Landsvirkjun

Group

Consolidated Financial Statements 2017

Landsvirkjun
Háaleitisbraut 68
103 Reykjavík
Iceland

Id.no. 420269-1299

Contents

Key figures - Unaudited

Management's presentation of the operation of Landsvirkjun

	2017	2016	2015	2014	2013
Operation					
Operating revenues	491,175	415,480	410,496	428,655	407,676
Realised aluminium hedges	(8,098)	4,890	10,956	9,629	15,228
Total operating revenues	483,077	420,370	421,452	438,284	422,904
Operating expenses	(137,503)	(118,630)	(99,932)	(106,126)	(93,768)
EBITDA	345,574	301,740	321,520	332,158	329,136
Depreciation and impairment loss	(127,086)	(118,571)	(115,554)	(114,045)	(117,670)
EBIT	218,488	183,169	205,966	218,113	211,466
Financial items	(64,844)	(60,045)	(73,418)	(69,838)	(86,988)
Associated companies	(228)	(5,448)	(1,921)	(1,419)	(2,647)
Profit before unrealised financial items	153,416	117,676	130,627	146,856	121,831
Unrealised financial items:					
Fair value changes in embedded derivatives	84,494	21,164	(59,925)	(88,484)	(174,641)
Fair value changes in other derivatives	(12,990)	(1,269)	5,466	(8,426)	5,014
Unrealised foreign exchange difference	(60,745)	(23,314)	47,657	60,271	(16,658)
	10,759	(3,419)	(6,802)	(36,639)	(186,285)
Profit (loss) before income tax	164,175	114,257	123,825	110,217	(64,454)
Income tax	(56,211)	(47,437)	(39,652)	(31,797)	25,913
Net Profit (loss)	107,964	66,820	84,173	78,420	(38,541)
Balance sheet					
Total assets	4,506,392	4,332,864	4,284,703	4,270,098	4,568,965
Equity	2,063,112	1,969,088	1,916,634	1,704,724	1,658,134
Liabilities	2,443,280	2,363,776	2,368,069	2,565,374	2,910,831
Net debt *	2,042,642	1,960,497	1,985,411	2,190,459	2,429,176
Cash flow					
Funds from operations (FFO)	282,774	235,602	240,354	258,226	257,704
Cash flow from operating activities	277,937	229,827	248,955	233,816	258,485
Investing activities	(253,740)	(172,277)	(77,486)	(88,271)	(149,455)
Financing activities	(45,282)	(59,305)	(235,465)	(220,687)	(12,893)
Liquidity					
Cash and cash equivalents at year end	126,544	144,534	142,127	207,070	287,987
Undrawn loans	421,363	472,448	360,824	200,000	301,947
Total liquidity	547,907	616,982	502,951	407,070	589,934
Key ratios					
Return on equity	5.5%	3.5%	4.9%	4.7%	(2.3%)
Equity ratio	45.8%	45.4%	44.7%	39.9%	36.3%
Interest cover (EBITDA/net interest expenses)	5.53x	5.15x	4.60x	3.76x	3.51x
FFO / net liabilities	13.8%	12.0%	12.1%	11.8%	10.6%
FFO / interest expenses	4.35x	3.80x	3.27x	2.82x	2.66x
Net debt / EBITDA	5.91x	6.50x	6.18x	6.59x	7.38x
Credit rating at year end without state guarantee					
Standard & Poor's	BBB	BBB-	BB+	BB	BB
Moody's	Baa3	Baa3	Ba1	Ba2	Ba2

* Net debt are interest bearing long-term liabilities less cash and cash equivalents.

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Quarterly statement 2017 - Unaudited

Management´s presentation of the operation of Landsvirkjun, contd.

