

REPORT OF THE BOARD OF DIRECTORS OF SKELJUNGUR HF. ON THE TAKE-OVER BID MADE BY STRENGUR HF. TO THE SHAREHOLDERS OF SKELJUNGUR HF.

Last 8 November the companies RES 9 ehf., Reg. No. 590318-0940 (**“RES 9”**), 365 hf. Reg. No. 480702-2390 (**“365”**) or a subsidiary owned by 365 and RPF ehf., Reg. No. 510108-1160 (**“RPF”**) (jointly referred to as the **“Partners”** (i.e. “persons acting in concert”).) announced that as of that date a partnership had been established among them in the understanding of Sections 100(1) and 100(2) of the Act on securities transactions no. 108/2007 (**“Securities Trading Act”**) with regard to shares issued by Skeljungur hf., Reg. No. 590269-1749 (**“Skeljungur”**). The announcement revealed that the Partners had entered into an agreement on transferring their shares in Skeljungur to Strengur ehf., Reg. No. 410920-1230 (**“Strengur Holding”**). Since the combined holdings of the Partners in Skeljungur surpassed 30%, a mandatory bid obligation was formed in accordance with Point 1 of Section 100(2) of the Securities Trading Act, and the Partners are therefore required to extend a take-over bid to all shareholders of Skeljungur hf. in compliance with Chapter X of the Securities Trading Act.

In accordance with the above the partners published an offer document in respect of a take-over bid made by Strengur hf., Reg. No. 411020-1500 (**“Strengur”** or the **“Offeror”**), a subsidiary of Strengur Holding, last 6 December, disclosing the information required by Section 113 of the Securities Trading Act. On 15 December, Strengur made public the questions received by the company in respect of the offer document and its responses to the questions. The offer made by Strengur is effective for four weeks, from 09:00 a.m. on 06 December 2020 to 16:00 p.m. on 04 January 2021 and amounts to 8.315 per share, free of encumbrances and liens. At the time of publication of the offer document Strengur and its related parties controlled holdings and voting rights amounting to a total of 754,639,578 shares, corresponding to 38.0% of the total shares in Skeljungur, or 38.98% of the outstanding shares, taking into account the shares held by Skeljungur itself.

According to Sections 104(5) and 104(6) of the Securities Trading Act the board of directors of a target company shall draw up and make public a report setting out its reasoned opinion of the bid and its terms. The opinion must include the views of the board on the offeror’s strategic plans and what implications the board believes the bid may have for the company’s interests, the jobs of its management and personnel and the locations of the company’s places of business.

The board of directors of Skeljungur has now prepared and approved the following report, referring to the matters above. The board of directors of Skeljungur comprises Jón Ásgeir Jóhannesson, Birna Ósk Einarsdóttir, Þórarinn Arnar Sævarsson, Elín Jónsdóttir and Dagný Halldórsdóttir. The directors Jón Ásgeir and Þórarinn Arnar have interests in the understanding of Section 104(6) of the Securities Trading Act with regard to the take-over bid. Therefore they were not involved in the preparation of this report.

Introduction

The Skeljungur Group is composed of two established management companies with a history of over 90 years of operation, Skeljungur and the Faroese subsidiary P/F Magn. Skeljungur serves over 60 thousand customers in Iceland and the Faroe Islands; the principal role of the company has been to serve the energy needs of individuals and enterprises in an efficient and secure manner in harmony with its environment. In addition, Skeljungur engages in various retail activities in the consumer market.

According to Skeljungur's interim statement for the third quarter of 2020, 62% of the company's contribution margin derived from operations in Iceland, while 38% of the margin derived from the Faroe Islands. The group's EBITDA for the same period was generated in equal proportions in Iceland and the Faroe Islands. The COVID 19 pandemic had a lesser impact on the group's operations in the Faroe Islands than on the group's Icelandic companies.

Skeljungur owns nine subsidiaries: seven in Iceland (Bensínorkan ehf., Íslenska vetnisfélagið ehf., Tollvörugeymsla Skeljungs ehf., Barkur ehf., 26 fasteign ehf., Langholt ehf. and Basko ehf.) and two in the Faroe Islands (P/F Magn and P/F Demich). In addition, Skeljungur holds shares in nine associated companies: EAK ehf. (33%), EBK ehf. (25%), Fjölver ehf. (25%), Vegsauki ehf. (50%), Wedo ehf. (34%), P/F Jarðhiti (20%), Brauð&Co ehf. (25%), Lyfsalinn ehf. (10%) and Gló ehf. (25%).

Offer price and terms

The requirement for the partners to make a take-over bid arose last 8 November, with the announcement of the concert of the partners and the transfer of their shares in Skeljungur to Strengur. With their take-over bid, the partners are therefore responding to their legal obligation under Article 100 of the Securities Trading Act.

