HS Orka hf.

Condensed Consolidated
Interim Financial Statements
for the six months ended 30 June 2016
ISK 000's

HS Orka hf.
Brekkustígur 36
260 Reykjanesbæ
kt. 680475-0169

Contents

Endorsement by the Board of Directors and the CEO

The condensed consolidated financial statements of HS Orka hf. (the "Company" or "HS Orka") for the period from 1 January to 30 June 2016 are prepared in accordance with the International Accounting Standard, IAS 34, Interim Financial Reporting.

According to the condensed consolidated interim statement of comprehensive income, the Company's operating revenue amounted to ISK 3,507 million for the period 1 January to 30 June 2016 (2015: ISK 3,824 million) and the profit for the period amounted to ISK 1,278 million (2015: ISK 142 million). Total comprehensive income amounted to ISK 1,193 million (2015: ISK 75 million). According to the condensed consolidated interim statements of financial position, the Company's assets amounted to ISK 47,701 million at the end of June 2016 (at year end 2015: ISK 49,296 million). Equity amounted to ISK 29,739 million at the end of June 2016 (at year end 2015: ISK 28,901 million) or 62.3% of total capital (at year end 2015: 58.6%).

To the best knowledge of the Board of Directors and the CEO, the Company's condensed consolidated financial statements are in accordance with International Accounting Standard, IAS 34, Interim Financial Reporting as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the condensed consolidated financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 30 June 2016, its financial performance, and the changes in cash flows during the period from 1 January to 30 June 2016.

Furthermore, it is the opinion of the Board of Directors and the CEO that the condensed consolidated 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 consolidated interim financial statements for the six months ended 30 June 2016 and confirmed by means of their signatures.

Reykjanesbær, 9 August 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 and Shareholders of HS Orka hf.

We have reviewed the accompanying condensed consolidated interim statement of financial position of HS Orka hf. as at 30 June 2016 and the related condensed consolidated interim statement of comprehensive income, changes in equity and cash flows for the six-month period then ended, and notes to the condensed consolidated interim financial information. Management is responsible for the preparation and fair presentation of this condensed consolidated 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 consolidated interim financial information is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting.

Reykjavik, 9 August 2016.

KPMG ehf.

Margret G. Flóvenz

Condensed Consolidated Statements of Comprehensive Income for the six months ended 30 June 2016

	Notes	2016 Q2	2015 Q2	2016 YTD	2015 YTD
Operating revenue		1.645.913	1.749.235	3.507.323	3.823.892
Production cost and cost of sales		(1.306.053)	(1.245.215)	(2.740.883)	(2.703.423)
Gross profit		339.860	504.020	766.440	1.120.469
Other income	6	77.324	(34)	78.631	1.806
Other operating expenses	7	(264.308)	(113.115)	(384.832)	(292.244)
Research and development		(72.901)	(18.761)	(99.580)	(18.862)
Profit from operations		79.975	372.110	360.659	811.169
Finance income		29.609	62.504	55.644	123.964
Finance costs		(58.399)	(83.957)	(172.247)	(171.717)
Net exchange rate differences		67.308	106.261	149.547	(281.780)
Changes in fair value of embedded derivatives		645.899	(635.292)	840.629	(1.239.036)
Net finance income (expense)	8	684.417	(550.484)	873.573	(1.568.569)
Share of profit of associates		201.585	605.322	290.267	747.567
Profit (loss) before income tax		965.977	426.948	1.524.499	(9.833)
Income tax (expense) recovery		(152.888)	35.674	(246.856)	151.480
Net profit for the period		813.089	462.623	1.277.642	141.647
Other comprehensive income					
Items that will not be reclassified to profit or loss					
Remeasurement of defined benefit liability		(35.601)	(21.808)	(43.217)	(32.777)
Tax on items not reclassified to profit or loss		7.120	4.362	8.643	6.555
		(28.481)	(17.446)	(34.574)	(26.222)
Items that may be reclassified subsequently to profit or loss					
Currency translation difference on associates		(41.823)	3.254	(49.855)	(40.574)
Other comprehensive loss for the period		(70.304)	(14.192)	(84.429)	(66.796)
Total comprehensive income		742.785	448.430	1.193.213	74.851
Profit attributable to:					
Owners of the Parent Company		813.089	462.623	1.277.642	141.647
Comprehensive income attributable to:					
Owners of the Parent Company		742.785	448.430	1.193.213	74.851
Earnings per share:					
Basic and diluted earnings per share		0,10	0,06	0,16	0,02

