



**Condensed Consolidated Interim Financial Statements  
1 January to 30 June 2009**

Landsvirkjun  
Háaleitisbraut 68  
103 Reykjavík

Reg. no. 420269-1299

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# Endorsement by the Board of Directors and Managing Director

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Landsvirkjun's objective is to operate in the energy sector and to engage in other business and financial operations according to the decision of the Board of Directors at each time. The Company's condensed consolidated interim financial statements include, in addition to the parent company, five subsidiaries, Landsnet hf., Landsvirkjun Power ehf., Fjarski ehf., Hraunaveita ehf. and Icelandic Power Insurance Ltd. In addition, the parent company has two sub-subsidiaries, Íslensk jarðhitatækni ehf. and HydroKraft Invest hf. Amounts are presented in USD thousand unless otherwise stated.

According to the income statement the profit for the period January to June 2009 amounted to USD 47.3 million while the Group's profit during the same period in the year 2008 amounted to USD 83.4 million. The Group's operating revenues amounted to USD 139 million during the period compared to USD 239.6 million during the same period in the year 2008. It must be taken into consideration that included in financial income for the period is recognised USD 40.1 million realised profit on hedges related to aluminium price while recognised loss on comparable hedges amounted to USD 35.7 million during the same period in the previous year. The Group's equity at the end of June amounted to USD 1,421.5 million according to the balance sheet compared to USD 1,376.8 million at year end 2008.

At the end of June 2009, the Group's cash and cash equivalents amounted to a total of USD 129 million and Revolving Credit Facility amounted to USD 308 million or a total of USD 437 million. Taking cash flow from operation into account the Company believes that it has guaranteed sufficient liquidity through the year 2011.

## Statement by the Board of Directors and the Managing Director

According to the best knowledge of the Board of Directors and the Managing Director, the Group's 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 Managing Director that the interim financial statements give a fair view of the Company's assets, liabilities and financial position as at 30 June 2009, the Group's operating results and changes in cash flow during the period from 1 January to 30 June 2009.

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

The Board of Directors and the Managing Director hereby confirm these consolidated interim financial statements with their signature.

Fljótsdalur, 20 August 2009.

The Board of Directors:  
Bryndís Hlöðversdóttir  
Sigurbjörg Gísladóttir  
Ingimundur Sigurpálsson  
Páll Magnússon  
Stefán Arnórsson

The Managing Director:  
Friðrik Sophusson

# Independent Auditor's Review Report

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To the Board of Directors and owners of Landsvirkjun

We have reviewed the accompanying condensed interim financial statements of Landsvirkjun, which comprise the consolidated statement of financial position as at 30 June, 2009 and the consolidated income statement, statement of comprehensive income, statement of changes in equity and cash flow statement 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 Standards as adopted by the EU. 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 does not give a true and fair view of the financial position of the entity as at June 30, 2009, and of its financial performance and its cash flows for the six-month period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Fljótsdalur, 20 August 2009.

**KPMG hf.**

Reynir Stefán Gylfason

Árni Claessen

# Consolidated Income Statement

## 1 January to 30 June 2009

	Notes	2009 1.1.-30.6.	2008 1.1.-30.6.
<b>Operating revenues</b>			
Power sales .....		115,594	207,132
Transmission .....		21,257	30,671
Other income .....		2,158	1,820
		139,009	239,623
<b>Operating expenses</b>			
Energy production costs .....		54,431	59,653
Transmission costs .....		15,045	20,862
Cost of general research .....		4,495	2,554
Other operating expenses .....	7	15,679	18,514
		89,650	101,583
<b>Operating profit .....</b>		49,359	138,040
<b>Financial income and (financial expenses)</b>			
Interest income .....		3,139	9,287
Interest expenses .....	(	45,889)	( 91,350)
Net income (expenses) on financial assets and liabilities .....		55,350	79,467
Associated companies .....	(	427)	( 1,018)
	8	12,173	( 3,614)
<b>Profit before taxes .....</b>		61,532	134,426
Income tax .....	(	14,274)	( 50,977)
<b>Profit for the period .....</b>		47,258	83,449
<b>Profit attributable to:</b>			
Owners of the parent company .....		46,779	105,421
Non-controlling interest .....		479	( 21,972)
		47,258	83,449

# Consolidated Statement of Comprehensive Income

## 1 January to 30 June 2009

	2009 1.1.-30.6.	2008 1.1.-30.6.
<b>Profit for the period .....</b>	47,258	83,449
<b>Other comprehensive income</b>		
Translation differences due to functional currencies .....	( 2,596)	( 4,586)
Revaluation of fixed assets .....	0	102,182
Income tax on revaluation of fixed assets .....	0	( 15,327)
<b>Other comprehensive income for the period.....</b>	( 2,596)	82,269
 <b>Total comprehensive income for the period .....</b>	 44,662	 165,718
 <b>Total comprehensive income attributable to:</b>		
Owners of the parent company .....	45,222	161,254
Non-controlling interest .....	( 560)	4,464
	44,662	165,718

