

Hitaveita Suðurnesja hf.

**Condensed Interim
Financial Statements
1 January - 30 June 2007
ISK**

Hitaveita Suðurnesja hf.
Brekkestíg 36
260 Reykjanesbær
Iceland
Reg. no. 680475-0169

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Endorsement by the Board of Directors and the Management

The Condensed Interim Financial Statements of Hitaveita Suðurnesja hf. (Suðurnes Regional Heating hf.) for the period from 1 January to 30 June 2007 have been prepared in accordance with International Financial Reporting Standards for interim accounts, IAS 34. These are the Company's first IFRS Condensed Interim Accounts. The Company's financial statements for the previous years have been prepared in accordance with the Financial Statement Act and accounting principles in Iceland. The total effect of IFRS adoption on the Company's financial statements is that equity at the beginning of the year 2007 increases by ISK 2,192 million, from ISK 15,695 million to ISK 17,887 million. The total effect of IFRS adoption on the Company's net income in year 2006, which amounted to ISK 2,344 million, according to Icelandic accounting rules, is that the net income is increasing to ISK 3,571 million. Further explanation regarding the impact of transition to IFRSs is provided in note 19.

According to the Income Statement, the Company's operational revenues amounted to ISK 3,412 million and net profit amounted to ISK 2,720 million. According to the Balance Sheet, Company's assets amounted to ISK 35,867 million. Stockholders' equity at end of June 2007 amounted to ISK 20,207 million or 56% of the total capital. This ratio was 54% in the beginning of the year.

On August 3, 2007, the Company sold a power distribution structure to Landsnet hf. for the amount of ISK 1,460 million. Gain on the sale amounted to ISK 505 million.

The Board of Directors and the Management of Hitaveita Suðurnesja hf. hereby confirm the Company's Interim Financial Statements for the period from 1 January to 30 June 2007 with their signatures.

Njarðvík, 31 August 2007.

Board of directors:

Árni Sigfússon

Ásgeir Margeirsson

Björk Guðjónsdóttir

Guðbrandur Einarsson

Gunnar Svavarsson

Jón Sigurðsson

Jóna Lárusdóttir

Managing Director:

Júlíus Jónsson

Assistant Managing Director:

Albert Albertsson

Auditors' Review Report

To the Board of Directors of Hitaveita Suðurnesja hf.

Introduction

We have reviewed the accompanying balance sheet of Hitaveita Suðurnesja hf. as of 30 June 2007 and the related statements of income, changes in equity and cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting standard IAS 34. 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.

Our review also addressed those changes made to the Company's balance sheet in relation to the implementation of IFRS. As presented in the interim financial statements, amounts might change, among other things due to the fact that the financial reporting also takes note of the standards as they will be presented at the end of the year and changes thereto might therefore incur some effects.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the entity as at 30 June 2007 and of its financial performance and its cash flows for the six month period then ended in accordance with International Financial Reporting standard IAS 34, Interim Financial Statements.

Njarðvík, 31 August 2007.

KPMG hf.

Sæmundur Valdimarsson

Kristrún H. Ingólfssdóttir

Income Statement for the Six Months Ended 30 June 2007

	Notes	2007 1.1.-30.6.	2006 1.1.-30.6.
Operating revenue	5	3,411,841	2,669,994
Production cost and cost of sales		(2,106,276)	(1,423,195)
Gross profit		1,305,565	1,246,799
Other income	5,6	636,029	12,436
Operating expenses		(257,256)	(214,586)
Results from operating activities		1,684,338	1,044,649
Finance income		1,794,629	1,967,899
Finance expenses		(213,193)	(1,534,408)
Net finance costs	8	1,581,436	433,491
Share of profit of associates		10,979	(102,123)
Profit before income tax		3,276,753	1,376,017
Income tax asset at the beginning of taxation		0	1,243,991
Income tax for the period	9	(557,023)	(251,992)
Profit for the period		<u>2,719,730</u>	<u>2,368,016</u>
Earnings per share			
Basic and diluted earnings per share		0.36	0.32

