HS Orka hf.

Condensed Consolidated Interim Financial Statement for the three months ended 31 March 2016 ISK 000´s

HS Orka hf.
Brekkustígur 36
260 Reykjanesbær

Reg. no. 680475-0169

Contents

Endorsement by the Board of Directors and the Management

The consolidated condensed interim financial statements of HS Orka hf. (the Company) for the period from 1 January to 31 March 2016 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 1,863 million for the period 1 January - 31 March 2016 (2015: ISK 2,076 million) and the profit for the period amounted to ISK 465 million (2015: Loss ISK 321 million). Total comprehensive income amounted to ISK 450 million (2015: Loss ISK 374 million). According to the statement of financial position, the Company's assets amounted to ISK 48,135 million at the end of March 2016 (at year end 2015: ISK 49,296 million). Equity amounted to ISK 28,992 million at the end of March 2016 (at year end 2015: ISK 28,901 million) or 60.23% of total capital (at year end 2015: 58.63%).

To the best knowledge of the Board of Directors and the CEO, 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 CEO 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 2016, and its financial performance and changes in cash flows in the period from 1 January to 31 March 2016.

Furthermore, it is the opinion of the Board of Directors and the CEO that the consolidated condensed interim financial statements and endorsement by the Board of Directors and the CEO 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 CEO of HS Orka hf. have today approved the Company's condensed interim financial statements for the three months ended 31 March 2016 and confirmed by means of their signatures.

Reykjanesbær, 10 May 2016.

The Board of Directors:

Ross Beaty
Chairman of the board

Gylfi Árnason

John Carson

Anna Skúladóttir

Lynda Freeman

Chief Executive Officer
Ásgeir Margeirsson

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 31 March 2016 and the related statements of comprehensive income, changes in equity and cash flows for the three-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, 10 May 2016

KPMG ehf.

Statement of Comprehensive Income/(Loss) for the three months ended 31 March 2016

	Note	2016 Q1	2015 Q1
Operating revenue	5	1.862.717	2.076.496
Production cost and cost of sales		(1.434.829)	(1.443.633)
Gross profit		427.887	632.863
Other operating expenses	6	(120.524)	(179.129)
Research and development		(26.679)	(14.676)
Results from operating activities		280.684	439.058
Finance income		15.175	61.460
Finance costs		(102.989)	(87.760)
Net exchange rate differences		82.239	(388.041)
Changes in fair value of embedded derivatives		194.730	(603.744)
Net finance income (expense)	7	189.156	(1.018.085)
Share of profit of associates		88.681	142.245
Profit (loss) before income tax		558.521	(436.781)
Income tax (expense) recovery		(93.968)	115.805
Profit (loss) for the period		464.553	(320.976)
Other comprehensive income (loss)			
Items that will never be reclassified to profit or loss			
Remeasurement of defined benefit liability		(7.615)	(10.969)
Tax on items that will never be reclassified to profit or loss		1.523	2.194
		(6.092)	(8.775)
Items that may be reclassified subsequently to profit or loss			
Foreign currency translation difference on associates		(8.032)	(43.828)
Other comprehensive loss, net of tax		(14.124)	(52.603)
Total comprehensive income (loss) for the period		450.429	(373.579)
Earnings per share			
Basic and diluted earnings (loss) per share		0,06	(0,04)
Profit (loss) for the period attributable to:			
Owners of the Parent Company		464.553	(320.976)
Non-controlling interest		0	0
		464.553	(320.976)
Total comprehensive income (loss) for the period attributable to:			
Owners of the Parent Company		450.429	(373.579)
Non-controlling interest		0	0
		450.429	(373.579)

Notes on pages 9 to 14 are an integral part of these financial statements

Certain of the comparative year figures have been reclassified to conform to the current year's presentation, see note 3.

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Statement of Financial Position
as at 31 March 2016

