



HS ORKA HF

# ÁRSSKÝRSLA 2010

FINANCIAL STATEMENTS 2010





During the year 2010 there were again considerable changes in the ownership of HS Orka hf ("the company"), with 57.38% of the shares changing hands. Magma Energy Sweden A.B. bought Geysir Green Energy's shares and increased their stake from 40.943% to 98.323%. In March it was decided to increase the share capital by ISK 844,531,548 in nominal value; this was sold for approximately ISK 2.5 billion to Magma who now owns 98.526% of the total share capital. Further changes are expected in 2011 as negotiations are ongoing with a group of Icelandic pension funds interested in buying 25% of Magma's stake and in bringing in some new equity, but a deal has yet to be concluded.

During the year negotiations on new and revised loan agreements continued with the three foreign banks that had partly financed the Reykjanes Power Plant etc. The negotiations are required because the general financial difficulties in Iceland led to the company not fulfilling all of the original loan covenants, of note the equity ratio. An agreement was reached at the end of 2009, according to which there are temporary reliefs to the loan covenants for the years 2009 and 2010. The company now meets all the covenants except the equity ratio for the loans made by the EIB, and a temporary waiver for the year 2011 has been signed with this bank. Currently the company is working with NIB to merge its two loans into one new and restated loan, with some changes to the conditions.

The company is still working on plans to increase electricity production to fulfill the expected future demand of the proposed aluminum smelter in Helgúvík and of other large industrial customers. The company has bought a 50 MW turbine generator from Japan and a condensing unit from Germany for the planned expansion at Reykjanes. Tender documents for the civil work have been prepared. The company is still working on the operating permit and the financing arrangements for the expansion. The start of exploration drilling at the geothermal fields at Eldvörp and Krýsuvík has also been slowed, as necessary changes to the master and detailed plans for those areas have been delayed by the relevant municipalities and an agreement for the exploitation of the geothermal resource in Krýsuvík is still not finalized. In February 2011 the company signed a Power Purchase Agreement contract for the delivery of 30 MW from May 2013 until the end of 2015 to the Icelandic Silicon company at Helgúvík. Sufficient power will become available for commitment from the expiry of a contract with Nordural at Grundartangi for 35 MW as of October 1st 2011.

Investments in the year 2010 were higher than the year before, mainly because of the procurement of the turbine generator and the condensing unit, along with the drilling of well 29, all in preparation for the Reykjanes expansion. Investments amounted in total to ISK 2.9 billion (USD 25mm.) in comparison to ISK 1.36 billion in 2009. Of the investments in 2010, ISK 2.54 billion was for the Reykjanes expansion, ISK 220 million was for miscellaneous projects at Svartsengi, and ISK 140 million went to other investments.

In 2010 geothermal fluid extraction in Svartsengi decreased by 7.9%. The net geothermal fluid production was 6.8 million tonnes. In 2010 geothermal fluid production at Reykjanes was 18.4 million tonnes, about the same as last year. Reinjection in well 20 started at Reykjanes in 2009 and increased in 2010 up to 2.2 million tonnes, from 0.66 million tonnes in 2009, an increase of 344%. This resulted in a net production of 16.2 million tonnes.



## BOARD OF DIRECTORS, OWNERSHIP, MANAGEMENT

HS Orka's hf Annual General Meeting (AGM) for the year 2009 was held on March 15th 2010 in Svartsengi. The Board remained unchanged and after a Board meeting after the AGM at which Chairman etc. was elected the Board was as follows:

**Chairman:**

Alexander Guðmundsson, Geysir Green Energy

**Deputy chairman:**

Ross Beaty, Magma Energy Sweden A.B.

**Secretary:**

Lyle Braaten, Magma Energy Sweden A.B.

**Other:**

Gylfi Árnason, Geysir Green Energy

Katrín Friðriksdóttir, Geysir Green Energy

**Deputy:**

Auður Árnadóttir, Geysir Green Energy

Ásgeir Margeirsson, Magma Energy

On September 17th a shareholders meeting was held and after a Board meeting after the AGM at which Chairman etc. was elected the Board was as follows:

**Chairman:**

Ásgeir Margeirsson, Magma Energy Sweden A.B.

**Deputy chairman:**

Ross Beaty, Magma Energy Sweden A.B.

**Secretary:**

Gylfi Árnason, Magma Energy Sweden A.B.

**Other:**

Andrea Zaradic, Magma Energy Sweden A.B.

Annette Cushworth, Magma Energy Sweden A.B.

**Deputy:**

Júlíus Jónsson, HS Orku

Lyle Braaten, Magma Energy Sweden A.B.

Ownership of HS Orka hf on 31.12.2010:

	Shares	Percentage
Magma Energy Sweden A.B.	6.860.311.994	98,526%
Reykjanesbær Municipality	45.784.444	0,658%
Grindavíkurbær Municipality	31.144.706	0,447%
Garður Municipality	19.581.248	0,281%
Vogar Municipality	6.096.156	0,088%
<b>Total</b>	<b>6.962.918.548</b>	<b>100,000%</b>

**The company's management**

**CEO:** Júlíus Jónsson

**Deputy CEO:** Albert Albertsson





Ásgeir Margeirsson



Ross Beaty



Gylfi Árnason



Andrea Zaradic



Annette Cushworth



Júlíus Jónsson  
*CEO*



Albert Albertsson  
*Deputy CEO*



## POWER PLANT

### GEOTHERMAL DISTRICT HEATING WATER PRODUCTION 2010

The Svartsengi Power Plant's total hot water production of 11,515,524 tonnes was almost on par with last year's production. In terms of the energy content of the water, the total energy produced was 637.9 GWh, 2.8% less than in 2009. In line with last year, the coldest month was December, which required 1,112,155 tonnes of water to supply 65.2 GWh of heat energy. The maximum production rate was 101.5 thermal MW at noon on December 23.

### GEOTHERMAL POWER PRODUCTION 2010

Total electricity production was 1,349.2 GWh as compared to 1,430.8 GWh in 2009, a decline of 5.7%. The main cause of the decline is the major overhaul of the 30 MWe, turbine unit SVAE 11 (plant 5). Further, units SVAD 8 and 9 (Ormat units) were out of operation for several months because of maintenance. Yet another contributing factor was the increased water level of the Blue Lagoon, which required plant operation to reduce the geothermal production from two phase flow wells.

### OPERATION OF THE SVARTSENGI GEOTHERMAL SYSTEM 2010

During 2010 produced geothermal fluid was 12.3 million tonnes, down by 7.9% from the 2009 level. This difference was partly due to the 6 week shutdown of power plant 5, but it also reflects more accurate measurements of well flow-rates. As can be seen on figure 1X, pressure at 900 m depth had been rising, but after a new casing was set in and cemented in the injection well SVAH 24 on February 13 (ref. annual report 2009), pressure has been edging down. This has resulted in increased wellhead pressure of the steam wells (SVAH-10, -16, -20, and -23). Today the well head pressure is about 2 bar higher than a year ago. Figure 2X shows temperature measurements at 900 m depth in four wells at Svartsengi and at 1100 m in the Eldvörp well. It is quite apparent from these measurements that the geothermal reservoir in Svartsengi is being utilized in a sustainable manner.

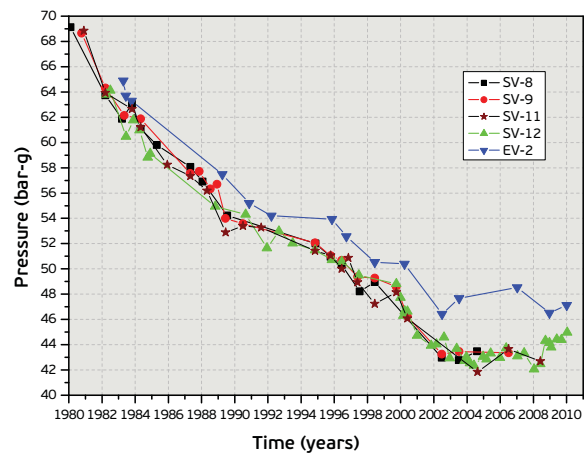


Fig 1X. Pressure at 900 m. in four wells at Svartsengi and in well EV-2 in Eldvörp.

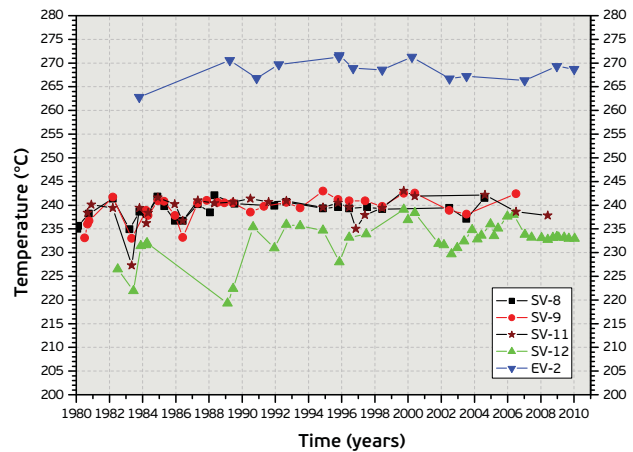


Fig. 2X. Temperature at 900 m. in four wells at Svartsengi and at 1,100 m. in well EV-2 in Eldvörp.

Reinjection into wells SVAH-17 and -24 was 5.5 million tonnes; so the net geothermal fluid production was 6.8 million tonnes. Disposal of this geothermal fluid was as follows: 1) 530,000 tonnes to power plant 2 where brine at 5.6 bar is flashed to produce LP steam to heat district heating water in direct contact heat exchangers (the spent brine goes to the Blue Lagoon surface and is included in item 5); 2) 792,000 tonnes of geothermal brine is sold to the Blue Lagoon spa; 3) 267,000 tonnes is disposed below groundwater into the shallow injection well SVAN-21; 4) 1.2 million tonnes is mixed with fresh water and fed into disposal wells SVAN-20,-22, and -23; and 5) roughly 4 million tonnes evaporates or seeps into the lava at the Blue Lagoon.

## OPERATION OF THE REYKJANES GEOTHERMAL SYSTEM

Well REYH10 was reconnected back into operation after being worked over during 2009. Total production in 2010 was 18.4 million tonnes, about the same as last year. Reinjection into well REYH-20 was 2.2 million tonnes, an increase of 334% from last year. This resulted in a net production of 16.2 million tonnes, a reduction of 8.6% from 2009. Wells are gradually getting clogged up with metal sulfide scales and two wells are planned for work over in 2011.

As shown on Fig. 3X, temperatures in the wells have been increasing since the 100 MWe plant was commissioned in May 2006. This clearly supports the plans of HS Orka to increase the production capacity of the Reykjanes Power plant.

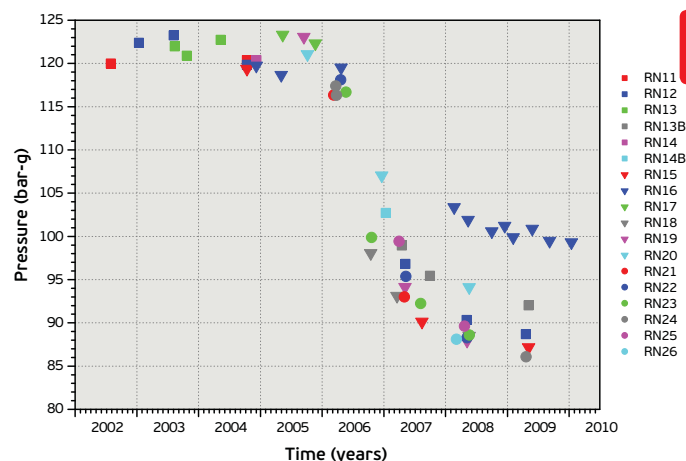


Fig. 3X. Pressure at 1,500 m. in wells at Reykjanes.

## GROUNDWATER AND GEOTHERMAL DIVISION

The Groundwater and Geothermal Division (GOJ) supervises the company's research and development activities, the preparation for new Power Plants and the operation of geothermal fields. During the year 2010 much work was dedicated to discussions with the National Energy Authority (NEA) on the application for an operating permit for the Reykjanes power plant expansion. Comprehensive supporting material was prepared to clarify HS Orka's goals and policies regarding operation of the Reykjanes geothermal system, in order to answer questions and requirements set forth by NEA. Well 29, located between the volcanic fissures at Stampar, was drilled to a depth of 2,837m to demonstrate that the geothermal system enveloped a much greater area than NEA had argued. A new technology for stimulating wells, deflagration, was tested in well 29. This technology, which had not previously been utilized in Iceland, uses gas from the deflagration process to create a high pressure impulse on the formation to open up fractures. Towards the end of the year NEA gave the company a positive conditioned draft of the operating permit for the 80 MWe expansion at Reykjanes, which is now being discussed further.

At Reykjanes the company proceeded with concurrent preparation of tender documents for unit-3 and the design of unit-4, along with updates of the drilling program and

drilling costs. Numerical modeling encompassing the fissure swarm at Reykjanes and the fields at Eldvorp and Svartsengi was undertaken, primarily focusing on Reykjanes. Resistivity surveys (MT) were made and regional temperatures changes studied. Reinjection in the deep reservoir was increased from 50 kg/s to 85 kg/s and measurements of rate of flow and enthalpy (thermal energy of the fluid and steam) with tracers was commenced on flowing production wells. Finally, drilling pads were prepared for the drilling of new wells adjacent to the mountains Skalafell and Syrfell.