Notes on pages 9 to 26 are an integral part of these financial statements

Balance Sheet as at 30 June 2007

	Notes	30.6.2007	31.12.2006
Assets			
Operating assets	10	26,776,556	25,556,400
Operating assets under construction	10	2,666,731	854,603
Intangible assets	11	933,821	920,616
Investments in associates	12	558,776	379,166
Investments in other companies		69,235	26,098
Deferred tax asset		189,473	748,906
Total non-current assets		31,194,592	28,485,789
Inventories		401,549	397,685
Accounts receivable		750,705	994,203
Other receivables		343,084	127,331
Derivatives	15	2,980,777	2,830,888
Cash and cash equivalents		196,537	55,956
Total current assets		4,672,652	4,406,063
Total assets		35,867,244	32,891,852
Equity			
Share capital		7,454,816	7,454,816
Statutory reserve		1,863,704	1,863,704
Retained earnings		10,888,533	8,568,803
Total equity		20,207,053	17,887,323
Liabilities			
Loans and borrowings	13	11,057,110	12,105,699
Pension fund commitment	14	1,029,139	1,016,017
Total non-current liabilities		12,086,249	13,121,716
Loans and borrowings	13	1,053,270	459,166
Trade payables		1,913,731	808,284
Other payables		606,941	615,363
Total current liabilities		3,573,942	1,882,813
Total liabilities		15,660,191	15,004,529
Total equity and liabilities		35,867,244	32,891,852

Notes on pages 9 to 26 are an integral part of these financial statements

Statement of Changes in Equity

for the Six Months Ended 30 June 2007

	Share capital	Legal reserve	Retained earnings	Total
1 January to 30 June 2006				
Equity at 31 December 2005	7,454,816	1,749,844	4,566,591	13,771,251
IFRS adoption			965,012	965,012
Equity at 1 January 2006, restated	7,454,816	1,749,844	5,531,603	14,736,263
Profit for the period			2,368,016	2,368,016
Dividends			(420,000)	(420,000)
Equity at 30 June 2006	7,454,816	1,749,844	7,479,619	16,684,279
1 January to 30 June 2007				
Equity at 31 December 2006	7,454,816	1,863,704	6,376,498	15,695,018
IFRS adoption			2,192,305	2,192,305
Equity at 1 January 2007, restated	7,454,816	1,863,704	8,568,803	17,887,323
Profit for the period			2,719,730	2,719,730
Dividends			(400,000)	(400,000)
Equity at 30 June 2007	7,454,816	1,863,704	10,888,533	20,207,053

Notes on pages 9 to 26 are an integral part of these financial statements

Statement of Cash Flows

for the Six Months Ended 30 June 2007

	2007 1.1.-30.6	2006 1.1.-30.6
Cash flows from operating activities		
Profit for the period	2,719,730	2,368,016
Items not affecting working capital:		
Loss (gain) on sale of assets	0	(12,436)
Increase in pension fund obligation	13,122	0
Depreciation	626,486	395,474
Share of profit of associates	(10,979)	102,123
Net finance costs	(1,581,436)	(433,491)
Income tax	557,023	(991,999)
Inventories, increase	(3,864)	(68,560)
Receivables, decrease	27,745	295,461
Current liabilities, decrease	(428,809)	(244,952)
Net cash from operations before interest and taxes	1,919,018	1,409,636
Interest income received	9,071	19,774
Interest expenses paid	(233,466)	(349,180)
Net cash from operating activities	1,694,623	1,080,230
Cash flows from investing activities		
Acquisition of operating assets	(1,837,018)	(3,446,031)
Acquisition of operating assets under construction	(653,071)	(138,018)
Acquisition of intangible assets	(22,830)	(355,489)
Proceeds from sale of operating assets	0	41,440
Acquisition of shares in associates	(166,222)	0
Acquisition of shares in other companies	(43,137)	(96,555)
Net cash used in investing activities	(2,722,278)	(3,994,653)
Cash flows from financing activities		
Proceeds from new borrowings	673,890	2,996,451
Repayment of borrowings	(250,923)	(229,187)
Short-term loans, increase	745,269	0
Net cash provided by financing activities	1,168,236	2,767,264
Increase (decrease) in cash and cash equivalents	140,581	(147,159)
Cash and cash equivalents at 1 January	55,956	476,006
Cash and cash equivalents at 30 June.....	196,537	328,847
Investing and financing activities not affecting cash flow:		
Dividends to shareholders	(400,000)	(420,000)
Acquisition in operating assets under constructions	(1,159,057)	0
Current liabilities	1,559,057	420,000

Notes on pages 9 to 26 are an integral part of these financial statements

Notes to the Interim Financial Statements

1. Reporting entity

Hitaveita Suðurnesja hf. (the "Company") is a Company domiciled in Iceland. The address of the Company is Brekkustígur 36, Reykjanesbær. The Company handles production and sale of hot water and electric power supply to consumers, freshwater retention for the habitants of Sudurnes and the Westman Islands, in addition to selling geothermal steam to industries.

