

HS Orka hf.

Condensed Interim Financial Statements
three months ended 31 March 2013
ISK

HS Orka hf.
Brekkuvegur 36
260 Reykjanesbær

Reg. no. 680475-0169

Contents

Endorsement by the Board of Directors and Management	3
Independent Auditors' Review Report	4
Condensed Statement of Comprehensive Income	5
Condensed Statement of Financial Position	6
Condensed Statement of Changes in Equity	7
Condensed Statement of Cash Flows	8
Notes to the Financial Statements	9

Endorsement by the Board of Directors and the Management

The condensed interim financial statements of HS Orka hf. (the Company) for the period from 1 January to 31 March 2013 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 1,947 million for the first three months of 2013 (2012: ISK 1,841 million) and the loss for the period amounted to ISK 910 million (2012: ISK 8 million profit). Other comprehensive income amounted to ISK 32 million (2012: ISK 25 million). According to the statement of financial position, the Company's assets amounted to ISK 47,122 million at the end of March 2013 (at year end 2012: ISK 49,825 million). Equity amounted to ISK 25,512 million at the end of March 2013 (at year end 2012: ISK 26,605 million) or 54.1% of total capital (at year end 2011: 47.0%).

To the best knowledge of the Board of Directors and the Management, the Company's condensed interim financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the Management that the condensed interim financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 31 March 2013, its financial performance, and the changes in cash flows in the period from 1 January to 31 March 2013.

Furthermore, it is the opinion of the Board of Directors and the Management that the condensed interim financial statements and endorsement by the Board of Directors and the Management contain a fair overview of the Company's financial development and performance, its position and describe the main risk factors and uncertainties faced by the Company.

The Board of Directors and the Management of HS Orka hf. have today approved the Company's condensed interim financial statements for the period from 1 January to 31 March 2013 and confirmed by means of their signatures.

Reykjanesbær, 10 May 2013.

The Board of Directors:

Ásgeir Margeirsson
Chairman of the board

Gylfi Árnason

John Carson

Anna Skúladóttir

Ross Beaty

Managing Director:
Július Jónsson

Assistant Managing Director:
Albert Albertsson

Independent Auditors' 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 of 31 March 2013 and the related statements of comprehensive income, changes in equity and cash flows for the three-month period then ended and a summary of significant accounting policies and other explanatory information. Management is responsible for the preparation and 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 2013

KPMG ehf.

Sæmundur Valdimarsson
Margret G. Flóvenz

Condensed Statement of Comprehensive Income for the three months ended 31 March 2013

	Note	2013 Q1	2012 Q1
Operating revenue	5	1.947.270	1.841.469
Production cost and cost of sales		<u>(1.318.110)</u>	<u>(1.192.847)</u>
Gross profit		629.160	648.622
Other operating expenses	6	<u>(173.502)</u>	<u>(111.122)</u>
Results from operating activities		455.658	537.500
Finance income		1.022.431	48.137
Finance costs		<u>(162.057)</u>	<u>(913.194)</u>
Changes in fair value of currency and interest rate swap contracts		253.453	<u>(94.204)</u>
Changes in fair value of embedded derivatives in power sales contracts		<u>(2.755.939)</u>	461.861
Net finance expenses	7	<u>(1.642.112)</u>	<u>(497.400)</u>
Share of profit (loss) of associates		<u>38.775</u>	<u>(40.462)</u>
Loss before income tax		<u>(1.147.679)</u>	<u>(362)</u>
Income tax recovery (expense)		<u>237.296</u>	<u>(8.020)</u>
Loss for the period		<u>(910.383)</u>	<u>(8.382)</u>
Other comprehensive income			
Foreign currency translation difference of associates.....		<u>(31.815)</u>	25.228
Other comprehensive (loss) income for the period, net of income tax		<u>(31.815)</u>	<u>25.228</u>
Total comprehensive (loss) income for the period		<u>(942.198)</u>	<u>16.846</u>
Loss per share			
Basic and diluted loss per share		<u>(0,12)</u>	<u>(0,001)</u>
Weighted average of number of shares outstanding		7.694.757	7.206.865

