

HS Orka hf.

Condensed Consolidated
Interim Financial Statements
for the three months ended 31 March 2017

ISK 000's

HS Orka hf.
Svartsengi
240 Grindavík
kt. 680475-0169

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Endorsement by the Board of Directors and the CEO

The consolidated financial statements of HS Orka hf. (the "Company" or "HS Orka") for the period 1 January to 31 March 2017 are prepared in accordance with the International Accounting Standard, IAS 34, Interim Financial Reporting as adopted by the EU.

According to the consolidated statement of comprehensive income, the Company's operating revenue amounted to ISK 1,977 million for the period 1 January to 31 March 2017 (2016: ISK 1,861 million) and the profit for the period amounted to ISK 1,619 million (2016: ISK 465 million). Total comprehensive income amounted to ISK 1,641 million (2016: ISK 450 million).

According to the consolidated statements of financial position, the Company's assets amounted to ISK 47,074 million at the end of March 2017 (at year end 2016: ISK 46,951 million). Equity amounted to ISK 32,525 million at the end of March 2017 (at year end 2016: ISK 31,304 million) or 69.1% of total capital (at year end 2016: 66.7%).

Statement of Board of Directors and CEO

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, as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 31 March 2017, its financial performance, and the changes in cash flows during the period 1 January to 31 March 2017.

Furthermore, it is the opinion of the Board of Directors and the CEO that the 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 discussed the Company's condensed consolidated interim financial statements for the three months ended 31 March 2017 and confirmed by means of their signatures

Reykjanesbær, 10 May 2017

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 31 March 2017 and the related condensed consolidated interim statement of comprehensive income, changes in equity and cash flows for the year 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, 10 May 2017.

KPMG ehf.

Margret G. Flóvenz

Sigurjón Örn Arnarson

Consolidated Statements of Comprehensive Income for the three months ended 31 March 2017

	Notes	2017 Q1	2016 Q1
Operating revenue	5	1.977.362	1.861.410
Production cost and cost of sales		(1.684.822)	(1.434.829)
Gross profit		<u>292.540</u>	<u>426.581</u>
Other income		0	1.307
Other operating expenses	6	(166.661)	(120.524)
Research and development		(7.788)	(26.679)
Profit from operations		<u>118.091</u>	<u>280.684</u>
Finance income		16.846	15.175
Finance costs		(41.212)	(102.989)
Net exchange rate differences		(91.262)	82.239
Changes in fair value of embedded derivatives		1.743.962	194.731
Net finance income	7	<u>1.628.334</u>	<u>189.156</u>
Share of profit of associates		<u>221.675</u>	<u>88.681</u>
Profit before income tax		<u>1.968.100</u>	<u>558.521</u>
Income tax expense		(349.285)	(93.968)
Net profit for the period		<u>1.618.815</u>	<u>464.553</u>
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Remeasurement of defined benefit liability		(7.587)	(7.615)
Tax on items not reclassified to profit or loss		1.517	1.523
		<u>(6.070)</u>	<u>(6.092)</u>
Items that may be reclassified subsequently to profit or loss			
Currency translation difference on associates		28.177	(8.032)
Other comprehensive income (loss) for the period		<u>22.108</u>	<u>(14.124)</u>
Total comprehensive income		<u>1.640.923</u>	<u>450.429</u>
Profit attributable to:			
Owners of the Parent Company		1.618.815	464.553
Comprehensive income attributable to:			
Owners of the Parent Company		1.640.923	450.429
Earnings per share:			
Basic and diluted earnings per share		0,21	0,06