# Consolidated Statement of Financial Position

## 30 June 2009

<b>Assets</b>	Notes	30.6. 2009	31.12. 2008
<b>Non-current assets</b>			
Property, plant and equipment .....	9	3,745,821	3,789,129
Projects under construction .....		11,867	12,243
Intangible assets .....	10	142,760	138,077
Derivative financial instruments .....	12	294,308	287,513
Associated companies .....		12,766	13,342
Shares in other companies .....		364	127
Long-term notes receivable .....		152	246
Deferred tax asset .....		118,285	133,409
Total fixed assets		4,326,323	4,374,086
<b>Current assets</b>			
Inventories .....		4,099	4,269
Accounts receivables and other receivables .....		73,785	89,962
Assets available for sale .....		7,697	8,412
Derivative financial instruments .....	12	14,590	17,498
Cash and cash equivalents .....		128,844	124,993
Total current assets		229,015	245,134
<b>Total assets</b>		4,555,338	4,619,220
<b>Equity and liabilities</b>			
<b>Equity</b>			
Owners' contributions .....	14	586,512	586,512
Revaluation account .....	15	114,698	116,268
Translation difference .....	15	(35,227)	(33,670)
Other equity .....		734,734	686,384
Equity of the owners of the parent company		1,400,717	1,355,494
Minority interest .....		20,738	21,298
Total equity		1,421,455	1,376,792
<b>Long-term liabilities</b>			
Long-term debt .....	16	2,696,522	2,789,261
Accrued pension liabilities .....		21,836	22,118
Obligation due to demolition .....		3,846	3,936
Derivative financial instruments .....	12	101,919	123,971
		2,824,123	2,939,286
<b>Current liabilities</b>			
Accounts payable and other short-term liabilities .....		59,842	95,537
Current maturities of long-term debt .....	17	229,964	186,008
Derivative financial instruments .....	12	19,954	21,597
		309,760	303,142
Total liabilities		3,133,883	3,242,428
<b>Total equity and liabilities</b>		4,555,338	4,619,220

## Consolidated Statement of Changes in Equity

### 1 January to 30 June 2009

<b>1 January to 30 June 2008</b>	Owners' contribution	Revaluation account	Translation difference	Other equity	<b>Total</b>	Minority interest	<b>Total equity</b>
Equity at 1 January 2008 .....	586,512		(687)	985,861	1,571,686	28,459	1,600,145
Comprehensive income for the period ...		56,221	(388)	105,421	161,254	4,464	165,718
Dividends paid .....				(7,831)	(7,831)		(7,831)
Equity at 30 June 2008 .....	586,512	56,221	(1,075)	1,083,451	1,725,108	32,923	1,758,031
<b>1 January to 30 June 2009</b>							
Equity at 1 January 2008 .....	586,512	116,268	(33,670)	686,384	1,355,494	21,298	1,376,792
Comprehensive income for the period ...			(1,557)	46,779	45,222	(560)	44,662
Depreciation of revaluation transferred to equity, net of tax .....		(1,570)		1,570	0		0
Equity at 30 June 2009 .....	586,512	114,698	(35,227)	734,734	1,400,717	20,738	1,421,455

# Consolidated Statement of Cash Flows

## 1 January to 30 June 2009

	2009 1.1.-30.6.	2008 1.1.-30.6.
<b>Operating activities</b>		
Cash received from customers .....	165,753	220,018
Cash expenses .....	( 40,931)	( 59,418)
Cash flow from operation excluding interest .....	124,822	160,600
Interest income received .....	2,757	9,220
Interest expenses and foreign exchange difference paid .....	( 64,420)	( 61,616)
Hedge disbursements .....	40,485	( 31,848)
Cash flow from operating activities	103,644	76,356
<b>Investment activities</b>		
Kárahnjúkar project - hydropower station .....	( 12,300)	( 121,273)
Transmission .....	( 5,700)	( 8,137)
Development costs .....	( 11,468)	( 23,208)
Purchased shares .....	( 1,428)	( 11,067)
Sold shares .....	8	8,023
Other capital expenditure .....	( 4,337)	( 10,993)
Assets sold .....	49	55
Unpaid construction cost, change .....	( 12,040)	( 47,023)
	( 47,216)	( 213,623)
Other receivables, change .....	( 12,424)	0
Investment activities	( 59,640)	( 213,623)
<b>Financing activities</b>		
Cash dividends .....	0	( 7,831)
New loans .....	45,953	272,802
Currency swaps .....	4,818	63,963
Amortization of long-term debt .....	( 86,586)	( 231,863)
Financing activities	( 35,815)	97,071
<b>Increase (decrease) in cash and cash equivalents .....</b>	<b>8,189</b>	<b>( 40,196)</b>
<b>Effect of exch. diff. on cash and cash equivalents .....</b>	<b>( 4,338)</b>	<b>( 1,923)</b>
<b>Cash and cash equivalents at beginning of the year .....</b>	<b>124,993</b>	<b>179,578</b>
<b>Cash and cash equivalents at the end of the period .....</b>	<b>128,844</b>	<b>137,459</b>

# Notes

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## Reporting entity

### 1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and with its headquarters at Háaleitisbraut 68, Reykjavík. Landsvirkjun operates on the basis of the Act on Landsvirkjun no. 42/1983. The interim financial statements include the Company's condensed consolidated interim financial statements and its subsidiaries. The Company's main objective is to engage in operations in the energy sector.

### 2. Statement of compliance

These consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard (IFRS) 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 consolidated financial statements of the Group for the year ended 31 December 2008.