Notes on pages 9 to 12 are an integral part of these condensed interim financial statements

Condensed Statement of Financial Position as at 31 March 2013

Assets	31.3.2013	31.12.2012
Operating assets	31.697.756	31.494.192
Operating assets under construction	3.725.627	3.664.287
Intangible assets	993.227	990.063
Investments in associates	743.042	740.937
Investments in other companies	27.075	27.075
Bonds	374.705	363.028
Embedded derivatives in power sales contracts	1.526.863	4.071.213
Prepaid lease and royalty fee	484.474	475.166
Long term receivable	329.752	289.646
Total non-current assets	39.902.521	42.115.607
Inventories	427.121	414.088
Bonds	81.273	78.740
Trade and other receivables	1.454.336	1.234.576
Embedded derivatives in power sales contracts	0	189.458
Short term investments	572.811	565.800
Cash and cash equivalents	4.707.031	5.227.728
Total current assets	7.242.572	7.710.390
Total assets	47.145.093	49.825.997
Equity		
Share capital	7.841.124	7.841.124
Share premium	7.038.855	7.038.855
Translation reserve	302.650	334.465
Revaluation reserve	6.368.025	6.443.110
Retained earnings	3.961.850	4.947.149
Total equity	25.512.504	26.604.703
Liabilities		
Loans and borrowings	14.717.105	16.007.219
Pension obligations	1.787.700	1.726.700
Deferred tax liability	588.683	825.978
Currency and interest rate swap contracts	485.867	677.508
Total non-current liabilities	17.579.355	19.237.405
Loans and borrowings	2.279.261	2.381.334
Trade and other payables	1.353.185	1.142.086
Embedded derivatives in power sales contracts	22.131	0
Currency and interest rate swap contracts	398.657	460.469
Total current liabilities	4.053.234	3.983.889
Total liabilities	21.632.589	23.221.294
Total equity and liabilities	47.145.093	49.825.997

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Condensed Statement of Changes in Equity for the three months ended 31 March 2013

	Share capital	Share premium	Translation reserve	Revaluation reserve	Retained earnings	Total
Q1 2012						
Equity at 1 January 2012	6.962.919	3.218.660	297.542	1.647.187	4.270.960	16.397.268
Total comprehensive income			25.228	0 (8.382)	16.846
Revaluation reserve transferred to retained earnings				(19.068)	19.068	0
Share capital increase	878.205	3.820.195				4.698.400
Equity at 31 March 2012	7.841.124	7.038.855	322.770	1.628.119	4.281.646	21.112.514
Q1 2013						
Equity at 1 January 2013	7.841.124	7.038.855	334.465	6.443.110	4.947.149	26.604.703
Total comprehensive loss			(31.815)		(910.383)	(942.198)
Revaluation reserve transferred to retained earnings				(75.085)	75.085	0
Dividends declared ISK 0,02 pr. share					(150.000)	(150.000)
Equity at 31 March 2013	7.841.124	7.038.855	302.650	6.368.025	3.961.850	25.512.504

Notes on pages 9 to 12 are an integral part of these condensed interim financial statements

Condensed Statement of Cash Flows

for the three months ended 31 March 2013

	2013	2012
	YTD	YTD
Cash flows from operating activities		
Loss for the period	(910.383)	(8.382)
Adjustments:		
Gain on sale of operating assets	0	(2.242)
Increase in pension obligations	61.000	3.000
Depreciation and amortization	325.768	248.817
Net finance expenses	1.642.112	497.400
Share of (profit) loss of associates	(38.775)	40.462
Income tax	(237.296)	8.020
	842.426	787.075
Inventories, increase	(13.033)	(102)
Receivables, (increase) decrease	(231.935)	59.412
Current liabilities, increase	77.711	57.682
Net cash from operations before interest and taxes	675.169	904.067
Interest income received	27.697	26.760
Interest and indexation costs paid	(126.741)	(121.577)
Net cash from operating activities	576.125	809.250
Cash flows from investing activities		
Acquisition of operating assets during the year	(586.981)	(61.319)
Payments for operating assets acquired in prior year	0	(174.394)
Proceeds from sale of operating assets	0	2.701
Acquisition of intangible assets	(6.855)	(10.519)
Dividend received from associate	4.855	4.855
Investment in marketable securities	0	(466.035)
Net cash used in investing activities	(588.981)	(704.711)
Cash flows from financing activities		
Share capital increase	0	4.698.401
Repayment of borrowings	(485.041)	(486.674)
Net cash (used in) provided by financing activities	(485.041)	4.211.727
(Decrease) Increase in cash and cash equivalents	(497.897)	4.316.266
Cash and cash equivalents at 1 January	5.227.728	1.304.713
Effect of exchange rate fluctuations on cash held	(22.800)	43.435
Cash and cash equivalents at 31 March	4.707.031	5.664.414
Investing and financing activities not affecting cash flows		
Unpaid dividends	(150.000)	0
Current liabilities	150.000	0