Necessary changes to the master and detailed plans for Reykjanesbær were authorized, but those for Grindavíkurbær have been delayed. Minor changes of the master and detailed plans for the Hafnarfjörður municipality were authorized; these are necessary for the proposed exploration drilling at Hveradalir near Krysuvík. All the required permits for the drilling of three directionally drilled deep wells have been issued. The nature preservation and resource harnessing strategy of Hafnarfjörður has not been established yet, an issue for the company since that municipality is the owner of the land and resources, so the company is working on getting a contract with Hafnarfjörður for the exploitation of the planned wells and to harness the field. The Krysuvík

## INVESTMENTS 2010

Investments in 2010 decreased considerably from 2009 and amounted to 2,791 in Power plants (ISK 1,254 in 2009) and in total ISK 2,901 (ISK 1,356 in 2009). Investment items:

	Thousand ISK	
<b>Reykjanes</b>		
Extension, 50 MW .....	2.516.740	
Extension, 30 MW .....	6.124	
Environmental study .....	2.457	
Scaling experiments .....	9.072	
Geothermal field; miscellaneous .....	3.658	
Steam distribution system .....	6.135	2.544.185
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<b>Svartsengi</b>		
Geothermal pumping station .....	41.995	
Disposal of geothermal water .....	59.573	
Reinjection .....	248	
Power Plant 2 .....	4.828	
Power Plant 5 .....	15.425	
Power Plant 6 .....	21.743	
Geothermal wells .....	71.926	
Steam supply system .....	3.145	
Geothermal field; miscellaneous .....	805	219.689
<hr/>		
<b>Research</b>		
Research Eldvörp .....	2.030	
Research Krýsuvík .....	25.188	
Research Trölladyngju .....	128	27.346
<hr/>		
<b>Power Plants total</b>		<b>2.791.221</b>
<hr/>		
<b>Information system</b>		
Axapta/Excellent billing system .....	33.478	
Computer systems .....	2.122	
DMM (Dynamisk Maintenance Management) .....	857	
Other .....	188	36.645
<hr/>		
<b>Other investments</b>		
Employee's vacation house .....		2.831
<hr/>		
<b>Share Capital</b>		
HS Orkurannsóknir ehf. ....		70.000
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<b>Investments total</b>		<b>2.900.697</b>
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project was introduced to the town council members and to representatives from Hafnarfjordur and Sudurlindir. Extended communication with the municipality has delayed the research planned for Krysuvik, however geological mapping and the interpretation of resistivity surveys has continued. Seismicity and land movements in the area continue, possibly due to deep magma intrusions. Proposed locations of drill pads for exploration wells and the potential location of a power plant at Eldvorp were introduced to Grindavik for their work on establishing a new master and detailed plan. A similar undertaking was commenced for drill pads east of the Grindavik highway and for those potential drill sites at the Krysuvik area that are within the Grindavik jurisdiction. These matters are progressing slowly due to long processing times at the municipality.

Considerable work was done regarding the handling of the effluent from the Svartsengi plant. In February inter-zonal flow observed in the injection well SV-24 was stopped by casing the upper part of the well. As a result a pressure increase in the geothermal system was halted, improving the conditions of the steam cap and thus the operating conditions for the plant. Two shallow injection wells (SVAN-23 and 24) were drilled and an old injection well (SVAN-21) was deepened. Well SVAN-23 is located at the northern end of the Blue Lagoon and SVAN-24 is located just south of the power plant. The wells are cased through the freshwater layer and are designed to dispose of the lagoon fluid into the brackish water underneath the fresh water layer. A fluid mixing tank was put in operation at the northern end of the lagoon, in which freshwater is mixed with fluid from the lagoon in order to minimize scaling in the disposal wells. Drill pads were sited near a fracture swarm west of the Blue Lagoon parking lot. Design work commenced for the piping of a lagoon and fresh water mix to the fracture swarm and the necessary changes to the master and detail plans were prepared. A facility for acidizing the effluent from the plant in order to minimize scaling was completed. The intent is to recover a large part of the effluent that today flows into the lagoon, mix it with acid and dispose of it into the shallow injection wells near the plant. Finally, preparations began for the planning and design of a disposal pipe to the sea, which is intended to be the longer-term solution for the disposal of the effluent that currently flows to the lagoon.

HS Veitur in the Vestmannaeyjar Island was assisted with the establishment of a backup freshwater resource at the location at Álum, where there is a risk of water pollution related to the volcanic activity and the eruption at Eyjafjallajokull, which is near the location of the main freshwater resource for the island. The potential for space heating with heat pumps fed by seawater from wells was examined.

HS Orka is involved in various research and development projects. Among them are two projects that receive funding from GEORG. One project is based at Krysuvik examining the peculiarities of the velocity ratio of the primary and secondary seismic waves, the other project is at Reykjanes examining the relationship between the change in resistivity and the changes in production and subsidence. The GEISER project examines earthquakes induced by the operation of geothermal fields. The company continued participation in other projects such as materials testing, the Iceland deep drilling project (IDDP), design of high temperature geothermal wells (in cooperation with Innovation Centre Iceland), utilization of the CO<sub>2</sub> resource stream from the power plants (Carbon Recycling International (CRI) is constructing a methanol fuel plant fed with CO<sub>2</sub>, power, steam and ground water from the power plant), cultivation of thermophilic algae, fish farming fed by off streams from the power plant at Reykjanes and more. Finally, we participated in the International Geothermal Conference in Bali, where employees of HS Orka were authors and co-authors of 19 papers.



## ELECTRICITY PRODUCTION IN 2010

	% GWst	% af heild	2009 GWst	% af heild	% breyting
AEG turbines (2 x 1 MW) . . . . .	0.000	0.00%	0.000	0.00%	
Fuji turbine (6 MW). . . . .	46.740	3.46%	47.908	3.44%	-2.44%
Ormat turbines (7 x 1.2 MW) . . . . .	47.107	3.49%	46.878	3.36%	0.49%
Fuji 1999 (30.0 MW) . . . . .	200.192	14.84%	229.477	16.46%	-12.76%
Fuji 2007 (30.0 MW) . . . . .	186.149	13.80%	200.098	14.36%	-6.97%
<b>Svartsengi total</b>	<b>480.187</b>	<b>35.59%</b>	<b>524.361</b>	<b>37.62%</b>	<b>-8.42%</b>
Reykjanes Power Plant (2 x 50 MW) . . . . .	869.037	64.40%	869.030	62.35%	0.00%
	869.037	64.40%	869.030	62.35%	0.00%
Steam turbine Kalka (Incinerator station) . . . .	0.000	0.00%	0.100	0.01%	-100.00%
Other production . . . . .	0.138	0.01%	0.240	0.02%	-42.26%
	0.138	0.01%	0.340	0.02%	-59.26%
	1,349.363	100.00%	1,393.731	100.00%	-3.18%
Múla hydro Plant. . . . .	8.437		13.486		-37.44%
Fjarðarár hydro Plants . . . . .	58.005		41.880		38.50%
	66.442		55.367		20.00%

## POWER PLANTS SVARTSENGI &amp; REYKJANES - PRODUCTION 1976 - 2010

		2010	2009	Change 2010 - 2009	Total 1976 - 2010
<b>Svartsengi</b>					
Electricity to the Grid . . . . .	GWh	447,47	488,92	-8,48%	5.502,73
Own consumption . . . . .	GWh	32,71	34,15	-4,21%	600,89
<b>Total</b>	<b>GWh</b>	<b>480,19</b>	<b>523,07</b>	<b>-8,20%</b>	<b>6.103,61</b>
<b>Reykjanes.</b> . . . . .					2006 - 2010
Electricity to the Grid . . . . .	GWh	869,04	869,03	0,00%	3.960,12
Own consumption . . . . .	GWh	29,89	30,15	-0,85%	135,51
<b>Total</b>	<b>GWh</b>	<b>898,93</b>	<b>899,18</b>	<b>-0,03%</b>	<b>4.095,63</b>
Geothermal production. . . . .	Tonn	11.525.524	11.500.122	0,22%	251.876.608
Geothermal production (energy). . . . .	GWh	637,90	656,30	-2,80%	16.766,81
<b>Svartsengi</b>					
Extracted from geothermal field . . . . .	Th. Ton	13,341	13,677	-2,46%	294,001
Reinjected into geothermal field. . . . .	Th. Ton	-5,465	-6,577	-16,91%	-37,834
	<b>Th. Ton</b>	<b>7,876</b>	<b>7,100</b>	<b>10,93%</b>	<b>256,167</b>
<b>Reykjanes</b>					
Extracted from geothermal field . . . . .	Th. Ton	18,650	19,140	-2,56%	142,886
Reinjected into geothermal field. . . . .	Th. Ton	-2,194	-0,657	234,00%	-2,851
	<b>Th. Ton</b>	<b>16,456</b>	<b>18,483</b>	<b>-10,97%</b>	<b>140,035</b>

## FINANCIAL RESULTS

The company's profit for the year amounted to ISK 865 million, compared to a profit of ISK 6,798 million in 2009. After taking into account income and expenses recognized in equity, comprehensive income for 2010 amounted to ISK 711 million compared to ISK 8,155 million in 2009. The main factors impacting comprehensive income were: changes in the fair value of embedded derivatives, which reduced income to the amount of ISK 1,396 million in 2010 as compared to boosting income ISK 7,069 million in 2009, for a net change of ISK 8,465 million; foreign exchange gains of ISK 928 million compared to losses in 2009 amounting to ISK 1,245 million, for a net positive change of ISK 2,173 million; and a decrease in other comprehensive income between the years 2010 and 2009 amounting to ISK 1,511 million, mostly due to a revaluation of assets in 2009.

According to the statement of comprehensive income, HS Orka hf's operating revenue in 2010 amounted to ISK 6,994 million, compared to ISK 6,226 million in 2009. The increase is mainly due to revenue increases stemming from higher average aluminum prices during 2010 as compared to 2009.

Production costs and cost of sales amounted to ISK 4,693 million in 2010 compared to ISK 4,502 million in 2009. The main reason for the increase is greater power purchase costs and maintenance costs as a result of a major overhaul in one of the power plants. Other operating expenses amounted to ISK 406 million during the period, compared to ISK 416 million in 2009. In 2010 there was a write-off of assets of ISK 63 million for the new headquarters (design work for a project that has now been cancelled), while in 2009 there was an impairment of intangible assets of ISK 142 million. Compared to 2009 there was a moderate increase in administration costs, and a moderate decrease in pension fund costs.

## RECORD MANAGEMENT

HS Orka is in the process of implementing a professional Electronic Record Management system (ERM). The aim is to have the company's records accessible in centralized information software by 2012. This system will strengthen both the quality and security structure of the company as well as simplifying document handling, improving accessibility, reducing the time spent on record handling and fulfilling certain legal requirements. Such a professional records management system will further strengthen HS Orka's procedures and improve the safety of critical files and documents and the business continuity of the company.

Preparations for the implementation of the records management system began in early 2008. The implementation process is being based on the international standards ISO 15489 (Record Management) and ISO 9001 (Total Quality Management-TQM). Part of the implementation was systematizing and categorizing the company's document storage processes and some of the key employees' office procedures. As a result all of the company's documents have now been restructured and

filed under the company's new filing plan. The company's library has also been established formally and is now a part of the national libraries network - Gegnir. The new arrangement enables HS Orka's employees to borrow books from the company's library as well as from other Gegnir libraries.

In early 2009 a diverse group of employees was established to study the different ERM software choices. After a careful inspection of the available and suitable solutions, the group came up with a recommendation for a preferred software that is most effective at meeting all of the company's requirements. The contract is not yet signed, but we are in the final phase of the negotiations. According to the implementation plan, the software will be tested with a limited group of employees in May, and then throughout the summer it will be engineered to match the company's defined needs. The company expects to make the software available to the rest of the employees in the autumn of 2011. Proper use of the software is important to HS Orka to ensure successful records management, which is the responsibility of every employee.