The condensed interim financial statements were approved by the Board of Directors on 31 August 2007.

2. Basis of preparation

a. Statement of compliance

The condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) for interim financial statements, IAS 34. These are the Company's first IFRS condensed interim financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1, *First-time adoption of International Financial Reporting Standards* has been applied. The condensed interim financial statements do not include all of the information required for full annual financial statements.

An explanation of how the transition to IFRSs has affected the reported financial position and financial performance of the Company is provided in note 19. This note includes reconciliations of income statements, balance sheet and equity for comparative periods reported under Iceland's GAAP (previous GAAP) to those reported for those periods under IFRSs.

b. Basis of measurement

The financial statements have been prepared on the historical cost basis except for derivative financial instruments and investments in other companies that are measured at fair value.

c. Functional and presentational currency

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

d. Use of estimates and judgements

The preparation of interim financial statements in accordance with International Financial Reporting Standards requires management to make judgments, 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.

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

- Note 14 - pension fund commitment
- Note 15 - derivatives

3. **Significant accounting policies**

The accounting policies set out below have been applied consistently to all periods presented in these interim financial statements. They also have been applied in preparing an opening IFRS balance sheet at 1 January 2006 for the purposes of the transition to IFRSs.

a. ***Basis of consolidation***

Associates

Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies. Associates are accounted for using the equity method. The interim financial statements include the Company's share of the income and expenses of associates from the date that significant influence commences until the date that significant influence ceases. When the Company's share of losses exceeds its interest in an associate, the carrying amount of that interest (including any long-term investments) is reduced to nil 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 associate.

b. ***Foreign currency***

Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency at exchange rate 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. 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 recognised in profit or loss.

c. ***Financial instruments***

Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Company commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Company's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and expense is discussed in note 3(m).

Investments at fair value through profit or loss

An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments 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. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Notes, cont.

3. Significant accounting policies, cont.

c. *Financial instruments, cont.*

Other

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments

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.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognised in profit and loss.

Economic hedges

The Company uses derivatives to lower its interest risk. Hedge accounting is not applied. Changes in the fair value of such derivatives are recognised in profit or loss.

Separable embedded derivatives

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

(iii) Share capital

Ordinary shares

Incremental costs directly attributable to issue of ordinary shares are recognised as a deduction from equity.

Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity.

d. *Operating assets*

(i) Recognition and measurement

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

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets include the cost of materials, direct labor and any other costs directly attributable to bring the asset to a working condition for its intended use. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Notes, cont.

3. Significant accounting policies, cont.

d. Operating assets, cont.

(ii) Subsequent costs

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

(iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

Power plants	10-50 years
Electrical systems	5-30 years
Hot water and cold water distribution systems	7-20 years
Other operating assets	5-50 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

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 acquire further scientific and technical knowledge, is recognised 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 capitalised only if future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the power plant. The expenditure capitalised includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in profit or loss when incurred.

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

Capitalised development expenditure is measured at cost less accumulated amortisation 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 amortisation and accumulated impairment losses. Water rights are capitalised in the balance sheet at cost as intangible assets with infinite useful lives when purchase of the rights is distinguishable from purchase of land.

(iii) Subsequent expenditure

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

Notes, cont.

3. Significant accounting policies, cont.

e. Intangible assets, cont.

(iv) Amortisation

Amortisation is recognised 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 are as follows:

Software 5-10 years

f. Leased assets

Leases are operating leases and the leased assets are not recognised on the balance sheet.

g. Inventories

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and selling expenses. 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.

h. Impairment

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.

Impairment is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment is recognised 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.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. 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 amortisation, if no impairment loss had been recognised.

i. Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss as incurred.

(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, and the fair value of any plan assets is deducted. Interests in excess of price level increase are rated at 3.5% and salary increase in excess of price level increase is rated at 1.5% per year, in general. The calculation is performed by qualified actuaries using a method based on earned benefits. Changes in pension fund commitment are recognised as incurred in profit or loss.

Notes, cont.

3. Significant accounting policies, cont.

j. Provisions

A provision is recognised 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.

k. Revenue

Revenue on sale of electric power and water along with power transportation and distribution are recognised in profit or loss based on recorded measurement of delivery during the period. Other revenues are recognised when the goods or services are delivered.

l. Lease payments

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

m. Finance income and expenses

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

Finance expenses comprise interest expense on borrowings, unwinding of the discount on provisions, foreign currency losses, impairment losses recognised on financial assets, and losses on derivatives that are recognised in profit or loss. All borrowing costs are recognised in profit or loss using the effective interest method.

n. Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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 recognised 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 the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. 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 realised.

