaining this recognition annually is part of this effort. The board and employees of Stefir have encouraged awareness and discussion of corporate governance during the first half of 2014. In March Hrunn Rudolfsdóttir, chairman of Stefir, gave a presentation at a conference on model companies in good corporate governance and also participated in a panel discussion on the subject. Stefir invited all management and all board directors of companies managed by Stefir to participate in a special course on corporate governance. Good attendance and focused discussion of corporate governance better enable board directors to carry out the varied tasks entrusted to them.

Assets under management increased from approximately ISK 413 billion to more than ISK 421 billion, an increase of 1.6%.

Returns on different asset classes have varied in the first half of 2014. The strengthening of the ISK and lower than forecast inflation resulted in higher yields and lower prices of indexed bonds. This development affected Stefir funds with indexed instruments and all long-term bond funds at Stefir yielded negative returns in the first half of 2014. Returns on non-indexed instruments were far better as lower inflation resulted in stronger returns on medium duration funds. However, only non-indexed bond funds generated positive returns in the first half of the year in this category. The turnover on the Icelandic stock market in the first six months of 2014 was slightly less than the same period last year and share price performance has varied greatly between companies. While companies such as Össur and Hagar have seen sharp increases in their share prices on the back of strong financial figures, Marel and the insurance companies have had a difficult time. Domestic equities funds and balanced funds with a focus on equities reflect this position to some extent. International funds managed by the company had a respectable first six months, mirroring the performance of international markets generally. The MSCI world index in euros yielded almost 6% during the period. Emerging equities markers have shown a recovery, which is clearly demonstrated in the performance of international funds focusing in these markets. The capital controls place significant restrictions on international investments by individuals and institutional investors, and international funds run and managed by Stefir have limited growth potential in this environment.

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

In order to sharpen the focus of the available funds it was decided to merge the investment funds Stefmir – Verðbréfavall 1, Stefmir – Verðbréfavall 2 and Stefmir – Balanced Fund under the name of the latter. The merged fund has a capacity of more than ISK 5 billion and almost 4000 unit holders. At the end of June the fund Hávaxtasjóður was dissolved after a process stretching back to June 2008. Final payments to unit holders were made in June and the fund was subsequently dissolved.

Alternative investments have increased in recent quarters, particularly investments in Icelandic private equity and real estate. SÍA II slhf, a company with an operating agreement with Stefmir, and a consortium of investors completed the acquisition of part of the domestic operations of Norvík through Festi hf. which is the new parent of the sold company. This acquisition means that Festi is taking over the operations of Kaupás, which operates supermarkets under the names Krónan, Nóatún and Kjarval, Elko, Intersport, the advertising agency Expo and the warehouse hotel Bakkinn. Festi has also acquired part of the real estate portfolio of Smáragarður. The institutional investor fund BRIC ELN had a bond with a nominal value of ISK 678 million admitted to trading on NASDAQ OMX Iceland hf. at the end of February 2014. On behalf of SRE II slhf, Stefmir's real estate team acquired a property at Síðumúli in Reykjavík which houses the service company Fastus. It also acquired a property at Faxafen which is home to the bed company Beta bak. The refinancing and funding of the extension of Hótel Borg was completed at the beginning of the summer. An indexed mortgage bond in the amount of ISK 3,150 million will be issued to investors in the company.

Risk management and corporate governance

Risk management and active internal control are mainstays of the responsible operation of a fund management company. The board of directors of Stefmir has mapped the company's risk management environment. The risks facing the company have been systematically analysed and measured, and the board is regularly informed of matters relating to risk management and internal control. Measures to manage and mitigate possible risk factors are vital to the operational security of the company. The outsourcing of tasks and monitoring such outsourcing are critical components of risk management and mitigation. The company has also prepared a written contingency plan concerning the risks which may disrupt or stop the company's operations temporarily and has presented it to Stefmir's employees.

The board of directors of Stefmir is committed to good corporate governance and endeavours to promote responsible behaviour and corporate culture within Stefmir for the benefit of all the company's stakeholders.

Forthcoming events, risk factors and uncertainties in the company's operations


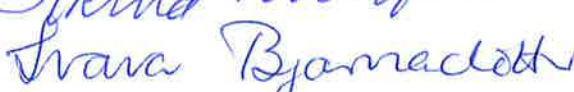
Capital controls hamper the growth of the company's international funds; new investments are not possible and the Central Bank's actions relating to lifting the capital controls have pressured the Icelandic pension funds into selling foreign assets, including UCITS.

Endorsement of the board of directors and the Managing Director

The Board of Directors and Managing Director of Stefmir hf. hereby attest the company's interim financial statement for the period 1 January to 30 June 2014 by signing below.

Reykjavík, 28 August 2014

The Board of Directors:




Managing Director:



Report on review of interm financial statements

To the Board of Directors and Shareholder of Stefmir hf.