According to Section 103(2) of the Securities Trading Act the price offered in a take-over bid must, at a minimum, be equivalent to the highest price paid by the offeror, or by parties acting in concert with it, for shares acquired in the company in question during the six months prior to making the bid. The bid must, however, be at least equal to the latest transaction price for shares in the undertaking in question the day before the mandatory bidding obligation arose or notification was given of the proposed bid.

The offer price of the offerors amounts to 8.315 for each share in Skeljungur. According to the offeror the offer price corresponds to the highest price paid by Strengur and the partners for shares in Skeljungur over the six months preceding the requirement to launch a bid. Furthermore, the offer price is higher than the last trading price posted on Nasdaq Iceland on the last trading day before the announcement of an impending offer; on that day the price of shares in Skeljungur was ISK 7.8 per share. Accordingly, the price offered by the offerors is the lowest that will comply with the provisions of the Securities Trading Act regarding minimum price.

The market price of shares in Skeljungur has been in the range of ISK 7.00 to 10.17 per share over 2020 to date. At the beginning of the year the price rose somewhat, reaching its high point of ISK 10.17 per share on 19 February. From that date the price of the shares fell somewhat sharply in line with the general fall in prices in stock markets following news reports on the spread of COVID 19.

End-of-day prices from turn of year*

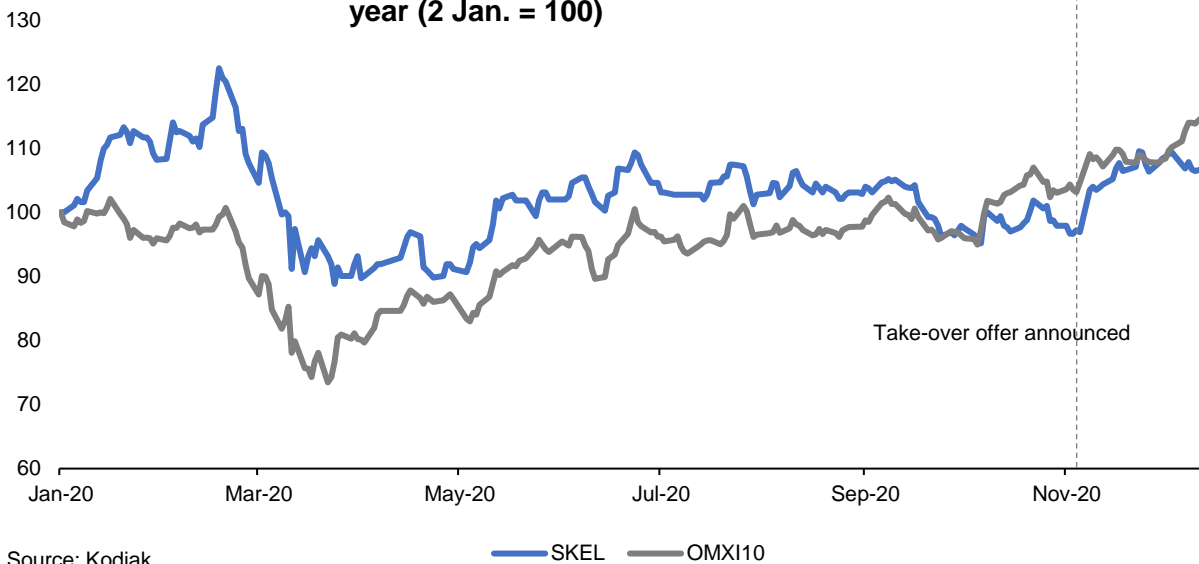


Source: Kodiak

*End-of day price from year-end to and incl. ex-dividend day (6 March 2020) adjusted for dividend payment (0.28 ISK/share)

The market price of the shares was at its lowest point of the year shortly after mid-March when the first wave of the COVID 19 pandemic hit Iceland. Thus, several trades occurred at the price of 7.00 per share in the period 16 to 27 March. In the first days of spring the price of shares in the company rose somewhat, although it never reached the heights of earlier in the year. Concurrently with the tightened limitations on public gatherings in the fall as a result of the increased number of COVID 19 infections in Iceland, the share price fell again. Following positive news of the development of a COVID 19 vaccine and the announcement of a mandatory offer by the offerors the share price rose again, and has since that time been somewhat above the offer price. The rise over the past weeks is consistent with the general market increases following positive news of a vaccine.

Skeljungur and OMXI10 selected share index price trend from turn of year (2 Jan. = 100)



The board of directors notes that the market price of Skeljungur shares at the end of the last day of trading before the approval of this report was 8.56 ISK per share, or approximately 0.25 ISK above the offer price.

According to the offer document the offer price will be paid in cash no later than five (5) business days after the expiry of the take-over bid, i.e. at the latest on 11 January 2021. The purchase by the offeror pursuant to the bid will be financed by means of an equity contribution and loan capital. Also, Íslandsbanki and Arion banki will guarantee the payment of cash to shareholders who accept the offer. The payment terms of the offer are therefore reasonable and a fully valid guarantee of payment has been obtained in line with Section 103(5) of the Securities Trading Act.