Tax asset at the beginning of taxation of the Company is at the same time recognised in profit or loss as income for that period.

Notes, cont.

3. Significant accounting policies, cont.

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. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which possible could be issued.

p. *Segment reporting*

A segment is a distinguishable component of the Company that is engaged either in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Company's format for segment reporting is based on business segments.

q. *New standards and interpretations not yet adopted*

IFRS 7 *Financial Instruments Disclosures* requires extensive disclosures about the significance of financial instruments and on the nature and extent of risks. IFRS 7 become mandatory from 1 January 2007.

IFRS 8 *Operating Segments* describes how an entity should disclose information regarding its operating segments, the products it sells and services it provides as well as information regarding the geographical segments in which it operates and its primary customers. IFRS 8 becomes mandatory from 1 January 2009.

IFRIC 11 *IFRS 2 Group and Treasury Share Transactions* describes how an entity is to recognise in its financial statements and those of its subsidiaries specific types of cash-settled share-based contracts. IFRIC 11 becomes mandatory from 1 March 2007 and will not affect the Company's financial statements.

IFRIC 12 - *Service Concession Arrangement* provides guidance regarding recognition and measurement issues that arises in accounting for public-to-private service concession arrangements. IFRIC 12 becomes mandatory for financial periods beginning 1 January 2008 or later.

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. Where 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 recognised as a result of a business combination is based on market values. The market value of property is the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of items of other operating assets is based on the quoted market prices for similar items.

b. *Intangible assets*

The fair value of intangible assets is based on the discounted cash flows expected to be derived from the use of the assets.

Notes, continued

4. **Determination of fair values, cont.**

c. *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.

d. *Accounts receivable and other receivables*

The fair value of accounts and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

e. *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. Periodically, the Company calibrates the valuation technique and tests it for validity using prices for many observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

f. *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. **Segment reporting**

Segment information is presented in respect of the Company's business segments based on its management and internal reporting structure. The Company does not present geographical segments as its' operation is only in Iceland.

Inter-segment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly of income generating assets, loans and borrowings and related expenses and deferred tax asset.

Notes, cont.

5. Segment reporting, cont.

Business segments

	Production	Electricity sale	Electricity distribution	Hot water - sale and distribution	Cold water - sale and distribution	Rent and service	Elimi- nations	Total
1 January to 30 June 2007								
External revenue	1,036,367	761,730	772,179	1,193,301	137,525	146,768	0	4,047,870
Inter-segment revenue	566,265	0	0	0	0	0	(566,265)	0
Segment revenue	1,602,632	761,730	772,179	1,193,301	137,525	146,768	(566,265)	4,047,870
Segment result, EBIT	683,222	(20,239)	180,424	690,800	45,495	104,636	0	1,684,338
1 January to 30 June 2006								
External revenue	273,651	735,851	763,447	722,383	114,523	72,575	0	2,682,430
Inter-segment revenue	727,116	0	0	0	0	0	(727,116)	0
Segment revenue	1,000,767	735,851	763,447	722,383	114,523	72,575	(727,116)	2,682,430
Segment result, EBIT	575,097	18,889	239,802	128,091	42,715	40,055	0	1,044,649

Included in hot water sale and distribution revenue for the six months period ended 30 June 2007 is a lump-sum payment to the amount of ISK 636 million from the United States Government due to the termination of an agreement on purchase of hot water supply for the defence force at Keflavik airport.

Notes, cont.

6. Other income

<i>Other income consists of:</i>	2007	2006
	1.1.-30.6.	1.1.-30.6.
Lump-sum payment from the US Government	636,029	0
Gain on sale of fixed assets	0	12,436
Total other income	<u>636,029</u>	<u>12,436</u>

In June 2007, the Company received a lump-sum payment to the amount of USD 10 million from the United States Government due to the termination of an agreement on purchase of hot water supply for the defence force at Keflavik airport, as the military base was closed down in October 2006.