These consolidated interim financial statements were approved by the Board of Directors on 20 August 2009.

### 3. Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 31 December 2008, except for changes in accordance with the revised IAS 1 and introduction of IFRS 8. Previously, segment reporting was presented in accordance with IAS 14. The Company's financial statements can be found at its website [www.landsvirkjun.com](http://www.landsvirkjun.com) and at the website of the Icelandic Stock Exchange; [www.omxnordicexchange.com](http://www.omxnordicexchange.com).

The Group applies the revised IAS 1 *Presentation of Financial Statements (2007)*, which became effective as of 1 January 2009. As a result all non-owner changes in equity are presented in the consolidated statement of comprehensive income. This presentation has been applied in these condensed interim financial statements as of and for the six months period ended on 30 June 2009.

The interim financial statements are prepared in USD, which is Landsvirkjun's functional currency as of the beginning of the year 2008. Amounts are presented in USD thousand unless otherwise stated. The interim financial statements have been prepared on the historical cost basis except for the following assets and liabilities, which have been measured at fair value: derivative financial instruments, transmission system, telecommunications system, trading financial assets and liabilities and shares in other companies.

### 4. Use of estimates and judgements

The preparation of interim financial statements in accordance with International Financial Reporting Standards requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

## Segment reporting

### 5. Statement of segments

Segment information is presented by sectors. The primary segment statement is presented according to the nature of the operation and is based on the Group's structure and internal reporting.

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

Segment results include items that are directly attributable to a segment as well as those that can be allocated on a reasonable basis. Assets and liabilities of the Group are allocated to segments based on the beforementioned premises.

## Notes, contd.:

Landsvirkjun Group's segments are the following.

### *Energy production*

The parent company's operation falls under the segment of energy production but Landsvirkjun's objectives according to law is to engage in operations in the energy sector in addition to other business and financial operations in accordance with decisions by the Company's Board of Directors at each time. Landsvirkjun's energy production is entirely based on hydroelectric and geothermal power. Landsvirkjun sells all its electric power production in Iceland wholesale to electricity retailers and also in great quantity to power intensive industries. Furthermore, the operation of Icelandic Power Insurance Ltd falls under this segment as that Company handles insurance of Landsvirkjun's power stations.

### *Energy transmission*

The operation of Landsnet hf. falls under the segment of energy transmission. Landsnet hf. was established in August 2004 on the basis of the Energy Act approved by the Icelandic Parliament in spring 2003. The objective of Landsnet hf. is to handle energy transmission and system operation in Iceland in accordance with provisions of chapter III of the Energy Act no. 65/2003 and may thus not undertake other activities than necessary for meeting with its obligations according to the Energy Act.

### *Other segments*

The companies Fjarski ehf. and Landsvirkjun Power ehf., together with subsidiaries of the latter, fall under other segments. Fjarski's objective is to own and run a telecommunications system throughout Iceland and rent access thereto in addition to other related operations. Landsvirkjun Power ehf. provides technical and operational consulting to third parties and does or supervises general research, preparatory research for power projects and project management for Landsvirkjun, and when appropriate, for subsidiaries and associated companies of Landsvirkjun Power ehf. and Landsvirkjun.

The major part of the Group's operations are carried out in Iceland.

<b>Operating segments 1.1. - 30.6 2009</b>	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party .....	116,485	21,280	1,244		139,009
Income within the Group .....	7,151	32,170	3,154	( 42,475)	0
Segment income .....	123,636	53,450	4,398	( 42,475)	139,009
Segment operating expenses .....	( 58,102)	( 15,357)	( 3,865)	42,475	( 34,849)
EBITDA .....	65,534	38,093	533		104,160
Depreciation and impairment losses .....	( 45,053)	( 9,527)	( 384)	163	( 54,801)
Segment earnings, EBIT .....	20,481	28,566	149	163	49,359
Segment assets .....	4,445,366	553,008	13,425	( 469,227)	4,542,572
Shares in associated companies .....	12,055	342	369		12,766
Total assets .....	4,457,421	553,350	13,794	( 469,227)	4,555,338
Segment liabilities .....	3,036,046	494,755	4,933	( 401,851)	3,133,883
Total liabilities .....	3,036,046	494,755	4,933	( 401,851)	3,133,883
Investments .....	35,300	10,268	277		45,845

**Notes, contd.:**

<b>Operating segments 1.1. - 30.6 2008</b>	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party .....	207,984	30,743	896		239,623
Income within the Group .....	13,003	36,626	4,894	( 54,523)	0
Segment income .....	220,987	67,369	5,790	( 54,523)	239,623
Segment operating expenses .....	( 73,297)	( 26,469)	( 5,006)	54,523	( 50,249)
EBITDA .....	147,690	40,900	784		189,374
Depreciation and impairment losses .....	( 39,224)	( 11,974)	( 372)	237	( 51,333)
Segment earnings, EBIT .....	108,466	28,926	412	237	138,040
Segment assets 31.12.2008 .....	4,508,699	571,818	13,843	( 488,482)	4,605,878
Shares in associated companies .....	12,270	400	672		13,342
Total assets 31.12.2008 .....	4,520,969	572,218	14,515	( 488,482)	4,619,220
Segment liabilities 31.12.2008 .....	3,144,273	512,032	5,765	( 419,642)	3,242,428
Total liabilities 31.12.2008 .....	3,144,273	512,032	5,765	( 419,642)	3,242,428
Investments .....	191,634	18,914	1,324	( 1,238)	210,634