We have reviewed the accompanying interim financial statements of Stefmir hf. for the 6 months ended 30 June 2014. 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, 28 August 2014

Ernst & Young ehf.



Margrét Pétursdóttir

State Authorized Public Accountant

Statement of Income

for the period 1 January to 30 June 2014

	Note	1.1. - 30.6. 2014	1.1. - 30.6. 2013
Operating income			
Management and performance based fees	4	994.060	771.756
Net financial income	10	23.945	(1.958)
Net operating income		<u>1.018.005</u>	<u>769.798</u>
Operating expense			
Salaries and related expense	11	272.531	222.209
Safe keeping commission		93.465	96.558
Service fee to Arion bank hf.		8.340	19.803
Other expense		103.064	111.933
Operating expense		<u>477.400</u>	<u>450.503</u>
Earnings before tax		540.605	319.295
Income tax	12	(103.249)	(63.030)
Net earnings	16	<u>437.356</u>	<u>256.265</u>

Statement of Financial Position

as at 30 June 2014

	Note	30.6.2014	31.12.2013
Assets			
Securities with variable income		1.655.085	1.907.043
Securities with fixed income		54.090	59.476
Total Securities	5, 13	<u>1.709.175</u>	<u>1.966.519</u>
Receivable from Arion Bank hf.		0	2.391
Accounts receivables	7	<u>703.188</u>	<u>472.077</u>
Total Receivables		<u>703.188</u>	<u>474.468</u>
Tax assets	9, 17	49.544	47.046
Other assets		9.957	151.464
Cash and cash equivalents	8	<u>266.469</u>	<u>597.587</u>
Total Other Assets		<u>325.970</u>	<u>796.098</u>
Total Assets		<u><u>2.738.333</u></u>	<u><u>3.237.085</u></u>
Equity			
Share capital		43.500	43.500
Statutory reserve		10.875	10.875
Retained earnings		1.952.859	2.515.503
Total Equity	16	<u>2.007.234</u>	<u>2.569.878</u>
Liabilities			
Payable to Arion Bank hf.		281.565	277.113
Accounts payable		16.017	4.901
Other liabilities		208.589	211.678
Tax liabilities	17	<u>224.928</u>	<u>173.515</u>
Total liabilities		<u>731.100</u>	<u>667.207</u>
Total Equity and Liabilities		<u><u>2.738.333</u></u>	<u><u>3.237.085</u></u>

Statement of Cash Flows

for the period 1 January to 30 June 2014

	Note	1.1. - 30.6. 2014	1.1. - 30.6. 2013
Cash flows from operating activities			
Net earnings	16	437.356	256.265
Non-cash items included in net earnings:			
Valuation changes of securities	(30.025)	(50.783)
Income tax recognised in profit or loss		103.249	63.030
Changes in operating assets and liabilities	(74.734)	(3.330)
		<u>435.847</u>	<u>265.182</u>
Income tax paid	17	(54.333)	0
Net cash from operating activities		<u>381.513</u>	<u>265.182</u>
Investing activities			
Change in Securities with variable income		281.942	658.976
Change in Securities with fixed income		<u>5.426</u>	<u>5.607</u>
Investing activities		<u>287.369</u>	<u>664.582</u>
Finance activities			
Dividend paid	16	(1.000.000)	(900.000)
Finance activities		<u>(1.000.000)</u>	<u>(900.000)</u>
Net change in cash and cash equivalents		(331.118)	29.765
Cash and cash equivalents at the beginning of the year		<u>597.587</u>	<u>755.688</u>
Cash and cash equivalents at the end of the period.....	8	<u>266.469</u>	<u>785.452</u>

Notes to the Financial Statements

Accounting policies

1. General information

Stefnir hf. is a limited liability entity and operates in accordance with Act. 2/1995 on Limited Liability 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 Interim Financial Statements are prepared on the historical cost basis except for Securities that are valued at fair value. The Interim Financial Statements are presented in Icelandic króna (ISK), rounded to the nearest thousand unless otherwise stated. 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, 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, total assets or subscriptions 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 entities 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 and shares in special purpose entities are measured at cost at end of the period. Listed fund units are measured at market value at end of the period.

b. Securities with fixed income

Bonds that are listed on regulated securities market which is active and price generating are measured at market price at each time. The expression "active and price generating" means that the closing price of a 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 the period.

Notes, continued:

6. Foreign currency transactions

Transactions in foreign currencies are translated to Icelandic króna at exchange rates at the dates of transactions, according to Reuter. Assets and liabilities denominated in foreign currency are translated at exchange rate at the end of the period. Net foreign assets at 30 June amount to ISK 954 millions and are specified as follows:

	EUR	USD	GBP	Other
Assets	899.775	30.759	32.416	196
Liabilities	0	0	0	(3.119)
Net balance 30.06.2014	899.775	30.759	32.416	(2.923)
Net balance 31.12.2013	1.085.233	38.115	30.320	4.483

7. Receivables

Receivables are measured at nominal value deducted by impairment.

