

Intellectual Capital Report

2005



Table of contents

Table of contents	2
Why Intellectual Capital report?	3
Our short history of 20 years	3
Vision/Mission	6
Challenges/Actions.....	6
The market/customers.....	6
Processes	6
Employees	6
Financial	6
Human Capital	7
Relational Capital.....	8
Structural Capital	8
Conclusion/remarks	8

Why Intellectual Capital report?

Tölvumiðlun is a first generation company participating in a Nordic project, called "Putting IC into practice" or (PIP) for short.

The PIP project is a 3 year project aiming to develop a framework for measuring IC performance indicators and report Intellectual Capital of companies in the IT sector of the Nordic countries. Special attention is on small and medium size companies to lower the threshold for them to work effectively with IC as well as forming a baseline for managerial business models.

One of the values of the PIP project, is to have common performance indicators that gives us the opportunity to benchmark, using information not known to us previously.

Our IC report, covers the three aspects of Intellectual Capital: Human Capital, Relational Capital and Structural Capital and is an addition to our annual financial report, describing our intangible assets. Combined these two reports are a fuller and more complete account of the real assets and future potential of an IT company, especially a company like ours, a software house.

Our short history of 20 years

Tölvumiðlun hf., whose staff celebrated the 20th. anniversary in February, was established in 1985 in Reykjavik, Iceland. The purpose of the company is to develop, sell and service software. Tölvumiðlun is a software house specializing in service to companies and institutions.



One of the foundations of Tölvumiðlun was a contract the company won to develop a financial system to be used by the local communities in Iceland. Today, majority of the local communities still use this software, called SFS.

In 1987 Tölvumiðlun purchased a software house that had specialized in payroll systems. With a contract with the federation of Icelandic hospitals, the usage of the payroll software H-Laun became widespread and has been growing ever since.

In 1988 Tölvumiðlun installed an information system at hospitals and began marketing and selling various software for hospitals. In January 2000 a new company was founded based on the department servicing the health care sector, merged with another company specializing in the same field and later sold.

Shortly after 1990 Tölvumiðlun initiated development projects for the Land registry of Iceland to develop a new mass valuation system for residential properties for taxation purposes. These systems value, store information on

all valuations, including detailed descriptions of properties and allow access to the information to real estate brokers and other users of the information.

In relation to the projects for the Land registry of Iceland, Tölvumiðlun has developed a notarization system for real estates that processes and stores information on all notarizations and documentation of residential and commercial real estates and other assets such as motor vehicles, airplanes, vessels and such. This system has been installed at District Commissioners throughout Iceland.

The operations of Tölvumiðlun are divided into three main categories: Software development, User service and management and office operations. Employees are 27 in total and most of them are working on software development and service.

Today, the main projects of Tölvumiðlun are as follows:

Payroll

The payroll system H-Laun is well recognized in the Icelandic market and enjoys a widespread usage. Among users are many of the local communities, most hospitals and numerous companies and institutions. Users range in size from small to the largest companies in Iceland.

Employee total solution

The payroll system is in constant development. This year Tölvumiðlun is releasing and installing a new generation of the system, together with HRM system and related functionality such as employee web, hiring system, education system, analysis and forecasting tools etc.

The total solution, HLaun³ is a software that is fully competitive with other solutions in the market and is designed in Iceland for the local market, utilizing international development and trends in academy and practice of management and business operations.

Financial systems

Tölvumiðlun developed the financial system SFS for the local communities in Iceland. Other systems were built parallel to the financial system to better meet the special needs of the local communities.

Majority of the local communities are users of the system and Tölvumiðlun handles maintenance and development of these systems together with supplying service to users and supervisors.

The land registry of Iceland

Tölvumiðlun developed software together with The land registry of Iceland that processes and stores information on all residential and commercial properties. In the database is a colossal amount of information on residential and commercial properties, e.g. type and estimate of the quality of floor material for all real estates. The system is in operation 24/7 and can be accessed via the internet by real estate brokers and other users.

Tölvumiðlun handles maintenance, development and services supervisors.

Notarization system for the Ministry of justice

Tölvumiðlun developed software together with The land registry of Iceland that handles reception, processes and stores documents for notarizations, creation of forms etc. Examples of documents are: Contracts due to sales of real estate, mortgages, bonds etc.

Radiology Information System

Tölvumiðlun sells and supports Radiology Information System (RIS) from Eastman Kodak, in Iceland. RIS is used by the largest hospitals in Iceland to view and manage digital radiology images.

Network operation service and hosting

Tölvumiðlun offers network operation service to companies and institutions. The service consists of examination of and consultation on the structure of client's network and regular monitoring of the network.