	Q1	Q2	Q3	Q4	Total
Operating revenues					
Power sales	98,592	94,745	96,632	111,545	401,514
Realised aluminium hedges	(653)	(1,159)	(2,549)	(3,737)	(8,098)
Transmission	19,048	19,631	19,789	22,558	81,026
Other income	1,825	331	1,098	5,381	8,635
	118,812	113,548	114,970	135,747	483,077
Operating expenses					
Energy production costs	12,473	14,168	13,750	13,634	54,025
Transmission costs	6,310	6,455	7,785	10,478	31,028
Cost of general research	2,376	3,290	2,682	4,035	12,383
Other operating expenses	9,385	10,219	8,869	11,594	40,067
Depreciation and impairment loss	29,180	29,141	28,749	40,016	127,086
	59,724	63,273	61,835	79,757	264,589
Operating profit	59,088	50,275	53,135	55,990	218,488
Financial income and (expenses)					
Interest income	645	596	546	761	2,548
Interest expenses	(15,717)	(16,952)	(15,905)	(16,486)	(65,060)
Realised foreign exchange difference	(247)	(1,832)	1,286	(1,539)	(2,332)
	(15,319)	(18,188)	(14,073)	(17,264)	(64,844)
Associated companies	12	(736)	640	(144)	(228)
Profit before income tax and unrealised items	43,781	31,351	39,702	38,582	153,416
Unrealised financial items:					
Fair value changes in embedded derivatives	42,555	(6,739)	30,378	18,300	84,494
Fair value changes in other derivatives	(8,110)	5,159	(5,968)	(4,071)	(12,990)
Unrealised foreign exchange difference	(3,568)	(44,927)	(7,596)	(4,654)	(60,745)
	30,877	(46,507)	16,814	9,575	10,759
Profit (loss) before income tax	74,658	(15,156)	56,516	48,157	164,175
Income tax	(25,277)	5,488	(17,700)	(18,722)	(56,211)
Net Profit (loss)	49,381	(9,668)	38,816	29,435	107,964
Attributable to:					
Owners of the parent company	46,865	(10,871)	35,080	27,010	98,084
Subsidiaries minority interest	2,516	1,203	3,736	2,425	9,880
	49,381	(9,668)	38,816	29,435	107,964
From cash flow					
Cash flow from operating activities	66,285	76,081	58,066	77,505	277,937

Other key metrics for Landsvirkjun parent company	**2017**	**2016**	**2015**	**2014**	**2013**
Installed capacity at year end (MW)	2,000	1,957	1,957	1,957	1,862
Average price for industrial users (incl. transm.) USD/MWh	26.6	23.9	24.5	25.9	25.8
Average price for retail sales comp.(excl. transm.) ISK/kWh	4.5	4.6	4.4	4.3	4.0
Sales in GWh	14,325	13,625	13,900	13,082	13,186
Research and development	20,004	16,829	19,529	30,606	26,799
Accident frequency: H200*	0.0	0.3	0.4	0.4	0.7

* H200 is the number of absence accidents per each 200,000 working hours.

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Endorsement by the Board of Directors and CEO

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 consolidated financial statements include, in addition to the parent company, four subsidiaries, Landsnet hf., Orkufjarskipti hf., Icelandic Power Insurance Ltd. and Landsvirkjun Power ehf.

The financial statements of Landsvirkjun for the year 2017 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act. The functional currency of the Company is US Dollar (USD) and amounts in the financial statements are rounded to the nearest thousand USD.

The Group's operating revenues amounted to USD 483.1 million in the year 2017 compared to USD 420.4 million in the previous year. Thus, revenues increased by USD 62.7 million. Operating expenses amounted to USD 264.6 million in the year 2017 compared to USD 237.2 million in the year 2016. Thus, the Company's operating profit amounted to USD 218.5 million in the year 2017 compared to USD 183.2 million in the previous year.

Landsvirkjun has entered into derivative contracts in order to manage risk. Contracts have been made due to interest rate risk and foreign exchange risk. In addition, derivative contracts have been made in order to hedge risk due to fluctuations of aluminium prices in the global market as a part of revenues is based thereon.

Financial expenses in excess of financial income amounted to USD 54.1 million in the year 2017, compared to USD 63.5 million the previous year. The change between years amounts to USD 9.4 million. The main reason for this difference between years are changes in currency exchange differences and fair value changes in derivatives which are mostly unrealised and must be kept in mind in the evaluation of the Company's results for the year. Profit before unrealised financial items amounted to USD 153.4 million during the year compared to USD 117.7 million in the year 2016. According to the income statement, profit for the year amounted to USD 108.0 million compared to USD 66.8 million in the previous year.

