HS Orka hf.

Condensed Interim Financial Statements for the three months ended 31 March 2014 ISK

HS Orka hf.
Brekkustígur 36
260 Reykjanesbær

Reg. no. 680475-0169

Contents

Endorsement by the Board of Directors and the Management

The condensed interim financial statements of HS Orka hf. (the Company) for the period from 1 January to 31 March 2014 are prepared in accordance with the International Accounting Standard, IAS 34, *Interim Financial Reporting.*

According to the statement of comprehensive income, the Company's operating revenue amounted to ISK 1,899 million for the period 1 January - 31 March 2014 (2013: ISK 1,947 million) and the profit for the period amounted to ISK 90 million (2013: ISK 910 million loss). Total comprehensive income amounted to ISK 75 million (2013: ISK 942 comprehensive loss). According to the statement of financial position, the Company's assets amounted to ISK 44,644 million at the end of March 2014 (at year end 2013: ISK 44,873 million). Equity amounted to ISK 25,876 million at the end of March 2014 (at year end 2013: ISK 26,021 million) or 58.0% of total capital (at year end 2013: 58.0%).

To the best knowledge of the Board of Directors and the Management, the Company's condensed interim financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the Management that the condensed interim financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 31 March 2014, and its financial performance and changes in cash flows in the period from 1 January to 31 March 2014.

Furthermore, it is the opinion of the Board of Directors and the Management that the condensed interim financial statements and endorsement by the Board of Directors and the Management contain a fair overview of the Company's financial development and performance, its position and describe the main risk factors and uncertainties faced by the Company.

The Board of Directors and the Management of HS Orka hf. have today approved the Company's condensed interim financial statements for the three months ended 31 March 2014 and confirmed by means of their signatures.

Reykjanesbær, 12 May 2014.

The Board of Directors:

Ross Beaty
Chairman of the board

Gylfi Árnason

John Carson

Anna Skúladóttir

Lynda Freeman

Managing Director:
Ásgeir Margeirsson

Assistant Managing Director:
Albert Albertsson

Independent Auditors' Review Report

To the Board of Directors of HS Orka hf.

We have reviewed the accompanying statement of financial position of HS Orka hf. as at 31 March 2014 and the related statements of comprehensive income, changes in equity and cash flows for the three-month period then ended, and a summary of significant accounting policies and other explanatory information. Management is responsible for the preparation and fair presentation of this condensed interim financial information in accordance with IAS 34 *Interim Financial Reporting.* Our responsibility is to express a conclusion on this condensed interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity.* A review of interim financial information 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 condensed interim financial information is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting.*

Reykjavík, 12 May 2014

KPMG ehf.

Sæmundur Valdimarsson
Margret G. Flóvenz

Statement of Comprehensive Income (Loss) for the three months ended 31 March 2014

	Note	2014 Q1	2013 Q1
Operating revenue	5	1.899.108	1.947.270
Production cost and cost of sales		(1.291.526)	(1.318.110)
Gross profit		607.582	629.160
Other operating expenses	6	(118.336)	(173.502)
Results from operating activities		489.246	455.658
Finance income		303.864	1.022.431
Finance costs		(101.210)	(162.057)
Changes in fair value of swap contracts		21.169	253.453
Changes in fair value of embedded derivatives		(707.768)	(2.755.939)
Net finance expense	7	(483.945)	(1.642.112)
Share of profit of associates		86.205	38.775
Profit (loss) before income tax		91.506	(1.147.679)
Income tax (expense) recovery		(1.060)	237.296
Profit (loss) for the period		90.446	(910.383)
Other comprehensive income (loss)			
Items that will never be reclassified to profit or loss			
Remeasurement of defined benefit liability		7.002	0
Tax on items that will never be reclassified to profit or loss		(1.400)	0
		5.602	0
Items that may be reclassified subsequently to profit or loss			
Foreign currency translation difference on associates		(20.979)	(31.815)
Other comprehensive income (loss), net of tax		(15.377)	(31.815)
Total comprehensive income (loss) for the period		75.069	(942.198)
Earnings per share			
Basic and diluted earnings (loss) per share		0,01	(0,12)

Notes on pages 9 to 13 are an integral part of these financial statements

Condensed Interim Financial Statements 31 March 2014 of HS Orka hf. 5 All amounts are in thousands of ISK