## EMPLOYEES

	2010				2009			
	Total	Total fulltime		Total	Total fulltime			
Management .....	3	3,0		3	3,0			
Sales and marketing .....	1	1,0		1	1,0			
Power Plant management .....	2	2,0		2	2,0			
Control and steering .....	3	3,0		3	3,0			
Technical department .....	3	3,0		3	3,0			
Maintenance and operations .....	24	36,0	24,0	36,0	23	35,0	23,0	35,0
Utilities .....	66	65,1		66	65,4			
Office .....	31	97,0	29,8	95,0	33	99,0	31,3	97
<b>Total</b>		<b>133,0</b>	<b>131,0</b>		<b>134,0</b>	<b>131,7</b>		
Suðurnes - Njarðvík .....	65	64,6		65	64,4			
Suðurnes - Svartsengi .....	29	29,0		30	30,0			
Hafnarfjörður .....	20	19,5		20	20,5			
Vestmannaeyjar .....	15	13,8		15	13,8			
Selfoss .....	4	133,0	4,0	131,0	4	134,0	4,0	132,7
		<b>133,0</b>	<b>131,0</b>		<b>134,0</b>	<b>132,7</b>		

## SVARTSENGI

Production from wells (million tons):

	2010	2009	Change %
HSH- 7 .....	1,649	1,605	2,79%
HSH- 8 .....	1,355	1,583	-14,37%
HSH- 9 .....	1,473	1,464	0,58%
HSH-10 .....	0,600	0,688	-12,77%
HSH-11 .....	2,050	1,886	8,73%
HSH-14 .....	0,060	0,104	-42,35%
HSH-16 .....	0,410	0,608	-32,59%
HSH-18 .....	1,044	1,110	-5,92%
HSH-19 .....	0,879	1,022	-14,01%
HSH-20 .....	0,440	0,587	-25,02%
HSH-21 .....	1,517	1,968	-22,91%
HSH-22 .....	0,175	0,534	-67,21%
HSH-23 .....	0,636	0,519	22,52%
	<b>12.289</b>	<b>13.677</b>	<b>-10.15%</b>
HSH-5/6/12/17; reinjection .....	( 5.465 )	( 6.577 )	-16.91%
<b>Total production from field</b>	<b>6.824</b>	<b>7.100</b>	<b>-3.88%</b>

## REYKJANES

Production from wells (million tons):

	2010	2009	Change %
RN-10 .....	1,440	0,000	
RN-11 .....	2,347	2,369	-0,94%
RN-12 .....	2,882	2,904	-0,75%
RN-13 .....	1,070	1,130	-5,31%
RN-14 .....	0,990	1,130	-12,39%
RN-15 .....	0,280	0,690	-59,42%
RN-18 .....	0,610	0,950	-35,79%
RN-19 .....	0,986	1,149	-14,16%
RN-21 .....	1,800	1,828	-1,52%
RN-22 .....	0,560	0,808	-30,67%
RN-23 .....	1,800	2,170	-17,05%
RN-24 .....	1,800	2,087	-13,74%
RN-27 .....	1,290	0,760	69,74%
RN-28 .....	0,560	0,529	5,92%
	<b>18.415</b>	<b>18.503</b>	<b>-0,47%</b>
RN- 20; reinjection .....	( 2,194 )	( 0,657 )	234,00%
<b>Total production from field</b>	<b>16,221</b>	<b>17,846</b>	<b>-9,11%</b>

## POWER PURCHASES AND SALES

HS Orka's domestic sales declined in 2010 due to stronger competition in the Icelandic power market. Domestic power prices increased twice during the year, parallel to price changes in the Icelandic power market. Our competitors have raised their tariffs more than HS Orka, which has created an opportunity to attract new customers.

The sales of power to energy-intensive industries in 2010 was stable, with sales to the Nordural aluminum smelter slightly under budget due to maintenance work at the smelter. In 2010 HS Orka sold electrical power on short term contracts to Orkusalan (a retailer); Landsnet (the owner of the transmission grid) and Reykjavik Energy (OR), the latter due to maintenance work at their geothermal plant at Hellisheiði.

HS Orka's power generation declined by 3.3% in 2010. The main cause was the scheduled regular maintenance of one unit in Svartsengi. HS Orka has long term contracts to purchase power from Landsvirkjun, Múlavirkjun and Fjarðará for the domestic retail & small businesses market. The purchases are mainly used to meet seasonal and daily fluctuations in demand that exceed own production. Power purchases through these contracts increased insignificantly in 2010. Further, HS Orka purchased additional power from Landsvirkjun and OR in order to enable the company to fulfill contractual obligations during maintenance work at the Svartsengi and at the Reykjanes power plants. Power supply to customers in the energy-intensive industry sectors was not affected by the maintenance stoppages.

Approximately 46% of HS Orka's revenues are derived from power sold under PPAs with pricing that is indexed to the US dollar price of aluminum, resulting in higher revenues as aluminum prices increase. The market price of aluminum rose significantly in 2010, which along with a strengthening of the US dollar against the Icelandic krona resulted in higher energy prices for HS Orka. HS Orka did not enter into new PPAs in 2010; the negotiation with Iceland Silica Corporation in Helguvik for purchasing 30 MWe was concluded in early 2011. These 30 MWe will become available when one of the Nordural PPAs expires in late 2011. Yet another party has shown interest in establishing a polysilicon plant near Eldvorp to produce purified silica for solar cells. The global demand for solar cells is growing rapidly and leading to a commensurate growth in the demand for silica; annual demand is projected to grow as much as 30% - 40% per annum.

HS Orka previously entered into a conditional PPA with Nordural Helguvik sf. (Nordural) to sell power from the expansion program to a new aluminum smelter being constructed and located at Helguvík in Reykjanesbaer. The PPA was executed on April 23, 2007 and contained a number of conditions which were not subsequently fulfilled. Accordingly, HS Orka holds the view that the PPA has lapsed in accordance with its terms, but Nordural disputes this interpretation and maintains that the PPA is still a valid agreement. The PPA provides that disputes relating to the PPA shall be resolved by arbitration, and Nordural has initiated arbitration proceedings to determine the validity of the PPA. The arbitration proceedings were initiated on July 19, 2010 and a hearing date has been set for May 2011.







# **FINANCIAL STATEMENTS**

**2010**

## BOARD OF DIRECTORS AND MANAGEMENT REPORT

The financial statements of HS Orka hf (the Company) for the year 2010 are prepared in accordance with the International Accounting Standard, (IFRSs) as adopted by the European Union(EU) and additional Icelandic disclosure requirements.

According to the statement of comprehensive income, the Company's operating revenue amounted to ISK 6,994 million in the year 2010 (2009: ISK 6,226 million) and the profit of the year amounted to ISK 865 million (2009: ISK 6,798 million). Total comprehensive income amounted to ISK 711 million (2009: ISK 8,155 million). According to the statement of financial position, the Company's assets amounted to ISK 41,536 million at year end 2010 (2009: ISK 42,069 million). Equity amounted to ISK 17,296 million at the end of the year 2010 (2009: ISK 14,089 million) or 41.6% of total capital (2009: 33.5%).

At a board meeting on the 30 March 2010 the board of directors agreed to increase the share capital of the Company by 845 million shares at the rate of ISK 3 per share. The total share capital increase amounted to ISK 2,534 million and has been paid. After the increase the share capital amounted to ISK 6,963 million.

The operating assets and capitalized development cost were reviewed for indication of impairment at year-end by estimating its recoverable amount. The results were that there is not an indication of impairments for these assets. Operating assets under construction were tested for impairment at year-end by calculating the

recoverable amount of those assets. There is a high uncertainty related to future timing of the project due to a delay in receiving operational license and financing of the project which could affect the recoverability of the assets. Management estimates that the recoverability of the projects is more likely than not.

During the year management has been in negotiations with its banks regarding the future terms of the loan agreements and expects that a conclusion will be reached in a short time. It is therefore the management's view that the Company will continue as a going concern for the foreseeable future.

The Company's shareholders numbered five at year-end compared to six at the beginning of the year. At the end of the year one shareholder Magma Energy Sweden A.B. held 98.53% of the shares in HS Orka hf.

The Company's Board of Directors proposes that no dividends will be paid to shareholders in the year 2011, and refers to the financial statements for further allocation of profits and changes in equity during the year.

## STATEMENT BY THE BOARD OF DIRECTORS AND THE MANAGEMENT

According to the best knowledge of the Board of Directors and the Management, the Company's 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 financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 31 December 2010 and its financial performance and changes in cash flows during the year 2010.

Furthermore, it is the opinion of the Board of Directors and the Management that the 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 is describing the main risk factors and uncertainties faced by the Company.

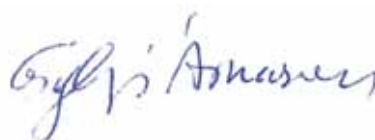
The Board of Directors and the Management of HS Orka hf. have today discussed the Company's financial statements for the year 2010 and confirmed by means of their signatures. The Board of Directors and the Management submit the financial statements for approval at the annual general meeting.

Reykjanesbær, 14 February 2011.

### THE BOARD OF DIRECTORS:



Chairman of the board




CEO



Deputy CEO

## INDEPENDENT AUDITORS' REPORT

### To the Board of Directors of HS Orka hf

We have audited the accompanying financial statements of HS Orka hf., which comprise the statement of financial position as at 31 December, 2010, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial

statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### OPINION

In our opinion, the financial statements give a true and fair view of the financial position of HS Orka hf. as at December 31, 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

### REPORT ON THE BOARD OF DIRECTORS REPORT

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we report, to the extent of our competence, that the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the financial statements.

Reykjanesbær, 14 February 2011.



KPMG hf.

## STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER

	Notes	2010	2009
Operating revenue .....	7	6,993,773	6,225,965
Production cost and cost of sales .....	8	( 4,692,753)	( 4,501,773)
<b>Gross profit .....</b>		<b>2,301,020</b>	<b>1,724,192</b>
Other income .....	9	0	783,516
Other operating expenses .....	10	( 405,730)	( 416,246)
<b>Results from operating activities .....</b>		<b>1,895,290</b>	<b>2,091,462</b>
Finance income .....		1,163,746	483,230
Finance costs .....		( 862,409)	( 2,405,753)
Changes in fair value of derivatives .....		405,946	330,226
Changes in fair value of embedded derivatives in sales contracts .....		( 1,395,995)	7,068,540
<b>Net finance (costs) income .....</b>	<b>13</b>	<b>( 688,712)</b>	<b>5,476,243</b>
Share of (loss) profit of associates .....	18	( 177,467)	227,381
<b>Profit before income tax .....</b>		<b>1,029,111</b>	<b>7,795,086</b>
Income tax expense .....	14	( 164,549)	( 997,380)
<b>Profit for the year .....</b>		<b>864,562</b>	<b>6,797,706</b>
<b>OTHER COMPREHENSIVE INCOME</b>			
Revaluation of operating assets .....	15	0	1,200,000
Income tax effect of revaluation .....	14	0	( 216,000)
Foreign currency translation difference of associate .....	18	( 110,749)	407,383
Effects of change in tax rate .....	14	( 43,089)	( 34,546)
<b>Other comprehensive income for the period, net of income tax .....</b>		<b>( 153,838)</b>	<b>1,356,837</b>
<b>Total comprehensive income for the period .....</b>		<b>710,724</b>	<b>8,154,543</b>
<b>EARNINGS PER SHARE</b>			
Basic and diluted earnings per share .....	26	0.13	1.11

## STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER

	Notes	2010	2009
<b>ASSETS</b>			
Operating assets	15	24,781,700	25,492,705
Operating assets under construction	16	4,746,587	2,221,463
Intangible assets	17	981,275	952,899
Investments in associates	18	638,611	893,984
Investments in other companies	19	27,075	127,543
Bonds	20	495,604	2,742,040
Embedded derivatives in electric power sale contracts	21	5,096,653	6,623,015
Deferred tax asset	22	276,318	483,954
Long term receivable	23	559,221	532,081
		<b>37,603,044</b>	<b>40,069,684</b>
<b>Total non-current assets</b>			
Inventories		340,926	346,371
Bonds	20	647,793	0
Trade and other receivables	23	1,070,586	802,002
Embedded derivatives in electric power sales contracts	21	829,969	699,602
Cash and cash equivalents	24	1,043,250	151,782
		<b>3,932,524</b>	<b>1,999,757</b>
<b>Total current assets</b>			
		<b>41,535,568</b>	<b>42,069,441</b>
<b>Total assets</b>			
<b>EQUITY</b>			
Share capital		6,962,919	6,118,387
Share premium and statutory reserves		3,218,660	1,529,597
Translation reserve		296,634	407,383
Revaluation reserve		1,723,505	1,830,311
Reserve for shares in associate		( 37,157)	0
Retained earnings		5,131,395	4,203,116
		<b>17,295,956</b>	<b>14,088,794</b>
<b>Total equity</b>			
<b>LIABILITIES</b>			
Loans and borrowings	27	18,570,882	21,212,751
Pension fund obligation	28	1,400,000	1,375,700
Currency and interest rate swap contract	29	886,753	0
		<b>20,857,635</b>	<b>22,588,451</b>
<b>Total non-current liabilities</b>			
Loans and borrowings	27	1,951,594	2,563,250
Trade and other payables	30	1,158,045	1,263,911
Currency and interest rate swap contract	29	272,338	1,565,035
		<b>3,381,977</b>	<b>5,392,196</b>
<b>Total current liabilities</b>			
		<b>24,239,612</b>	<b>27,980,647</b>
<b>Total liabilities</b>			
		<b>41,535,568</b>	<b>42,069,441</b>
<b>Total equity and liabilities</b>			

Notes on pages 92 to 127 are an integral part of these financial statements. All amounts are in thousand of ISK.

# STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER

	Share capital	Share premium and statutory reserve	Translation reserve	Revaluation reserve	Reserve for shares in associate	Retained earnings	Total
<b>2009</b>							
Equity at 1 January 2009	6,118,387	1,529,597	0	929,933	0 ( 2,643,666 )	5,934,251	5,934,251
Profit for the year . . .						6,797,706	6,797,706
Revaluation of operating assets . . . . .				1,200,000			1,200,000
Income tax effect of revaluation . . . . .				( 216,000)			( 216,000)
Effects of change in tax rate . . . . .				( 34,546)			( 34,546)
Foreign currency translation difference of associate			407,383				407,383
Total comprehensive income . . . . .			407,383	949,454	0	6,797,706	8,154,543
Depreciation transferred to retained earnings . .				( 49,076)		49,076	0
Equity at 31 December 2009 . . . . .	6,118,387	1,529,597	407,383	1,830,311	0	4,203,116	14,088,794
<b>2010</b>							
Equity at 1 January 2010	6,118,387	1,529,597	407,383	1,830,311	0	4,203,116	14,088,794
Profit for the year . . .						864,562	864,562
Effects of change in tax rate . . . . .				( 43,089)			( 43,089)
Foreign currency translation difference of associate			( 110,749)				( 110,749)
Total comprehensive income . . . . .			(110,749)	(43,089)	0	864,562	710,724
Depreciation and tax transferred to retained earnings . .				( 63,717)		63,717	0
Share capital increase	844,532	1,689,063					2,533,595
Effects of put option on own shares of an associate					( 277,354)		( 277,354)
Expired put options on own shares of an associate					240,197		240,197
Equity at 31 December 2010 . . . . .	6,962,919	3,218,660	296,634	1,723,505	( 37,157)	5,131,395	17,295,956

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER

	Notes	2010	2009*
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit for the period .....		864,562	6,797,706
Items not affecting working capital:			
Gain on sale of operating assets .....		0	( 783,516)
Increase in pension fund obligation .....	28	24,300	127,700
Depreciation and amortization .....	12	988,202	864,873
Impairment .....	12	0	142,063
Share of loss (profit) of associates .....	18	177,467	( 227,381)
Finance income and costs .....	13	688,712	( 5,476,243)
Income tax expense .....	14	164,549	997,380
		<u>2,907,792</u>	<u>2,442,582</u>
Inventories, decrease (increase) .....		5,445	( 80,227)
Receivables, (increase) decrease .....		( 247,739)	915,117
Current liabilities, increase (decrease) .....		16,782	( 729,464)
		<u>2,682,280</u>	<u>2,548,008</u>
Interest income received .....		64,303	141,448
Interest and indexation costs paid .....		( 674,261)	( 864,053)
		<u>2,072,322</u>	<u>1,825,403</u>
		<u>2,072,322</u>	<u>1,825,403</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisition of operating assets during the period .....		( 2,133,290)	( 1,236,490)
Payments for operating assets acquired in prior year .....		0	( 959,235)
Proceeds from sale of operating assets .....		0	1,606
Acquisition of intangible assets .....		( 61,869)	( 78,779)
Acquisition of shares in associates and other companies .....		( 70,000)	( 41,500)
Proceeds from sale of bonds .....		1,354,081	1,914,089
		<u>( 911,078)</u>	<u>( 400,309)</u>
		<u>( 911,078)</u>	<u>( 400,309)</u>

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER, CONTINUED

	Notes	2010	2009*
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Share capital increase .....	25	2,533,595	0
Paid with-holding tax of dividend .....		0 ( 50,000)	
Repayment of borrowings .....		( 1,813,823)	( 1,712,883)
Loan from HS Veitur .....		0	378,815
Repayment of loan from HS Veitur .....		( 378,815)	0
Short-term loans, decrease .....		( 549,013)	( 692,120)
		<u>( 208,056)</u>	<u>( 2,076,188)</u>
Net used in financing activities			
<b>Increase (decrease) in cash and cash equivalents .....</b>		<b>953,188</b>	<b>( 651,094)</b>
<b>Cash and cash equivalents at 1 January .....</b>		<b>151,782</b>	<b>822,305</b>
<b>Effect of exchange rate fluctuations on cash held .....</b>		<b>( 61,720)</b>	<b>( 19,429)</b>
<b>Cash and cash equivalents at year end .....</b>		<b>1,043,250</b>	<b>151,782</b>
<b>INVESTING AND FINANCING ACTIVITIES NOT AFFECTING CASH FLOWS</b>			
Acquisition of operating assets .....		( 635,538)	0
Current liabilities .....		257,062	0
Sale of operating assets .....		0	854,472
Investment in bonds .....		0	( 854,472)
Sale of bonds .....		378,476	0
* Adjusted for comparative purpose			

## NOTES TO THE FINANCIAL STATEMENTS

### 1. REPORTING ENTITY

HS Orka hf (the „Company“) is a limited liability company domiciled in Iceland. The Company's registered office is Brekkustígur 36, Reykjanesbær, Iceland. The Company handles production of electric power, hot water and geothermal steam and sale of electric power. The Company became a subsidiary of Magma Energy Sweden AB. in the year 2010. The financial statements of the Company are part of the consolidated financial statements of the Ultimate Parent Company Magma Energy Corp.

The financial statements of the Company comprise the company's financial statements and share in associates.

### 2. BASIS OF PREPARATION

#### a. Statement of compliance

The Company's Financial Statements are prepared according to International Financial Reporting Standards (IFRS) as adopted by the EU and additional Icelandic disclosure requirement in accordance with Icelandic Financial Statement Act nr. 3/2006.

The financial statements were authorized for issue by the Board of Directors on 14 February 2011.

#### b. Basis of measurement

The financial statements have been prepared on the historical cost, except for the following material items in the statement of financial position:

- a majority of operating assets are recognized at revalued cost, which is their fair value at the revaluation date
- 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 (bonds and shares)
- available for sale financial instruments are measured at fair value

The methods used to measure fair values are discussed further in note 4.

As explained in note 27, management has been in a process of continuous negotiations with the Company's lenders since the Company breached covenants in loan agreements during the year 2008. In November 2009 the management concluded an agreement with the lenders where covenants in loan agreements were revised. During the year 2010 management has been in negotiations with its banks regarding the future terms of the loan agreements and expects that favorable conclusion will be reached soon. It is therefore the management's view that the Company will continue as a going concern for the foreseeable future.

#### c. Functional and presentation currency

These financial statements are presented in Icelandic kronas (ISK), which is the Company's functional currency. All financial information presented in ISK has been rounded to the nearest thousand except where otherwise noted.

#### d. Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that effect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

## 2. BASIS OF PREPARATION, CONTINUED

### d. Use of estimates and judgments, continued

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is included in the following notes:

- Note 15 - operating assets
- Note 21 - embedded derivatives in electric power sales contracts
- Note 28 - pension fund obligation
- Note 29 - currency and interest rate swap contracts

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

- Note 15 - operating assets
- Note 16 - operating assets under construction
- Note 17 - intangible assets
- Note 20 - bonds
- Note 21 - embedded derivatives
- Note 22 - deferred taxes
- Note 29 - currency and interest rate swap contracts

## 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. Certain comparatives have been reclassified to conform with this year's presentation.

### a. Basis of consolidation - Investment in associates

Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity.

Investments in associates are accounted for using the equity method (equity-accounted investees) and are recognized initially at cost. The cost of the investment includes transaction costs.

The financial statements include the Company's share of the profit or loss and other comprehensive income, after adjustments to align the accounting policies with those of the Company, from the date that significant influence or joint control commences until the date that significant influence ceases.

When the Company's share of losses exceeds its interest in an equity-accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the investee.

Unrealized gains arising from transactions with associates are eliminated against the investment to the extent of the Company's interest in the associate. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### b. Foreign currency

##### (i) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currencies of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the year. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

##### (ii) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to ISK at exchange rates at the reporting date. The income and expenses of foreign operations are translated to ISK at exchange rates at the dates of the transactions.

Foreign currency differences are recognized in other comprehensive income. Such differences have been recognized in the translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount in the translation reserve is transferred to profit or loss as part of the profit or loss on disposal.

#### c. Financial instruments

##### (i) Non-derivative financial assets

The Company initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets including assets designated at fair value through profit or loss are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### c. Financial instruments, continued

##### Financial assets at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

##### Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and cash equivalent and trade and other receivables.

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less.

##### Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the previous categories. The Company's investments in certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale equity instruments, are recognized in other comprehensive income and presented within equity in the fair value reserve. When an investment is derecognized, the cumulative gain or loss in other comprehensive income is transferred to profit or loss.

##### (ii) Non-derivative financial liabilities

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities including liabilities designated at fair value through profit or loss are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities other than derivatives comprise loans and borrowings and trade and other payables.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### c. Financial instruments, continued

##### (ii) Derivative financial instruments

Derivatives are recognized initially at fair value; attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value in the statement of financial position and changes in fair value are recognized in profit or loss as part of financial income or cost in the statement of comprehensive income.

##### Separable embedded derivatives

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

##### (iii) Share capital

##### Ordinary shares

Incremental costs directly attributable to issue of ordinary shares are recognized as a deduction from equity, net of any tax effects.

##### Repurchase of share capital (treasury shares)

When share capital recognized as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, net of any tax effects, is recognized as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity, and the resulting surplus or deficit on the transaction is presented in share premium.

#### d. Operating assets

##### (i) Recognition and measurement

Items of operating assets are measured at cost or revalued cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use and capitalized borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

The Company's power plants, distribution systems and real estates are measured at revalued cost in the statement of financial position. The revalued cost is the fair value at the revaluation date less accumulated depreciation. Revaluation is carried out on a regular basis. Any increase in the carrying amount of operating assets as a result of revaluation is recognized in equity under the heading of revaluation reserve net of income tax. Depreciation of the revalued cost is recognized in profit or loss. In case of sale or disposal of an asset the part of the revaluation reserve pertaining to the asset is transferred to retained earnings along with a depreciation of the revaluation cost.

When part of an item of operating assets have different useful lives, they are accounted for as separate items of operating assets.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### d. Operating assets, continued

Gains and losses on disposal of an item of operating assets are determined by comparing the proceeds from disposal with the carrying amount of operating assets, and are recognized net within other income/other expenses in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve are transferred to retained earnings.

##### (ii) Subsequent costs

The cost of replacing component of an item of operating assets is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Company and its cost can be measured reliably. The carrying amount of the replaced component is derecognized. The costs of the day-to-day servicing of operating assets are recognized in profit or loss as incurred.

##### (iii) Depreciation

Depreciation is based on the cost of an asset less its residual value. Significant components of individual assets are assessed and if a component has a useful life that is different from the remainder of that asset, that component is depreciated separately.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each component of an item of operating assets. Land is not depreciated.

The estimated useful lives for the current and comparative years are as follows:

Power plant .....	40 years
Boreholes .....	20 years
Electrical systems .....	50 years
Hot water and cold water distribution systems .....	50 years
Real estates .....	50 years
Other operating assets .....	5 - 20 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

#### e. Intangible assets

##### (i) Research and development

Expenditure on research activities, undertaken with the prospect of surveying geothermal areas where exploitation probability is uncertain, and in order to gain new scientific or technical knowledge, is recognized in profit or loss when incurred.

Development activities involve surveys of geothermal areas where there is probability of future exploitation and power production or harnessing together with related plans and designs. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and capitalized borrowing costs. Other development expenditure is recognized in profit or loss as incurred.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### e. Intangible assets, continued

When a decision on producing power or harnessing of geothermal areas has been made and all required licenses have been obtained the preparation cost due to harnessing or production of power is transferred to operating assets under construction.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

##### (ii) Other intangible assets

Other intangible assets that are acquired by the Company, which have finite useful lives, are measured at cost less accumulated amortization and accumulated impairment losses.

##### (iii) Subsequent expenditure

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognized in profit or loss when incurred.

##### (iv) Amortization

Amortization is based on the cost of an asset less its residual value.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The estimated useful lives for the current and comparative years are as follows:

Software .....	5-10 years
----------------	------------

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

#### f. Leased assets

Leases are operating leases and the leased assets are not recognized on the Company's statement of financial position.

#### g. Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and selling expenses.

#### h. Impairment

##### (i) Non-derivative financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### h. Impairment, continued

In assessing collective impairment the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

##### (ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated each year at the same time.

Impairment is recognized if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment loss of revalued operating assets is recognized in equity under revaluation reserve. Impairment losses of other assets are recognized in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

#### i. Employee benefits

##### (i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

##### (ii) Defined benefit plans

The Company's net obligation in respect of defined benefit pension plans or pension fund commitment is calculated separately for each plan by estimating the amount of future benefit that current and former employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. The calculation is performed annually by qualified actuaries using a method based on earned benefits. Changes in pension fund obligation are recognized as incurred in profit or loss.

#### j. Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### k. Revenue

Revenue on sale of electric power and water along with power transmission and distribution are recognized in profit and loss based on recorded measurement of delivery during the period. Between measurements, usage is estimated based on prior period usage. Other revenues are recognized when the goods or services are delivered.

Service revenues from HS Veitur hf. are based on service contract.

Lease revenues are recognized in profit or loss on a straight-line basis over the term of the lease.

#### l. Lease payments

Payments under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

#### m. Net finance income (costs)

Finance income comprises interest income on funds invested, dividend income, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains and gains on derivatives that are recognized in profit or loss. Interest income is recognized as it accrues in profit and loss, using the effective interest method. Dividend income is recognized on the date that the Company's right to receive payment is established.

Finance costs comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, losses on derivatives that are recognized in profit or loss changes in the fair value of financial assets at fair value through profit or loss, and impairment losses recognized on financial assets. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

#### n. Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

### 3. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

#### o. Earnings per share

The Company presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS equals to basic EPS due to the Company has not issued convertible notes nor granted share options.

#### p. Segment reporting

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's management to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

#### q. New standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2010, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Company.

### 4. DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

#### a. Operating assets

The fair value of operating assets is calculated using the income approach or cash-flow analysis where the estimated future cash-flow of the related business units which operating assets are a part of is calculated at present value.

The fair value of real estates is their market value according to a value assessment carried out by a state authorized real estate agent.

#### b. Investments in equity and debt securities

The fair value of financial assets at fair value through profit or loss is determined by reference to their market price at the reporting date. If a listed market price is not available, then fair value is estimated using accepted valuation techniques.

#### c. Trade and other receivables

The fair value of trade and other receivables, is estimated at the present value of future cash flows, discounted at the market rate of interest at the reporting date if applicable. This fair value is determined for disclosure purposes.

#### 4. DETERMINATION OF FAIR VALUES, CONTINUED

##### d. Derivatives

The fair value of derivative contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated using accepted valuation techniques.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments.

