

HS Orka hf.

Condensed Interim Financial Statements
for the nine months ended 30 September 2014
ISK

HS Orka hf.
Brekkuvegur 36
260 Reykjanesbær

Reg. no. 680475-0169

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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 30 September 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 5,311 million for the period 1 January - 30 September 2014 (2013: ISK 5,142 million) and the profit for the period amounted to ISK 1,198 million (2013: ISK 302 million loss). Total comprehensive income amounted to ISK 1,142 million (2013: ISK 359 million comprehensive loss). According to the statement of financial position, the Company's assets amounted to ISK 44,361 million at the end of September 2014 (at year end 2013: ISK 44,873 million). Equity amounted to ISK 26,943 million at the end of September 2014 (at year end 2013: ISK 26,021 million) or 60.7% 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 30 September 2014, and its financial performance and changes in cash flows in the period from 1 January to 30 September 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 nine months ended 30 September 2014 and confirmed by means of their signatures.

Reykjanesbær, 12 November 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 Auditor's 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 30 September 2014 and the related statements of comprehensive income, changes in equity and cash flows for the nine-month period then ended, and notes to the interim financial 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 November 2014

KPMG ehf.

Sæmundur Valdimarsson
Margret G. Flóvenz

Statement of Comprehensive Income (Loss) for the nine months ended 30 September 2014

	Note	2014 Q3	2013 Q3	2014 YTD	2013 YTD
Operating revenue	5	1.729.172	1.551.943	5.311.329	5.142.040
Production cost and cost of sales		(1.348.200)	(1.194.939)	(4.043.634)	(3.906.764)
Gross profit		380.972	357.004	1.267.695	1.235.276
Other operating expenses	6	(106.116)	(70.112)	(327.093)	(306.063)
Results from operating activities		274.856	286.892	940.602	929.213
Finance income		74.448	88.393	349.834	1.284.913
Finance costs		(205.693)	(234.697)	(298.250)	(392.149)
Changes in fair value of swap contracts		(8.621)	11.537	32.597	346.265
Changes in fair value of embedded derivatives		65.487	907.089	(176.576)	(3.043.279)
Net finance income (expense)	7	(74.379)	772.322	(92.395)	(1.804.250)
Share of profit of associates		297.518	266.067	519.787	398.478
Profit (loss) before income tax		497.995	1.325.281	1.367.994	(476.559)
Income tax (expense) recovery		(40.095)	(211.842)	(169.641)	175.008
Profit (loss) for the period		457.900	1.113.439	1.198.353	(301.551)
Other comprehensive income (loss)					
Items that will never be reclassified to profit or loss					
Remeasurement of defined benefit liability		(29.491)	(2.682)	(42.316)	(36.173)
Tax on items that will never be reclassified to profit or loss		5.898	536	8.463	7.235
		(23.593)	(2.146)	(33.853)	(28.938)
Items that may be reclassified subsequently to profit or loss					
Foreign currency translation difference on associates		(7.740)	9.758	(22.659)	(28.722)
Other comprehensive loss, net of tax		(31.333)	7.612	(56.512)	(57.660)
Total comprehensive income (loss) for the period		426.567	1.121.051	1.141.841	(359.211)
Earnings per share					
Basic and diluted earnings (loss) per share		0,06	0,14	0,15	(0,04)

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

Statement of Financial Position as at 30 September 2014

Assets	Note	30.9.2014	31.12.2013
Operating assets		31.057.116	31.422.097
Operating assets under construction		3.848.283	3.841.191
Intangible assets		1.118.314	1.050.738
Investments in associates		1.051.398	863.619
Investments in other companies		27.075	27.075
Bonds		248.692	313.586
Embedded derivatives in power sales contracts		0	260.580
Prepaid lease and royalty fee		499.936	492.449
Long term receivable		384.578	331.364
Total non-current assets		<u>38.235.392</u>	<u>38.602.699</u>
Inventories		440.658	414.388
Bonds		81.577	81.532
Trade and other receivables		1.160.542	1.003.885
Short term investments		365.866	357.020
Cash and cash equivalents	8	4.077.287	4.413.403
Total current assets		<u>6.125.930</u>	<u>6.270.228</u>
Total assets		<u><u>44.361.322</u></u>	<u><u>44.872.927</u></u>
Equity			
Share capital		7.841.124	7.841.124
Share premium		7.038.855	7.038.855
Translation reserve		263.278	285.937
Revaluation reserve		5.921.768	6.142.790
Retained earnings		5.877.700	4.712.178
Total equity		<u>26.942.725</u>	<u>26.020.884</u>
Liabilities			
Loans and borrowings		10.672.643	12.299.097
Pension obligations		1.876.500	1.792.000
Deferred tax liability		793.142	631.964
Embedded derivatives in power sales contracts		18.599	0
Currency and interest rate swap contracts		223.954	263.495
Total non-current liabilities		<u>13.584.838</u>	<u>14.986.556</u>
Loans and borrowings		2.233.337	2.221.609
Trade and other payables		1.146.962	1.094.759
Embedded derivatives in power sales contracts		35.397	137.999
Currency and interest rate swap contracts		418.063	411.120
Total current liabilities		<u>3.833.759</u>	<u>3.865.487</u>
Total liabilities		<u>17.418.597</u>	<u>18.852.043</u>
Total equity and liabilities		<u><u>44.361.322</u></u>	<u><u>44.872.927</u></u>