Statement of Financial Position
as at 31 March 2014

Assets	Note	31.3.2014	31.12.2013
Operating assets		31.156.095	31.422.097
Operating assets under construction		3.924.155	3.841.191
Intangible assets		1.047.255	1.050.738
Investments in associates		928.844	863.619
Investments in other companies		27.075	27.075
Bonds		318.958	313.586
Embedded derivatives in power sales contracts		0	260.580
Prepaid lease and royalty fee		494.788	492.449
Long term receivable		319.680	331.364
Total non-current assets		38.216.850	38.602.699
Inventories		404.098	414.388
Bonds		82.929	81.532
Trade and other receivables		956.550	1.003.885
Short term investments		361.197	357.020
Cash and cash equivalents	8	4.622.063	4.413.403
Total current assets		6.426.837	6.270.228
Total assets		44.643.687	44.872.927
Equity			
Share capital		7.841.124	7.841.124
Share premium		7.038.855	7.038.855
Translation reserve		264.958	285.937
Revaluation reserve		6.069.116	6.142.790
Retained earnings		4.661.900	4.712.178
Total equity		25.875.953	26.020.884
Liabilities			
Loans and borrowings		11.656.103	12.299.097
Pension obligations		1.768.500	1.792.000
Deferred tax liability		634.424	631.964
Embedded derivatives in power sales contracts		421.318	0
Currency and interest rate swap contracts		256.369	263.495
Total non-current liabilities		14.736.714	14.986.556
Loans and borrowings		2.193.041	2.221.609
Trade and other payables		1.277.032	1.094.759
Embedded derivatives in power sales contracts		163.870	137.999
Currency and interest rate swap contracts		397.077	411.120
Total current liabilities		4.031.020	3.865.487
Total liabilities		18.767.734	18.852.043
Total equity and liabilities		44.643.687	44.872.927

Notes on pages 9 to 13 are an integral part of these financial statements

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Statement of Changes in Equity
for the three months ended 31 March 2014

	Share capital	Share premium	Translation reserve	Revaluation reserve	Retained earnings	Total
1 January - 31 March 2013						
Equity at 1 January 2013	7.841.124	7.038.855	334.465	6.443.110	4.947.149	26.604.703
Loss for the period					(910.383)	(910.383)
Other comprehensive loss			(31.815)		0	(31.815)
Total comprehensive loss			(31.815)		(910.383)	(942.199)
Revaluation reserve transferred to retained earnings				(75.085)	75.085	0
Dividends declared ISK 0.02 per share					(150.000)	(150.000)
Equity at 31 March 2013	7.841.124	7.038.855	302.650	6.368.025	3.961.851	25.512.504
1 January - 31 March 2014						
Equity at 1 January 2014	7.841.124	7.038.855	285.937	6.142.790	4.712.178	26.020.884
Profit for the period					90.446	90.446
Other comprehensive (loss) income			(20.979)		5.602	(15.377)
Total comprehensive (loss) income			(20.979)		96.048	75.069
Revaluation reserve transferred to retained earnings				(73.674)	73.674	
Dividends declared ISK 0.03 per share					(220.000)	(220.000)
Equity at 31 March 2014	7.841.124	7.038.855	264.958	6.069.116	4.661.900	25.875.953

Notes on pages 9 to 13 are an integral part of these financial statements

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Statement of Cash Flows
for the three months ended 31 March 2014

	Note	2014 Q1	2013 Q1
Cash flows from operating activities			
Profit (loss) for the period		90.446	(910.383)
Adjustments:			
(Profit) loss on sale of operating assets		(564)	0
(Decrease) increase in pension obligations		(16.499)	61.000
Depreciation and amortization		338.360	325.768
Net finance expenses	7	483.945	1.642.112
Share of profit of associates		(86.205)	(38.775)
Income tax expense (recovery)		1.060	(237.296)
		810.543	842.426
Inventories, decrease (increase)		10.290	(13.033)
Receivables, decrease (increase)		70.415	(231.935)
Current liabilities, (decrease) increase		(26.654)	77.711
Net cash from operations before interest and taxes		864.594	675.169
Interest income received		47.557	27.697
Interest and indexation costs paid		(97.034)	(126.741)
Net cash provided by operating activities		815.117	576.125
Cash flows from investing activities			
Acquisition of operating assets and assets under construction		(150.950)	(586.981)
Proceeds from sale of operating assets		4.200	0
Acquisition of intangible assets		(4.524)	(6.855)
Dividend received from associates		0	4.855
Net cash used in investing activities		(151.274)	(588.981)
Cash flows from financing activities			
Repayment of borrowings		(453.110)	(485.041)
Net cash used in financing activities		(453.110)	(485.041)
Increase (decrease) in cash and cash equivalents		210.733	(497.897)
Cash and cash equivalents at 1 January		4.413.403	5.227.728
Effect of exchange rate fluctuations on cash held		(2.073)	(22.800)
Cash and cash equivalents at 31 March		4.622.063	4.707.031
Investing and financing activities not affecting cash flows			
Unpaid dividends		(220.000)	(150.000)
Current liabilities		220.000	150.000