8. Cash

Cash consists of cash and deposits with credit institutions.

9. Tax assets

The calculation of deferred tax asset 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 securities and foreign exchange gain and loss are distributed over three years in the tax return.

10. Net financial income

Net financial income is specified as follows:

	1.1. - 30.6.	1.1. - 30.6.
	2014	2013
Valuation change in securities assets	42.038	77.793
Dividend received	4.143	4.144
Foreign exchange gain (loss)	(26.544)	(60.434)
Interest income	4.378	6.604
Interest expense	(70)	(30.065)
Net financial income	23.945	(1.958)

11. Personnel

Salaries and related expenses are specified as follows:

Salaries	213.679	170.735
Salary related expenses	58.851	51.923
Salaries invoiced	0	(450)
Salaries and related expenses	272.531	222.209

Number of employees is as follows:

Employees at the end of the period	22	20
Average number of employees during the period	21	18

Notes, continued:

	1.1. - 30.6. 2014	1.1. - 30.6. 2013
12. Income tax		
Current period	103.249	63.030
Total Income tax expense	<u>103.249</u>	<u>63.030</u>

13. Securities

Securities with variable income are specified as follows:

Fund units issued by funds operated by Stefnir hf.	1.365.132	1.700.015
Fund units issued by others	68.647	69.368
Shares in investment companies	184.689	137.660
Shares in companies	36.617	0
	<u>1.655.085</u>	<u>1.907.043</u>

Securities with fixed income are specified as follows:

Listed on NASDAQ OMX Iceland:

Issued by public entities	9.221	10.614
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Unlisted:

Issued by public entities	4.160	4.150
Issued by others	40.709	44.712
	<u>54.090</u>	<u>59.476</u>

Securities total	<u>1.709.175</u>	<u>1.966.519</u>
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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 2014:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	86.095	659.611	280.605	281.565
Funds in operation	1.010.701	0	261.145	0
	<u>1.096.796</u>	<u>659.611</u>	<u>541.751</u>	<u>281.565</u>

Notes, continued:

15. Assets under Management

Assets under Management in funds in operation by Stefmir at the end of the period amount to ISK 421 billions compared to ISK 414 billions at year end 2013.

16. Equity

a. Total share capital amounts to ISK 43.5 million at the end of the period and is the same as at year end 2013. One vote is associated with every one króna share.

b. Changes in equity are specified as follows:

	Share capital	Statutory reserve	Retained earnings	Total
Equity 1.1.2013	43.500	10.875	2.369.581	2.423.956
Dividend paid			(900.000)	(900.000)
Net earnings			1.045.921	1.045.921
Equity 31.12.2013	<u>43.500</u>	<u>10.875</u>	<u>2.515.503</u>	<u>2.569.878</u>
Equity 1.1.2014	43.500	10.875	2.515.503	2.569.878
Dividend paid			(1.000.000)	(1.000.000)
Net earnings			437.356	437.356
Equity 30.06.2014	<u>43.500</u>	<u>10.875</u>	<u>1.952.859</u>	<u>2.007.234</u>

c. Equity at end of the period is ISK 2,007 thousands or 73.3% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 56.9%, exceeding the minimum legal requirement of 8%. The ratio is calculated as follows:

	30.6.2014	31.12.2013
Total equity	2.007.234	2.569.878
Tax asset	(49.544)	(47.046)
Total own funds for solvency purposes	<u>1.957.689</u>	<u>2.522.831</u>
Total capital requirements are specified as follows:		
Credit risk	198.036	216.792
Market risk	77.052	92.652
Capital requirement	<u>275.088</u>	<u>309.445</u>
Capital adequacy ratio	56,9%	65,2%

Notes, continued:

17. Tax assets (liabilities)	30.6.2014	31.12.2013
Changes in tax assets and liabilities are specified as follows:		
Tax assets at the beginning of the year	(126.468)	23.556
Income tax recognised in profit or loss	(103.249)	(254.053)
Income tax paid	54.333	104.029
Net tax assets (liabilities) at the end of the period	<u>(175.384)</u>	<u>(126.468)</u>
Specified as follows:		
Current taxes	(224.928)	(173.514)
Deferred tax asset	49.544	47.046
Net tax assets (liabilities) at the end of the period	<u>(175.384)</u>	<u>(126.468)</u>
Deferred tax asset es attributable to the following:		
Securities	39.057	39.057
Deferred foreign exchange gain and loss	8.936	5.043
Other items	1.551	2.946
Deferred tax asset at the end of the period	<u>49.544</u>	<u>47.046</u>

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.