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Statement of Changes in Equity

for the nine months ended 30 September 2014

	Share capital	Share premium	Translation reserve	Revaluation reserve	Retained earnings	Total
1 January - 31 September 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					(301.551)	(301.551)
Other comprehensive loss			(28.722)		(28.938)	(57.660)
Total comprehensive loss			(28.722)		(330.489)	(359.211)
Revaluation reserve transferred to retained earnings				(225.245)	225.245	0
Dividends declared ISK 0.02 per share					(150.000)	(150.000)
Equity at 30 September 2013	7.841.124	7.038.855	305.743	6.217.865	4.691.905	26.095.492
1 January - 31 September 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					1.198.353	1.198.353
Other comprehensive loss			(22.659)		(33.853)	(56.512)
Total comprehensive (loss) income			(22.659)		1.164.500	1.141.841
Revaluation reserve transferred to retained earnings				(221.022)	221.022	0
Dividends declared ISK 0.03 per share					(220.000)	(220.000)
Equity at 30 September 2014	7.841.124	7.038.855	263.278	5.921.768	5.877.700	26.942.725

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

Statement of Cash Flows

for the nine months ended 30 September 2014

	2014 YTD	2013 YTD
Cash flows from operating activities		
Profit (loss) for the period	1.198.353	(301.551)
Adjustments:		
(Profit) loss on sale of operating assets	(1.888)	16
Increase in pension obligations	42.184	37.127
Depreciation and amortization	1.022.545	977.488
Net finance expenses	92.395	1.804.250
Share of profit of associates	(519.787)	(398.478)
Income tax expense (recovery)	169.641	(175.008)
	2.003.443	1.943.844
Inventories, increase	(26.270)	(8.436)
Receivables, (increase) decrease	(172.228)	306.316
Current liabilities, increase (decrease)	49.461	(80.441)
Net cash from operations before interest and taxes	1.854.406	2.161.283
Interest income received	158.738	178.314
Interest and indexation costs paid	(260.307)	(339.944)
Net cash provided by operating activities	1.752.837	1.999.653
Cash flows from investing activities		
Acquisition of operating assets and assets under construction	(645.344)	(1.041.689)
Proceeds from sale of operating assets	6.510	950
Acquisition of intangible assets	(91.511)	(15.073)
Acquisition of shares in associates	(8.000)	(18.000)
Sale of shares in associates	0	7.877
Dividend received from associates	317.349	217.100
Proceeds from sale of short term investments	0	232.411
Proceeds from repayment of bonds	84.479	82.624
Net cash used in investing activities	(336.517)	(533.800)
Cash flows from financing activities		
Paid dividends	(220.000)	(150.000)
Repayment of borrowings	(1.588.110)	(1.636.220)
Net cash used in financing activities	(1.808.110)	(1.786.220)
Decrease in cash and cash equivalents	(391.790)	(320.366)
Cash and cash equivalents at 1 January	4.413.403	5.227.728
Effect of exchange rate fluctuations on cash held	55.674	(53.901)
Cash and cash equivalents at 30 September	4.077.287	4.853.461

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

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 nine months ended 30 September 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 November 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.

Notes, continued

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.