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

Consolidated Statements of Financial Position

as at 31 March 2017

Assets	Notes	31.3.2017	31.12.2016
Fixed assets			
Operating assets		35.957.813	36.213.477
Operating assets under construction		3.415.486	3.399.732
Intangible assets		1.709.506	1.643.748
Investments in associates		2.361.222	2.113.796
Investments in other companies		27.075	27.075
Bonds		59.269	59.269
Prepaid lease and royalty fee		519.119	517.736
Long-term receivables		659.521	640.561
		<u>44.709.011</u>	<u>44.615.394</u>
Current assets			
Inventories		469.556	487.444
Trade and other receivables		1.232.375	1.310.280
Restricted cash and cash equivalents	8	507.735	508.500
Cash and cash equivalents		155.451	29.234
		<u>2.365.117</u>	<u>2.335.458</u>
Total assets		<u>47.074.128</u>	<u>46.950.852</u>
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		(83.762)	(111.939)
Other reserves		1.166.800	945.125
Revaluation reserve		8.009.958	8.120.761
Retained earnings		8.438.115	7.356.242
Total equity attributable to owners of the parent company		<u>32.411.090</u>	<u>31.190.168</u>
Non-controlling interest		113.519	113.519
Total equity		<u>32.524.609</u>	<u>31.303.687</u>
Liabilities			
Loans and borrowings	9	4.656.170	4.950.857
Pension obligations		2.186.000	2.178.300
Deferred tax liability		1.924.544	1.605.903
Embedded derivatives in power sales contracts		1.316.300	2.802.385
		<u>10.083.014</u>	<u>11.537.445</u>
Current liabilities			
Loans and borrowings	9	2.228.820	1.798.361
Current tax payable		29.127	0
Trade and other payables		2.054.725	1.899.648
Embedded derivatives in power sales contracts		153.833	411.710
		<u>4.466.505</u>	<u>4.109.720</u>
Total liabilities		<u>14.549.519</u>	<u>15.647.165</u>
Total liabilities and equity		<u>47.074.128</u>	<u>46.950.852</u>

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

Statements of Changes in Equity for the three months ended 31 March 2017

	Share Capital	Share Premium	Translation Reserve	Revaluation Reserve	Other Reserves*	Retained Earnings	Attributable to Parent	Non- controlling Interest	Total Equity
Equity at 1 January 2016	7.841.124	7.038.855	176.041	8.601.406	0	5.135.258	28.792.684	108.618	28.901.302
Profit for the period						464.553	464.553		464.553
Other comprehensive loss			(8.032)	0		(6.092)	(14.124)		(14.124)
Total comprehensive income			(8.032)	0	0	458.461	450.430	0	450.429
Revaluation reserve transferred to Retained earnings				(111.551)		111.551	0		0
Dividends paid ISK 0.04 per share						(360.000)	(360.000)		(360.000)
Equity at 31 March 2016	<u>7.841.124</u>	<u>7.038.855</u>	<u>168.009</u>	<u>8.489.855</u>	<u>0</u>	<u>5.345.269</u>	<u>28.883.112</u>	<u>108.618</u>	<u>28.991.730</u>
Equity at 1 January 2017	7.841.124	7.038.855	(111.939)	8.120.761	945.125	7.356.242	31.190.168	113.519	31.303.687
Profit for the period					221.675	1.397.140	1.618.815		1.618.815
Other comprehensive income (loss)			28.177			(6.070)	22.107		22.107
Total comprehensive income			28.177	0	221.675	1.391.070	1.640.922	0	1.640.923
Revaluation reserve transferred to Retained earnings				(110.803)		110.803			0
Dividends declared ISK 0.05 per share						(420.000)	(420.000)		(420.000)
Equity at 31 March 2017	<u>7.841.124</u>	<u>7.038.855</u>	<u>(83.762)</u>	<u>8.009.958</u>	<u>1.166.800</u>	<u>8.438.115</u>	<u>32.411.090</u>	<u>113.519</u>	<u>32.524.609</u>

*Other reserves include recognized share in profit and loss of subsidiaries and associates which is in excess of received or declared dividend by the subsidiary or the associate in accordance with change made to the Icelandic Financial statements act in the year 2016. Funds in the reserve can not be declared for dividend payments