Notes on pages 9 to 13 are an integral part of these financial statements

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Notes to the Condensed Interim Financial Statements

1. Reporting entity

HS Orka hf. is a limited liability company domiciled in Iceland. The Company's registered office address is Brekkustígur 36, Reykjanesbær, Iceland. The Company generates and sells electricity and hot water for heating. The condensed interim financial statements as at and for the three months ended 31 March 2014 comprise of the Company and its interest in associates. The Company is a subsidiary of Magma Energy Sweden AB. The financial statements of the Company are part of the consolidated financial statements of the ultimate parent company Alterra Power Corp., headquartered in Canada.

The Company's financial statements can be found at its website www.hsorka.is and at the website of the Icelandic Stock Exchange; www.nasdaqomxnordic.com.

2. Statement of compliance

This condensed interim financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* . Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the Company since the last annual financial statements as at and for the year ended 31 December 2013. This condensed interim financial report does not include all the information required for full annual financial statements prepared in accordance with International Financial Reporting Standards and should be read in conjunction with the Financial Statements of 31 December 2013.

These condensed interim financial statements were approved by the Board of Directors on 12 May 2014.

3. Significant accounting policies

Except as described below, the accounting policies applied by the Company in these condensed interim financial statements are the same as those applied by the Company in its financial statements as at and for the year ended 31 December 2013.

These condensed interim financial statements are prepared in Icelandic krona, which is the Company's functional currency and all amounts have been rounded to the nearest thousand. They are based on historical cost, except for the following:

- a part of operating assets is recognized at revalued cost, which was the fair value at the revaluation dates of 1.1.2008 and 31.12.2012
- derivative financial instruments are measured at fair value
- embedded derivatives in power sales contracts are measured at fair value
- financial instruments at fair value through profit or loss are measured at fair value

a Changes in accounting policies

The Company has adopted all new standards and amendments to standards with a date of initial application prior to or on 1 January 2014 that have been adopted by the EU (European Union). None of those effective from 1 January 2014 had effects on these financial statements.

4. Use of estimates and judgments

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, liabilities, income and expenses. Actual results may differ from these estimates.

In preparing these condensed interim financial statements, the significant judgements made by management in applying the Company's accounting policies and the key source of estimation uncertainty were the same as those that applied to the financial statements as at and for the year ended 31 December 2013.

5. Segment reporting

The Company has three operating segments that are described below:

Power Production

Includes production and sale of electricity, heating water and fresh water from subterranean steam.

Electricity Sale

Includes purchases and sale of electricity to users other than mass users and power companies.

Other

Includes sale of service, rental of facilities and equipment, and other sales.

1 January - 31 March 2014	**Power production**	**Electricity sale**	**Other**	**Total**
External revenue	744.576	923.899	230.633	1.899.108
Inter-segment revenue	466.739			466.739
Total segment revenue	1.211.315	923.899	230.633	2.365.847
Segment operating results	398.242	70.918	20.086	489.246
Unallocated items				
Net finance expenses				(483.945)
Share of profit of associates				86.205
Income tax expense				(1.060)
Profit for the period				90.446
Segment assets	35.553.350	43.105	531.050	36.127.505
Unallocated assets				8.516.182
Total assets				44.643.687
Unallocated liabilities				18.767.734
Capital expenditures	149.300	897	5.277	155.474
Depreciation and amortization	324.245	1.599	12.516	338.360

1 January - 31 March 2013				
External revenue	814.708	857.462	275.100	1.947.270
Inter-segment revenue	472.511			472.511
Total segment revenue	1.287.219	857.462	275.100	2.419.781
Segment operating results	434.837	8.274	12.547	455.658
Unallocated items				
Net finance expenses				(1.642.112)
Share of profit of associates				38.775
Income tax recovery				237.296
Loss for the period				(910.383)
Segment assets	35.814.902	47.427	554.281	36.416.610
Unallocated assets				10.728.483
Total assets				47.145.093
Unallocated liabilities				21.632.589
Capital expenditures	587.712	889	5.235	593.836
Depreciation and amortization	316.042	1.444	8.282	325.768

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5. Segment reporting, contd.:

Major customers

Revenues from one customer of the Company's power production segment represents approximately ISK 393 million of the Company's total revenues during the period (1.1.2013 - 31.3.2013: ISK 505 million).