**Salaries and salary related expenses**

	2009 1.1.-30.6.	2008 1.1.-30.6.
6. Total salaries of employees are specified as follows:		
Salaries .....	11,355	17,512
Retirement pension and pension increase .....	1,448	3,318
Other salary related expenses .....	2,770	3,952
	<u>15,573</u>	<u>24,782</u>

Salaries are divided as follows in the income statement:

Energy production costs .....	4,969	7,653
Transmission costs .....	4,062	6,267
Cost of general research .....	89	108
Other operating expenses .....	6,453	10,754
	<u>15,573</u>	<u>24,782</u>

**Other operating expenses**

7. Other operating expenses are specified as follows:

Corporate office .....	1,443	2,118
Finance .....	1,473	2,144
Human resources .....	457	706
Information technology .....	1,067	1,811
Engineering and construction .....	222	538
Pension .....	1,347	3,165
Other shared costs .....	963	891
	<u>6,972</u>	<u>11,373</u>
Other costs - relating to subsidiaries .....	5,231	5,199
Assets available for sale, impairment .....	1,595	0
Depreciation .....	1,881	1,942
	<u>15,679</u>	<u>18,514</u>

## Notes, contd.:

### Financial income and (expenses)

	2009 1.1.-30.6.	2008 1.1.-30.6.
8. Financial income and (expenses) are specified as follows:		
Interest income .....	3,139	9,287
Interest expenses .....	( 42,814)	( 93,144)
Guarantee-fee paid to owners .....	( 3,505)	( 3,553)
Capitalised interest costs .....	430	5,347
Total interest expenses .....	( 45,889)	( 91,350)
Exchange rate difference .....	( 22,759)	( 144,475)
Fair value changes of embedded derivatives .....	47,692	414,919
Fair value changes of other derivatives .....	( 9,345)	( 155,256)
Realised profit/(loss) on aluminium hedges .....	40,074	( 35,721)
Fair value changes of shares .....	( 317)	0
Sales profit on shares in an associated company .....	4	0
Net income (expenses) on financial assets and liabilities .....	55,350	79,467
Share of profit of associated companies .....	( 427)	( 1,018)
Financial income and (expenses)	12,173	( 3,614)

### Non-current assets

9. Property, plant and equipment, their initial value and depreciation is specified as follows:

	Power stations	Trans- mission	Communicat. equipment	Other assets	Total
Total value at 1.1.2008 .....	4,413,840	686,724	12,734	77,057	5,190,355
Effect of foreign exchange rate changes .....	0	( 406,714)	( 6,546)	( 19,411)	( 432,671)
Additions during the year .....	143,159	10,484	1,210	5,771	160,624
Revaluation of non-current assets .....	0	230,338	2,715	0	233,053
Transferred from assets in construction .....	264,421	0	0	0	264,421
Sold and disposed of .....	0	0	0	( 607)	( 607)
Total value at 31.12.2008 .....	4,821,420	520,832	10,112	62,810	5,415,174
Effect of foreign exchange rate changes .....	0	( 25,515)	( 495)	( 1,155)	( 27,165)
Additions during the period .....	14,916	1,739	157	8,716	25,528
Transferred from assets in construction .....	0	6,704	0	0	6,704
Sold and disposed of .....	0	0	0	( 233)	( 233)
Total value at 30.6.2009 .....	4,836,336	503,760	9,774	70,138	5,420,008

**Notes, contd.:**

	Power stations	Trans- mission	Communicat. equipment	Other assets	Total
<b>Depreciation and impairment loss</b>					
Total value at 1.1.2008 .....	1,477,090	34,474	5,579	21,550	1,538,693
Depreciation of the year .....	77,697	19,422	700	2,780	100,599
Revaluation of depreciation .....	0	20,054	0	0	20,054
Effect of foreign exchange rate changes .....	0	( 27,921)	( 2,923)	( 1,935)	( 32,778)
Sold and disposed of .....	0	0	0	( 524)	( 524)
Total value at 31.12.2008 .....	1,554,787	46,030	3,357	21,871	1,626,044
Depreciation of the period .....	41,105	8,470	375	1,240	51,190
Effect of foreign exchange rate changes .....	0	( 2,522)	( 177)	( 150)	( 2,849)
Sold and disposed of .....	0	0	0	( 200)	( 200)
Total value at 30.6.2009 .....	1,595,892	51,978	3,555	22,761	1,674,185

**Book value**

1.1.2008 .....	2,936,750	652,250	7,155	55,507	3,651,660
31.12.2008 og 1.1.2009 .....	3,266,633	474,803	6,756	40,939	3,789,129
30.6.2009 .....	3,240,444	451,782	6,220	47,377	3,745,821

10. Intangible assets are specified as follows:

	Capitalised development cost	Water and geothermal rights	Software	Total
<b>Cost value</b>				
Total value at 1.1.2008 .....	93,760	40,568	5,691	140,019
Effect of foreign exchange rate changes .....	( 6,599)	0	( 1,650)	( 8,249)
Additions during the year .....	55,134	0	1,685	56,819
Total value at 31.12.2008 .....	142,295	40,568	5,726	188,589
Effect of foreign exchange rate changes .....	( 477)	0	( 130)	( 607)
Additions during the period .....	13,257	0	313	13,570
Transferred to buildings under construction in the period .....	( 4,708)	0	0	( 4,708)
Total value at 30.6.2009 .....	150,367	40,568	5,909	196,844