7. Depreciation and amortisation

Depreciation and amortisation is specified as follows:

Depreciation of operating assets, see note 10	616,861	385,518
Amortisation of intangible assets, see note 11	9,625	9,956
Depreciation and amortisation recognised in the income statement	<u>626,486</u>	<u>395,474</u>

Depreciation and amortisation is allocated as follows to operating items:

Production cost and cost of sales	604,045	370,982
Operating expenses	22,441	24,492
Depreciation and amortisation recognised in the income statement	<u>626,486</u>	<u>395,474</u>

8. Finance income and expenses

Finance income and expenses specifies as follows:

Interest income	9,071	19,774
Net foreign exchange gain	1,635,669	0
Fair value changes in embedded derivatives in electric power sales agreements	149,889	1,948,125
Total finance income	<u>1,794,629</u>	<u>1,967,899</u>
Interest expenses	226,876	363,283
Net foreign exchange loss	0	1,574,405
Capitalised financial expenses	(13,683)	(403,280)
Total finance expenses	<u>213,193</u>	<u>1,534,408</u>
Net finance costs	<u>1,581,436</u>	<u>433,491</u>

Net finance costs due to constructing power plants amounted to ISK 14 million are capitalised and have been reduced from finance income and expenses.

Notes, continued

9. Income tax expense

Effective tax rate is specified as follows:

	2007		2006	
	1.1.-30.6.		1.1.-30.6.	
Profit before tax		<u>3,276,753</u>		<u>1,376,017</u>
Income tax according to current tax rate	18.0%	(589,816)	18.0%	(247,683)
Non-taxable water supply operation	(0.9%)	30,817	(1.0%)	14,073
Share of profit of associates	(0.1%)	<u>1,976</u>	1.3%	(18,382)
Effective income tax	<u>17.0%</u>	<u>(557,023)</u>	<u>18.3%</u>	<u>(251,992)</u>

10. Operating assets

Operating assets consist of:

	Power plants	Electrical systems	Hot and cold water distribution systems	Other operating assets	Total
Cost at 1.1.2007	19,009,327	6,588,393	2,776,576	1,040,551	29,414,847
Depreciation 1.1.2007	(1,974,017)	(1,000,094)	(634,654)	(249,683)	(3,858,448)
Carrying amounts at 1.1.2007	<u>17,035,310</u>	<u>5,588,299</u>	<u>2,141,922</u>	<u>790,868</u>	<u>25,556,400</u>
Additions	1,238,282	331,955	246,726	20,055	1,837,018
Transferred from electrical system to power plants	195,938	(195,938)	0	0	0
Depreciation for the period	(393,939)	(124,608)	(75,694)	(22,620)	(616,861)
Carrying amount at 30.6.2007	<u>18,075,591</u>	<u>5,599,708</u>	<u>2,312,954</u>	<u>788,303</u>	<u>26,776,556</u>
Cost at 30.6.2007	20,443,547	6,724,410	3,023,302	1,060,606	31,251,865
Depreciation at 30.6.2007	(2,367,956)	(1,124,702)	(710,348)	(272,303)	(4,475,309)
Carrying amounts at 30.6.2007	<u>18,075,591</u>	<u>5,599,708</u>	<u>2,312,954</u>	<u>788,303</u>	<u>26,776,556</u>

Operating assets under constructions consist of:

	Power plant 6 Svartsengi
Cost at 1.1.2007	854,603
Additions	<u>1,812,128</u>
Cost at 30.6.2007	<u>2,666,731</u>

Provisions

The Company has concluded agreements on purchase of services and material due to the construction of a power plant to the amount of ISK 1,050 million, payable in following months.

Notes, continued

11. Intangible assets

<i>Intangible assets are as follows:</i>	Software	Development	Total
Cost at 1 January 2007	224,392	817,064	1,041,456
Amortisation at 1 January 2007	(120,840)	0	(120,840)
Carrying amounts at 1 January 2007	103,552	817,064	920,616
Additions	74	22,756	22,830
Amortisation for the period	(9,625)	0	(9,625)
Carrying amounts at 30 June 2007	94,001	839,820	933,821
Cost at 1 January 2007	224,466	839,820	1,064,286
Amortisation at 30 June 2007	(130,465)	0	(130,465)
Carrying amounts at 30 June 2007	94,001	839,820	933,821

12. Associates

<i>Associates are as follows:</i>	Share	Carrying amount at 30.6.2007	Share	Carrying amount at 31.12.2006
Bláa lónið hf.	33.8%	558,776	33.8%	379,166
DMM lausnir ehf.	27.5%	0	30.4%	0
Total shares in associates		558,776		379,166