Equity at year end 2017 amounted to USD 2,063.1 million compared to USD 1,969.1 million at year end 2016 according to the balance sheet. The Company's Board of Directors proposes that the profit for the year will be recognised as an increase in equity. The Company's Board of Directors will during the Annual General Meeting propose a dividend payment to the owners of the Company but otherwise refers to the notes to the financial statements and statement of equity for further changes in equity. Landsvirkjun is a partnership owned by the State and Eignarhlutir ehf. The State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%.

Cash and cash equivalents at year end amounted to USD 126.5 million and undrawn Revolving Credit and Loan Facilities amounted to USD 421.4 million. Cash and cash equivalents and undrawn Revolving Credit and Loan Facilities therefore amounted to USD 547.9 million at year end. Cash flow from operations amounted to USD 277.9 million. Landsvirkjun borrowed USD 209.2 million in the year and repaid debt amounting to USD 227.7 million. Cash and cash equivalents decreased by USD 18.0 million during the year.

Endorsement by the Board of Directors and CEO, contd.

Corporate Governance

The Board of Directors of Landsvirkjun endeavours to maintain good corporate governance taking into consideration the Guidelines on Corporate Governance issued by the Iceland Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The Board of Directors has laid down comprehensive guidelines wherein the competences of the Board is defined and its scope of work vis-à-vis the CEO. The Board of Directors has appointed an Audit Committee. In the year 2017, 15 Board meetings were held and 5 meetings in the Audit Committee. Meetings have been attended by the majority of the Board of Directors and the majority of the Audit Committee. According to changes to the Financial Statements Act enacted in June 2016, public interest entities shall provide information necessary for an understanding of the entity's development, performance, position and impact of its activity relating to environmental, social and employee matters, policy regarding human rights, how the entity counteracts corruption and bribery matters, and a brief description of the entity's business model etc. Information on the Company's policy and successes in these matters is provided in an appendix to the financial statements. Further information on the Parent Company’s corporate governance and risk management is included in notes 28 to 37 and appendix to the financial statements. Landsnet hf. has disclosed information on corporate governance and non-financial information in an appendix to its financial statements.

Statement by the Board of Directors and the CEO

According to the best knowledge of the Board of Directors and the CEO, the consolidated financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements in the Icelandic Financial Statement Act and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Groups’s assets, liabilities and financial position as at 31 December 2017 and the Group’s results and changes in cash in the year 2017.

Furthermore, it is the opinion of the Board of Directors and the CEO that the financial statements and the Endorsement by the Board of Directors for the year 2017 give a fair view of the Group’s results, financial position and development and describe the main risk factors faced by the Group.

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

Reykjavik, 15 February 2018.

The Board of Directors:

Jónas Þór Guðmundsson

Haraldur Flosi Tryggvason

Ragnheiður Elín Árnadóttir

Álfheiður Ingadóttir

Kristín Vala Ragnarsdóttir

The CEO:

Hörður Arnarson

Independent Auditors' Report

To the Board of Directors and owners of Landsvirkjun

Opinion

We have audited the consolidated financial statements of Landsvirkjun for the year ended December 31, 2017 which comprise the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flow for the year then ended and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Landsvirkjun as at December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the consolidated Financial Statements section of our report. We are independent of Landsvirkjun in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) and the Icelandic Institute of State Authorized Public Accountants, Code of Ethics (FLE Code) and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How the matter was addressed in the audit
Power sales	
More than 70% of Landsvirkjun power sales comes from sales to industry. The revenue is based on delivered power and contractual prices that are based on certain parameters. Due to both the magnitude and variability of prices, we believe that power sales to industry are a key audit matter.	During our audit of power sales to industry we have confirmed that there is an effective internal control at Landsvirkjun regarding calculation and approval of invoices. We have also confirmed calculation of sales prices by comparing the calculation to contractual agreement and public information in addition to comparing delivered power to metering.
Valuation of power stations	
Included in property, plant and equipment are power stations which amount to 3,056 million USD at year-end. Power stations are measured at cost less accumulated depreciation and impairment. We consider the valuation of power stations to be a key audit matter due to their magnitude and management estimation of their expected useful life. As to the valuation of the assets, we refer to fixed assets in note 8 and accounting policies note 50.	We reviewed the impairment test of power stations prepared by management. During our audit we examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included: • Reviewing the operating plan which is the basis for the valuation. • Reviewing the assumptions for the weighted average cost of capital (WACC) used. We assessed if the valuation’s calculations were in accordance with IFRS and assessed that the disclosures were appropriate.