	Power production	Electricity sale	Other	Total
1 January - 30 September 2014				
External revenue	2.087.850	2.499.391	724.088	5.311.329
Inter-segment revenue	1.075.074			1.075.074
Total segment revenue	3.162.924	2.499.391	724.088	6.386.403
Segment operating results	558.054	350.520	32.028	940.602
Unallocated items				
Net finance expenses			(92.395)	
Share of profit of associates				519.787
Income tax expense			(169.641)	
Profit for the period				1.198.353
Segment assets	35.425.457	50.601	547.655	36.023.713
Unallocated assets				8.337.609
Total assets				44.361.322
Unallocated liabilities				17.418.597
Capital expenditures	676.767	11.917	48.171	736.855
Depreciation and amortization	978.618	5.123	38.804	1.022.545
1 January - 30 September 2013				
External revenue	2.247.378	2.178.020	716.642	5.142.040
Inter-segment revenue	1.037.494			1.037.494
Total segment revenue	3.284.872	2.178.020	716.642	6.179.534
Segment operating results	609.698	274.173	45.342	929.213
Unallocated items				
Net finance expenses			(1.804.250)	
Share of profit of associates				398.478
Income tax recovery				175.008
Loss for the period			(301.551)	
Segment assets	35.640.526	45.129	541.195	36.226.850
Unallocated assets				10.040.963
Total assets				46.267.813
Unallocated liabilities				20.172.320
Capital expenditures	1.047.092	1.404	8.266	1.056.762
Depreciation and amortization	948.370	4.044	25.074	977.488

Notes, continued

5. Segment reporting, contd.:

Major customers

Revenues from one customer of the Company's power production segment represents approximately ISK 1,247 million of the Company's total revenues during the period (1.1.2013 - 30.9.2013: ISK 1,383 million).

Revenues from HS Veitur hf. Amounted to ISK 1,410 million during the period (1.1.2013 - 30.9.2013: ISK 1,402 million) and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 30.9.2014	514.800	207.012	687.805	1.409.617
Revenues 1.1. - 30.9.2013	578.714	188.928	634.523	1.402.165

6. Other operating expenses

Operating expenses specifies as follows:

	2014 Q3	2013 Q3	2014 YTD	2013 YTD
Salaries and related expenses	47.076	38.283	150.099	121.946
Changes in pension fund commitment	3.902	4.511	15.245	16.556
Administrative expenses	50.384	24.696	148.507	157.738
Depreciation and amortization	4.754	2.622	13.242	9.823
Total operating expenses	106.116	70.112	327.093	306.063

7. Net finance expenses

Net finance expenses specifies as follows:

	2014 Q3	2013 Q3	2014 YTD	2013 YTD
Interest income on cash, loans and receivables	64.314	76.718	203.867	229.578
Net foreign exchange gain	0	0	112.319	1.008.149
Fair value changes on financial assets through profit or loss	10.134	11.675	33.648	47.186
Total finance income	74.448	88.393	349.834	1.284.913
Interest expense	(90.160)	(103.796)	(268.917)	(320.301)
Indexation	(7.082)	(13.245)	(29.333)	(71.848)
Net foreign exchange loss	(108.451)	(117.656)	0	0
Total finance costs	(205.693)	(234.697)	(298.250)	(392.149)
Changes in fair value of swap contracts	(8.621)	11.537	32.597	346.265
Changes in fair value of embedded derivatives	65.487	907.089	(176.576)	(3.043.279)
Net finance income (expense)	(74.379)	772.322	(92.395)	(1.804.250)

8. Restricted cash

At the end of September 2014 cash in the amount of ISK 546 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 non 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 September 2014.

Notes, continued

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:

	30.9.2014		31.12.2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing loans and borrowings	12.905.980	12.675.920	14.520.706	14.142.410

Carrying amount of other financial instruments 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:

	30.9.2014	31.12.2013
Embedded derivatives in power purchase agreements (USD)	0,83%-3,72%	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
30 September 2014				
Operating assets			31.057.116	31.057.116
Embedded derivatives	(39.532)	(14.464)	(53.996)	
Bonds		330.269		330.269
Currency and interest rate swap contracts	(264.489)		(264.489)	
Investments in other companies			27.075	27.075
Short term investments	365.866			365.866
Total	365.866	26.248	31.069.727	31.461.841
31 December 2013				
Operating assets			31.422.097	31.422.097
Embedded derivatives	(21.386)		143.966	122.580
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	31.593.138	32.021.063

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.

Notes, continued

11. Other matters

Litigations and claims

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. HS Orka wrote a statement of objections and has delivered this to the court. 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 rejects the claims made in the subpoena. There has not been set a date for the hearing to take place, but it is expected to be in the last quarter of 2014.

HS Orka has commenced an arbitration to determine the validity of the Power Purchase Agreement between HS Orka and Nordural dated 23 April 2007. The proceeding was commenced on 10 July 2014. Arbitrators have been appointed for the tribunal and hearings are expected to take place in 2016.