**Depreciation and impairment loss**

Total value at 1.1.2008 .....	43,515	0	2,389	45,904
Depreciation and impairment loss during the year .....	4,108	0	824	4,932
Effect of foreign exchange rate changes .....	( 10)	0	( 315)	( 325)
Total value at 31.12.2008 .....	47,613	0	2,898	50,511
Depreciation and impairment loss during the period .....	3,184	0	427	3,611
Effect of foreign exchange rate changes .....	( 5)	0	( 35)	( 40)
Total value at 30.6.2009 .....	50,792	0	3,290	54,082

**Book value**

1.1.2008 .....	50,245	40,568	3,302	94,113
31.12.2008 og 1.1.2009 .....	94,682	40,568	2,828	138,077
30.6.2009 .....	99,575	40,568	2,619	142,760

**Notes, contd.:**

11. The Group's depreciation and impairment is divided as follows:	2009	2008
	1.1.-30.6.	1.1.-30.6.
Power stations .....	41,105	37,802
Transmission .....	8,470	10,769
Other assets .....	1,615	1,825
Depreciation of assets in operation .....	51,190	50,396
Impairment loss on development cost .....	3,184	517
Depreciation of software .....	427	420
	<u>54,801</u>	<u>51,333</u>

The Group's depreciation and impairment is divided as follows by sector:

Energy production costs .....	41,377	38,105
Transmission costs .....	8,470	10,769
Cost of general research .....	3,073	516
Other operating expenses .....	1,881	1,943
	<u>54,801</u>	<u>51,333</u>

12. Derivative financial instruments in the balance sheet are specified as follows:

Assets:	30/06/2009	31/12/2008
Embedded derivatives in electricity sales agreements .....	238,778	195,944
Aluminium hedges .....	64,907	98,032
Currency swaps .....	2,367	11,035
Interest rate swaps .....	2,296	0
Other derivatives .....	550	0
	<u>308,898</u>	<u>305,011</u>

Derivative financial instruments are divided as follows:

Long-term component of derivative agreements .....	294,308	287,513
Short-term component of derivative agreements .....	14,590	17,498
	<u>308,898</u>	<u>305,011</u>

Liabilities:

Embedded derivatives in electricity sales agreements .....	21,382	26,242
Currency swaps .....	65,409	63,396
Interest rate swaps .....	12,936	10,754
Other derivatives .....	22,146	45,176
	<u>121,873</u>	<u>145,568</u>

Derivative financial instruments are divided as follows:

Long-term component of derivatives .....	101,919	123,971
Short-term component of derivatives .....	19,954	21,597
	<u>121,873</u>	<u>145,568</u>

## Notes, contd.:

13. Landsvirkjun's subsidiaries are specified as follows:

	Share
Fjarski ehf. ....	100.0%
Hraunaveita ehf. ....	100.0%
Icelandic Power Insurance Ltd. ....	100.0%
Landsnet hf. ....	64.7%
Landsvirkjun Power ehf. ....	100.0%

## Equity

14. The parent company is a partnership owned by the Icelandic State and Eignarhlutir ehf. The State owns a 99.9% share in the Company and Eignarhlutir ehf. holds 0.1%. The Company is an independent taxable entity. The Group's equity ratio at the end of the period was 31.2%, compared to 29.8% at year end 2008.

15. The revaluation account consists of revaluation of fixed assets of subsidiaries net of income tax. Translation difference is the foreign exchange difference arising due to Landsvirkjun's subsidiaries with other functional currencies.

## Liabilities

16. Long-term debt is specified as follows by currencies:

		30.06.2009		31.12.2008	
	Maturity date	Average interests	Remaining balance	Average interests	Remaining balance
Liabilities in ISK, indexed .....	2009-2020	3.9%	350,673	3.9%	333,592
Liabilities in ISK, unindexed .....	2009		0	6.8%	3,902
Liabilities in CHF .....	2012-2022	2.5%	91,817	2.5%	93,487
Liabilities in EUR .....	2009-2028	1.7%	1,438,367	2.7%	1,431,944
Liabilities in GBP .....	2014-2016	11.4%	15,365	11.4%	13,433
Liabilities in JPY .....	2009-2013	0.8%	113,071	1.1%	175,483
Liabilities in USD .....	2009-2026	2.0%	917,193	2.2%	923,428
			<u>2,926,486</u>		<u>2,975,269</u>
Current maturities of long-term debt .....			<u>( 229,964)</u>		<u>( 186,008)</u>
Total long-term debt .....			<u>2,696,522</u>		<u>2,789,261</u>

Interest rates on the parent company's loans range from 1.0-14.5%. On average, nominal interests for the period were approximately 2.61% but they were approximately 4.51% the previous year.

The city of Reykjavik and the township of Akureyri provide, together with the State, a Guarantee of Collection for all obligations of Landsvirkjun, entered into before the end of year 2006. From the beginning of year 2007 the State and Eignarhlutir ehf. provide such a guarantee for all of Landsvirkjun's obligations entered into after that date.