The most reliable verification of the fair value of derivative agreements at the beginning is the purchase value, unless the fair value of the instrument can be verified by comparison to other listed and recent market transactions of a comparable instrument or based on an evaluation method where variables are solely based on market documents. When such documents are available the Company recognizes profit and loss at the initial registration date of the instruments.

##### e. Non-derivative financial liabilities

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.

#### 5. FINANCIAL RISK MANAGEMENT

##### a. Overview

The Company's activities expose to financial risk consisting of market risk, credit risk and liquidity risk. Market risk consist of interest, currency risk and market risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

##### Risk management framework

The risk management is carried out by the management under policies approved by the board of directors. Management identifies, evaluates and managed financial risk in close co-operation with the Board of Directors. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company determines whether to use derivative financial instruments to hedge certain risk exposures if they are available. The Company does not hedge its risk exposure except for part of currency risk where revenue in USD are hedge against loans in USD.

##### b. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from customers.

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Approximately 68% (2009: 65%) of the Company's revenue is attributable to sales transactions with the two largest customers. Trade and other receivables are receivables from individuals, companies, mass consumers and power plants.

The Company has set a credit policy where all new significant customers are evaluated. Payment history of those customers is checked.

## 5. FINANCIAL RISK MANAGEMENT, CONTINUED

### b. Credit risk, continued

Most of the Company's customers have been its customers for many years and loss on receivables has been insignificant in proportion to turnover. Credit risk management due to customers mainly takes into account age of receivables and financial standing of each customers. The statistic of development of aging of receivables is reviewed on a regular basis by credit controller which reports to management on the credit risk. Customers that are behind in payments can not make further transactions with the Company unless they pay up their debt or the Company's collection department approves further transactions based on an agreement. As a result of the deteriorating economic circumstances in 2008 through 2010, a shorter time is given from a non-payment from customer to actual closing of delivery to the customer.

The Company establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for Company's of similar receivables in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar receivables.

### c. Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company has not made agreements for loan facilities and has no unused loan facilities at year end 2010 (2009: ISK 220 million).

In an increasingly difficult funding market, where access to new funding sources is limited, the need for active liquidity risk management has increased substantially. Cash flow forecasts are done and monitored by management. The liquidity status of the Company is reviewed on a regular basis. The current liquidity position was good at year and will be increased by a sale of bonds classified as current.

### d. Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, aluminum price and interest rates will effect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

#### (i) Currency risk

The Company is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than ISK. The currencies in which these transactions primarily are denominated are US Dollar (USD), Swiss Francs (CHF), Euro (EUR), Canadian Dollar (CAD), Swedish Kronas (SEK) and Japanese Yen (JPY).

Due to current market condition in Iceland the Company is not able to hedge against foreign exchange rate risk as there are no counterparty for forward contracts or other derivatives available in Iceland. The Company does hedge a portion of its revenue in USD against borrowings in USD. The company holds at year end USD amounting to ISK 776 million against repayments of loans in foreign currencies.

## 5. FINANCIAL RISK MANAGEMENT, CONTINUED

### d. Market risk, continued

#### (ii) Interest rate risk

Majority of the Company's borrowings carry variable interest rates. Due to current market conditions in Iceland the Company does not hedge its interest rates risk as there are no counterparty for forward contracts or other derivatives available in Iceland.

#### (iii) Aluminum price risk

The Company has entered into agreements on sale of electric power where the sales value of electric power is based on the world market value of aluminum. The Company does not hedge against aluminum price changes.

#### (iv) Other market risk

Other market value risk is related to investments in bonds and shares.

### e. Capital management

The Board's policy is to maintain a strong capital base to sustain future development of the business.

The Company's Board of Directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. Return on equity was positive by 6% in the year 2010 (2009: 115%). And equity ratio was 42% at year end 2010 (2009: 33%).

There were no changes in the Company's approach to capital management during the year and the Company is not obliged to comply with external rules on minimum equity other than related to covenants in loan agreements.

## 6. SEGMENT REPORTING

The Company has three segments that are described below:

### Power Production

Include production and sale of electrical energy, heating district water and distilled water with subterranean steam.

### Electricity Sale

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

### Other

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

## 6. SEGMENT REPORTING, CONTINUED

	Power production	Electricity sale	Other	Total
<b>Year 2010</b>				
External revenues .....	4,051,003	2,059,966	882,804	6,993,773
Inter-segment revenue .....	710,416			710,416
Total segment revenue .....	4,761,419	2,059,966	882,804	7,704,189
Segment operating result .....	1,814,570	15,469	65,251	1,895,290
Unallocated items				
Net finance income .....				( 688,712)
Share of loss of associates .....				( 177,467)
Income tax .....				( 164,549)
Profit for the year .....				864,562
Segment assets .....	29,846,428	54,871	608,263	30,509,562
Unallocated assets .....				11,026,006
Total assets .....				41,535,568
Unallocated liabilities .....				
				24,239,612
Capital expenditures .....	2,802,800	4,635	23,262	2,830,697
Depreciation and amortisation .....	930,682	10,789	46,731	988,202

### Major customers

Revenues from one customer of the Company's Production segment represents approximately ISK 3,110 million of the Company's total revenues.

Revenues from one customer of the Company's represents approximately ISK 1,618 million of the Company's total revenues and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues .....	643,480	166,365	808,076	1,617,921

## 6. SEGMENT REPORTING, CONTINUED

	Power production	Electricity sale	Other	Total
<b>Year 2009</b>				
External revenues .....	3,278,118	2,062,257	885,590	6,225,965
Other revenues .....	783,516			783,516
Inter-segment revenue .....	742,375			742,375
Total segment revenue .....	4,804,009	2,062,257	885,590	7,751,856
Segment operating result .....	1,818,278	216,686	56,498	2,091,462
<b>Unallocated items</b>				
Net finance income .....				5,476,243
Share of loss of associates .....				227,381
Income tax .....				( 997,380 )
Profit for the year .....				6,797,706
Segment assets .....	26,742,058	47,108	677,940	27,467,106
Unallocated assets .....				14,602,335
Total assets .....				42,069,441
Unallocated liabilities .....				27,980,647
Capital expenditures .....	1,271,126	5,417	38,692	1,315,235
Impairment .....	142,063			142,063
Depreciation and amortisation .....	823,868	5,220	35,785	864,873

**Major customers**

Revenues from one customer of the Company's Production segment represents approximately ISK 2,442 million of the Company's total revenues.

Revenues from one customer of the Company's represents approximately ISK 1,492 million of the Company's total revenues and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues .....	599,978	144,528	747,154	1,491,660

## 7. OPERATING REVENUE

	2010	2009
<b>Operating revenues are specified as follows:</b>		
Production revenue .....	4,051,003	3,278,118
Retail revenue .....	2,059,966	2,062,257
Service revenue, lease income and other revenue .....	882,804	885,590
Total operating revenue .....	6,993,773	6,225,965

## 8. PRODUCTION COST AND COST OF SALES

	2010	2009
<b>Production cost and cost of sales are specified as follows:</b>		
Production cost .....	2,659,229	2,640,809
Cost of sales .....	1,215,971	1,031,872
Cost of service .....	817,553	829,092
Total production cost and cost of sales .....	4,692,753	4,501,773

## 9. OTHER INCOME

### Other income specifies as follows:

Gain on sale of fixed assets .....	0	783,516
Total other income .....	0	783,516

## 10. OTHER OPERATING EXPENSES

### Operating expenses specifies as follows:

Salaries and related expenses .....	130,517	116,241
Increase in pension fund obligation .....	8,115	44,902
Administrative expenses .....	181,066	97,005
Depreciation and amortization .....	86,032	16,035
Impairment on intangible assets (see note 17) .....	0	142,063
Total operating expenses .....	405,730	416,246

During the period capitalized cost in the amount ISK 62,5 millions related to new headquarters was written off.

## 11. SALARIES AND RELATED EXPENSES

### Salaries and salary related expenses are as follows:

Salaries .....	861,063	827,149
Contribution to defined benefit fund .....	83,691	79,308
Increase in pension fund obligation .....	92,618	194,390
Other salary related expenses .....	128,292	140,751
Total salaries and salary related expenses .....	1,165,664	1,241,599
Average number of full time employees equivalent .....	136	132

### Salaries and salary related expenses are allocated as follows:

Capitalized on projects .....	39,822	49,700
Production cost and cost of sale .....	987,210	947,958
Other operating expenses .....	138,632	243,941
Total salaries and salary related expenses .....	1,165,664	1,241,599

Salaries paid to the Board of Directors and Management amounted to ISK 45 million in 2010 (2009: ISK 44 million).

## 12. DEPRECIATION, AMORTIZATION AND IMPAIRMENT

	2010	2009
<b>Depreciation, amortization and impairment is specified as follows:</b>		
Depreciation of operating assets, see note 15 .....	954,710	846,592
Amortization of intangible assets, see note 16 .....	33,493	18,281
Impairment of intangible assets, see note 16 .....	0	142,063
	<hr/>	<hr/>
Depreciation and amortization recognized in the income statement .....	988,203	1,006,936
	<hr/>	<hr/>
<b>Depreciation and amortization is allocated as follows:</b>		
Production cost and cost of sales .....	902,171	848,838
Other operating expenses .....	86,032	16,035
	<hr/>	<hr/>
Depreciation and amortization recognized in the income statement .....	988,203	864,873
	<hr/>	<hr/>
<b>Impairment loss is allocated as follows to operating items:</b>		
Operating expenses .....	0	142,063
	<hr/>	<hr/>

## 13. FINANCE INCOME AND COSTS

	2010	2009
<b>Finance income and costs specifies as follows:</b>		
Interest income on loans and receivables .....	54,565	43,471
Interest income on available for sale securities .....	122,427	439,759
Net foreign exchange gain .....	927,722	0
Fair value changes on financial assets through profit and loss .....	59,032	0
	<hr/>	<hr/>
Total finance income .....	1,163,746	483,230
	<hr/>	<hr/>
Interest expenses .....	( 674,268)	( 764,153)
Indexation .....	( 87,673)	( 284,607)
Net foreign exchange loss .....	0	( 1,245,095)
Changes in fair value of financial assets through profit and loss .....	( 100,468)	( 49,927)
Other financial costs .....	0	( 61,971)
	<hr/>	<hr/>
Total finance costs .....	( 862,409)	( 2,405,753)
	<hr/>	<hr/>
Currency and interest rate swap, fair value change .....	405,946	330,226
Fair value changes of embedded derivatives in electric power sale contracts .....	( 1,395,995)	7,068,540
	<hr/>	<hr/>
Net finance (costs) income .....	( 688,712)	5,476,243
	<hr/>	<hr/>

## 14. INCOME TAX

		2010		2009
<b>Income tax expense is specified as follows:</b>				
Increase decrease of deferred income tax assets .....		( 164,549)		( 997,380)
Income tax expense .....		<u>( 164,549)</u>		<u>( 997,380)</u>
<b>Deferred income tax is specified as follows:</b>				
Origination and reversal of temporary difference .....		( 235,268)		(1,148,585)
Change in tax rate .....		70,719		151,205
		<u>( 164,549)</u>		<u>( 997,380)</u>
		<b>2010</b>		<b>2009</b>
<b>Effective tax rate is specified as follows:</b>				
Profit for the year .....		864,562		6,797,706
Income tax .....		164,549		997,380
Profit before income tax .....		1,029,111		7,795,086
Income tax according to current tax rate .....	18.0%	185,240	15.0%	1,169,263
Change in tax rate 20% to 18/ 15% to 18% .....	( 6.9%)	(70,719)	( 1.9%)	( 151,205)
Effect of associates .....	3.1%	31,944	( 0.4%)	( 34,107)
Other items .....	1.8%	18,084	0.2%	13,429
Effective income tax rate .....	<u>16.0%</u>	<u>164,549</u>	<u>12.8%</u>	<u>997,380</u>
		<b>2010</b>		<b>2009</b>
<b>Deferred income tax recognized directly in equity is specified as follows:</b>				
Income tax on revaluation of operating assets in continuing operations .....		0		216,000
Effects of change in tax rate .....		43,089		34,546
		<u>43,089</u>		<u>250,546</u>

## 15. OPERATING ASSETS

### Revaluation of operating assets 2009

The Company's power plants were revalued at fair value on 31 December 2009. In calculating present value an interest rate that reflect WACC of the Company, that is the cost of capital and interest-bearing loans, net of income tax is used. The discount rate was 10.98% for Svartsengi and 8.28% for Reykjanes. The cash-flow was estimated using the operating budget for the next five years and future value calculated for the years thereafter. In the cash-flow, it is expected that the increase in revenue for the first year is 14.9% for Svartengi and 39.2% for Reykjanes due to increase in aluminum prices compared to 2009 and for year two to five between 2,4% to 4,4% and that future increase in revenue will be 2,9%. The calculations were performed by independent experts. Revaluation of Company's Power Plants amounted to ISK 1,200 million. A change in one variable can have significant effects on revaluation.

### Indication of impairment

Management reviewed whether there was an indication of impairment of the Company's operating assets at the year end 2010. At the year end 2010 no such indication existed.