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

Consolidated Statements of Cash Flows for the year three months 31 March 2017

	Notes	2017 Q1	2016 Q1
Cash flows from operating activities			
Profit for the period		1.618.815	464.553
Gain on sale of operating assets		0	(1.307)
Increase in pension obligations		113	9
Depreciation and amortization		429.641	424.411
Net finance income		(1.628.334)	(189.156)
Share of profit of associates		(221.675)	(88.681)
Income tax expense		349.285	93.968
Cash generated by operations		547.845	703.797
Inventories, decrease, (increase)		17.888	(11.420)
Receivables, decrease		72.273	181.063
Current liabilities, decrease		(190.043)	(217.641)
Net cash from operations before interest and taxes		447.964	655.798
Interest received		2.135	0
Interest paid		(43.174)	(52.116)
Net cash provided by operating activities		406.925	603.682
Cash flows from investing activities			
Acquisition of operating assets		(171.820)	(783.281)
Acquisition of operating assets under construction		(15.754)	0
Proceeds from sale of operating assets		0	2.000
Acquisition of intangible assets		(67.914)	(76.573)
Acquisition of shares in associates		0	(4.000)
Dividends received from associates		2.428	2.428
Proceeds from sale of short-term investments		0	600.000
		(253.060)	(259.426)
Cash flows from financing activities			
Paid dividends from prior year		(67.205)	0
New short-term borrowings		407.783	0
Repayment of borrowings		(366.354)	(429.677)
		(25.775)	(429.677)
Increase, (decrease) in cash and cash equivalents		128.090	(85.421)
Cash and cash equivalents at 1 January		29.234	841.072
Effect of exchange rate fluctuations on cash held		(1.873)	(22.945)
Cash and cash equivalents at 31 March		155.451	732.707
Investing and financing activities not affecting cash flows			
Unpaid dividends		(420.000)	(360.000)
Current liabilities		420.000	360.000

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

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 Orkubraut 3, Svartsengi, Grindavík, 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 consolidated financial statements of the Company consolidate the financial statements of its subsidiary Vesturverk ehf. (Vesturverk) and the Company's 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.

As at March 31, 2017 the Company holds a working capital deficit of ISK 2,101 million (ISK 1,774 million deficit at December 31, 2016). Though the Company projects that it will be able to meet its working capital needs from operating results, it is currently in late stage negotiations with lenders for a loan to provide expansion capital for financing of expansion and development projects.

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 2016. 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 2016.

These financial statements were authorized for issue by the Board of Directors on 10 May 2017.

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 2016.

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 2017 that have been approved by the EU (the European Union). No new standards adopted during the period effected 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.

Notes to the Condensed Consolidated Financial Statements

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 2016.

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.

2017	Power production	Electricity sale	Other	Total
External revenue	706.446	1.243.638	27.278	1.977.362
Inter-segment revenue	396.228			396.228
Total segment revenue	1.102.673	1.243.638	27.278	2.373.590
Segment operating results	139.961	149.152	3.427	292.540
Unallocated items				
Other income				0
Research and development				(7.788)
Other operating expenses				(166.661)
Net finance income				1.628.334
Share of profit of associates				221.675
Income tax expense				(349.285)
Net profit for the period				1.618.815
Segment assets	39.195.462	700	0	39.196.162
Unallocated assets				7.877.968
Total assets				47.074.130
Unallocated liabilities				14.549.519
Capital expenditures	199.366	0	0	199.366
Unallocated capital expenditures				56.125
Depreciation and amortization	420.811	0	0	420.811
Unallocated depreciation and amortization				8.830

Notes to the Condensed Consolidated Financial Statements

5. Segment reporting (continued)

2016	Power production	Electricity sale	Other	Total
External revenue	681.149	1.118.947	61.314	1.861.410
Inter-segment revenue	502.948	0	0	502.948
Total segment revenue	1.184.097	1.118.947	61.314	2.364.358
Segment operating results	328.233	94.585	3.763	426.581

Unallocated items

Other income				1.307
Research and development				(26.679)
Other operating expenses				(120.524)
Net finance income				189.156
Share of profit of associates				88.681
Income tax expense				(93.968)
Net profit for the period				464.554
Segment assets	40.032.153	1.529	213.625	40.247.306
Unallocated assets				7.887.573
Total assets				48.134.880
Unallocated liabilities				15.647.164
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

Major customers (customers with more than 10% of total revenue)

Revenues from one customer of the Company's power production segment amounted to ISK 372 million (1.1.2016 - 31.3.2016 ISK 351 million).