The company also offers hosting services, where customers, both Icelandic and international, house their hardware at our premises.

We of course do a lot more, and as an example we also tailor-make software for various clients such as Reykjavík Botanic Gardens, Icelandic Cancer Society and others.

Vision/Mission

Our objective is to foster a future relationship with our clients, provide them with valuable solutions that are both cost effective and rich of functions.

Every contact we have with our clients is and will be based on honesty and fairness for the greater good of the relationship.

Our business model is based on software development, as off the shelf products or specific solutions for various clients. We market and sell our shelf products and supply our users with service, consultation and various seminars on usage of our systems.

Challenges/Actions

Financial

We aim to have sound financial operations, where we are profitable and deliver a healthy ROI to our shareholders.

Employees

Our goals can only be met by our employees and therefore our challenge is to maintain overall employee satisfaction at least at the level of 4 on the scale of 1 to 5. To achieve this we must rigorously monitor the satisfaction of our employees and take necessary actions to ensure that our goals are met.

The market/customers

Our goal is to be the leading provider of employee solutions for companies and institutions in Iceland. As such we aim to be always on time and within given budget when we install software.

Processes

Our processes must reflect our challenges regarding the market and our customers and thus we aim to install and effectively use Balanced scorecard in our operations, and elevate our usage of the Prince II method in various processes.

Human Capital

A software house like ours builds on the talent of our employees and thus our people are of great importance to us. We aim to maintain a spirit of fun and playfulness in order to elevate the feel-good factor of employees.

To monitor our progress, we conduct employee satisfaction surveys annually, and have been doing so since 2003. To ensure confidentiality we have the surveys executed by a third party, using a web solution.

The survey consists of 97 questions, answered whether the participant agreed or disagreed on a scale of 1-5, with 3 being neutral. The answers were grouped into 16 categories.

All surveys have had an impressive response rate of 100%.

Following are some of the results of the surveys:

Employee satisfaction survey - results

	2003	2004	2005
Employee satisfaction	3,62	4,16	4,30
Culture and team spirit	3,68	3,96	4,02
Attitude towards management	3,62	3,92	3,94
Working conditions	3,84	4,09	4,03
Professionalism	3,81	3,94	3,93
Mutual respect	3,51	3,61	3,79
Attitude towards service provision	4,13	4,04	4,03
Workload and balance between work and family	3,15	3,64	3,44

*The grade is on the scale of 1-5. The higher the grade, the better.

The management is quite pleased with the outcome of the surveys. Employee satisfaction has been rising, so has Culture and team spirit, Attitude towards management and other indicators as well.

Working conditions, Professionalism, Attitude towards service rendered and Workload and balance between work and family is on the decline and that is believed to be due to heavy workload over the last year. Employees have been putting in extra hours, focusing on results that lead to the decline of those indicators.

On November 19th 2002 Tölvumiðlun went through reorganization and introduced a new organization chart. The main changes were formalization of departments, redefining responsibility and assignment and introduction of managers of these departments.

Reorganization often stirs the equilibrium in companies and at Tölvumiðlun we have experienced that. We have however looked upon these changes as an opportunity to do even better and have tried to do so. The positive

development of the results of the employee satisfaction surveys certainly is a motivation to the management and an indicator that the company is on the correct track.

An internal project group designed our employee policy, which is a declaration made by employees and management based on the expectations, purpose and goals of both parties. The employee policy was delivered to all employees on March 4th 2005. It focuses e.g. on the necessity for flexibility and balance between work and family.

Tölvumiðlun encourages maternity leave and supports employees when they become parents. With males being 74% of employees in 2004 (76% in 2003), it is worth mentioning that employees going on maternity leave in 2004 and 2003 where males. Employees spent a total of 71 days on maternity leave in 2004 and 31 days respectively in 2003.

For most of our operating years, the workforce has been very stable, with very low staff turnover and accumulation of years in service.

We have however in the last years experienced some staff turnover though a low one. Average number of years in service per employee in 2004 was 5,7 years.