## 15. OPERATING ASSETS, CONTINUED

Operating assets are specified as follows:

	Power plants	Electrical systems	Hot and cold water distribution systems	Other operating assets	Total
<b>Cost</b>					
Balance at 1.1.2009 .....	23,932,056	322,428	135,890	1,453,387	25,843,761
Transferred to power plants and other operating assets .....	135,890	( 322,428)	( 135,890)	322,428	0
Transferred from intangible assets .....	18,492				18,492
Additions during the year .....	294,313			9,990	304,303
Disposals .....	( 76,317)				( 76,317)
Revaluation 31.12.2009 .....	1,200,000				1,200,000
Depreciation adjustment .....	( 587,494)				( 587,494)
Balance at 31.12.2009 .....	24,916,940	0	0	1,785,805	26,702,745
Balance at 1.1.2010 .....	24,916,940	0	0	1,785,805	26,702,745
Additions during the year .....	241,583			2,122	243,705
Disposals .....				( 161,816)	( 161,816)
Balance at 31.12.2010 .....	25,158,523	0	0	1,626,111	26,784,634
<b>Depreciation and impairment losses</b>					
Balance at 1.1.2009 .....	763,535	15,254	2,692	169,461	950,942
Transferred to power plants and other operating assets .....	2,692	( 15,254)	( 2,692)	15,254	0
Depreciation for the year .....	802,576			44,016	846,592
Depreciation adjustment .....	( 587,494)				( 587,494)
Balance at 31.12.2009 .....	981,309	0	0	228,731	1,210,040
Balance at 1.1.2010 .....	981,309	0	0	228,731	1,210,040
Depreciation for the year .....	846,251			108,459	954,710
Disposals .....				( 161,816)	( 161,816)
Balance at 31.12.2010 .....	1,827,560	0	0	175,374	2,002,934
<b>Net book value</b>					
1.1.2009 .....	23,168,521	307,174	133,198	1,283,926	24,892,819
31.12.2009 and 1.1.2010 .....	23,935,631	0	0	1,557,074	25,492,705
31.12.2010 .....	23,330,963	0	0	1,450,737	24,781,700
<b>Net book value without revaluation</b>					
31.12.2009 .....	21,792,931	0	0	1,449,939	23,242,870
31.12.2010 .....	21,279,342	0	0	1,347,440	22,626,782

All amounts are in thousand of ISK.

## 15. OPERATING ASSETS, CONTINUED

### Disposals of operating assets

In July 2009, the Company sold land and geothermal heat rights to the Municipality of Reykjanes. The land is 39 hectare on the tip of the Reykjanes peninsula and 63 hectare land in Svartsengi. The sales value amounted to ISK 854 million and was paid with bond a with 10 year maturity. The gain on the sale amounted to ISK 784 million. At the same time, the Company entered into an operating lease agreement on the sold land and geothermal heat rights over the next 65 years with the possibility of renewing the lease term for another 65 years.

In the year 2010 the Municipality of Grindavik entered into the deal for the land in Svartsengi and based on that the sale price for the land in Svartsengi is recorded as receivable from Municipality of Grindavik.

### Capital commitments

The company anticipates that it needs to invest in a new discharge pipe system for Svartsengi in the next 3 years and that the majority of the investment will be in the year 2012 but design is ongoing. Once the discharge system is in full operation more geothermal fluid can be extracted from the reservoir resulting in increased power generation estimated to be approximately 5 MW from already installed turbine generators.

### Pledge of assets

The Company's Power Plants at Reykjanes and Svartsengi are pledged to secure bank loans in the amount of ISK 16,926 millions (2009: ISK 19,237 million).

### Rateable value and insurance value

Rateable value of the Company's assets excluding land measured at rateable value amounted to approximately ISK 2,393 million at year-end 2010 (2009: ISK 2,748 million) and land measured at rateable value amounted to approximately ISK 570 million (2009: ISK 560 million). Insurance value of the Company's assets amounted to approximately ISK 23,150 million (2009: ISK 20,685 million).

## 16. OPERATING ASSETS UNDER CONSTRUCTIONS

	2010	2009
<b>Operating assets under constructions are specified as follows:</b>		
Net book value 1.1. ....	2,221,463	1,285,521
Additions .....	2,525,124	935,942
	<hr/>	<hr/>
Net book value 31.12. ....	4,746,587	2,221,463
	<hr/>	<hr/>
Total value 31.12. ....	4,746,587	2,221,463
	<hr/>	<hr/>
Total operating assets and operating assets under constructions .....	29,528,287	27,714,168
	<hr/>	<hr/>

### Indication of impairment

Operating assets under construction is capitalized cost related to a new power plant at Reykjanes, which was planned to supply Norðurál with power for a new aluminum smelter in Helgúvík. In 2007, HS Orka and Norðurál concluded an electric power sales agreement on power for the new aluminum smelter in Helgúvík. Due to the current market condition, which is affecting the financing of the Company and a delay in receiving operational license there is a delay in opening the new power plant and the length of the delay is uncertain. The agreement with Norðurál is currently under dispute and Norðurál has initiated arbitration proceedings to determine the validity of the agreement, which is further explained in note 33. The delay of the project is an indication of impairment. Despite the delay and the dispute with Norðurál it is the management's opinion that the recoverable amount of operating assets under construction is above carrying amount as the Company has an opportunity to negotiate on power sale.

## 16. OPERATING ASSETS UNDER CONSTRUCTIONS, CONTINUED

### Impairment test at end of year 2010

The operating assets under construction were tested for impairment at year end 2010 by estimating its recoverable amount and the result was that there was no need for impairment as the recoverable amount was above the estimated total cost. The impairment test was based on several assumptions but negotiations are ongoing with two parties. The main assumptions for the test: i) Weighted Average Cost of Capital (WACC) is between 7.2%-8.3%, ii) the future growth is between 2.2%-2.5%, iii) the company will be able to deliver electricity power in the beginning of the year 2014 and iv) both projects are given the same probability of occurring in the results. There is a high uncertainty related to future timing of the project due to a delay in receiving operational license and financing of the project which could affect the recoverability of the assets.

## 17. INTANGIBLE ASSETS

Intangible assets are specified as follows:

	Software	Development cost	Total Cost
Balance 1.1.2009 .....	285,344	935,659	1,221,003
Transferred to operating assets .....	0	( 18,492)	( 18,492)
Additions during the year .....	51,059	27,720	78,779
Balance 31.12.2009 .....	336,403	944,887	1,281,290
Additions during the year .....	34,523	27,346	61,869
Disposals .....	( 36,716)	0	( 36,716)
Balance at 31.12.2010 .....	334,210	972,233	1,306,443
<b>Amortization and impairment losses</b>			
Balance at 1.1.2009 .....	163,869	4,178	168,047
Amortization for the year .....	18,281	0	18,281
Impairment .....	0	142,063	142,063
Balance at 31.12.2009 and 1.1.2010 .....	182,150	146,241	328,391
Amortization for the year .....	33,493	0	33,493
Disposals .....	( 36,716)	0	( 36,716)
Balance at 31.12.2010 .....	178,927	146,241	325,168
<b>Book value</b>			
1.1.2009 .....	121,475	931,481	1,052,956
31.12.2009 and 1.1.2010 .....	154,253	798,646	952,899
31.12.2010 .....	155,283	825,992	981,275

### Impairment test 2010

Intangible assets consist of software, ISK 155 million, and development cost ISK 826 million. Costs for the experimental drilling at Trölladyngja, Krýsuvík and Eldvörp is capitalized to the extent that it is probable that future benefits are generated in order to recover the investment. HS Orka holds a research permission in these areas and according to management results from recent testings are positive. If it becomes evident that development cost will not be utilized by the company for revenue it must be expensed as impairment cost. Management confirmed that the above projects are positive and it is likely that they will generate revenues in the future. At the end of 2010 there has been no material changes to the assumption regarding impairment of intangible assets.

## 17. INTANGIBLE ASSETS, CONTINUED

### Impairment of development cost in the year 2009

Due to the current market condition management expects that future planned projects will be delayed. This has caused the Company to assess the recoverable amount of the development cost. The recoverable amount of the development costs were tested for impairment by estimating the value in use and as a result of that the company fully impaired development cost at Hallkellsholar during the year 2009. Impairment of the asset amounted to ISK 142 million and is recognized in other operating expenses. Other development cost was tested for impairment with a positive result.

## 18. INVESTMENTS IN ASSOCIATES

The Company's share in loss of its associates for the year was ISK 177 million (2009: profit ISK 228 million). Currency translation difference for the year was negative in the amount of ISK million 111 million (2009: positive ISK 407 million).

### Associates are as follows:

	2010		2009	
	Share	Carrying amount	Share	Carrying amount
Bláa lónið hf. (The Blue Lagoon), Iceland .....	24.4%	509,755	24.4%	845,881
DMM-lausnir ehf., Iceland .....	25.3%	17,356	25.3%	6,603
Suðurorka ehf. ....	47.9%	111,500	31.2%	41,500
Total .....		<u>638,611</u>		<u>893,984</u>

Share in Blue lagoon was decreased by ISK 277,354 during the year due to put option on own shares in the Blue lagoon. In June 2011 the Blue Lagoon is obligated to acquire outstanding shares from one of its shareholders. HS Orka has recognizes its share in the put option in the reserve for shares in associate within equity. The reserve is decreased by HS Orka share in expired put option which amounted to ISK 240 million during the year. The calculations of the Company's share in the equity and comprehensive income of the Blue Lagoon are based on draft financial informations.

The Company increased its share in Suðurorka ehf. during the year by ISK 70 million and plans to increase it share by ISK 20 - 30 million during the year 2012 taking its share up to 50%.

## 19. INVESTMENTS IN OTHER COMPANIES

### Investments in other companies are as follows:

	2010		2009	
	Share	Carrying amount	Share	Carrying amount
Eignarhaldsfélag Farice ehf., Iceland .....	0.0%	0	4.2%	82,968
Keilir ehf., Iceland .....	11.3%	17,500	11.3%	35,000
Vistorka hf., Iceland .....	11.3%	9,575	11.3%	9,575
Total .....		<u>27,075</u>		<u>127,543</u>

During the year shares in Eignarhaldsfélagið Farice ehf. were written down in the amount of ISK 83.0 million but had previously been impaired by ISK 41.0 million and shares in Keilir, Atlantic Center of Excellence ehf. by ISK 17.5 million.

## 20. BONDS

	2010	2009
<b>Non-current</b>		
Financial assets designated through profit and loss, Reykjanesbær bond .....	495,604	437,740
Available for sale financial assets, HS Veitur hf. bonds .....	0	2,304,300
	<u>495,604</u>	<u>2,742,040</u>
<b>Current</b>		
Available for sale financial assets, HS Veitur hf. bonds .....	647,793	0
	<u>647,793</u>	<u>0</u>

Bonds receivable from HS Veitur hf. is now classified as current as it is management's intention to sell them within the next 12 months.

Interest-bearing available-for-sale financial assets, with a carrying amount of ISK 648 millions at 31 December 2010 (2009: ISK 2,304 millions) have stated interest rates of 5.3 percent plus indexation (2009: 5.3 percent) and mature in the year 2018.

Interest-bearing financial assets designated through profit and loss, with a carrying amount of ISK 496 millions at 31 December 2010 (2009: 438 millions) have stated interest rates of 5.0 percent plus indexation and mature in the year 2019. The bond is valued at 6,5% interest rate which is the available market rate from June 2010. The counter party is the municipality of Reykjanesbær and due to financial difficulties of the municipality a certain uncertainty exists regarding the valuation of the bond.

## 21. EMBEDDED DERIVATIVES IN ELECTRIC POWER SALES AGREEMENTS

The Company has concluded electric power sales agreements with Norðurál on power supply until the years 2011 and 2026. The Company has also concluded an agreement with Landsvirkjun on the sale of power until the year 2019. The agreements are in USD and are partly linked to the price of aluminium.

The long-term power sale agreements feature embedded derivatives, on which income is contingent upon changes in the price of aluminium in the future.

In evaluating the value of embedded derivatives, generally accepted evaluation methods are applied, as the market value is not available. The fair value of the agreements is calculated on the basis of the forward price of aluminium and experts' projections. The expected present value of cash flows on the reporting date is calculated on the basis of registered forward price of aluminium with the LME (London Metal Exchange) over the next 10 years after the reporting date and expectations of price trends of aluminium when a forward market ends. Future growth for calculation was 0.52% (2009: 1.89%) The expected present value of cash flows, from the agreements, on the agreement date is deducted from this value based on aluminium price presumptions used as the basis for the conclusion of the agreements. The difference is a fair value change of the derivative, which is recognized in profit and loss. Embedded derivatives in electric power sales agreements are expected to have no value at the beginning of the agreements.

In addition, the Company has concluded electric power sales agreements with Landsvirkjun where the power price is based on Landsvirkjun's price list, which is based on indexation in ISK. There are no specified embedded derivatives in those agreements.

<b>Fair value of embedded derivatives are as follows:</b>	2010	2009
Fair value of embedded derivatives at 1.1. ....	7,322,617	254,077
Changes in fair value .....	( 1,395,995)	7,068,540
	<u>5,926,622</u>	<u>7,322,617</u>
Fair value of embedded derivatives at 31.12. ....	5,926,622	7,322,617

## 22. DEFERRED TAX ASSET

In December 2010 the Icelandic Parliament, Althingi, approved an increase in the income tax rate from 18% to 20% as of 1 January 2011 and the change will become effective in the tax assessment for the year 2012. Due to this, the deferred tax asset has increased by ISK 28 million. An increase is recognized in profit and loss for the year 2010 in the amount of ISK 71 million and decrease in other comprehensive income in the amount of ISK 43 million. At year end 2009 tax rate applicable for the year 2010 increased from 15% to 18%.