Revenues from HS Veitur hf. were as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 31.3.2017	233.476	64.261	4.314	302.050
Revenues 1.1. - 31.3.2016	241.746	63.648	41.758	347.151

6. Other operating expenses

	2017	2016
Salaries and related expenses	79.469	40.756
Increase in pension fund obligation	5.756	6.289
Administrative expenses	72.932	66.185
Depreciation and amortization	8.505	7.294
	166.661	120.524

Notes to the Condensed Consolidated Financial Statements

7. Finance income and expense

Finance income and expenses are specified as follows:

Finance income:

	2017	2016
Interest income on cash, loans and receivables	16.846	15.175
	<u>16.846</u>	<u>15.175</u>
Finance cost		
Interest expense	(40.146)	(45.693)
Indexation	(1.065)	(3.814)
Fair value changes through profit or loss	0	(53.482)
	<u>(41.212)</u>	<u>(102.988)</u>
Net exchange rate differences	(91.262)	82.239
Changes in fair value of embedded derivatives	1.743.962	194.731
	<u>1.628.334</u>	<u>189.156</u>

8. Restricted cash

At 31 March 2017 cash in the amount of ISK 508 million (USD 4.5 million) (at year end 2016: ISK 509 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.

9. Loans and borrowings

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortized cost.

	31.3.2017	31.12.2016
Unsecured bank loans	728.275	320.491
Secured bank loans with covenants	5.844.415	6.117.492
Unsecured bond issue	312.301	311.235
Total interest bearing debt and borrowings	<u>6.884.990</u>	<u>6.749.218</u>
Current maturities	1.731.163	1.708.488
Short-term credit facility	497.657	89.873
Current debt	<u>2.228.820</u>	<u>1.798.361</u>
Non current debt	<u>4.656.170</u>	<u>4.950.857</u>
Annual maturities loans and borrowings are as follows:	31.3.2017	31.12.2016
Year 2018/2017	2.228.820	1.798.361
Year 2019/2018	1.418.862	1.397.123
Year 2020/2019	1.418.862	1.397.123
Year 2021/2020	946.974	928.790
Year 2022/2021	455.604	685.478
Subsequent	415.868	542.344
	<u>6.884.990</u>	<u>6.749.218</u>

Notes to the Condensed Consolidated Financial Statements

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:

	31.3.2017		31.12.2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing long-term debts	6.884.990	6.719.086	6.749.219	6.631.885

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:

Interest rates used for determining fair value:

	1.1-31.03.2017	1.1.-31.12.2016
Interest-bearing long-term debts	Libor + 250 bp	Libor + 250 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

	31.3.2017	31.12.2016
Loans and receivables	2.555.082	2.488.575
Financial assets designated held for trading at fair value through profit or loss	86.344	86.344
	<u>2.641.426</u>	<u>2.574.920</u>

Financial liabilities

	31.3.2017	31.12.2016
Financial liabilities designated at fair value through profit or loss	1.470.133	3.214.095
Financial liabilities measured at amortized cost	8.939.715	8.648.867
	<u>10.409.848</u>	<u>11.862.962</u>

Notes to the Condensed Consolidated Financial Statements

11. 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 (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
31 March 2017				
Operating assets			35.957.813	35.957.813
Embedded derivatives		(1.470.133)		(1.470.133)
Bonds		59.269		59.269
Investments in other companies			27.075	27.075
Total	0	(1.410.863)	35.984.888	34.574.024
31 December 2016				
Operating assets			36.213.477	36.213.477
Embedded derivatives		(3.214.095)		(3.214.095)
Bonds		59.269		59.269
Investments in other companies			27.075	27.075
Total	0	(3.154.825)	36.240.552	33.085.726

12. Other matters

Litigation and claims

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 now up to the court to resolve the matter. Conclusion is expected in 2017.

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 Helgúvík, 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 a 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 Althingi, the Icelandic parliament suggesting that Búlandsvirkjun falls 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 framework masterplan is in the hands of Althingi and HS Orka believes that there will be, more likely than not, changes made to the proposal before its approval by Althingi. Since this proposal has not been approved HS Orka does not consider it appropriate to write off its investment in Suðurorka at this time. However, that could change should the current proposal be approved by Althingi. HS Orka's total investment in Suðurorka at the end of March 2017 was ISK 240 million.