

HS Orka hf.

Condensed Interim Financial Statements
three months ended 31 March 2011
ISK

HS Orka hf.
Brekkuftigur 36
260 Reykjanesbær

Reg.no. 680475-0169

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Endorsement by the Board of Directors and the Management

The condensed interim financial statements of HS Orka hf. for the period from 1 January to 31 March 2011 are prepared in accordance with the International Accounting Standard, IAS 34, *Interim Financial Reporting*.

According to the statement of comprehensive income, the Company's operating revenue amounted to ISK 1,953 million in the first three months of the year 2011 (2010: ISK 1,812 million) and the profit of the period amounted to ISK 2,231 million (2010: ISK 1,190 million). Comprehensive income amounted to ISK 2,249 million (2010: ISK 1,164 million). According to the statement of financial position, the Company's assets amounted to ISK 43,962 million at the end of March 2011 (at year end 2010: ISK 41,536 million). Equity amounted to ISK 19,545 million at the end of March 2011 (at year end 2010: ISK 17,296 million) or 44.5% of total capital (at year end 2010: 41.6%).

At the end of the period Magma Energy Sweden A.B. held 98.53% of the shares in HS Orka hf.

According to the best knowledge of the Board of Directors and the Management, the Company's condensed interim financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the Management that the interim financial statements give a true and fair view of the Company's assets, liabilities and financial position as at 31 March 2011 and its financial performance and changes in cash flows in the period from 1 January to 31 March 2011.

Furthermore, it is the opinion of the Board of Directors and the Management that the interim financial statements give a fair view of the Company's financial development, financial position and performance and describe the main risk factors and uncertainty faced by the Company.

The Board of Directors and the Management of HS Orka hf. have today discussed the Company's interim financial statements for the period from 1 January to 31 March 2011 and confirmed by means of their signatures.

Reykjanesbær, 12 May 2011.

The Board of Directors:

Ásgeir Margeirsson
Chairman of the board

Gylfi Árnason

John Carson

Annette Cusworth

Ross Beaty

Managing Director:

Júlíus Jónsson

Assistant Managing Director:

Albert Albertsson

Independent Auditor's Review Report

To the Board of Directors of HS Orka hf.

We have reviewed the accompanying statement of financial position of HS Orka hf. as of 31 March 2011 and the related statements of comprehensive income, changes in equity and cash flows for the three-month period then ended. Management is responsible for the preparation and presentation of this interim financial information in accordance with IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Reykjavík, 12 May 2011.

KPMG ehf.

Sæmundur Valdimarsson
Margret G. Flóvenz

Statement of Comprehensive Income for the three months ended 31 March

	Notes	2011 Q1	2010 Q1
Operating revenue		1.952.953	1.812.280
Production cost and cost of sales		(1.282.087)	(1.257.949)
Gross profit		670.866	554.331
Other operating expenses	6	(164.880)	(55.716)
Results from operating activities		505.986	498.615
Finance income		27.363	83.880
Finance costs		(469.922)	(316.856)
Changes in fair value of derivatives		118.259	46.362
Changes in fair value of embedded derivatives in sales contracts		2.607.744	1.210.597
Net finance income	7	2.283.444	1.023.983
Share of loss of associates		(683)	(58.544)
Profit before income tax		2.788.747	1.464.054
Income tax expense		(557.749)	(274.068)
Profit for the period		2.230.998	1.189.986
Other comprehensive income			
Foreign currency translation difference of associates		18.401	(26.134)
Other comprehensive income for the period, net of income tax		18.401	(26.134)
Total comprehensive income for the period		<u>2.249.399</u>	<u>1.163.852</u>
 Earnings per share			
Basic and diluted earnings per share		0,32	0,17

Notes on pages 9 to 11 are an integral part of these financial statements

Statement of Financial Position as at 31 March

Assets	Notes	31.3.2011	31.12.2010
Operating assets		24.591.677	24.781.700
Operating assets under construction		4.763.104	4.746.587
Intangible assets		976.114	981.275
Investments in associates	8	651.473	638.611
Investments in other companies		27.075	27.075
Bonds		506.498	495.604
Embedded derivatives in electric power sale contracts		7.557.342	5.096.653
Deferred tax asset		0	276.318
Long term receivable		611.571	559.221
Total non-current assets		39.684.854	37.603.044
Inventories		354.349	340.926
Bonds		0	647.793
Trade and other receivables		1.152.341	1.070.586
Embedded derivatives in electric power sales contracts		977.024	829.969
Cash and cash equivalents	9	1.793.234	1.043.250
Total current assets		4.276.948	3.932.524
Total assets		43.961.802	41.535.568
Equity			
Share capital		6.962.919	6.962.919
Share premium and statutory reserve		3.218.660	3.218.660
Translation reserve		315.035	296.634
Revaluation reserve		1.704.425	1.723.505
Reserve for shares in associate .....	(	37.157)	(37.157)
Retained earnings		7.381.473	5.131.395
Total equity		19.545.355	17.295.956
Liabilities			
Loans and borrowings	10	18.233.838	18.570.882
Pension obligation		1.480.400	1.400.000
Deferred tax liability		281.432	0
Currency and interest rate swap contract		770.321	886.753
Total non-current liabilities		20.765.991	20.857.635
Loans and borrowings		2.063.758	1.951.594
Trade and other payables		1.316.189	1.158.045
Currency and interest rate swap contract		270.509	272.338
Total current liabilities		3.650.456	3.381.977
Total liabilities		24.416.447	24.239.612
Total equity and liabilities		43.961.802	41.535.568