Assets	Note	31.03.2016	31.12.2015
Operating assets		36.876.506	36.566.711
Operating assets under construction		3.208.790	3.151.270
Intangible assets		1.538.334	1.470.899
Investments in associates		1.956.390	1.874.168
Investments in other companies		27.075	27.075
Bonds		128.264	193.886
Prepaid lease and royalty fee		509.331	507.236
Long-term receivable		524.194	504.018
Total non-current assets		44.768.885	44.295.264
Inventories		494.788	483.368
Bonds		78.835	77.554
Trade and other receivables		1.187.389	1.367.118
Short-term investments		316.390	907.174
Restricted cash and cash equivalents		555.885	1.324.298
Cash and cash equivalents		732.707	841.072
Total current assets		3.365.994	5.000.584
Total assets		48.134.879	49.295.848
Equity			
Share capital		7.841.124	7.841.124
Share premium and statutory reserve		7.038.856	7.038.856
Translation reserve		168.009	176.041
Revaluation reserve		8.489.855	8.601.406
Retained earnings		5.345.269	5.135.257
Equity attributable to owners of the parent company		28.883.114	28.792.684
Non-controlling interest		108.617	108.617
Total equity		28.991.730	28.901.301
Liabilities			
Loans and borrowings		7.147.186	7.681.185
Pension obligations		2.060.024	2.052.400
Deferred tax liability		1.173.260	1.080.815
Embedded derivatives in power sales contracts		3.894.206	4.058.803
Total non-current liabilities		14.274.675	14.873.203
Loans and borrowings		2.240.519	2.264.472
EU grant payable to participants		0	741.143
Trade and other payables		2.035.792	1.893.434
Embedded derivatives in power sales contracts		592.163	622.296
Total current liabilities		4.868.473	5.521.344
Total liabilities		19.143.149	20.394.547
Total equity and liabilities		48.134.879	49.295.848

Notes on pages 9 to 14 are an integral part of these financial statements

Certain of the comparative year figures have been reclassified to conform to the current year's presentation, see note 3.

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Statement of Cash Flows
for the three months ended 31 March 2016

	Note	2016 Q1	2015 Q1
Cash flows from operating activities			
Profit (loss) for the period		464.553	(320.976)
Adjustments:			
(Profit) loss on sale of operating assets		(1.307)	34
Increase in pension obligations		9	5.531
Depreciation and amortization		424.411	350.862
Net finance (income) expenses		(189.156)	1.018.085
Share of profit of associates		(88.681)	(142.245)
Income tax expense (recovery)		93.968	(115.805)
		703.797	795.486
Inventories, increase		(11.420)	(13.490)
Receivables, decrease		181.063	50.000
Current liabilities, (decrease) increase		(217.641)	172.667
Net cash from operations before interest and taxes		655.799	1.004.663
Interest income received		0	36.357
Interest and indexation costs paid		(52.116)	(82.719)
Net cash provided by operating activities		603.683	958.301
Cash flows from investing activities			
Acquisition of operating assets and assets under construction		(783.281)	(915.550)
Proceeds from sale of operating assets		2.000	100
Acquisition of intangible assets		(76.573)	(14.713)
Acquisition of shares in associates		(4.000)	(4.000)
Dividend received from associates		2.428	4.855
Investment in short-term investment		0	(908.870)
Proceeds from sale of short-term investments		600.000	201.000
Net cash used in investing activities		(259.426)	(1.637.178)
Cash flows from financing activities			
Repayment of borrowings		(429.677)	(469.559)
Net cash used in financing activities		(429.677)	(469.559)
Decrease in cash and cash equivalents		(85.420)	(1.148.436)
Cash and cash equivalents at 1 January		841.072	3.769.443
Effect of exchange rate fluctuations on cash held		(22.945)	90.567
Cash and cash equivalents at 31 March		732.707	2.711.574
Investing and financing activities not affecting cash flows			
Unpaid dividends		(360.000)	(320.000)
Current liabilities		360.000	320.000

Notes on pages 9 to 14 are an integral part of these financial statements

Certain of the comparative year figures have been reclassified to conform to the current year's presentation, see note 3.

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Statement of Changes in Equity
for the three months ended 31 March 2016

	Share capital	Share premium	Translation reserve	Revaluation reserve	Retained earnings	Non-controlling interest	Total
1 January - 31 March 2015							
Equity at 1 January 2015	7.841.124	7.038.855	271.942	5.852.098	5.475.923	0	26.479.942
Loss for the period					(320.976)		(320.976)
Other comprehensive loss			(43.828)		(8.775)		(52.603)
Total comprehensive loss			(43.828)		(329.751)		(373.579)
Revaluation reserve transferred to retained earnings				(72.673)	72.673		0
Dividends declared ISK 0.04 per share					(320.000)		(320.000)
Aquisition of subsidiary with non-controlling .... interest							0
Equity at 31 March 2015	7.841.124	7.038.855	228.114	5.779.425	4.898.845	0	25.786.363
1 January - 31 March 2016							
Equity at 1 January 2016	7.841.124	7.038.856	176.041	8.601.406	5.135.257	108.617	28.792.684
Profit for the year					464.553		464.553
Other comprehensive loss			(8.032)		(6.092)		(14.124)
Total comprehensive (loss) income			(8.032)		458.461		450.429
Revaluation reserve transferred to retained earnings				(111.551)	111.551		0
Dividends declared ISK 0.05 per share					(360.000)		(360.000)
Equity at 31 March 2016	7.841.124	7.038.856	168.009	8.489.855	5.345.269	108.617	28.991.730

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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 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 condensed consolidated interim financial statements of the Company includes interim financial statements of its subsidiary Vesturverk ehf. and the Companys share of associates accounted for on an equity basis of accounting.

