

HS Orka hf.

Condensed Consolidated
Interim Financial Statements
for the six months ended 30 June 2017

ISK 000's

HS Orka hf.
Orkubraut 3, 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 30 June 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 3,722 million for the period 1 January to 30 June 2017 (2016: ISK 3,507 million) and the profit for the period amounted to ISK 1,995 million (2016: ISK 1,278 million). Total comprehensive income amounted to ISK 1,933 million (2016: ISK 1,193 million).

According to the consolidated statements of financial position, the Company's assets amounted to ISK 46,402 million at the end of June 2017 (at year end 2016: ISK 46,951 million). Equity amounted to ISK 32,816 million at the end of June 2017 (at year end 2016: ISK 31,304 million) or 70.7% of total capital (at year end 2016: 66.7%).

Statement of the Board of Directors and the 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 30 June 2017, its financial performance, and the changes in cash flows during the period 1 January to 30 June 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 six months ended 30 June 2017 and confirmed by means of their signatures

Svartsengi, 9 August 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 30 June 2017 and the related condensed consolidated interim statement of comprehensive income, changes in equity and cash flows for the 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 2017.

KPMG ehf.

Margret G. Flóvenz

Sigurjón Örn Arnarson

Consolidated Statements of Comprehensive Income for the six months ended 30 June 2017

	Notes	2017 Q2	2016 Q2	2017 H1	2016 H1
Operating revenue	5	1.744.405	1.645.913	3.721.767	3.507.323
Production cost and cost of sales		(1.540.191)	(1.306.053)	(3.225.014)	(2.740.883)
Gross profit		<u>204.214</u>	<u>339.860</u>	<u>496.753</u>	<u>766.440</u>
Other income		0	77.324	0	78.631
Other operating expenses	6	(134.966)	(264.308)	(301.627)	(384.832)
Research and development		(7.585)	(72.901)	(15.373)	(99.580)
Profit from operations		<u>61.663</u>	<u>79.975</u>	<u>179.753</u>	<u>360.659</u>
Finance income		17.888	29.609	34.734	55.644
Finance costs		(39.841)	(58.399)	(81.052)	(172.247)
Net exchange rate differences		271.972	67.308	180.710	149.548
Changes in fair value of embedded derivatives		(134.700)	645.899	1.609.262	840.629
Net finance income	7	<u>115.319</u>	<u>684.417</u>	<u>1.743.654</u>	<u>873.573</u>
Share of profit of associates		<u>234.729</u>	<u>201.585</u>	<u>456.404</u>	<u>290.267</u>
Profit before income tax		<u>411.711</u>	<u>965.977</u>	<u>2.379.812</u>	<u>1.524.499</u>
Income tax expense		(35.396)	(152.888)	(384.681)	(246.856)
Net profit for the period		<u>376.315</u>	<u>813.089</u>	<u>1.995.131</u>	<u>1.277.642</u>
Other comprehensive income					
Items that will not be reclassified to profit or loss					
Remeasurement of defined benefit liability		(20.295)	(35.601)	(27.883)	(43.217)
Tax on items not reclassified to profit or loss		4.059	7.120	5.577	8.643
		<u>(16.236)</u>	<u>(28.481)</u>	<u>(22.306)</u>	<u>(34.574)</u>
Items that may be reclassified subsequently to profit or loss					
Currency translation difference on associates		(68.291)	(41.823)	(40.114)	(49.855)
Other comprehensive loss for the period		<u>(84.527)</u>	<u>(70.304)</u>	<u>(62.420)</u>	<u>(84.429)</u>
Total comprehensive income		<u>291.788</u>	<u>742.785</u>	<u>1.932.711</u>	<u>1.193.213</u>
Profit attributable to:					
Owners of the Parent Company		376.315	813.089	1.995.131	1.277.642
Comprehensive income attributable to:					
Owners of the Parent Company		291.788	742.785	1.932.711	1.193.213
Earnings per share:					
Basic and diluted earnings per share		0,05	0,10	0,25	0,16