Notes on pages 9 to 11 are an integral part of these financial statements

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

	Share capital	Share premium and statutory reserve	Translation reserve	Revaluation reserve	Reserve for shares in associate	Retained earnings	Total
1 January to 31 March 2010							
Equity at 1 January 2010	6.118.387	1.529.597	407.383	1.830.311	0	4.203.116	14.088.794
Total comprehensive income			(26.134)			1.189.986	1.163.852
Depreciation transferred to retained earnings				(25.174)		25.174	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					14.716		14.716
Equity at 31 March 2010	<u>6.962.919</u>	<u>3.218.660</u>	<u>381.249</u>	<u>1.805.137</u>	<u>(262.638)</u>	<u>5.418.276</u>	<u>17.523.603</u>
1 January to 31 March 2011							
Equity at 1 January 2011	6.962.919	3.218.660	296.634	1.723.505	(37.157)	5.131.395	17.295.956
Total comprehensive income			18.401			2.230.998	2.249.399
Depreciation of revaluations net of tax transferred to retained earnings				(19.080)		19.080	0
Equity at 31 March 2011	<u>6.962.919</u>	<u>3.218.660</u>	<u>315.035</u>	<u>1.704.425</u>	<u>(37.157)</u>	<u>7.381.473</u>	<u>19.545.355</u>

Notes on pages 9 to 11 are an integral part of these financial statements

Statement of Cash Flows

for the three months ended 31 March

	Notes	2011 Q1	2010 Q1
Cash flows from operating activities			
Profit for the period		2.230.998	1.189.986
Items not affecting working capital:			
Increase in pension fund obligation		80.400	21.556
Depreciation and amortization		258.015	228.637
Net finance income .....	(	2.283.444)	(1.023.983)
Share of loss of associates		683	58.544
Income tax expense		557.750	274.068
		844.402	748.808
Inventories, increase .....	(	13.423)	(2.302)
Receivables, increase .....	(	110.453)	(211.154)
Current liabilities, decrease		172.764	77.214
Net cash from operations before interest and taxes		893.290	612.566
Interest income received		4.722	0
Interest and indexation costs paid .....	(	164.408)	(174.481)
Net cash from operating activities		733.604	438.085
Cash flows from investing activities			
Acquisition of operating assets during the period .....	(	78.794)	(633.830)
Acquisition of intangible assets .....	(	554)	(31.955)
Dividend received		4.855	0
Proceeds from sale of bonds		634.164	560.868
Net cash provided by (used in) investing activities		559.671	(104.917)
Cash flows from financing activities			
Share capital increase		0	633.399
Repayment of borrowings .....	(	538.184)	(430.831)
Repayment of loan from HS Veitur		0	(378.816)
Short-term loans, decrease		0	(49.013)
Net cash used in financing activities	(	538.184)	(225.261)
Increase in cash and cash equivalents		755.091	107.907
Cash and cash equivalents at 1 January		1.043.250	151.782
Effect of exchange rate fluctuations on cash held.....	(	5.107)	6.578
Cash and cash equivalents at 31 March		1.793.234	266.267
Investing and financing activities not affecting cash flows			
Share capital increase		0	1.900.196
Share capital subscribed		0	(1.900.196)

Notes on pages 9 to 11 are an integral part of these financial statements

Notes to the Condensed Interim 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 interim financial statements of the Company are part of the consolidated interim financial statements of the Ultimate Parent company Magma Energy Corp., Canada.

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

2. Statement of compliance

The Company's interim financial statements are prepared in accordance with *IAS 34, Interim Financial Reporting*. They do not include all of the information required for full annual financial statements and should be read in conjunction with the financial statements of the Company as at and for the year ended 31 December 2010.

These condensed interim financial statements were approved by the Board of Directors on 12 May 2011.

3. Significant accounting policies

The accounting policies applied by the Company in these condensed interim financial statements are the same as those applied by the Company in its financial statements as at and for the year ended 31 December 2010.