## Notes, contd.:

17. According to loan agreements, current maturities of long-term debt are as follows:

	2009
1.7.2009-30.06.2010 .....	229,964
1.7.2010-31.12 2010 .....	104,161
2011 .....	282,034
2012 .....	201,124
2013 .....	151,256
2014 .....	135,186
Later .....	2,052,726
	<u>2,926,486</u>

## Risk management

18. Risk management

One of the most important factors in effective risk management is the analysis of risk factors, risk measurement, response in order to limit the risk and monitoring. The Company's Board of Directors has approved a risk management policy, which is based on the following factors:

- That risk is defined and its origin is known
- That generally accepted methods are used in assessing the risk
- That effective management is applied in accordance with authorisations
- That effective monitoring on risk factors is ensured
- That information provided to the risk management committee and the Board of Directors is accurate and provided on a regular basis

Landsvirkjun's risk management strategy defines a benchmark in each risk category with respect to hedging limits. The Company's Board of Directors receives on an ongoing basis an overview of the Company's risks and results of risk management.

Decisions and the supervision of how hedging is implemented are entrusted to a risk management committee. The risk management committee consists of the Managing Director, his deputy and the Financial Director. The Managing Director is the chairman of the risk management committee. Daily risk management is in the hands of the Head of Risk Management.

The objectives of risk management are to analyse, manage and monitor Landsvirkjun's risks in order to stabilise operating results by reducing operating fluctuations due to exchange rate, interest and aluminium price changes. Financial risk is divided into market risk, liquidity risk and counterparty risk.

The Company's market risk consists mainly in three risk categories:

- Risk due to fluctuations in world market price of aluminium
- Interest rate risk due to the Company's liabilities
- Exchange rate risk due to liabilities and income in foreign currencies

19. Aluminium price risk

The Company is exposed to substantial risk due to future aluminium price fluctuations. The Company has thus entered into derivative agreements in order to secure its income base and reduce fluctuations. Such agreements consist in most cases of fixing aluminium price at a certain level. The Company therefore loses income if aluminium price increases considerably, but at the same time guarantees better cash flow should the price of aluminium decrease in the markets. Risk management may hedge up to 100% of aluminium price risk and proportionally less over the next 10 years. The duration is based on an effective market with aluminium and official price changes with the LME (London Metal Exchange). At the end of June fair value of the hedges in question was positive by USD 65 million while the agreements are effective over the next five years.

## Notes, contd.:

According to the IFRSs, embedded derivatives are derivative agreements that are a part of other agreements but are treated as separate derivative agreements when their economic character and inherent risk are not closely linked to the original agreement. The Company has defined the part of the electric power sales agreements related to aluminium price as embedded derivative. Therefore, the fair value of the Company's embedded derivatives in electric power sales agreements changes parallel to changes in the price of aluminium. Fair value changes of the agreements is recognised in the Company's income statement.

In evaluating the value of embedded derivatives, generally accepted evaluation methods are used as the market value is not available. Fair value of the agreements is calculated on the basis of the forward price of aluminium, discounted at zero-coupon in the USA allowing for fluctuations. Effective market with aluminium extends over the next 10 years and the price of aluminium must therefore be estimated from that time until the end of the underlying energy agreements. This has been done by extending forward aluminium process with unchanged prices from the last effective price in the process.

The Company uses standard methods in the evaluation of the value of embedded derivatives with a longer duration than 10 years and levies a charge on interests for the discounting of payment flow for a longer period than 10 years.

Landsvirkjun has entered into agreements on the purchase of energy for resale to power intensive industries. Those agreements are related to aluminium price development and do thus have embedded derivatives. The fair value of the agreements is calculated in the same way and on the basis of the same conditions as the Company's power sales contracts.

The fair value of embedded derivatives is specified as follows:	30.06.2009	31.12.2008
Fair value of embedded derivatives at the beginning of the year .....	169,702	665,158
Exchange rate effect .....	0	1,712
Fair value changes during the period .....	47,693	( 497,168)
Fair value of embedded derivatives at the end of the period .....	<u>217,395</u>	<u>169,702</u>

Division of embedded derivatives is specified as follows:

Long-term components of embedded derivatives .....	225,014	183,667
Short-term component of embedded derivatives .....	( 7,619)	( 13,965)
Total embedded derivatives .....	<u>217,395</u>	<u>169,702</u>

Fair value of embedded derivatives, taking into account derivative agreements entered into in order to hedge, amounted to USD 282 million at the end of June (31.12.2008: USD 268 million). The accompanying table shows fair value changes of agreements related to aluminium price and interest changes, while effects due to volatility are insubstantial.

Amounts in the table are before taxes.

		Aluminium price		
		-10%	0%	10%
Interest	-100bp	(179,923)	27,101	235,012
	0	(189,331)	0	190,224
	+100bp	(197,399)	(23,273)	151,750

## 20. Foreign exchange risk

Foreign exchange risk is the risk of losses due to unfavourable foreign exchange rate changes. The Company is exposed to foreign exchange risk on cash flow, financial assets and liabilities, in addition to all general transactions in other currencies than the functional currency.