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

Consolidated Statements of Financial Position as at 30 June 2017

Assets	Notes	30.6.2017	31.12.2016
Fixed assets			
Operating assets		35.664.377	36.213.477
Operating assets under construction		3.429.836	3.399.732
Intangible assets		1.836.947	1.643.747
Investments in associates		2.090.464	2.113.797
Investments in other companies		27.075	27.075
Bonds		59.269	59.269
Prepaid lease and royalty fee		523.097	517.736
Long-term receivables		695.996	640.561
		<u>44.327.061</u>	<u>44.615.394</u>
Current assets			
Inventories		473.168	487.444
Trade and other receivables		1.123.964	1.310.279
Restricted cash and cash equivalents	8	463.905	508.500
Cash and cash equivalents		14.078	29.233
		<u>2.075.115</u>	<u>2.335.456</u>
Total assets		<u>46.402.176</u>	<u>46.950.850</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		(152.053)	(111.939)
Other reserves		961.906	945.125
Revaluation reserve		7.899.155	8.120.761
Retained earnings		9.113.892	7.356.242
Total equity attributable to owners of the parent company		<u>32.702.879</u>	<u>31.190.168</u>
Non-controlling interest		113.519	113.519
Total equity		<u>32.816.398</u>	<u>31.303.687</u>
Liabilities			
Loans and borrowings	9	4.166.968	4.950.857
Pension obligations		2.222.000	2.178.300
Deferred tax liability		1.940.306	1.605.903
Embedded derivatives in power sales contracts		1.418.168	2.802.385
		<u>9.747.442</u>	<u>11.537.445</u>
Current liabilities			
Loans and borrowings	9	1.706.129	1.798.361
Current tax payable		44.728	0
Trade and other payables		1.900.815	1.899.647
Embedded derivatives in power sales contracts		186.664	411.710
		<u>3.838.336</u>	<u>4.109.718</u>
Total liabilities		<u>13.585.778</u>	<u>15.647.163</u>
Total liabilities and equity		<u>46.402.176</u>	<u>46.950.850</u>

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

Statements of Changes in Equity for the six months ended 30 June 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	108.617	28.901.301
Profit for the period						1.277.642	1.277.642		1.277.642
Other comprehensive loss			(49.855)	0		(34.574)	(84.429)		(84.429)
Total comprehensive income			(49.855)	0	0	1.243.069	1.193.213	0	1.193.213
Revaluation reserve transferred to Retained earnings				(259.037)		259.037	0	4.901	4.901
Dividends declared ISK 0.04 per share						(360.000)	(360.000)		(360.000)
Equity at 30 June 2016	<u>7.841.124</u>	<u>7.038.855</u>	<u>126.186</u>	<u>8.342.369</u>	<u>0</u>	<u>6.277.363</u>	<u>29.625.897</u>	<u>113.518</u>	<u>29.739.415</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					456.404	1.538.727	1.995.131		1.995.131
Other comprehensive loss			(40.114)			(22.306)	(62.420)		(62.420)
Total comprehensive income			(40.114)	0	456.404	1.516.421	1.932.711	0	1.932.711
Revaluation reserve transferred to Retained earnings				(221.606)		221.606			0
Dividends received from associates					(439.623)	439.623			
Dividends declared ISK 0.05 per share						(420.000)	(420.000)		(420.000)
Equity at 30 June 2017	<u>7.841.124</u>	<u>7.038.855</u>	<u>(152.053)</u>	<u>7.899.155</u>	<u>961.906</u>	<u>9.113.892</u>	<u>32.702.879</u>	<u>113.519</u>	<u>32.816.398</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 six months 30 June 2017

	2017	2016
	H1	H1
Cash flows from operating activities		
Profit for the period	1.995.131	1.277.642
Gain on sale of operating assets	0	(78.631)
Increase, (decrease) in pension obligations	15.817	(39.843)
Depreciation and amortization	860.864	840.965
Net finance income	(1.743.654)	(873.573)
Share of profit of associates	(456.404)	(290.267)
Income tax expense	384.681	246.856
Cash generated by operations	1.056.435	1.083.149
Inventories, decrease	14.276	27.168
Receivables, decrease	125.519	318.087
Current liabilities, decrease	(355.858)	(281.375)
Net cash from operations before interest and taxes	840.372	1.147.029
Interest received	2.616	(2.098)
Interest paid	(46.311)	(96.183)
Net cash provided by operating activities	796.677	1.048.748
Cash flows from investing activities		
Acquisition of operating assets	(311.764)	(1.001.085)
Acquisition of operating assets under construction	(30.104)	(162.283)
Proceeds from sale of operating assets	0	361.075
Proceeds from sale of intangible assets	0	925
Acquisition of intangible assets	(193.064)	(146.656)
Acquisition of shares in associates	0	(4.000)
Dividends received from associates	439.623	421.517
Proceeds from sale of short-term investments	0	800.000
	(95.309)	269.493
Cash flows from financing activities		
Paid dividends from prior year	(67.205)	0
New short-term borrowings	266.044	0
Repayment of borrowings	(901.217)	(991.272)
Payment of share capital increase in subsidiary	0	4.901
	(702.378)	(986.371)
Increase in cash and cash equivalents	(1.009)	331.870
Cash and cash equivalents at 1 January	29.233	841.072
Effect of exchange rate fluctuations on cash held	(14.146)	(59.109)
Cash and cash equivalents at 30 June	14.078	1.113.833
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 June 30, 2017 the Company holds a working capital deficit of ISK 1,748 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 9 August 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

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.

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.