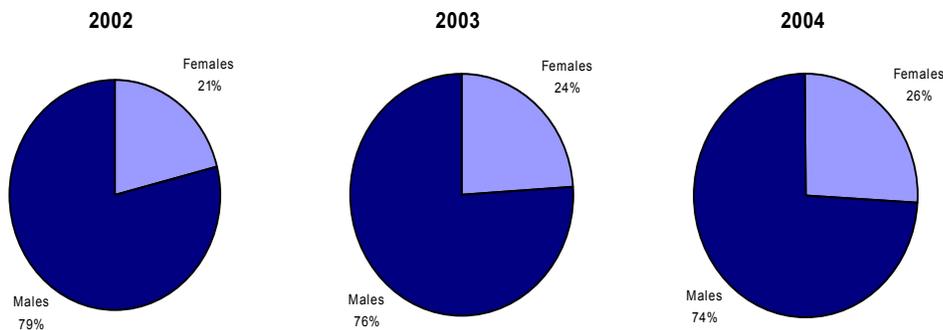


Changes in number of employees

	2002	2003	2004
Rookie rate	14%	0%	19%
Staff turnover	7%	12%	11%

Employees at Tölvumiðlun have a very active employee organization which organizes various activities over the year. Annually there are seven organized activities not including informal ones with a high rate of participation by employees and their families.

Gender distribution of employees



With our firm focus on service and quality of our software, one way of measuring how we are doing is to do surveys.

In our employee satisfaction surveys we measure the attitude to service rendered by us to our clients, and in our customer satisfaction surveys we measure the attitude to service received. The reason is to measure if there is a difference in perception between clients and our employees.

They do agree!

What do employees say?

	2002	2003	2004
Customers get good service	4,29	4,42	4,55
Good service is our priority	4,62	4,53	4,60

What to our customers say?

	2002	2003	2004
How pleased are you with service received?	-	4,49	-
Service received is sufficient to my needs	-	4,52	-

*The grade is on the scale of 1-5. The higher the grade, the better.

Our employees have extensive experience which is backed up with broad educational background.

Among our employees we have university degrees in Computer engineering, International business and Logistics. We also have an electrician, a tailor and we even have one Certified scrutinizer in ballroom dancing, working on his doctorate degree in business.

But of course education is an ongoing process. Our employees attend e.g. seminars and courses in their field. In 2004, a total of 98 days were used to extend knowledge.

Relational Capital

Our relationship with our clients is one of the crucial success factors demanding attention and care. At Tölvumiðlun we conduct customer satisfaction surveys annually. As with our employee satisfaction surveys, to ensure confidentiality we have the surveys executed by a third party, using a web solution.

The survey consists of 21 questions, answered whether the participant agreed or disagreed on a scale of 1-5, with 3 being neutral. The answers were grouped into 6 categories.

Our first survey was done in the fall of 2004, enjoying the reply rate of 59,31%. The results were even more impressive, of which we are thankful.

Following are some of the results of the survey:

Customer satisfaction survey

	2003	2004	2005
Customer satisfaction	-	4,45	-
Trust and integrity	-	4,35	-
Image in market	-	4,10	-
Quality of products and service	-	4,10	-
Benchmarking to competitors	-	3,43	-

*The grade is on the scale of 1-5. The higher the grade, the better.

As already mentioned, our customers are satisfied with service received and it is evident that customer satisfaction is healthy. Trust and integrity is also important and it is worth mentioning that the single highest score in the customer satisfaction survey was to the following question:

Employees at Tölvumiðlun are honest and fair in our business relationship	4,67
---	-------------

Customers view is that Tölvumiðlun has a strong image in the market, and likewise value the quality of the software and service received.

When it comes to benchmarking to competitors, customer were asked to rate the quality of our software on one hand and the quality of our service on the other, and compare with the software and service provided by other software houses.

One notices that the grade for 2004 is 3,43 and is practically neutral and is not in line with other grades in the survey.

The reason for this could be that participants in the customer satisfaction survey are users of our software and due to the fact that majority of our software is specialized software such as Payroll and Financial software, these same users might not necessarily have experience using similar software from other vendors. Thus their replies are neutral.

At Tölvumiðlun we monitor and track customer turnover by looking at support and upgrade contracts. Since each customer may, and often is a user of more than one of our software products, each customer has more than one support and upgrade contract valid at any given time. Thus it is more relevant for us to monitor contract turnover.

Customer contract turnover

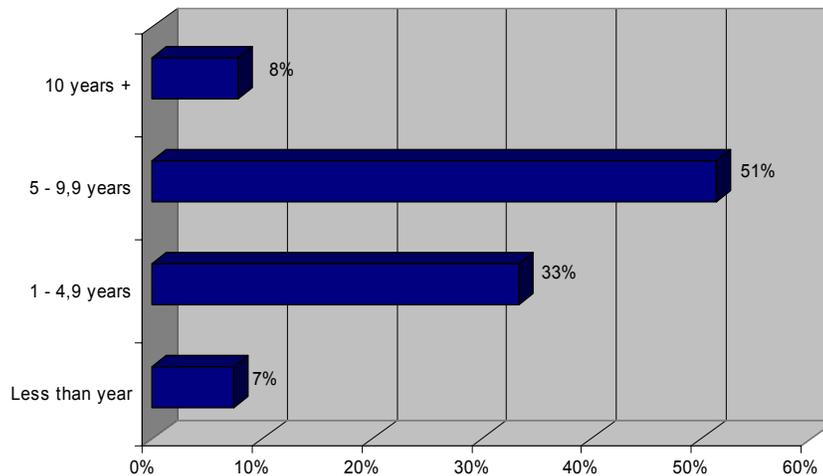
	2002	2003	2004
Contract rookie rate	-	10,5%	7,5%
Contract turnover	-	10,0%	6,3%