Notes on pages 9 to 12 are an integral part of these condensed interim financial statements

Notes to the Condensed Interim Financial Statements

1. Reporting entity

HS Orka hf. is a limited liability company domiciled in Iceland. The Company's registered office address is Brekkustígur 36, Reykjanesbær, Iceland. The Company generates and sells electricity and hot water for heating. The condensed interim financial statements as at and for the three months ended 31 March 2013 comprises the Company and its interest in associates. The Company is a subsidiary of Magma Energy Sweden AB. The financial statements of the Company are part of the consolidated financial statements of the ultimate parent company Alterra Power Corp., headquartered in Canada.

The Company's financial statements can be found at its website www.hsorka.is and at the website of the Icelandic Stock Exchange; www.nasdaqomxnordic.com.

2. Statement of compliance

This condensed interim financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* and are prepared in accordance with IFRS issued and outstanding of May 10 2013. 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 consolidated financial statements as at and for the year ended 31 December 2012. This condensed consolidated 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 2012.

These condensed interim financial statements were approved by the Board of Directors on 10 May 2013.

3. Significant accounting policies

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 2012.

These condensed interim financial statements are prepared in Icelandic krona, which is the company's functional currency and all amounts have been rounded to the nearest thousand. They are based on historical cost, except for the following:

- a part of operating assets is recognized at revalued cost, which was the fair value at the revaluation dates of 1.1.2008 and 31.12.2012
- derivative financial instruments are measured at fair value
- embedded derivatives in electric power sales contracts are measured at fair value
- financial instruments at fair value through profit or loss are measured at fair value

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 2012.

Notes, continued

5. Segment reporting

The Company has three operating segments that are described below:

Power Production

Includes production and sale of electricity, heating water and fresh water from subterranean steam.

Electricity Sale

Includes purchases and sale of electricity to users other than mass users and power companies.

Other

Includes sale of service, rental of facilities and equipment, and other sales.

	Power production	Electricity sale	Other	Total
1 January - 31 March 2013				
External revenue	814.708	857.462	275.101	1.947.270
Inter-segment revenue	472.511			472.511
Total segment revenue	1.287.219	857.462	275.101	2.419.781
Segment operating results	434.837	8.274	12.548	455.658
Unallocated items				
Net finance expenses				(1.642.112)
Share of profit of associates				38.775
Income tax recovery				237.296
Loss for the period				(910.383)
Segment assets	35.814.902	47.427	554.281	36.416.610
Unallocated assets				10.728.483
Total assets				47.145.093
Unallocated liabilities				21.632.589
Capital expenditures	587.712	889	5.234	593.836
Depreciation and amortization	316.042	1.444	8.282	325.768
1 January - 31 March 2012				
External revenue	830.507	758.371	252.591	1.841.469
Inter-segment revenue	468.415			468.415
Total segment revenue	1.298.922	758.371	252.591	2.309.884
Segment operating results	495.278	31.282	10.940	537.500
Unallocated items				
Net finance income				(497.400)
Share of loss of associates				(40.462)
Income tax expense				(8.020)
Loss for the period				(8.382)
Segment assets	29.528.000	51.359	573.715	30.153.074
Unallocated assets				14.795.072
Total assets				44.948.146
Unallocated liabilities				23.835.632
Capital expenditures	67.498	638	3.702	71.838
Depreciation and amortization	238.864	1.442	8.511	248.817

Notes, continued

5. Segment reporting, contd.:

Major customers

Revenues from one customer of the Company's Production segment represents approximately ISK 505 million of the Company's total revenues during the period (1.1.2012 - 30.3.2012: ISK 547 million).