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

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Condensed Consolidated Statements of Financial Position as at 30 June 2016

Assets	Notes	30.06.2016	31.12.2015
Fixed assets			
Operating assets		36.463.556	36.566.711
Operating assets under construction		3.313.553	3.151.270
Intangible assets		1.597.461	1.470.899
Investments in associates		1.697.064	1.874.168
Investments in other companies		27.075	27.075
Bonds	12	130.973	193.886
Prepaid lease and royalty fee		514.378	507.236
Long-term receivables		583.283	504.018
		44.327.343	44.295.264
Current assets			
Inventories		456.200	483.368
Bonds	12	80.598	77.554
Trade and other receivables		1.051.699	1.367.118
Short-term investments		118.176	907.174
Restricted cash and cash equivalents	9	553.230	1.324.298
Cash and cash equivalents		1.113.834	841.072
		3.373.737	5.000.584
Total assets		47.701.080	49.295.848
Equity and liabilities			
Equity			
Share capital		7.841.124	7.841.124
Share premium and statutory reserve		7.038.855	7.038.855
Translation reserve		126.186	176.041
Revaluation reserve		8.342.369	8.601.406
Retained earnings		6.277.364	5.135.258
Total equity attributable to owners of the parent company		29.625.899	28.792.684
Non-controlling interest		113.518	108.617
Total equity		29.739.417	28.901.301
Liabilities			
Loans and borrowings		6.518.252	7.681.185
Pension obligations		2.135.038	2.052.400
Deferred tax liability		1.319.029	1.080.815
Embedded derivatives in power sales contracts		3.367.231	4.058.803
		13.339.550	14.873.203
Current liabilities			
Loans and borrowings		2.240.706	2.264.472
EU grant payable to participants		0	741.143
Trade and other payables		1.908.170	1.893.434
Embedded derivatives in power sales contracts		473.238	622.296
		4.622.113	5.521.344
Total liabilities		17.961.663	20.394.547
Total liabilities and equity		47.701.080	49.295.848

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

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Condensed Consolidated Statements of Changes in Equity for the six months ended 30 June 2016

	Share Capital	Share Premium	Translation Reserve	Revaluation Reserve	Retained Earnings	**Attributable to Parent**	Non- controlling Interest	**Total Equity**
Equity at 1 January 2015	7.841.124	7.038.855	271.942	5.852.098	5.475.923	**26.479.942**	0	**26.479.942**
Profit for the period					141.647	**141.647**		**141.647**
Other comprehensive loss			(40.574)		(26.222)	**(66.796)**		**(66.796)**
Total comprehensive income			(40.574)	0	115.425	**74.851**	0	**26.554.793**
Revaluation reserve transferred to Retained earnings				(145.346)	145.346	**0**		**0**
Dividends paid ISK 0.04 per share					(320.000)	**(320.000)**		**(320.000)**
Equity at 30 June 2015	7.841.124	7.038.855	231.368	5.706.752	5.416.694	**26.234.793**	0	**26.234.793**
Equity at 1 January 2016	7.841.124	7.038.855	176.041	8.601.406	5.135.258	**28.792.684**	108.617	**28.901.301**
Profit for the period					1.277.642	**1.277.642**		**1.277.642**
Other comprehensive loss			(49.855)		(34.574)	**(84.428)**		**(84.428)**
Total comprehensive (loss), income			(49.855)	0	1.243.069	**1.193.214**	0	**30.094.515**
Share capital increase in subsidiary							4.901	**4.901**
Revaluation reserve transferred to Retained earnings				(259.037)	259.037			**0**
Dividends paid ISK 0.05 per share					(360.000)	**(360.000)**		**(360.000)**
Equity at 30 June 2016	7.841.124	7.038.855	126.186	8.342.369	6.277.364	**29.625.899**	113.518	**29.739.417**

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

All amounts in thousands of ISK

Condensed Consolidated Statements of Cash Flows for the six months ended 30 June 2016