With increased competition the focus on persistency increases. At Tölvumiðlun we aim to prevent terminations of business relationships. Every termination receives a phone call, giving us the opportunity to record the reasons for cancellations for the purpose of analysis and prevention.

As is evident in the table above, we are succeeding in our endeavors due to the fact that contract turnover has been declining and the Rookie contract rate exceeds the turnover.

At yearend 2004, the average Customer contract duration was 5 years. The following graph displays the distribution of the duration of our contract base.

Customer contract duration



One might be tempted to maintain that our relationship with our customers is solid and our customers are in general loyal to us, as is evident by the fact that 59% of customer contracts have a duration of 5 years or more.

At Tölvumiðlun we work closely with our customers when it comes to developing software. We encourage the users of our software to send us suggestions and requests for changes and additions. Our users have been very proactive in this respect which has helped us gain the level of quality as is evident in the ratings of the customer satisfaction survey.

Apart from the above, we have also been proactive when it comes to major changes or new generations of our software e.g. with HLaun³ employee total solution we are currently releasing. We involved a few of our customers to work closely with us during needs analysis, development and testing phase and believe the cooperation is beneficial to both parties, where the customer is delivered a software that better suits the needs of the operation and Tölvumiðlun has a more mature software on initial release.

Structural Capital

At Tölvumiðlun we base our processes and documentation on the Prince2 methodology, whether it be development, service or internal operations of the company. For every project we enter into that exceeds certain criteria, we create a Product Initiation Document (PID), describing the project, resources, goals etc. according to the Prince2 methodology.

Fundamentally software development is about understanding and furthermore, that everybody in the process understand the same thing in the same way. Only by achieving this momentum is it possible to balance expectations and functionality of the delivered product.

At Tölvumiðlun we strongly emphasize the necessity of needs analysis and formal processes to ensure that every individual in every project group is informed, accepts and understands the proceedings with the aim to maximize the effectiveness of the time and resources spent on product development.

Distribution of information internally is handled using e-mails together with our extensive intranet, used by all employees, with information on the company, processes, manuals etc. Additionally we have access controlled sections of our IT environment, used by our employees working in teams on various projects.

We have built customer mailing lists, we use for announcements and communication with our customers. Our customers also use the software support site on our website, where they can e.g. download upgrades to our systems.

The core of our operations is cooperation with our clients and daily users of our software. Using our own system, we monitor support phone calls and distribute the load between available employees. All client interactions are cases that are logged into our system for later reference. Based on the load of support phone calls we can e.g. monitor and react if there is a need to offer a tailored training course or if possibly there is a need for product or service enhancement. We are also able to project future support load and how many employees are needed to cover that load at all times.

At Tölvumiðlun we have in place an ever increasing amount of documented process descriptions such as:

- How phone calls are answered.
- How bills are created and shipped.
- How collections are handled.
- Documentation.
- Product development.
- Process for requests from users regarding product development (as displayed below).
- Formal process for software installation projects, large and small.
- etc.

We have for the past decade used our own system to originate, analyze, process, test and issue changes and additions to our systems.

This is one of many documented processes available for our employees for reference and is typical for our aim to maintain a high level of structure.

Customers and employees alike send in requests that are reviewed by a assigned project groups, which change the status of the request into “agreed”, “declined” or “on hold”. As soon as the status of the request changes, the requesting individual receives an automatic e-mail informing him/her on the change of status.