H1 2017	Power production	Electricity sale	Other	Total
External revenue	1.400.763	2.255.868	65.136	3.721.767
Inter-segment revenue	633.921			633.921
Total segment revenue	2.034.684	2.255.868	65.136	4.355.688
Segment operating results	117.013	376.876	2.864	496.753
Unallocated items				
Research and development				(15.373)
Other operating expenses				(301.627)
Net finance income				1.743.654
Share of profit of associates				456.404
Income tax expense				(384.681)
Net profit for the period				1.995.131
Segment assets	39.002.593	8.436	0	39.011.028
Unallocated assets				7.391.147
Total assets				46.402.176
Unallocated liabilities				13.585.778
Capital expenditures	460.873	7.782	0	468.655
Unallocated capital expenditures				66.412
Depreciation and amortization	842.184	47	0	842.231
Unallocated depreciation and amortization				18.633

Notes to the Condensed Consolidated Financial Statements

5. Segment reporting (continued)

H1 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	0	0	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	845.072

Unallocated items

Other income				0
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				1.277.644
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

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

Revenues from one customer of the Company's power production segment amounted to ISK 785 million (1.1.2016 - 30.6.2016 ISK 682 million).

Revenues from HS Veitur hf. were as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 30.6.2017	421.919	148.347	4.562	574.828
Revenues 1.1. - 30.6.2016	435.433	173.665	67.484	676.582

6. Other operating expenses

	Q2 2017	Q2 2016	H1 2017	H1 2016
Salaries and related expenses	66.732	75.921	146.201	116.677
Increase in pension fund obligation	4.818	4.508	10.574	10.797
Administrative expenses	54.909	176.584	127.841	242.769
Depreciation and amortization	8.505	7.295	17.010	14.589
	134.966	264.308	301.627	384.832

Decrease in administrative expenses is mostly due to arbitrations costs

Notes to the Condensed Consolidated Financial Statements

7. Finance income and expense

Finance income and expenses are specified as follows:

Finance income:

	Q2 2017	Q2 2016	H1 2017	H1 2016
Interest income on cash, loans and receivables	17.888	26.798	34.734	41.974
Fair value changes through profit or loss	0	2.811	0	13.670
	17.888	29.609	34.734	55.644

Finance cost

Interest expense	(39.789)	(54.550)	(79.935)	(100.243)
Indexation	(52)	(8.321)	(1.117)	(12.136)
Fair value changes through profit or loss	0	4.472	0	(59.869)
	(39.841)	(58.399)	(81.052)	(172.248)
Net exchange rate differences	271.972	67.308	180.710	149.547
Changes in fair value of embedded derivatives	(134.700)	645.899	1.609.262	840.629
	115.319	684.417	1.743.654	873.572

8. Restricted cash

At 30 June 2017 cash in the amount of ISK 464 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.

	30.6.2017	31.12.2016
Unsecured bank loans	586.536	320.491
Secured bank loans with covenants	5.286.562	6.117.492
Unsecured bond issue	0	311.235
Total interest bearing debt and borrowings	5.873.098	6.749.218

Short-term credit facility	355.918	89.873
Current maturities	1.350.212	1.708.488
Non current debt	4.166.968	4.950.857

Annual maturities loans and borrowings are as follows:

	30.6.2017	31.12.2016
Year 2018/2017	1.706.129	1.798.361
Year 2019/2018	1.350.212	1.397.123
Year 2020/2019	1.127.991	1.397.123
Year 2021/2020	856.536	928.790
Year 2022/2021	405.635	685.478
Subsequent	426.595	542.344
	5.873.098	6.749.218

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:

	30.6.2017		31.12.2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing long-term debts	5.873.097	5.734.544	6.749.218	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:

	1.1-30.06.2017	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

	30.6.2017	31.12.2016
Loans and receivables	2.297.944	2.488.573
Financial assets designated held for trading at fair value through profit or loss	86.344	86.344
	<u>2.384.288</u>	<u>2.574.917</u>

Financial liabilities

	30.6.2017	31.12.2016
Financial liabilities designated at fair value through profit or loss	1.604.832	3.214.095
Financial liabilities measured at amortized cost	7.773.912	8.648.865
	<u>9.378.744</u>	<u>11.862.960</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
30 June 2017				
Operating assets			35.664.377	35.664.377
Embedded derivatives		(1.604.832)		(1.604.832)
Bonds		59.269		59.269
Investments in other companies			27.075	27.075
Total	0	(1.545.563)	35.691.452	34.145.889
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	(3.154.826)	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 (ISK 696 million) 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.

Blue Lagoon Shares

Following several unsolicited expressions of interest, HS Orka announced in May that it would examine strategic alternatives for its 30% Blue Lagoon ownership interest, up to and including a full sale. This process took place in June, resulting in a decision on HS Orka keeping its share in the Blue Lagoon for now.

Suðurorka

Suðurorka, is 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. The proposal did not get approved in the last term of the Althingi and HS Orka does not consider it appropriate to write off its investment in Suðurorka at this time. However, that could change should the proposal be approved by Althingi. HS Orka's total investment in Suðurorka at the end of June 2017 was ISK 240 million.