	Notes	1.1-30.6.2016	1.1-30.6.2015
Cash flows from operating activities			
Profit for the period		1.277.642	141.647
(Gain), loss on sale of operating assets		(78.631)	1.806
(Decrease), increase in pension obligations		(39.843)	27.123
Depreciation and amortization		840.965	703.477
Net finance (income), expense		(873.573)	1.568.569
Share of profit of associates		(290.267)	(747.567)
Income tax (expense) recovery		246.856	(151.480)
Cash generated by operations		1.083.149	1.543.575
Inventories, decrease, (increase)		27.168	(29.485)
Receivables, decrease		318.087	228.025
Current liabilities, decrease		(281.375)	(189.088)
Net cash from operations before interest and taxes		1.147.030	1.553.027
Interest income		(2.098)	62.266
Interest expenses		(96.183)	(156.951)
Net cash provided by operating activities		1.048.749	1.458.341
Cash flows from investing activities			
Acquisition of operating assets		(1.001.085)	(1.044.413)
Acquisition of operating assets under construction		(162.283)	(21.841)
Proceeds from sale of operating assets		361.075	2.713
Proceeds from sale of intangible assets		925	0
Acquisition of intangible assets		(146.656)	(51.738)
Acquisition of shares in associates		(4.000)	(7.000)
Dividends received from associates		421.517	362.514
Investment in short-term investments		0	(908.870)
Proceeds from sale of short-term investments		800.000	1.153.042
		269.493	(515.593)
Cash flows from financing activities			
Paid dividends		0	(85.486)
Repayment of borrowings		(991.272)	(1.034.274)
Share capital increase in subsidiary		4.901	0
		(986.370)	(1.119.760)
Increase, (decrease) in cash and cash equivalents		331.872	(177.012)
Cash and cash equivalents at 1 January		841.072	3.769.443
Effect of exchange rate fluctuations on cash held		(59.109)	44.485
Cash and cash equivalents at 30 June		1.113.834	3.636.916
Investing and financing activities not affecting cash flows			
Unpaid dividends		360.000	234.514
Current liabilities		360.000	234.514

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

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Notes to the Condensed Consolidated 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 as well as 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 consolidate the interim financial statements of its subsidiary Vesturverk ehf. and the Companys share of associates are 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.

As at June 30, 2016 the Company holds a working capital deficit of ISK 1,248 million (ISK 521 million deficit at December 31, 2015). Though the Company projects that it will be able to meet its capital needs, it is currently in late stage negotiations with potential lenders for a loan to more fully accommodate working capital needs plus additional development and other elective expenditures.

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 9 August 2016.

3. Significant accounting policies

Except as described below, the accounting policies applied by the Company in these condensed consolidated 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 consolidated 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 consolidated interim statements 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 consolidated interim statements 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 estimate 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 consolidated 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.

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 - 30 June 2016	Power production	Electricity sale	Other	Total
External revenue	1.298.243	2.048.542	160.538	3.507.323
Other income			78.631	78.631
Inter-segment revenue	851.177			851.177
Total segment revenue	2.149.420	2.048.542	239.169	4.437.131
Segment operating results	432.289	272.197	140.586	845.071
Unallocated items				
Research and development				(99.580)
Other operating expenses				(384.832)
Net finance income				873.573
Share of profit of associates				290.267
Income tax expense				(246.856)
Net profit for the period				1.277.642
Segment assets	40.040.479	1.214	21.835	40.063.528
Unallocated assets				7.637.553
Total assets				47.701.081
Unallocated liabilities				17.961.663
Capital expenditures	1.199.239	0	0	1.199.239
Unallocated capital expenditures				42.283
Depreciation and amortization	807.618	630	17.480	825.728
Unallocated depreciation and amortization				15.237

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5. Segment reporting (continued)

1 January - 30 June 2015	Power production	Electricity sale	Other	Total
External revenue	1.615.848	2.034.263	173.781	3.823.892
Other income			1.806	1.806
Inter-segment revenue	943.257			943.257
Total segment revenue	2.559.105	2.034.263	175.587	4.768.955
Segment operating results	917.025	179.582	25.667	1.122.275

Unallocated items

Research and development				(18.862)
Other operating expenses				(292.244)
Net finance expense				(1.568.569)
Share of profit of associates				747.567
Income tax recovery (expense)				151.480
Net profit for the period				141.647
Segment assets	35.787.978	4.690	522.721	36.315.389
Unallocated assets				8.332.863
Total assets				44.648.252
Unallocated liabilities				18.413.458
Capital expenditures	1.105.802	0	0	1.105.802
Unallocated capital expenditures				12.190
Depreciation and amortization	671.647	630	21.149	693.426
Unallocated depreciation and amortization				10.051

Major customers

Revenues from one customer of the Company's power production segment amounted to ISK 682 million (2015: ISK 936 million).