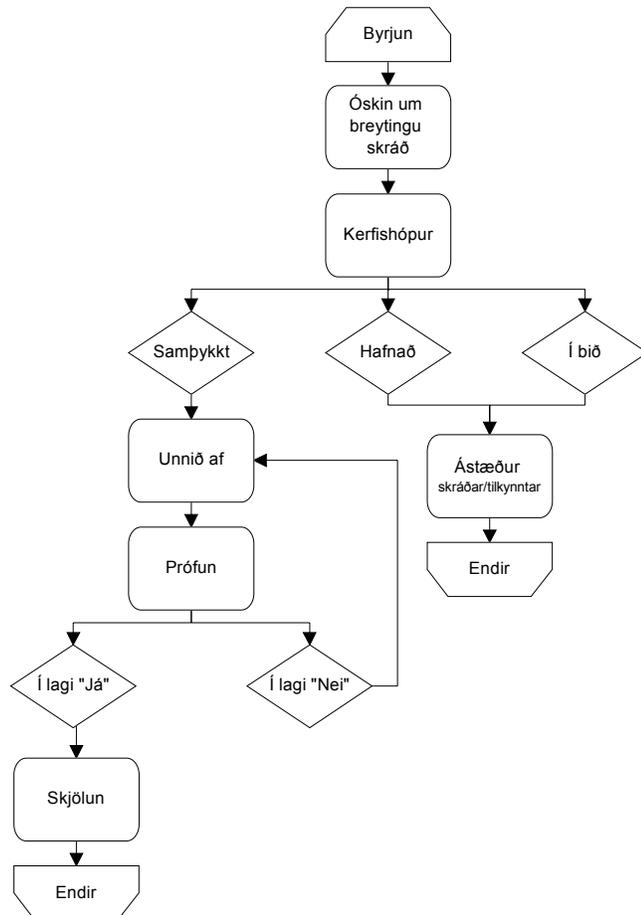
If the request was “agreed”, a loop initiates that ensures acceptable results regarding development and testing.

When the request has been completed, the assigned project group changes the status to “completed” and as before, the requesting individual is informed of the completion of the project.

Processes like these ensure the quality of development projects by minimizing errors, e.g. due to the fact that a programmer does not test what he/she has developed.

The automation built in this process encourages the innovation of customers and employees due to the fact that they can track the process and status of their own ideas put forth.

Recently Tölvumiðlun has been mapping in detail the general and specific knowledge of our employees. We define necessary level of knowledge and experience needed to work in relevant fields and examine how employees meet the criteria. Based on these results management discusses with each employee ways to increase the level of knowledge, and goals are set to reach those targets.



As mentioned on page 7, Tölvumiðlun went through reorganization and introduced a new organization chart on November 19th 2002.

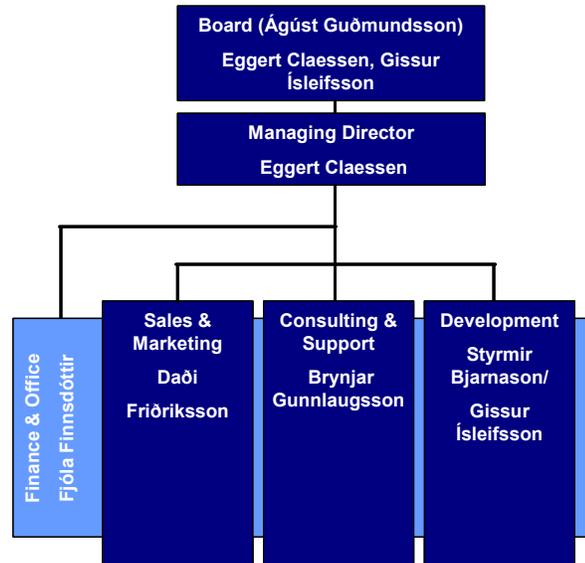
Sales & marketing deals with sales of our products and training courses to prospective customers, cross selling to existing ones, puts effort to maintain the persistency of the customer base together with marketing activities and participation in product development.

Consulting & Support deals with all direct support and consulting activities to customers, commits to product development, training at training courses, and handles all software installation projects.

The Development department is divided into maintenance and development of own software, and development for third party customers of special solutions, tailor-made for the needs of each customer.

The responsibilities of the Finance & Office department are financial, billing, collections, payroll, reception together with running the cantina.

All these departments work closely together to reach our goals which e.g. are to aim to have sound financial operations, where we are profitable and deliver a healthy ROI to our shareholders.



Conclusion/remarks

This report being our first external Intellectual Capital Report will develop and change over the years to reflect our growing maturity in dealing with IC and reporting it.

We hope this report has given the reader an understanding of where we are heading and the potential that exists within the company.

An Icelandic saying goes like this “Hálfnað verk þá hafið er”. A loose translation would be “You are half way there when you take your first step”. In relation to creating an IC report this is very true. The potential of the project is obvious from the start and our experience is that you get much more ideas than you possibly can follow.

We are very pleased to have had the opportunity to participate in the PIP project because it has given us the platform to build on and continue in our quest to increase our usage of managerial business models.