13. Loans and borrowings

<i>Loans and borrowings are as:</i>	Weighted average interest rate	Carrying amount at 30/06/2007	Weighted average interest rate	Carrying amount at 31/12/2006
Debt in foreign currency:				
Loans in CHF	2.2%	3,512,110	1.6%	3,782,420
Loans in EUR	4.1%	2,949,717	3.7%	3,345,505
Loans in USD	5.3%	2,130,108	5.4%	2,484,959
Loans in JPY	0.6%	1,050,771	0.4%	1,286,251
Loans in GBP	5.2%	629,248	4.9%	724,328
Loans in SEK	4.3%	555,202	3.0%	638,584
Loans in CAD	4.5%	343,462	-	0
		11,170,618		12,262,047
Loans in ISK:				
Indexed loans in ISK	7.5%	10,000	8.2%	200,995
Unindexed loans in ISK	13.3%	929,762	8.0%	101,823
		939,762		302,818
Total interest-bearing liabilities including current maturities		12,110,380		12,564,865
Current maturities		(1,053,270)		(459,166)
Total interest-bearing liabilities		11,057,110		12,105,699

Notes, continued

13. Loans and borrowings, cont.

<i>Aggregate annual maturities of interest-bearing loans and borrowings are as follows:</i>	30/06/2007
Year 2007 / 2008	1,053,270
Year 2008 / 2009	358,501
Year 2009 / 2010	889,322
Year 2010 / 2011	930,059
Year 2011 / 2012	1,015,072
Subsequent	7,864,156
Total interest-bearing liabilities, including current maturities	<u>12,110,380</u>

Loan commitments

The Company has made a loan agreement with the Council of Europe Development Bank, CEB, to finance the construction of new power plant in Svartsengi. The loan agreement amounted to EUR 20 million. The Company has already drawn EUR 17.5 million of the agreement and it is included in non-current liabilities in the Balance Sheet.

14. Pension fund commitment

According to actuary calculation the Company's pension fund obligation amounted to ISK 1,015 million at end of year 2006, discounted by using 2% discount rate and taken into account net assets of the pension funds. Estimated increase of the obligation for the first six months of the year 2007 is based on general increase of salaries during the period.

Movement in the pension fund commitments:

Pension fund commitment at 1 January 2007	1,016,017
Payment of pension obligation during the period	(29,738)
Increase of pension fund obligation during the period	42,860
Pension fund commitment at 30 June 2007	<u>1,029,139</u>

Pension fund commitments are as follows:

The pension fund for state employees	437,056
The pension fund for Hafnafjarðarkaupstaður employees	358,183
The pension fund for Westman Islands employees	233,900
Pension fund commitment at 30 June 2007	<u>1,029,139</u>

15. Embedded derivatives in electric power sales agreements

The Company has concluded electric power sales agreements with Nordural 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 concluded in USD and are partly related to the price of aluminium.

Following the introduction of the International Financial Reporting Standards (IFRS) the company must demonstrate the effect of embedded derivatives in concluded electric power sales agreements. According to the IFRS, embedded derivatives are deemed as derivative agreements, which are a part of other agreements, but are treated as separate derivative agreements when economic characteristics and risks are not incident with the original agreement. The company has specified that part of the electric power sales agreements related to the price of aluminium as embedded derivative. Therefore the fair value of embedded derivatives in the company's electric power sales agreements changes parallel to changes in aluminium prices. Changes in the fair value of the agreements are recognised in profit or loss. Fair value changes of embedded derivatives have no effects on the company's cash flows as the duration of the agreements is up to 19 years.

Notes, continued

15. Embedded derivatives in electric power sales agreements, cont.

In evaluating the value of embedded derivatives generally accepted evaluation procedures 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 flow on the reporting date is calculated on the basis of registered forward price of aluminium with the LME (London Metal Exchange) at the reporting date and expectations of price trends of aluminium for the next 30 years according to CRU's evaluation as presented on the reporting date. The expected present value of cash flows, from the agreements, on the reporting 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 recognised in profit and loss. Embedded derivatives in electric power sales agreements are expected to have no value at the beginning of the agreements.

Fair value of embedded derivatives are as follows:

	31/12/2006
Fair value of embedded derivatives at 1 January 2006	1,008,300
Changes in fair value	1,948,125
Fair value of embedded derivatives at 30 June 2006	<u>2,956,425</u>
Fair value of embedded derivatives at 1 January 2007	2,830,888
Changes in fair value	149,889
Fair value of embedded derivatives at 30 June 2007	<u>2,980,777</u>

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.

16. Credit risk

Interest rate risk

The Company has made an interest rate swap with the purpose of reducing its interest rate expenses. Interest rate swaps have decreased risk and interest expenses of the Company. Interest rate swaps are used to convert a loan denominated in ISK to loans denominated in foreign currencies with lower nominal interest rates. Notional amounts in the interest rate swaps contract amount to ISK 2,824 million.