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 2015. 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 2015.

These condensed interim financial statements were approved by the Board of Directors on 10 May 2016.

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 2015.

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, 31.12.2012 and 31.12.2015
- 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

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 2016 that have been adopted by the EU (European Union). None of those effective from 1 January 2016 had effects on these financial statements.

The Company has changed the presentation of the Statement of Comprehensive Income as research and development costs and net foreign exchange rate differences are now presented as a specific line item. Comparatives have been restated accordingly. Presentation of restricted cash and cash equivalents in the Statement of financial position is now presented as a specific line item. Comparatives have been restated accordingly. Segment reporting have been changed as other operating expenses and research and development is now presented as unallocated items. Comparatives have been restated accordingly.

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 2015.

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.

1 January - 31 March 2016	Power production	Electricity sale	Other	Total
External revenue	681.149	1.118.947	62.621	1.862.717
Inter-segment revenue	502.948			502.948
Total segment revenue	1.184.097	1.118.947	62.621	2.365.665
Gross profit	328.233	94.585	5.070	427.887
Unallocated items				
Reimbursement for research and development				0
Research and developement				(26.679)
Other operating expenses				(120.524)
Net finance expenses				189.156
Share of profit of associates				88.681
Income tax expense				(93.968)
Profit for the period				464.553
Segment assets	40.032.153	1.529	213.625	40.247.306
Unallocated assets				7.887.573
Total assets				48.134.879
Unallocated liabilities				19.143.149
Capital expenditures	790.357	0	0	790.357
Unallocated capital expenditures				39.844
Depreciation and amortization	407.061	315	9.416	416.792
Unallocated depreciation and amortization				7.618

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5. Segment reporting (continued)

1 January - 31 March 2015	Power production	Electricity sale	Other	Total
External revenue	823.141	1.169.452	78.819	2.071.412
Inter-segment revenue	500.054			500.054
Total segment revenue	1.323.195	1.169.452	78.819	2.571.466
Gross profit	510.088	109.578	13.197	632.863
Unallocated items				
Reimbursement for research and development				4.085
Research and development				(18.761)
Other operating expenses				(179.129)
Net finance expenses				(1.018.085)
Share of profit of associates				142.245
Income tax recovery				115.805
Profit for the period				(320.976)
Segment assets	35.937.932	2.788	519.195	36.459.915
Unallocated assets				8.236.398
Total assets				44.696.313
Unallocated liabilities				18.909.950
Capital expenditures	930.263	0	0	930.263
Unallocated capital expenditures				0
Depreciation and amortization	332.867	315	12.516	345.698
Unallocated depreciation and amortization				5.166

Changes have been made to the segment reporting relating to unallocated items. Comparative information have been adjusted accordingly.

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Notes, continued

5. Segment reporting, contd.:

Major customers

Revenues from one customer of the Company’s power production segment represents approximately ISK 351 million of the Company’s total revenues during the period (1.1.2015 - 31.3.2015 ISK 479 million).

Revenues from HS Veitur hf. amounted to ISK 386 million during the period (1.1.2015 - 31.3.2015: ISK 375 million) and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 31.3.2016	239.915	104.686	41.758	386.359
Revenues 1.1. - 31.3.2015	226.489	86.311	62.348	375.148

6. Other operating expenses

Operating expenses specifies as follows:

	2016 Q1	2015 Q1
Salaries and related expenses	40.756	44.876
Changes in pension fund commitment	6.289	5.305
Administrative expenses	66.185	124.106
Depreciation and amortization	7.294	4.842
Total operating expenses	120.524	179.129

7. Net finance expenses

Net finance expenses specifies as follows:

	2016 Q1	2015 Q1
Interest income on cash, loans and receivables	15.175	50.437
Fair value changes on financial assets through profit and loss	0	11.023
Total finance income	15.175	61.460
Interest expense	(45.693)	(82.584)
Indexation	(3.815)	(5.176)
Fair value changes on financial assets through profit and loss	(53.482)	0
Total finance costs	(102.989)	(87.760)
Net exchange rate differences	82.239	(388.041)
Changes in fair value of embedded derivatives	194.730	(603.744)
Net finance expense	189.156	(1.018.085)