## Notes, contd.:

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The Company's functional currency is the USD and therefore currency risk arises on net cash flow and open balance in the balance sheet in other currencies than the USD. The Company's income flow is mostly in USD. Other income is in ISK and NOK but currency risk due to those currencies is limited as expenses in ISK are almost the same as the income and income in NOK is relatively low. The Company's main currency risk arises due to its debt in EUR and interest expenses thereon. There is also limited risk related to JPY, CHF and GBP due to outstanding loans.

Risk due to changes in the loan portfolio is limited compared to risk benchmarks determined by the Board at each time. For that purpose, the Company uses currency swaps and options. Risk management also ensures the fixed rate of cash flows against the functional currency for up to three years with forward agreements and options.

### Sensitivity analysis

An increase in the USD by 10% against the following currencies at June 30, would have increased the Group's profit by the following amounts before taxes. The analysis assumes that all other variables, especially interest rates, remain unchanged. The analysis was made in the same way for the year 2008.

	Profit	
	30.06.2009	31.12.2008
EUR.....	113,038	95,600
JPY.....	13,399	18,000
ISK.....	5,345	23,168

A decrease in the USD by 10% against the beforementioned currencies would have the same effect in the opposite direction, provided that all other variables remain unchanged.

The fair value of currency swaps was negative by USD 63 million at the end of June 2009. The underlying principal amount is USD 397 million. The fair value of forwards currency agreements was negative by USD 500 thousand, the underlying principal amount being USD 70 million. The fair value of forward currency agreements was negative by USD 21 million with the underlying principal amount being approx. USD 498 million.

### 21. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's liabilities carry both fixed and floating interests and interest rate derivatives are used in order to hedge risk. Interest bearing liabilities are much higher than interest bearing assets and the Company's risk exposure thus consists in a possible interest rate increase accompanied with increased finance cost.

At the end of June 2009, the proportion of loans on floating interests was 83% compared to 80% at year end 2008. A change in interest rates by one percent would have led to a change in interest cost by USD 12 million in the first six months of the year 2009 (USD 26 million for the year 2008). The Company's financial instruments on fixed interests are not affected by interest rate changes.

The fair value of interest rate swaps, not denominated in a hedging purpose as fair value hedges, is recognised in the income statement. Landsvirkjun has entered into agreements on interest rate swaps, which aim at reducing the Company's interest expenses and risk exposure. At the end of June 2009, the fair value of interest rate swaps was negative by USD 11 million. The underlying amount is approx. USD 139 million. An increase in interest rate by 1% would have led to positive fair value changes in the agreements by USD 4.2 million. A decrease in interest rate by 1% would have led to negative fair value changes in the agreements by USD 5.6 million.

## Notes, contd.:

### 22. Liquidity risk

Liquidity risk consists of the risk of losses should the Company not be able to keep its obligations at maturity date. In order to limit such risk, the Company's liquidity balance is monitored by analysing the flow of revenues and expenses and the maturity dates of financial assets and liabilities. Effective control on liquidity ensures sufficient access to cash at each time. At the end of June 2009, the Group's cash and cash equivalents amounted to USD 117 million, market securities amounted to USD 12 million and Revolving Credit Facility amounted to USD 308 million, or a total of USD 437 million. Taking cash flow from operation into account the Company believes that it has guaranteed sufficient liquidity throughout the year 2011.

In order to ensure liquidity Landsvirkjun and the State have entered into an Credit Contingent Facility. The terms of the agreement are that the Icelandic Central Bank will provide the Company with foreign currency, for which Landsvirkjun will pay in ISK or in bonds, provided though that the Company has previously fully exhausted all other financing options. The contract amounts to a maximum of USD 300 million and expires on 1 July 2011.

Landsvirkjun has used different sources of financing to ensure access to cash and maintain flexibility in financing. In recent years the financing of the company has mostly been based on the EMTN (Euro Medium Term Note) loan agreement. The total amount of loans available through the EMTN-agreement is USD 2.500 million.

The Company's risk related to refinancing of the Company is reduced with even spread of amortization and interests in long-term outstanding loans.

Contractual payments due to financial instruments, including interest, are specified as follows:

30.06.2009	Book value	Contractual cash flow	Within the year	1 - 2 years	2 - 5 years	More than 5 years
<i>Non-derivative financial instruments</i>						
Long-term loans.....	( 2,926,486)	( 3,431,772)	( 146,521)	( 272,430)	( 771,376)	( 2,241,444)
Accounts receivable.....	81,482	81,482	81,482			
Accounts payable.....	( 59,842)	( 59,842)	( 59,842)			
	<u>( 2,904,846)</u>	<u>( 3,410,132)</u>	<u>( 124,881)</u>	<u>( 272,430)</u>	<u>( 771,376)</u>	<u>( 2,241,444)</u>
<i>Derivative financial instruments</i>						
Currency swaps.....	( 84,113)	( 82,437)	667	( 1,637)	( 81,467)	0
Interest rate swaps.....	( 10,640)	( 16,047)	( 1,353)	( 1,723)	( 5,157)	( 7,814)
Forward agreements.....	( 525)	( 537)			( 537)	
Aluminium derivatives.....	64,907	73,080	9,270	18,246	39,636	5,928
Embedded derivatives in electricity sales agreem...	217,395	724,845	( 5,234)	( 2,412)	36,765	695,726
	<u>187,024</u>	<u>698,904</u>	<u>3,350</u>	<u>12,474</u>	<u>( 10,760)</u>	<u>693,840</u>
31.12.2008						
<i>Non-derivative financial instruments</i>						
Long-term loans.....	( 2,975,269)	( 3,766,341)	( 267,387)	( 275,446)	( 831,726)	( 2,391,782)
Accounts receivable.....	98,374	98,374	98,374			
Accounts payable.....	( 95,537)	( 95,537)	( 95,537)			
	<u>( 2,972,432)</u>	<u>( 3,763,504)</u>	<u>( 264,550)</u>	<u>( 275,446)</u>	<u>( 831,726)</u>	<u>( 2,391,782)</u>
<i>Derivative financial instruments</i>						
Currency swaps.....	( 97,105)	( 64,537)	1,049	( 10,635)	( 67,596)	12,645
Interest rate swaps.....	( 10,754)	( 12,598)	( 1,309)	( 1,246)	( 3,738)	( 6,305)
Forward agreements.....	( 432)	( 447)	( 447)			
Aluminium derivatives.....	98,032	125,638	18,669	23,712	60,478	22,779
Embedded derivatives in electricity sales agreem...	169,702	438,669	( 14,061)	( 2,233)	75,642	379,321
	<u>159,443</u>	<u>486,725</u>	<u>3,901</u>	<u>9,598</u>	<u>64,786</u>	<u>408,440</u>