17. Events after balance sheet date

On 3 August 2007, the Company sold a power distribution structure to Landsnet hf. to the amount of ISK 1,460 million. Gain on the sale amounted to ISK 505 million.

The Company has concluded electric power sales agreements with Nordural on power supply due to a proposed power plant in Helguvik. The power supply is estimated to begin in year 2010. The agreement includes provisions stating that the Company is not liable to supply the power unless all specific requirements relating to the results of power stations, licensing and construction of the power plant are fulfilled. Due to the provisions, effects of the agreement are not entered in the interim financial statements.

18. Related parties

Identity of related parties

The Company has a related party relationship with its associates, its directors and executive officers.

Transactions with associates

The Company purchased services from its' associates for the amount of ISK 11 million during the period.

Notes, cont.

19. Transition to IFRSs

Changes to accounting policies in accordance with International Financial Reporting Standards (IFRSs)

As stated in note 2(a) on accounting policies, these are the Company's first condensed interim financial statement prepared in accordance to IFRS.

The accounting policies in note 2 have been applied in preparing the condensed interim financial statements of the six months ended 30 June 2007, the comparative information for the six months ended 30 June 2006, the financial statements for the year ended 31 December 2006 and the preparation of an opening IFRS balance sheet at 1 January 2006 (the Company's date of transition).

Amounts in the opening Balance Sheet of 1 January 2006 have been changed in accordance with IFRS, but were previously presented in accordance with Icelandic generally accepted accounting principles "Icelandic GAAP". An explanation of how the transition from Icelandic GAAP to IFRSs has affected the Company's financial position and financial performance is set out in following tables and notes that accompany the tables. No significant changes are made on the Company's cash flows from Icelandic GAAP to IFRS.

Changes in equity from Icelandic GAAP to IFRS:

	Equity
Equity according to Icelandic GAAP at 31 December 2006	15,695,018
Equity according to IFRS at 1 January 2007	<u>17,887,323</u>
Changes from Icelandic accounting policies to IFRS	<u>2,192,305</u>

Changes at the beginning of year 2006:

Fair value of derivatives	IAS 39	1,008,300
Intangible assets	IAS 38 (29,889)
Investments in associates	IAS 28 (13,399)
Total changes due to IFRS at 1 January 2006		<u>965,012</u>

Changes in profit for the year 2006:

Fair value of derivatives	IAS 39	1,822,588
Amortisation og intangible assets	IAS 38	4,666
Dividends from associates	IAS 28 (21,476)
Share of profit of associates	IAS 28 (92,533)
Tax asset at the beginning of taxation, effects due to changes at 1 January 2006	IAS 12 (173,702)
Income tax effects	IAS 12 (312,250)
Total changes due to IFRS for the year 2006		<u>1,227,293</u>

Changes from Icelandic GAAP to IFRS 2,192,305

Total effects of the transition to IFRSs in an increase in equity amounting to ISK 2,192 million. Following is an explanation of the effect of transition on the income statement and balance sheet.

Derivatives

In accordance to IAS 39, the Company has recorded embedded derivatives in electric power sales agreements at fair value which lead to an increase in equity by ISK 2,831 million.

Associates

Shares in associates are recognised according to the equity method but were previously measured at cost. This change decreases equity at year end 2006 by ISK 127 million.

Notes, cont.

19. Transition to IFRSs, cont.

Intangible assets

Development cost is capitalised in accordance with IAS 38. Research expenditure is expensed in profit or loss as incurred. The changes made results in a reduction of equity in the amount of ISK 25 million.

Intangible assets

Capitalised development cost was reclassified in accordance with IAS 38. The effect of this change is that operating assets decrease by ISK 920 million and intangible assets increase by ISK 920 million.

Income tax

Total income tax effect is that equity decreases by ISK 486 million at the end of year 2006.

Changes from previous GAAP to IFRS

The accompanying tables show an overview of the transition to IFRS and is divided into changes in estimates and changes in presentation.