Revenues from HS Veitur hf. represents ISK 556 million during the period (1.1.2013 - 31.3.2013: ISK 512 million) and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 31.3.2014	238.031	85.634	232.809	556.474
Revenues 1.1. - 31.3.2013	209.956	77.740	224.459	512.155

6. Other operating expenses

Operating expenses specifies as follows:

	2014 Q1	2013 Q1
Salaries and related expenses	53.195	45.852
Changes in pension fund commitment	7.133	20.895
Administrative expenses	53.938	103.246
Depreciation and amortization	4.070	3.509
Total operating expenses	118.336	173.502

7. Net finance expenses

Net finance expenses specifies as follows:

	2014 Q1	2013 Q1
Interest income on cash, loans and receivables	66.778	64.936
Net foreign exchange gain	225.700	936.274
Fair value changes on financial assets through profit or loss	11.386	21.221
Total finance income	303.864	1.022.431
Interest expense	(90.865)	(111.481)
Indexation	(10.345)	(50.576)
Total finance costs	(101.210)	(162.057)
Changes in fair value of swap contracts	21.169	253.453
Changes in fair value of embedded derivatives	(707.768)	(2.755.939)
Net finance expenses	(483.945)	(1.642.112)

8. Restricted cash

At the end of March 2014 cash in the amount of ISK 507 million (USD 4.5 million) (at year end 2013: ISK 520 million (USD 4.5 million)) was classified as restricted. The cash is dedicated to pay interest and loan payments on none ISK denominated loans in accordance with a collateral agreement concluded in March 2010 with the Company's lenders.

9. Agreement with banks

The Company has a temporary waiver with the European Investment Bank for the year 2014. All covenants were fulfilled by the Company at the end of March 2014.

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10. Fair value of financial instruments

Fair value versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the statement of financial position, are as follows:

	31.3.2014 Carrying amount	31.3.2014 Fair value	31.12.2013 Carrying amount	31.12.2013 Fair value
Interest-bearing loans and borrowings	13.849.144	13.457.728	14.520.706	14.142.410

For other financial instruments their carrying amount equals their fair value.

Interest rates used for determining fair value

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve at the reporting date in the case of ISK denominated debt, embedded derivatives and bonds. For foreign denominated debt the discount rates are based on interbank rates. All discount rates include an adequate credit spread, and were as follows.

Interest rates used for determining fair value:

	31.3.2014	31.12.2013
Embedded derivatives in power purchase agreements (USD)	1,65%-4,77%	1,64%-4,84%
Bonds	5.0%	5.0%
Interest bearing long term liabilities	Libor + 250 bp	Libor + 250 bp

Currency and interest rate swaps are discounted at swap rates for foreign currency denominated legs and the Housing Finance Fund curve for ISK CPI indexed legs.

Fair value hierarchy:

The table below analyses financial instruments carried at fair value, sorted by valuation method. The different levels have been defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)
Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3	Total
31 March 2014				
Operating assets			31.156.095	31.156.095
Embedded derivatives		(53.835)	(531.353)	(585.188)
Bonds		401.887		401.887
Currency and interest rate swap contracts		(281.658)		(281.658)
Investments in other companies			27.075	27.075
Short term investments	361.197			361.197
Total	361.197	66.394	30.651.817	31.079.408
31 December 2013				
Operating assets			31.422.097	31.422.097
Embedded derivatives		(21.386)	143.967	122.581
Bonds		395.118		395.118
Currency and interest rate swap contracts		(302.827)		(302.827)
Investments in other companies			27.075	27.075
Short term investments	357.020			357.020
Total	357.020	70.905	31.593.139	32.021.064

Embedded derivatives that expire in the year 2026 are classified in level 3 due to the fact that the forward market for aluminium only extends to maximum of ten years.

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Notes, continued

11. Dispute over swap agreement

A foreign currency swap agreement entered into between Glitnir Bank hf. and HS Orka hf. on 19 November 2006 is in dispute. Glitnir has now served a subpoena against HS Orka. The subpoena was filed with the District Court of Reykjanes on 26 March 2014, and HS Orka was granted 6 – 8 weeks to file a written statement of objections. HS Orka's primary claim with respect to Glitnir's payment claim will be that there are no payment obligations pursuant to swap agreement as Glitnir has unilaterally issued a letter circulated by the resolution committee of Glitnir to its customers on 27 October 2008, whereas it was stipulated that the aim is to "close and settle" all outstanding derivatives contracts, without referring to when that would take place. Furthermore it was stipulated that all derivative contracts would be automatically terminated would Glitnir be declared bankrupt, which would lead to all claims thereunder being matured. HS Orka opinion is that the Company has a strong case and intends to reject the claims made in the subpoena.