<b>Deferred tax asset is as follows:</b>	<b>2010</b>	<b>2009</b>
Deferred tax asset on 1.1. ....	483,954	1,731,861
Effect of changes in tax rate .....	27,632	116,659
Calculated income tax for the year .....	( 235,268)	( 1,148,566)
Income tax on revaluation .....	0	( 216,000)
Deferred tax asset on 31.12. ....	<u>276,318</u>	<u>483,954</u>
 <b>Tax asset is as follows at the year end:</b>	 <b>2010</b>	 <b>2009</b>
Operating assets .....	(38,453)	( 20,381)
Derivatives .....	(953,506)	( 1,036,365)
Long term receivables .....	(19,797)	( 14,904)
Inventories .....	3,399	3,059
Trade and other receivables .....	7,600	5,040
Pension fund obligation .....	280,000	247,626
Deferred foreign exchange (gain) loss .....	( 40,690)	149,411
Tax losses carried forward .....	1,037,765	1,150,468
Deferred tax asset on 31.12. ....	<u>276,318</u>	<u>483,954</u>

Tax loss carry-forward can be utilized over 10 years from the date that the loss is incurred. Tax loss carry -forward at year end amounted to ISK 5,189 million and is useable to the year 2018 (2009: ISK 6,391 million). Management has concluded based on their projections that their will be sufficient taxable profit in the future to use the tax loss carried forward.

## 23. RECEIVABLES

### Long-term receivables

<b>Long term receivables are specified as follows:</b>	<b>2010</b>	<b>2009</b>
Receivables due to sale of land .....	460,238	449,283
Long term receivable from HS veitur hf. due to pension liability .....	98,983	82,798
Total long term receivables .....	<u>559,221</u>	<u>532,081</u>

### Trade and other receivables

<b>Trade and other receivables are specified as follows:</b>		
Trade receivables .....	878,724	803,013
Receivable from HS veitur hf. ....	175,296	0
Other receivables .....	54,566	26,989
Allowance for bad debt .....	( 38,000)	( 28,000)
Total trade and other receivables .....	<u>1,070,586</u>	<u>802,002</u>

## 23. RECEIVABLES, CONTINUED

	2010	2009
Trade receivables are as follows:		
Mass users and power companies .....	502,423	468,985
Receivable from HS veitur hf .....	175,296	0
Other users .....	376,301	334,028
Total trade receivables .....	1,054,020	803,013

The Company's exposure to credit and currency risks and impairment losses related to trade and other receivable is disclosed in note 31.

## 24. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are as follows:

Bank balances .....	1,043,250	151,782
Cash and cash equivalents .....	1,043,250	151,782

At year end 2010 cash in the amount of ISK 517 million (USD 4.5 million) is dedicated to secure loan payments in accordance with a collateral agreement concluded in March 2010 with the Company's lenders.

The Company's exposure to interest rate risk and sensitivity analysis for financial assets and liabilities is disclosed in note 31.

## 25. EQUITY

### Issued capital

Issued share capital, as stipulated in the Company's Articles of Association, numbered to ISK 6,963 million. One vote is attached to each share of one ISK in the Company in addition to rights to receive dividends. All issued capital has been paid for.

	2010	2009
<b>Outstanding number of ordinary shares</b>		
Outstanding shares on 1 January .....	6,118,387	6,118,387
Share capital increase .....	844,532	0
Outstanding shares on 31 December .....	6,962,919	6,118,387

### Statutory reserve

Statutory reserve may be used to settle losses, which can not be settled by using other reserves. When the statutory reserve amounts to one fourth of share capital the amount, which is in excess, may be used to increase share capital or for other needs.

### Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of share in associate.

### Revaluation reserve

The revaluation reserve relates to the revaluation operating assets net of income tax. The revaluation reserve may not be distributed as dividends to the Company's shareholders.

## 25. EQUITY, CONTINUED

### Reserve for shares in associate

The reserve for shares in associate comprises HS Orka hf share in put option on own shares in associate.

### Dividends

No dividend was paid during the years 2010 and 2009

The Company's Board of Directors proposes that no dividends will be paid to shareholders in the year 2011.

## 26. EARNINGS PER SHARE

Basic and diluted earnings per share	2010	2009
Profit for the year .....	864,562	6,797,706
<b>Weighted average number of ordinary shares</b>		
Shares on 1 January .....	6,118,387	6,118,387
Effect of share capital increase .....	640,156	0
Weighted average number of ordinary shares .....	6,758,543	6,118,387
Basic and diluted earnings per share .....	0.13	1.11

## 27. 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. For more information about the Company's exposure to interest rate, foreign currency and liquidity risk, see note 31.

	31.12.2010	31.12.2009
<b>Non-current debt</b>		
Unsecured bank loans .....	590,865	674,427
Secured Bank loans with covenants .....	16,926,577	19,236,884
Unsecured bond issue .....	3,005,034	3,315,677
Current maturities .....	( 1,951,594)	( 2,014,237)
Non-current debt .....	18,570,882	21,212,751
<b>Current debt</b>		
Current maturities .....	1,951,594	2,014,237
Promissory note .....	0	549,013
Current loans and borrowings .....	1,951,594	2,563,250
Total interest-bearing loans and borrowing .....	20,522,476	23,776,001

All amounts are in thousand of ISK.

## 27. LOANS AND BORROWINGS, CONTINUED

## Terms of Loans and borrowings

Debt in foreign currency:	Final due date	31.12.2010		31.12.2009	
		Weighted average interest rate	Carrying amount	Weighted average interest rate	Carrying amount
Loans in USD .....	2019-2023	2.5%	3,545,391	2.5%	4,138,864
Loans in CHF .....	2019-2021	2.3%	5,115,667	2.5%	5,453,206
Loans in EUR .....	2019-2021	3.5%	3,881,076	3.3%	5,018,864
Loans in JPY .....	2019-2023	1.7%	2,035,249	1.9%	2,082,963
Loans in CAD .....	2021-2023	1.8%	1,397,604	1.0%	1,443,425
Loans in SEK .....	2021	4.4%	911,210	3.4%	1,016,352
Loans in GBP .....	2017-2019	1.2%	442,909	1.1%	545,805
			17,329,106		19,699,479
<b>Loans in ISK:</b>					
Indexed loans in ISK .....	2016-2017	3.9%	3,193,370	3.9%	3,527,509
Un-indexed loans in ISK .....	2010		-	19.2%	549,013
			3,193,370		4,076,522
Total interest-bearing loans and borrowings ...			20,522,476		23,776,001
<b>Annual maturities of non-current loans and borrowings are as follows:</b>					
Year 2011/2010 .....			1,951,594		2,014,237
Year 2012/2011 .....			2,128,825		2,031,097
Year 2013/2012 .....			2,147,502		2,213,279
Year 2014/2013 .....			2,166,931		2,231,526
Year 2015/2014 .....			2,187,145		2,250,508
Subsequent .....			9,940,479		12,486,341
Total non-current loans and borrowings, including current maturities .....			20,522,476		23,226,988

**Covenants**

At the end of the year 2009 the Company made temporary agreements with its lenders on covenants and interest rates. The agreements expired at the end of the year 2010. Management has been in negotiation with the banks regarding the future terms of the loan agreements and as the banks have received additional guarantees for the repayment of the loans. Management expect that a favorable conclusion will be reached soon.

## 28. PENSION FUND OBLIGATION

According to actuaries' assessment, the Company's accrued pension obligation amounted to ISK 1,400 million at year end 2010 (2009: ISK 1,376 million), discounted based on an interest rate of 2%, taken into account share in the net asset of the pension fund. Presumptions on life expectancy, mortality rate and discount rate are in accordance with provisions of Regulation no. 391/1998 on obligatory pension right insurance and pension funds' operation. The estimated increase in the obligation in the year is based on general salary increase taken into account interests. The Company's pension obligation is uncapitalized.

A part of the pension fund obligation pertains to the Company's employees providing services to HS Veitur hf and HS Veitur hf participates in the cost of the increase in these employees' pension fund obligation. HS Veitur hf's share in the increase in pension fund obligation during the year amounted to ISK 16 million (2009: ISK 83 million) and is recognized as long term receivable from HS Veitur hf.

<b>Movement in the pension fund obligation:</b>	<b>2010</b>	<b>2009</b>
Pension fund commitment at 1.1. ....	1,375,700	1,248,000
Contribution during the year. ....	( 68,318)	( 66,690)
Increase in obligation due to interests, salaries and change in fund's net assets. ....	92,618	194,390
Pension fund obligation at 31.12. ....	<u>1,400,000</u>	<u>1,375,700</u>
<b>Pension fund obligations are as follows:</b>		
The pension fund for State employees. ....	773,755	761,100
The pension fund for Municipality of Hafnarfjörður employees. ....	372,645	378,700
The pension fund for Municipality of Westman Islands employees. ....	253,600	235,900
Pension fund obligation at 31.12. ....	<u>1,400,000</u>	<u>1,375,700</u>

## 29. CURRENCY AND INTEREST RATE SWAP CONTRACTS

The Company held long term currency and interest rate swaps contracts with its bank, Glitnir bank hf., which was taken over by the Financial Supervisory Authority (FSA) in October 2008.

Upon the FSA's takeover of the bank, premises for the agreement no longer existed as the bank has not calculated nor collected the due payments on scheduled payment dates. The agreement is recognized as liability in the Company's financial statements based on the exchange rate ruling at year end 2010 plus payments fallen in due, total of ISK 1,159 (2009: ISK 1,565 million). It is uncertain whether the Company is obliged to settle the agreement or not as it is clear that the counterparty will not meet with its part of the agreement, in which case it will also be unclear which date and exchange rate shall be based upon.

The long term portion of currency and interest rate swap contract was classified as current in year 2009 due to an uncertainty of a settlement. The long term portion of the agreement has now been classified as long term liability as the resolution committee of Glitnir Bank has stated that it will collect the contract on its maturity. The contract is at 31 December 2010 classified according to the contracts term.

### 30. TRADE AND OTHER PAYABLES

Trade and other payables are as follows:	2010	2009
Trade payables .....	339,475	687,437
Debt related to construction of power plant .....	252,398	0
Payable to HS Veitur hf .....	0	243,796
Other payables .....	566,172	332,678
Total trade and other payables .....	<u>1,158,045</u>	<u>1,263,911</u>

The Company's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 31.

### 31. FINANCIAL INSTRUMENTS

#### Credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	Notes	2010	2009
Bonds .....		1,143,397	2,742,040
Long term receivables .....		559,221	532,081
Trade and other receivables .....	23	1,070,586	802,002
Cash and cash equivalents .....	24	1,043,250	151,782
		<u>3,816,454</u>	<u>4,227,905</u>

The maximum exposure to credit risk for trade receivables at the reporting date by type of customer was:

	2010	2009
Mass users and power companies .....	502,423	468,985
Receivable from HS Veitur .....	175,296	0
Common users .....	376,301	334,028
	<u>1,054,020</u>	<u>803,013</u>

#### Impairment

The aging of trade receivables and impairment at the reporting date was:

	2010		2009	
	Gross value	Impairment	Gross value	Impairment
Not past due .....	914,379		732,059	
Past due 0 - 30 days .....	48,257	603	24,990	
Past due 31 - 60 days .....	20,935	314	12,383	
Past due 61 - 90 days .....	8,627	431	5,388	1,400
Past due 91 days and older .....	61,822	36,652	28,193	26,600
	<u>1,054,020</u>	<u>38,000</u>	<u>803,013</u>	<u>28,000</u>

### 31. FINANCIAL INSTRUMENTS, CONTINUED

#### Impairment, continued

	2010	2009
The movement in the allowance for impairment in respect of receivables during the year was as follows:		
Balance at 1.1. ....	28,000	21,375
Impairment loss recognized .....	10,000	6,625
Balance at 31.12. ....	38,000	28,000

#### Liquidity risk:

The following are the contractual maturities of financial liabilities, including estimated interest payments:

	Carrying amount	Contractual cash flows	Less than one year	1 - 2 years	2- 5 years	After 5 years
<b>31 December 2010</b>						
Loans and borrowing .....	20,522,476	23,758,420	2,538,836	2,692,576	8,117,846	10,409,162
Trade and other payables .....	1,158,045	1,158,045	1,158,045			
Derivatives .....	1,159,091	1,072,839	268,698	73,014	440,173	290,954
<b>31 December 2009</b>						
Loans and borrowings .....	23,776,001	27,393,297	3,135,957	2,523,560	7,861,444	13,872,336
Trade and other payables .....	1,263,911	1,263,911	1,263,911			
Derivatives .....	1,565,035	1,526,663	269,667	111,341	558,263	587,392

#### Currency risk:

Exposure to currency risk

The Company's exposure to foreign currency risk, based on nominal amounts, was as follows:

	CHF	EUR	USD	JPY	GBP	Other currencies
<b>2010</b>						
Derivatives .....	( 1,820,496)	( 574,276)	5,217,275	( 713,385)	( 280,618)	
Receivables .....			300,602			
Cash and cash equivalents .....		14,134	776,193			
Loans and borrowings .....	( 5,115,666)	( 3,881,076)	( 3,545,392)	( 2,035,248)	( 442,909)	( 2,308,814)
Payables .....		( 43,184)	( 47,449)	( 209,214)		( 5,544)
Balance sheet risk .....	( 6,936,162)	( 4,484,402)	2,701,229	( 2,957,847)	( 723,527)	( 2,314,358)
Estimated sale 2011 .....			3,101,127			
Estimated purchases 2011 .....			( 552,000)			
Gross foreign exchange rate risk	0	0	2,549,127	0	0	0
Net foreign exchange rate risk ..	( 6,936,162)	( 4,484,402)	5,250,356	( 2,957,847)	( 723,527)	( 2,314,358)

All amounts are in thousand of ISK.