Income statement 1 January – 30 June 2006, changes from previous GAAP to IFRS

Icelandic GAAP	Change in estimates	Changes in presentation	IFRS	
Electricity sale	1,692,710	977,284	2,669,994	Operating revenue
Hot water sale	688,752	(688,752)	0	
Cold water sale	103,876	(103,876)	0	
		(1,423,195)	(1,423,195)	Production cost
Other income	184,656	(172,220)	12,436	Other income
Power generation	(171,287)	171,287	0	
Operation of electrical systems	(118,533)	118,533	0	
Electricity purchases and distribution ...	(669,274)	669,274	0	
Operation of hot water distribution	(69,370)	69,370	0	
Operation of cold water distribution	(23,749)	23,749	0	
General and administrative	(177,658)	(36,928)	(214,586)	Operating expenses
Depreciation and amortization	(397,239)	1,765	395,474	0
		1,926,649	41,250	1,967,899
Net financial expenses	(1,493,158)	(41,250)	(1,534,408)	Finance income
		(102,123)	(102,123)	Finance expenses
Tax asset at the beginning of taxation	1,417,693	(173,702)	1,243,991	Share of profit of associates
Income tax	98,988	(350,980)	(251,992)	Income tax asset at the beginning of taxation
Profit for the period	<u>1,066,407</u>	<u>1,301,609</u>	<u>0</u>	<u>2,368,016</u>
				Profit for the period

Notes, cont.

19. Transition to IFRSs, cont.

Income statement for the year 2006, changes from previous GAAP to IFRS

Previous GAAP		Changes in estimates	Changes in present- ation	IFRS	
Electricity sale	4,090,899		1,925,861	6,016,760	Operating revenue
Hot water sale	1,286,948		(1,286,948)	0	
Cold water sale	206,555		(206,555)	0	
			(3,299,830)	(3,299,830)	Production cost
Other income	447,006		(432,358)	14,648	Other income
Power generation	(592,473)		592,473	0	
Operation of electrical systems	(329,345)		329,345	0	
Electricity purchases and distribution ...	(1,176,708)		1,176,708	0	
Operation of hot water distribution	(200,659)		200,659	0	
Operation of cold water distribution	(58,826)		58,826	0	
General and administrative	(494,842)		(49,548)	(544,390)	Operating expenses
Depreciation and amortization	(996,033)	4,666	991,367	0	
Financial income	465,212	1,801,112		2,266,324	Finance income
Financial expenses	(1,538,825)			(1,538,825)	Finance expenses
		(92,533)		(92,533)	Share of profit of associates
Tax asset at the beginning of taxation	1,418,304	(173,702)		1,244,602	Income tax asset at the beginning of taxation
Income tax	(183,446)	(312,250)		(495,696)	Income tax for the year
Profit for the year	<u>2,343,767</u>	<u>1,227,293</u>	<u>0</u>	<u>3,571,060</u>	Profit for the year

Notes, cont.

19. Transition to IFRSs, cont.

Balance sheet 31 December 2006, changes from previous GAAP to IFRS

		Changes in estimates	Changes in present ation		IFRS 1 January 2007
Non-current assets					Assets
Fixed assets	25,659,952		(103,552)	25,556,400	Operating assets
Fixed assets under construction	1,671,667		(817,064)	854,603	Operating assets under construction
Intangible assets	25,223	(25,223)	920,616	920,616	Intangible assets
Investments in associates	506,574	(127,408)		379,166	Investments in associates
Investments in other companies	26,098			26,098	Investments in other companies
Tax asset	1,234,858	(485,952)		748,906	Deferred tax asset
Non-current assets	29,124,372	(638,583)	0	28,485,789	Total non-current assets
Current assets					
Inventories	397,685			397,685	Inventories
Accounts receivable	994,203			994,203	Accounts receivable
Other receivables	127,331			127,331	Other receivables
		2,830,888		2,830,888	Derivatives
Cash and cash equivalents	55,956			55,956	Cash and bank deposits
Total current assets	1,575,175	2,830,888	0	4,406,063	Total current assets
Total assets	30,699,547	2,192,305	0	32,891,852	Total assets
Equity and liabilities					
Equity					Equity
Share capital	7,454,816			7,454,816	Share capital
Statutory reserve	1,863,704			1,863,704	Statutory reserve
Retained earnings	6,376,498	2,192,305		8,568,803	Retained earnings
Total equity	15,695,018	2,192,305	0	17,887,323	Total equity
Liabilities					Liabilities
Interest-bearing loans and borrowings	12,105,699			12,105,699	Loans and borrowings
Pension fund commitment	1,016,017			1,016,017	Pension fund commitment
Long-term liabilities	13,121,716	0	0	13,121,716	Total non-current liabilities
Interest-bearing loans and borrowings	459,166			459,166	Loans and borrowings
Trade payables	808,284			808,284	Trade payables
Other payables	615,363			615,363	Other payables
Short-term liabilities	1,882,813	0	0	1,882,813	Total current liabilities
Total equity and liabilities	30,699,547	2,192,305	0	32,891,852	Total equity and liabilities