Revenues from HS Veitur hf. were as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1-30.6.2016	435.433	173.665	67.484	676.582
Revenues 1.1-30.6.2015	461.142	150.190	91.684	703.016

6. Other income

HS Orka sold its office building to HS Veitur hf. in June resulting in sales profit of ISK 77 million. HS Orka will move its head offices to Svartsengi in Q4 2016.

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Notes to the Condensed Consolidated Financial Statements

7. Other operating expenses

	Q2 2016	Q2 2015	YTD 2016	YTD 2015
Salaries and related expenses	75.921	46.264	116.677	91.140
Increase in pension fund obligation	4.508	5.675	10.797	10.980
Administrative expenses	176.584	55.968	242.769	180.074
Depreciation and amortization	7.295	5.208	14.589	10.050
	264.308	113.115	384.832	292.244

Increase in administrative expenses is mostly due to arbitration costs.

8. Finance income and expense

Finance income and expenses are specified as follows:

Finance income:

	Q2 2016	Q2 2015	YTD 2016	YTD 2015
Interest income on cash, loans and receivables	26.798	46.076	41.974	96.514
Fair value changes through profit or loss	2.811	16.428	13.670	27.451
	29.609	62.504	55.644	123.964
Finance cost				
Interest expense	(54.550)	(63.769)	(100.243)	(146.353)
Indexation	(8.321)	(20.188)	(12.136)	(25.364)
Fair value changes through profit or loss	4.472	0	(59.869)	0
	(58.399)	(83.957)	(172.247)	(171.717)
Net exchange rate differences	67.308	106.261	149.547	(281.780)
Changes in fair value of embedded derivatives	645.899	(635.292)	840.629	(1.239.036)
	684.418	(550.485)	873.573	(1.568.569)

9. Restricted cash

At the end of June 2016 cash in the amount of ISK 553 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.

10. 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:

	30.06.2016		31.12.2015	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Interest-bearing long-term debts	8.758.958	8.467.043	9.945.657	9.593.082

Interest rates used for determining fair value for disclosure purposes

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

For foreign denominated debt the discount rates are based on interbank rates. All discount rates include an adequate credit spread, and were as follows:

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10. Financial instruments (continued)

Interest rates used for determining fair value:

	1.1-30.6.2016	1.1-30.6.2015
Interest-bearing long-term debts	Libor + 300 bp	Libor + 300 bp

Fair value of other financial assets and liabilities is equal to their carrying amount.

Classification of financial instruments

Financial assets and liabilities are classified as follows:

Financial assets	30.06.2016	31.12.2015
Loans and receivables	3.816.423	4.543.742
Financial assets designated at fair value through profit or loss	356.822	1.205.690
	4.173.246	5.749.432

Financial liabilities	30.06.2016	31.12.2015
Financial liabilities designated at fair value through profit or loss	3.840.469	4.681.099
Financial liabilities measured at amortized cost	10.667.128	12.580.233
	14.507.597	17.261.332

11. Fair value hierarcy

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 (ie. as prices) or indirectly (ie. 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 June 2016				
Operating assets			36.463.556	36.463.556
Embedded derivatives		(3.840.469)		(3.840.469)
Bonds		211.571		211.571
Investments in other companies			27.075	27.075
Short-term investments	118.176			118.176
Total	118.176	(3.628.898)	36.490.631	32.979.909
31 December 2015				
Operating assets			36.566.711	36.566.711
Embedded derivatives		(234.088)	(4.447.010)	(4.681.099)
Bonds		271.440		271.440
Investments in other companies			27.075	27.075
Short-term investments	907.174			907.174
Total	907.174	37.352	32.146.776	33.091.302

Embedded derivatives have all been transfered from level 3 to level 2 due to the fact that the forward market for aluminium only extends to maximum of ten years.

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12. Other matters

Litigation 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 and HS Orka considers its claim on the basis of that agreement to be fully valid. Negotiations have not settled the matter and it is very likely that either party will soon resort to courts to resolve the matter.

Reykjanesbær bond

Since selling land to the Municipality of Reykjanesbær in 2009, HS Orka has held a bond issued by the Municipality. 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, but negotiations are still ongoing. If the municipality fails to reach a composition it is likely that it 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 71 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 44 MW, 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.

Suðurorka

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 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 parliament and HS Orka believes that there will be, more likely than not changes made 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 30 June 2016 was ISK 240 million.