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

- a part of operating assets are recognized at revalued cost, which was the fair value at the revaluation dates of 1.1.2008 and 31.12.2009
- 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
- financial assets available for sale are measured at fair value.

4. Use of estimates and judgments

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

In preparing these condensed interim financial statements, the significant judgements made by management in applying the Company's accounting policies and the key source of estimation uncertainty were the same as those that applied to the financial statements as at and for the year ended 31 December 2010.

Notes, continued

5. Segment reporting

The segment reporting comprise the industries, which form the basis for managerial decision taking.

1 January - 31 March 2011	Power production	Electricity sale	Other	Total
External revenue	1.086.529	595.444	270.980	1.952.953
Inter-segment revenue	246.938			246.938
Total segment revenue	1.333.467	595.444	270.980	2.199.891
Segment operating results	566.004	(75.818)	15.800	505.986
Unallocated items				
Net finance income				2.283.444
Share of loss of associates			(683)	
Income tax expense			(557.749)	
Profit for the period				2.230.998
Segment assets	29.678.471	54.214	598.210	30.330.895
Unallocated assets				13.630.907
Total assets				43.961.802
Unallocated liabilities				24.416.447
Capital expenditures	77.390	326	1.632	79.348
Depreciation and amortization	246.354	1.574	10.087	258.015
1 January - 31 March 2010				
External revenue	1.057.478	533.902	220.900	1.812.280
Inter-segment revenue	211.315			211.315
Total segment revenue	1.268.793	533.902	220.900	2.023.595
Segment operating results	542.271	(55.334)	11.678	498.615
Unallocated items				
Net finance income				1.023.983
Share of loss of associates			(58.544)	
Income tax expense			(274.068)	
Profit for the period				1.189.986
Segment assets	28.383.197	53.236	667.782	29.104.215
Unallocated assets				15.634.668
Total assets				44.738.883
Unallocated liabilities				27.215.280
Capital expenditures	657.935	7.748	102	665.785
Depreciation and amortization	216.797	1.620	10.220	228.637

Notes, continued

5. Segment reporting, contd.:

Major customers

Revenues from one customer of the Company's Production segment represents approximately ISK 821 million of the Company's total revenues during the period (Q1 2010: ISK 807 million).

Revenues from HS Veitur hf. represents ISK 462 million during the period (Q1 2010: ISK 437 million) and relates to segments as follows:

	Power production	Electricity sale	Other	Total
Revenues Q1 2011	188.415	59.411	214.207	462.033
Revenues Q1 2010	179.471	44.607	212.949	437.027

6. Other operating expenses

Operating expenses specifies as follows:

	2011	2010
Salaries and related expenses	37.960	29.597
Increase in pension fund commitment	36.381	8.623
Administrative expenses	86.302	12.276
Depreciation and amortization	4.237	5.220
Total operating expenses	164.880	55.716

Majority of the increase in administrative expenses are related to the arbitration case with Norðurál.

7. Net finance income

Net finance income specifies as follows:

	2011	2010
Interest income on loans and receivables	13.040	0
Interest income on available for sale securities	3.428	65.385
Net foreign exchange difference	0	18.495
Fair value changes on financial assets through profit and loss	10.895	0
Total finance income	27.363	83.880
Interest expenses	(152.661)	(187.150)
Indexation	(21.860)	(46.738)
Fair value changes on financial assets through profit and loss	0	(82.968)
Net foreign exchange difference	(295.401)	0
Total finance costs	(469.922)	(316.856)
Changes in fair value of derivatives	118.259	46.362
Changes in fair value of embedded derivative in electric power sale contracts	2.607.744	1.210.597
Net finance income	2.283.444	1.023.983

8. Share in Bláa Lónið hf. ("Blue Lagoon")

The calculations of the Company's share in the equity and comprehensive income of the Blue Lagoon are based on draft financial informations for the year ended 2010 as other financial informations are not available. During the period the Board of directors of the Blue Lagoon confirmed a demerger of the Company into four companies Bláa Lónið ehf., Blue Lagoon International ehf., Hótel Bláa Lónið ehf. and Hreyfing Eignarhaldsfélag ehf. HS Orka hf. holds a 24.36% share in each company.

9. Restricted cash

According to collateral agreement concluded in March 2010 with the Company's lenders to secure loan repayments, cash in foreign currency up to ISK 512 million (USD 4.5 million) is dedicated for repayment of loans.

10. Loans and borrowings

At the end of February 2011 the Company made an agreement with one of its lender for temporary waiver of covenants where the lender waives its original covenants for the the year 2011 in exchange for relaxed covenants. At the end of the period the company complies with all effective covenants in its loan agreements.