Revenues from HS Veitur hf. represents ISK 512 million during the period (1.1.2012 - 31.3.2012: ISK 500 million) and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues 1.1. - 31.3.2013	209.956	77.740	224.459	512.155
Revenues 1.1. - 31.3.2012	196.603	64.863	238.814	500.280

6. Other operating expenses

Operating expenses specifies as follows:

	2013 Q1	2012 Q1
Salaries and related expenses	45.852	43.733
Change in pension fund commitment	20.895	(2.334)
Administrative expenses	103.246	66.201
Depreciation and amortization	3.509	3.522
Total operating expenses	<u>173.502</u>	<u>111.122</u>

7. Net finance expenses

Net finance expenses specifies as follows:

	2013 Q1	2012 Q1
Interest income on cash and cash equivalents, loans and receivables	64.936	33.020
Net foreign exchange gain	936.274	0
Fair value changes on financial assets through profit and loss	21.221	15.117
Total finance income	<u>1.022.431</u>	<u>48.137</u>
Interest expense	(111.481)	(147.569)
Indexation	(50.576)	(47.389)
Net foreign exchange loss	0	(718.236)
Total finance costs	<u>(162.057)</u>	<u>(913.194)</u>
Fair value changes of currency and interest rate swap contracts	253.453	(94.204)
Fair value changes of embedded derivatives in electric power sale contracts	(2.755.939)	461.861
Net finance expenses	<u>(1.642.112)</u>	<u>(497.400)</u>

Notes, continued

8. Restricted cash

At the end of March 2013 cash in the amount of ISK 560 million (USD 4.5 million) (at year end 2012: ISK 578 million) was classified as restricted. The cash is dedicated to pay interest and loan payments on none ISK denominated loans in accordance with a collateral agreement concluded in March 2010 with the Company's lenders.

9. Agreement with banks

The Company has a temporary waiver with the European Investment Bank for the year 2013. All covenants were fulfilled by the Company at the end of March 2013.

10. Dispute over swap agreement

A foreign currency swap agreement entered into between Glitnir Bank hf. and HS Orka hf. on 19 November 2006 is in dispute. HS Orka claims the agreement was annulled in November 2008 when Glitnir stated in a communication to HS Orka that they did not intend to fulfill their part of the contract. Glitnir now claims the contract is still valid and demands payments from HS Orka. The parties have had discussions to seek a compromise and explore whether there is a possibility for negotiations to settle the agreement. Glitnir has made an offer to HS Orka where they claim an amount identical to the amount HS Orka has calculated, based on the original contract. However, they further claim a penalty interest assessment for the whole amount. The penalty interest is considered unacceptable by HS Orka in light of the facts, and if further negotiations will not lead to a result acceptable to HS Orka, it will be up to the courts to decide on the matter. HS Orka will claim principally that the agreement was terminated in November 2008 and therefore HS Orka has no obligations thereunder, but at the same time and alternatively, that net present calculations of obligations pursuant to the agreement should be substantially lower than those claimed by Glitnir. On February 20, 2013 Glitnir's attempted to terminate the swap agreement, as stipulated in a letter issued by the Winding up Board of Glitnir. In HS Orka's managements opinion the attempted termination is based on weak legal grounds and that it is unlikely that Glitnir's claim in that respect will be upheld.

11. Other matters

Litigations and claims

HS Orka hf. initiated on 16 December 2011 arbitration proceedings towards Norðurál Grundartangi concerning interpretation of certain clauses in the power purchase agreement for Grundartangi concerning minimum purchase of power. The full amount of revenue that should have been received under the agreement had been accrued at the end of March 2013. Hearings in the arbitration case took place in February 2013. Results are expected in mid 2013.