8. Restricted cash

At the end of March 2016 cash in the amount of ISK 556 million (USD 4.5 million) (at year end 2015: ISK 583 million (USD 4.5 million)) was classified as restricted. The cash is dedicated to secure loan payments in accordance with a collateral agreement concluded in March 2010 with the Company's lenders. EU grant payable to grant partners of ISK 741 million outstanding at year end 2015 was paid out in January 2016.

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9. 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:

	31.3.2016		31.12.2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing loans and borrowings	9.387.704	9.076.748	9.945.657	9.593.082

Fair value of other financial instruments is equal to their carrying amount.

Interest rates used for determining fair value for disclosure purpose

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:

	31.3.2016	31.12.2015
Embedded derivatives in power purchase agreements (USD)	1.28%-3.48%	1.55%-4.06%
Interest bearing long term liabilities	Libor + 300 bp	Libor + 300 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 assets and liabilities 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 2016				
Operating assets			36.876.506	36.876.506
Embedded derivatives		(210.363)	(4.276.005)	(4.486.368)
Bonds		207.099		207.099
Investments in other companies			27.075	27.075
Short-term investments	316.390			316.390
Total	316.390	(3.264)	32.627.576	32.940.703
31 December 2015				
Operating assets			36.566.711	36.566.711
Embedded derivatives		(234.089)	(4.447.010)	(4.681.099)
Bonds		271.440		271.440
Investments in other companies			27.075	27.075
Short-term investments	907.175			907.175
Total	907.175	37.351	32.146.776	33.091.302

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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10. Other matters

Litigations and claims

HS Orka has commenced an arbitration to determine the validity of the Power Purchase Agreement between HS Orka and Norðurál Helguvík ehf. (dated 23 April 2007). The proceeding commenced on 10 July 2014. The hearings took place in April 2016 and a decision is expected in the fall of 2016.

In February 2016 HS Orka issued a legal letter to HS Veitur hf demanding full payment of the long-term receivable in relation to the shared pension liability. This was following receipt of a termination notice by HS Veitur of an agreement regarding payments of the pension liability, sent on 31 December 2015. The two companies had reached an agreement in 2011 on HS Veitur's share of the liability and HS Orka considers its claim on the basis of that agreement to be fully valid. Negotiations have been ongoing in the last months, but have not settled the matter. How the matter will be resolved is unclear.

Reykjanesbær bond

Since selling land to the Municipality of Reykjanesbær in 2009, HS Orka has held a bond issued by the Municipality. Until now, HS Orka has received payments according to the original terms of the bond. Recently, representatives of the municipality contacted HS Orka to discuss the financial status of Reykjanesbær Municipality and to seek composition with its creditors. The composition was not approved by the creditors and now it is considered very likely that the Municipality will be put under administration by the government. How that will affect the Reykjanesbær bond receivable is uncertain, but HS Orka believes it is prudent to write it down by 25% or ISK 69 million. It is only done for precautionary reasons and does in no way indicate that HS Orka has given up on collecting the full amount of the bond. As a result it is not possible to give a definitive fair value.

Power purchase agreement

HS Orka hf has signed a power purchase agreement with Thorsil ehf., which is planning to construct and operate a silicon metal plant in Helguvík, Iceland. Under the contract, HS Orka would supply up to 32MW, a minority portion of the plant's power needs. The delivery of the power from HS Orka is subject to several conditions on behalf of both parties.

11. Subsequent events

Suðurorka, a company owned 50% by HS Orka and has in recent years been developing á 150 MW hydro project in Skaftá in Southern Iceland, called Búlandsvirkjun. Until now the project has been in the pending category of the framework masterplan in Iceland. Now, however the steering committee for the framework masterplan has delivered its proposal to the parliament of Iceland and in that proposal Búlandsvirkjun would fall in the preservation category. HS Orka strongly disagrees with the proposal and intends to protest against it. The final decision on the renewal of the masterplan lies with the parliament and HS Orka believes that there will be, more likely than not made changes to the proposal before it gets approved. Since this proposal has not been approved HS Orka does not consider it appropriate to write off its investment in Suðurorka at this time, that could however change if the proposal is approved. HS Orka total investment in Suðurorka at 31 March 2016 was ISK 240 million.