Independent Auditors' Report, contd.

Valuation of transmission network	
The transmission network of Landsnet, subsidiary of Landsvirkjun, is recognised according to the revaluation method. At year-end its carrying amount was USD 698 million. Transmission network valuation is based on management estimations therefore we consider it to be a key audit matter. Revaluation is performed on a regular basis and it is measured using a cash flow analysis. The assets were revaluated at year-end 2015 and it is management estimate that there is no basis for revaluation at year-end 2017. As to the valuation of the assets, we refer to fixed assets in note 8 and accounting policies note 50.	Our audit was focused on management estimations of operating value of transmission lines and substations at the year-end 2017. We examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included: • Reviewing the operating plan which is the basis for the valuation. • Reviewing the assumptions for the weighted average cost of capital (WACC) used. We assessed if the valuation's calculations and disclosures were in accordance with IFRS. We have also examined management assumption related to depreciation methods in accordance with IFRS.

Valuation of development cost	
Capitalised development cost consists of future power projects which amount to 130 million USD at year-end 2017. Valuation of the capitalised development cost is based on management estimation of the future revenue they will generate, that valuation is made with an impairment test. As the valuation of the assets is based on management's estimate we believe that their valuation is a key audit matter. As to the valuation of the assets, we refer to intangible assets in note 10 and accounting policies note 51.	We reviewed the impairment test of development cost prepared by management. During our audit we examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included: • Reviewing the operating plan which is the basis for the valuation. • Reviewing the assumptions for the weighted average cost of capital (WACC) used. We assessed if the valuation's calculations were in accordance with IFRS and assessed that the disclosures were appropriate. We have also selected a sample from capitalised cost during the year to make sure that it is in compliance with IFRS.

Independent Auditors' Report, contd.

Other information

The Board of Directors and the CEO are responsible for the other information. The other information comprises key figures, the endorsement by the board of directors and CEO, statement of corporate governance and non-financial reporting.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except the confirmation regarding report of the board of directors as stated below.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the financial statements.

Responsibilities of the Board of Directors and CEO for the Consolidated Financial Statements

The Board of Directors and the CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and for such internal control as the Board of Directors and the CEO determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors and the CEO are responsible for assessing Landsvirkjun's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors and the CEO either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

• Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Independent Auditors' Report, contd.

• Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Landsvirkjun's internal control.

• Evaluate the appropriateness of accounting policies used and related disclosures, and the reasonableness of accounting estimates made by management.

• Conclude on the appropriateness of management's use of the going concern basis of accounting and whether a material uncertainty exists related to events or conditions that may cast significant doubt on ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements. If such disclosures are inadequate we are required to modify our unqualified opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause Landsvirkjun to cease to continue as a going concern.

• Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

• Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors and the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors and the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors and the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Reykjavik, 15 February 2018.

Deloitte ehf.

Þorsteinn Pétur Guðjónsson
Auditor

Pétur Hansson
Auditor

Income Statement for the year 2017

	Notes	2017	2016
Operating revenues			
Power sales		401,514	347,865
Realised aluminium hedges		(8,098)	4,890
Transmission		81,026	64,545
Other income		8,635	3,070
		483,077	420,370
Operating expenses			
Energy production costs		141,539	134,094
Transmission costs		58,286	56,736
Cost of general research		21,378	10,144
Other operating expenses		43,386	36,227
		264,589	237,201
Operating profit	3	218,488	183,169
Financial income and (financial expenses)			
Interest income		2,548	3,323
Interest expenses		(65,060)	(61,943)
Foreign exchange difference		(63,077)	(24,739)
Fair value changes in embedded derivatives	30	84,494	21,164
Fair value changes in other derivatives		(12,990)	(1,269)
	6	(54,085)	(63,464)
Associated companies	13	(228)	(5,448)
Profit before income tax		164,175	114,257
Income tax	7	(56,211)	(47,437)
Net profit for the year		107,964	66,820
Attributable to:			
Owners of the Parent Company		98,084	71,394
Minority interest in subsidiaries		9,880	(4,574)
		107,964	66,820

Notes 1 to 58 are an integral part of these financial statements.