Future intentions of the offeror and their impact on the company

In the offer document the offeror expresses the view that the operating environment of Skeljungur will undergo fundamental changes in the coming years. For this reason, the offeror has plans for streamlining and changes in the core business of the company. In this regard it is noted that opportunities for organic growth are limited, and therefore Skeljungur's operations will need to be strengthened by means of acquisitions of operating units capable of creating synergies. Furthermore, the offeror discloses his intention to sell sites, real property and operating units, while streamlining business establishments that do not fit the future core business of the company at the first opportunity when circumstances permit. Furthermore, the view of the offeror is disclosed that in his opinion there is little synergy between the business of Skeljungur in Iceland and in the Faroe Islands, which could lead to the sale of individual business units in one or both countries. Unavoidable changes therefore lie ahead for Skeljungur, in the opinion of the offeror. This position of the offeror is reiterated in his responses published on 15 December, where it is revealed, among other things, that Strengur foresees the company as smaller in scope and lighter in assets, and that ways will be sought to broaden the company's income base, e.g. by seeking opportunities in the consumer market with regard to improved utilisation of the business establishment that the company does not intend to discontinue. It is also revealed in the responses from the offeror that attempts will be made to streamline the decision-making process

within the company, simplify the management structure, reduce the number of middle layers and introduce an incentive bonus system for key employees.

Also, the responses of the offeror to questions from shareholders have noted that the sale and/or discontinuation of business units will probably impact employees, as jobs will variously accompany the sold units to buyers or be discontinued with increased outsourcing. The offeror also has plans to use automation to improve operating efficiency and sell individual business establishments for other uses, at the same time that efficiency will be sought in property costs.

In addition the offerors disclose in the offer document that the process of repaying the loans of the offeror resulting from the offer assumes sales of Skeljungur's sites, properties and business units in the coming months, and in that regard it is also assumed that cash will to a greater extent be distributed to shareholders through dividend payments or reductions in the company's share capital, which will shrink the company's balance sheet.

The offeror also has plans to remove Skeljungur's shares from Nasdaq Iceland's main list, as he is of the opinion that Skeljungur will be better off remaining outside the regulated securities market.

From the above it appears obvious that if the offeror's plans are carried out, significant changes may be anticipated in Skeljungur's business operations. To this end it may be anticipated that assets will be sold and that the structure of the group will change. These changes will no doubt impact the interests of the company. The composition of the group's revenues will change, and, in addition, the risks in the operation of the company will be different. It is also likely that with the divestment of assets, smaller balance sheet, reduction in the number of business establishments, together with other streamlining measures described by the offeror, the number of employees of the company will be reduced and the composition of the staff will change. In this regard, the same will apply to workers and managers. Another consequence is that the number of Skeljungur's business establishments may be reduced and relocated.

The fact that the payment process of loans to the offeror assumes sales of assets may possibly result in pressure on such sales in order to enable payments out of the company. However, the offeror has noted in his responses to questions from shareholders that the timing and scope of such payments will be determined by the success of asset sales and the cash position of the company at any given time.

Additionally, if the de-listing of the company's shares from the regulated market takes place the shares in Skeljungur will be less liquid. For obvious reasons, this could have a negative impact on the price and price formation of the shares. On the other hand, this would reduce the expenditures of the company and could enable the company to make decisions more swiftly than before.

Position taken by the board members holding shares in Skeljungur regarding the offer

As noted above, the board members Jón Ásgeir Jóhannesson and Þórarinn Arnar Sævarson are related to the offeror and are therefore involved in the offer.

Of the three board members who were involved in the preparation of this report, Dagný Halldórsdóttir is the only one holding shares in Skeljungur. Also, no persons who are financially related to board members hold shares in Skeljungur. Dagný does not intend to accept the offer.

Opinions from employees

The employees of Skeljungur were invited to express their opinions regarding the take-over bid. No such opinions were received by the board.

From the above it is clear that changes may be anticipated in the business operations of Skeljungur if the plans of the offeror materialise. It is impossible for the board of directors of Skeljungur to assess specifically whether it is advantageous for individual shareholders to accept the offer or reject it, as the situation and nature of shareholders varies. For this reason, each and every shareholder will need to assess independently the offeror's offer price and whether the proposed changes and their impact are advantageous for Skeljungur and consistent with the situation of each individual shareholder. In this assessment the board of directors encourages shareholders to read the offeror's offer document and his responses to the individual questions of shareholders carefully and, as applicable, seek expert advice before taking a position regarding the offer.

The offer document includes a summary of notices published by Skeljungur in the Nasdaq news system and on the company's website from 01 January 2020 until the day that the offeror declared his intention to make the offer. Shareholders are also encouraged to read announcements from Skeljungur that have been published in the same places as of 9 November 2020.

Reykjavík, 21 December 2020



Birna Ósk Einarsdóttir



Elín Jónsdóttir



Dagný Halldórsdóttir

This is an English translation. Should there be discrepancy between this translation and the Icelandic version, the latter prevails.