## Notes, contd.:

### 23. Counterparty risk

Counterparty risk is the risk that a counterparty to an agreement does not comply with provisions of the agreement. Landsvirkjun's counterparty risk arises first and foremost due to the Company's energy contracts and derivatives entered into for hedging purposes, but such contracts are only entered into with financial companies. Though the amounts involved are considerably high, the risk is limited by the Company's requirements for counterparty quality. Landsvirkjun has set a benchmark for derivatives which involves that no derivative agreements are made with financial companies that have a lower rating than A- from Standard and Poor's or a comparable rating from other recognised credit rating agencies. If credit rating is not available, a special insurance agreement is made between parties limiting Landsvirkjun's risk. Before power sales contracts are made, the financial standing of the relevant companies and their parent companies are thoroughly reviewed, if applicable.

The Company's counterparty risk is specified as follows at year end:

	30.06.2009	31.12.2008
Derivative financial instruments .....	308,898	305,011
Other long-term receivables .....	152	246
Accounts receivables and other short-term receivables .....	81,483	98,374
Cash and cash equivalents .....	128,844	124,993
	<u>519,377</u>	<u>528,624</u>

### Other issues

24. On 22 August 2007, a special evaluation committee issued a ruling on a settlement amount for water rights due to the power project of Kárahnjúkar and its distribution between owners. The total amount amounted to USD 12.9 million. Most owners of water rights in Jökuldalur valley and three in Fljótisdalur valley announced that they would not accept the ruling of the committee and filed a case in court on 22 February 2008. Forty cases were confirmed in the District Court of East Iceland on January 15, 2008. The parties involved are owners of one third of the water rights.

Settlement payments for land rights due to Háslón in the land of Brú in Jökuldalur has been put on hold subsequent to the ruling of the Committee for the Interior, which deemed the land as public land. Landowners will challenge that ruling before courts of law.

In the year 2007, the Company entered into two currency swaps with domestic credit institutions, which consist in a change from ISK to USD. Due to the weakening of the ISK against the USD in the year 2008, unrealised foreign exchange loss arose, which has been recognised as negative fair value to the amount of USD 48 million in the Group's financial statements. It is considered likely that those agreements must be terminated before maturity in year 2012 at the request of the financial institutions in question and the Company does not approve the beforementioned evaluation under such condition.

The Company has capitalised water rights to the total amount of USD 40.6 million, whereof water rights related to Kárahnjúkar weigh the most. With law no. 58/2008 on the change of law on natural resources and the energy sector, which enters into effect on 1 July 2009, restrictions are set for the State, municipalities and companies owned by them on the endorsement of ownership of water rights for waters containing harnessable power in excess of 10 MW. However the State and municipalities are allowed to give to companies owned by them the right of use of the resources for up to 65 years at a time. Upon the adoption of this law, the Prime Minister shall nominate a committee to discuss the arrangement of leasing of water and geothermal energy rights owned by the State. The committee shall in its work discuss on lease amount, lease term, renewal of lease agreements and other issues related to parties' rights and obligations. The committee shall submit proposals in fall 2009.

Landsvirkjun's share in Theistareykir ehf. is 31.97% and owners have entered into guarantees due to the company's loans. The owners assume responsibility in proportion to their ownership and the total amount guaranteed by Landsvirkjun due to those loans is USD 1.6 million.

## **Notes, contd.:**

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On 8 July, the EFTA Surveillance Authority (ESA) issued a decision in relation to the institution's research on Landsvirkjun's owners' guarantees. In ESA's opinion the unlimited guarantee that Landsvirkjun enjoys with its owners is not entirely in accordance with provisions of the EEA treaty on state aid. However, ESA is of the opinion that a guarantee may be provided for loans provided that an appropriate guarantee fee is paid. The decision of ESA is issued in the form of "appropriate measures" to the Icelandic authorities and the Government has stated that it will react to ESA's decision by presenting a bill of law in order to meet with ESA's comments on the present arrangement. The bill of law relates to amendments to the Act on Landsvirkjun.