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Statement of Comprehensive Income for the year 2017

	2017	2016
Net profit for the year	107,964	66,820
Items that will not be reclassified subsequently to profit or loss		
Pension obligation after income tax, change	(2,647)	(3,110)
Items that may be reclassified subsequently to profit or loss		
Translation difference due to subsidiaries and associated companies	2,775	2,023
Total operating items moved to equity	128	(1,087)
Total Comprehensive Income for the year	108,092	65,733
Total Comprehensive Income attributable to:		
Owners of the Parent Company	98,021	70,008
Minority interest in subsidiaries	10,071	(4,275)
	108,092	65,733

Notes 1 to 58 are an integral part of these financial statements.

Consolidated Financial Statements of Landsvikjun 2017 12 Amounts are in USD thousand

Balance Sheet as at 31 December 2017

Assets	Notes	2017	2016
Non-current assets			
Property, plant and equipment	8	3,810,257	3,614,704
Projects under construction	9	232,425	282,318
Development cost	10	130,319	141,401
Other intangible assets	10	48,413	48,701
Derivative financial instruments	12	66,200	9,528
Associated companies	13	11,778	10,619
Other non-current assets	14	163	150
Deferred tax asset	7	14	0
Total non-current assets		4,299,569	4,107,421
Current assets			
Inventories	16	5,625	5,101
Accounts receivables and other receivables	17	66,383	72,599
Derivative financial instruments	12	8,271	3,209
Cash and cash equivalents	18	126,544	144,534
Total current assets		206,823	225,443
Total assets		4,506,392	4,332,864
Equity and liabilities			
Equity			
Owners' contributions	19	586,512	586,512
Revaluation account	20	169,329	175,712
Restricted reserves	20	10,390	1,039
Translation difference	20	(38,536)	(41,120)
Other equity		1,216,571	1,138,169
Equity of the owners of the Parent Company		1,944,265	1,860,312
Minority interest		118,847	108,776
Total equity		2,063,112	1,969,088
Long term liabilities			
Interest bearing liabilities	21	1,889,372	1,883,049
Pension fund obligation	23	40,597	35,383
Deferred income tax liability	7	91,268	54,517
Obligation due to demolition	24	8,551	7,023
Prepaid income		3,043	2,862
Derivative financial instruments	12	4,110	33,690
		2,036,941	2,016,524
Current liabilities			
Accounts payable and other payables	25	93,028	82,753
Interest bearing liabilities	22	279,814	221,982
Income tax payable	7	18,038	14,121
Derivative financial instruments	12	15,459	28,396
		406,339	347,252
Total liabilities		2,443,280	2,363,776
Total equity and liabilities		4,506,392	4,332,864

Notes 1 to 58 are an integral part of these financial statements.

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Statement of Equity for the year 2017

	Owners' contribution	Revaluation account	Restricted reserves	Translation difference	Other equity	Equity attrib-utable to the owners of the Parent Company	Minority interest	Total equity
Changes in equity year 2016								
Equity at 1 January 2016..	586,512	182,553	0	(42,844)	1,076,224	1,802,445	114,189	1,916,634
Translation difference...				1,724		1,724	299	2,023
Pension obligation, change.....................................					(3,110)	(3,110)		(3,110)
Net profit for the year...					71,394	71,394	(4,574)	66,820
Total Comprehensive Income..................................		0	0	1,724	68,284	70,008	(4,275)	65,733
Share of profit of subsidiaries and associated companies......................................			1,039		(1,039)	0	0	0
Revaluation transferred to other equity...		(6,841)			6,841	0	0	0
Dividend paid to owners...					(12,141)	(12,141)	(1,138)	(13,279)
Equity at 31 December 2016	586,512	175,712	1,039	(41,120)	1,138,169	1,860,312	108,776	1,969,088
Changes in equity year 2017								
Equity at 1 January 2017..	586,512	175,712	1,039	(41,120)	1,138,169	1,860,312	108,776	1,969,088
Translation difference...				2,584		2,584	191	2,775
Pension obligation, change.....................................					(2,647)	(2,647)		(2,647)
Net profit for the year...					98,084	98,084	9,880	107,964
Total Comprehensive Income..................................		0	0	2,584	95,437	98,021	10,071	108,092
Share of profit of subsidiaries and associated companies......................................			9,351		(9,351)	0	0	0
Revaluation transferred to other equity...		(6,383)			6,383	0	0	0
Dividend paid to owners...					(14,067)	(14,067)	0	(14,067)
Equity at 31 December 2017	586,512	169,329	10,390	(38,536)	1,216,571	1,944,265	118,847	2,063,112