## 31. FINANCIAL INSTRUMENTS, CONTINUED

## Currency risk, continued

## Exposure to currency risk, continued

	CHF	EUR	USD	JPY	GBP	Other currencies
<b>2009</b>						
Derivatives .....	( 2,092,053)	( 779,975)	6,426,626	( 793,990)	( 368,594)	0
Receivables .....			307,701			
Loans and borrowings .....	( 5,453,206)	( 5,018,864)	( 4,138,864)	( 2,082,963)	( 545,805)	( 2,459,777)
Payables .....		( 45,095)	( 54,440)			( 21)
Balance sheet risk .....	( 7,545,259)	( 5,843,934)	2,541,023	( 2,876,953)	( 914,399)	( 2,459,798)
Estimated sale 2010 .....			3,264,520			
Estimated purchases 2010 .....		( 250,600)	( 612,500)	( 958,750)		
Gross foreign exchange rate risk	0	( 250,600)	2,652,020	( 958,750)	0	0
Net foreign exchange rate risk .....	( 7,545,259)	( 6,094,534)	5,193,043	( 3,835,703)	( 914,399)	( 2,459,798)

	Average exchange rate 2010	2009	End of year exchange rate 2010	2009
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## The following significant exchange rates applied during the year:

	Average exchange rate 2010	2009	End of year exchange rate 2010	2009
CHF .....	117.56	114.64	123.25	121.60
EUR .....	162.34	173.15	154.23	180.38
USD .....	122.33	123.59	115.60	125.20
JPY .....	1.40	1.33	1.42	1.36
GBP .....	189.01	193.89	178.90	202.09

## Sensitivity analysis

A 10 percent strengthening of the ISK against the following currencies at 31 December would have increased (decreased) profit or loss after tax by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2009.

	Profit or (loss)	
	2010	2009
CHF .....	667,744	641,347
EUR .....	431,713	489,068
USD .....	( 214,818)	( 225,242)
JPY .....	284,752	244,541
GBP .....	69,654	77,724
Other .....	222,803	209,079

A 10 percent weakening of the ISK against the above currencies at 31 December would have had the equal but opposite effect on profit or loss after tax to the amounts shown above, on the basis that all other variables remain constant. The analysis is performed on the same basis for the year 2009.

### 31. FINANCIAL INSTRUMENTS, CONTINUED

#### Interest rate risk

Interest-bearing financial assets and liabilities are as follows at the year end:	2010	2009
<b>Financial instruments with fixed interest rate</b>		
Financial assets with fixed interest rate .....	1,603,635	2,742,040
Financial liabilities .....	( 3,193,370)	( 4,076,522)
	<u>( 1,589,735)</u>	<u>( 1,334,482)</u>
<b>Financial instruments with floating interest rate</b>		
Financial assets .....	1,043,250	151,782
Interest rate and foreign currency swap contracts .....	( 1,159,092)	( 1,565,035)
Financial liabilities .....	( 17,329,106)	( 19,699,479)
	<u>( 17,444,948)</u>	<u>( 21,112,732)</u>
<b>Derivatives</b>		
Embedded derivatives .....	5,926,622	7,322,617
Currency and interest rate swap .....	1,159,091	( 1,565,035)
	<u>7,085,713</u>	<u>5,757,582</u>

#### Fair value sensitivity analysis for fixed rate instruments:

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) profit or loss and equity after tax by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for the year 2009.

	Equity		Profit or loss	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
<b>2010</b>				
Financial assets with fixed interest rates .....	( 41,055)	44,448	( 33,179)	36,265
Fair value sensitivity analysis, net .....	<u>( 41,055)</u>	<u>44,448</u>	<u>( 33,179)</u>	<u>36,265</u>
<b>2009</b>				
Financial assets with fixed interest rates .....	( 130,760)	142,756	( 28,780)	31,716
Fair value sensitivity analysis, net .....	<u>( 130,760)</u>	<u>142,756</u>	<u>( 28,780)</u>	<u>31,716</u>

All amounts are in thousand of ISK.

### 31. FINANCIAL INSTRUMENTS, CONTINUED

#### Fair value sensitivity analysis for derivatives

A change in interest rates of 100 basis points at the reporting date would have increased (decreased) the return after tax by the following amounts. This analysis is based on that all other variables, in particular foreign currency rates, remain constant. The analysis was performed on the same basis for the year 2009.

	Profit or loss	
	100 bp increase	100 bp decrease
<b>2010</b>		
Embedded derivatives .....	( 245,387)	268,519
Currency and interest rate swap .....	( 72,238)	76,042
Fair value sensitivity analysis, net .....	<u>( 317,625)</u>	<u>344,561</u>
<b>2009</b>		
Embedded derivatives .....	( 387,725)	430,276
Currency and interest rate swap .....	93,254	( 98,748)
Fair value sensitivity analysis, net .....	<u>( 294,471)</u>	<u>331,528</u>

#### Cash flow sensitivity analysis for floating interest rate instruments

A change in interest rates of 100 basis points at the reporting date would have increased ( decreased ) the return after tax by the following amounts. This analysis is based on that all other variables, in particular foreign currency rates, remain constant. The analysis was performed on the same basis for the year 2009.

	Profit or loss	
	100 bp increase	100 bp decrease
<b>2010</b>		
Financial instruments with variable interest rates .....	( 137,578)	137,578
Cash flow sensitivity analysis, net .....	<u>( 137,578)</u>	<u>137,578</u>
<b>2009</b>		
Financial instruments with variable interest rates .....	( 167,446)	167,446
Cash flow sensitivity analysis, net .....	<u>( 167,446)</u>	<u>167,446</u>

#### Fair value

##### Fair value versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing long-term debts .....	(20,522,476)	( 19,883,342)	( 23,226,988)	(22,354,503)
	<u>(20,522,476)</u>	<u>( 19,883,342)</u>	<u>( 23,226,988)</u>	<u>(22,354,503)</u>

The basis for determining fair values is disclosed in note 4.

### 31. FINANCIAL INSTRUMENTS, CONTINUED

#### Interest rates used for determining fair value

The interest rates used to discount estimated cash flows, where applicable, are based on the government yield curve at the reporting date in the case of ISK denominated debt, embedded derivatives and bonds. For foreign denominated debt the discount rates are based on interbank rates. All discount rates include an adequate credit spread, and were as follows.

Interest rates used for determining fair value:	2010	2009
Embedded derivatives in electric power sales agreements ( USD )	1.79- 5.59%	2.04- 6.16%
Bonds	5,3-6,5%	5.3-6,3%
Interest bearing long term liabilities	Libor + 275 bp	Libor +250 -300 bp

Currency and interest rate swaps are discounted at swap rates for foreign currency denominated legs and the Housing Finance Fund curve for ISK CPI indexed legs.

#### Fair value hierarchy:

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 2	Level 3	Total
<b>31 December 2010</b>			
Embedded derivatives	664,934	5,261,688	5,926,622
Bonds	647,793	495,604	1,143,397
Other derivatives	( 934,950)		( 934,950)
Investment in other companies		27,075	27,075
	<u>377,777</u>	<u>5,784,367</u>	<u>6,162,144</u>
<b>31 December 2009</b>			
Embedded derivatives	907,872	6,414,745	7,322,617
Bonds	2,303,091	438,949	2,742,040
Other derivatives	( 1,347,556)		( 1,347,556)
Investment in other companies		127,543	127,543
	<u>1,863,407</u>	<u>6,981,237</u>	<u>8,844,644</u>

No financial assets or liabilities are classified as level 1.

Embedded derivatives that expire in the year 2026 are classified in level three due to the fact that the forward market for aluminium only reaches maximum of ten years.

#### Aluminium price risk

The Company has concluded electric power sales agreements with Norðurál on power supply until the year 2026. The Company has also concluded an agreement with Landsvirkjun on the sale of power until the year 2019. The agreements are in USD and are partly related to the price of aluminium.

## 31. FINANCIAL INSTRUMENTS, CONTINUED

## Sensitivity analysis

A 10 percent increase or weakening of aluminium prices at 31 December would have increased (decreased) profit or loss after tax by the amounts shown below. The analysis is performed on the same basis for 2009.

	Profit or (loss)	
	2010	2009
Increase of 10% .....	2,441,117	2,849,347
Decrease of 10% .....	( 2,441,117)	( 2,849,347)

## Classification of financial instruments

Financial assets and liabilities are classified as follows:

	Financial liabilities measured at amortized cost	Loans and receivables	Financial assets and liabilities at fair value through profit and loss	Financial assets and liabilities held for trading	Financial assets available for sale	Carrying amount
<b>2010</b>						
Shares .....			27,075			27,075
Bonds .....			495,604		647,793	1,143,397
Derivatives .....				5,926,622		5,926,622
Trade receivables .....		1,016,020				1,016,020
Other receivables .....		613,787				613,787
Cash .....		1,043,250				1,043,250
Total assets .....	0	2,673,057	522,679	5,926,622	647,793	9,770,151
Loans and borrowings .....	20,522,476					20,522,476
Derivatives .....				1,159,091		1,159,091
Trade payables .....	591,873					591,873
Other payables .....	566,172					566,172
Total liabilities .....	21,680,521	0	0	1,159,091	0	22,839,612
<b>2009</b>						
Shares .....			127,543			127,543
Bonds .....					2,742,040	2,742,040
Derivatives .....				7,322,617		7,322,617
Trade receivables .....		775,013				775,013
Other receivables .....		559,070				559,070
Cash .....		151,782				151,782
Total assets .....		1,485,865	127,543	7,322,617	2,742,040	11,678,065
Loans and borrowings .....	23,776,001					23,776,001
Derivatives .....				1,565,035		1,565,035
Trade payables .....	687,437					687,437
Other payables .....	576,474					576,474
Total liabilities .....	25,039,912	0	0	1,565,035	0	26,604,947

All amounts are in thousand of ISK.

## 32. GUARANTEES

Due to the division of the Company into HS Orka hf and HS Veitur hf the Company has entered into partial guarantee for the liabilities of HS veitur hf The Guarantee amounts to a maximum of ISK 91 million.

## 33. OTHER MATTERS

### Litigations and claims

HS Orka hf, in 2007, entered into a conditional power sale agreement with Nordural to sell power from a new power plant at Reykjanes, which is currently being prepared, to a new aluminum smelter in Helguvík. The agreement contained a number of conditions, which were not fulfilled by the time set out in the agreement. Accordingly, HS Orka holds the view that the agreement has lapsed in accordance with its terms and management view is that HS Orka has a strong case. Nordural disputes this interpretation and maintains that the agreement is in force. The agreement provides that disputes shall be resolved by arbitration and Nordural has initiated arbitration proceedings to determine the validity of the agreement. The arbitration proceedings were initiated on 19 July, 2010 and hearing date has been set on 27 May, 2011. There is an uncertainty about the conclusion of the arbitration, which leads to uncertainty if the electricity will be sold to the aluminum smelter or to other customers.

## 34. RELATED PARTIES

### Identity of related parties

The Company has a related party relationship with its shareholder with more than 25% share, associates, fellow subsidiaries, HS Veitur hf, its directors and executive officers and other companies owned by them.

The Company purchased goods and services from shareholders with more than 25% share to the amount of ISK 25 million in the year 2010 (2009: ISK 0 million).

The Company sold to shareholders with more than 25% share goods and services to the amount of ISK 1 million in the year 2010 (2009: ISK 1 million).

The Company purchased goods and services from associated companies to the amount of ISK 14 million in the year 2010 (2009: ISK 25 million).

The Company sold goods and services to associated companies to the amount of ISK 28 million (2009: ISK 28 million).

The Company purchased goods and services from fellow subsidiaries to the amount of ISK 680 million in the year 2010 (2009: ISK 88 million). At year end trade payables to fellow subsidiaries amounted to ISK 4 million. In addition there was an outstanding promissory notes in the amount of ISK 549 million to a fellow subsidiary at year end 2009 that was paid in April 2010.

Sales to HS Veitur hf amounted to ISK 1,617 million during the year (2009: ISK 1,492 million). Purchases from HS Veitur hf amounted to ISK 18 million (2009: ISK 49 million). At year end the receivables from HS Veitur hf amounted to ISK 163 million to HS Veitur (2009: Payable ISK 243 million).

**SKAMMSTAFANIR:**

kV	= kilóvolt	= 1.000 volt
kW	= kilóvatt	= 1.000 wött
MW	= megawatt	= 1.000 kW
kVa	= kilóvoltamper	= 1.000 voltamper
MVa	= megavoltamper	= 1.000 kVa
kWst	= kilóvattstund	= 1.000 wattstundir
MWst	= megawattstund	= 1.000 kWst.
GWst	= gígawattstund	= 1.000 MWst.
TWst	= terawattstund	= 1.000 GWst.
GL	= gígalítri	= 1.000 milljón l.

**ABBREVIATION:**

kV	= kilovolt	= 1.000 volt
kW	= kilowatt	= 1.000 watts
MW	= megawatt	= 1.000 kW
kVa	= kilovoltamper	= 1.000 voltamper
MVa	= megavoltamper	= 1.000 kVa
kWh	= kilowatthour	= 1.000 watthours
MWh	= megawatthour	= 1.000 kWh.
GWh	= gigawatthour	= 1.000 MWh.
TWh	= terawatthour	= 1.000 GWh.
GL	= gigaliter	= 1.000 million l.

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