Notes 1 to 58 are an integral part of these financial statements.

Consolidated Financial Statements of Landsvikjun 2017 14 Amounts are in USD thousand

Statement of Cash Flow for the year 2017

	2017	2016
Operating activities		
Operating profit	218,488	183,169
Adjustments for:		
Depreciation and impairment loss	127,086	118,571
Pension obligation, change	(1,795)	(1,356)
Obligation due to demolition, change	1,467	26
Other changes	(210)	(135)
Working capital from operation before financial items	345,036	300,275
Operating assets, change	2,021	(7,981)
Operating liabilities, change	4,381	3,105
Cash flow from operating activities before financial items	351,438	295,399
Interest income received	2,566	2,016
Interest expenses and foreign exchange difference paid	(61,093)	(58,870)
Taxes paid	(14,974)	(8,718)
Cash flow from operating activities	277,937	229,827
Investing activities		
Power stations in operation	(8,752)	(14,205)
Power stations under construction	(165,055)	(102,632)
Transmission	(71,559)	(45,208)
Power plant preparation cost	(6,822)	(6,831)
Purchased shares in other companies	(41)	(106)
Dividend received from associated company	0	12
Other capital expenditures	(6,469)	(6,627)
Assets sold	621	2,048
Other receivables, change	4,337	1,272
Investing activities	(253,740)	(172,277)
Financing activities		
Dividend paid to owners	(14,067)	(13,279)
New loans	209,218	241,480
Amortisation of long-term debt	(227,708)	(288,842)
Currency swaps	(12,725)	1,336
Financing activities	(45,282)	(59,305)
Change in cash and cash equivalents	(21,085)	(1,755)
Effect of exchange difference on cash and cash equivalents	3,095	4,162
Cash and cash equivalents at the beginning of the year	144,534	142,127
Cash and cash equivalents at the end of the year	126,544	144,534

Notes 1 to 58 are an integral part of these financial statements.

Consolidated Financial Statements of Landsvikjun 2017 15 Amounts are in USD thousand

Notes

General Information

1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavík. Landsvirkjun operates on the basis of the Act on Landsvirkjun No. 42/1983. The Company's objective is to engage in operations in the energy sector. The financial statements include the consolidated financial statements of the Company and its subsidiaries (referred to as "the Group") and share of profit or loss of associated companies.

2. Basis of preparation

a. Statement of IFRS compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional requirements in Icelandic Financial Statements Act.

The Company's Board of Directors approved the financial statements on 15 February 2018.

Note 41 includes information on the Group's significant accounting policies and changes therein in the year.

b. Basis of measurement

The 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, trading financial assets and shares in other companies. Operating assets and assets held for sale are recognised at the lower of book value or fair value. Operating assets of the subsidiaries Landsnet hf. and Orkufjarskipti hf. are recognised at revalued cost. Transmission network of the subsidiary Landsnet hf. was revalued during the year 2015, see note 8.

c. Presentation and functional currency

The financial statements are presented in USD, which is the Parent Company's functional currency. All financial information presented in USD has been rounded to the nearest thousand, unless otherwise stated.

d. Management's use of estimate and judgements

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

Estimates and underlying assumptions are reviewed on an ongoing basis and the effect of the changes are entered in the periods that the changes are made and in subsequent periods if the change also affects those periods.

Information on management's estimates and decisions made in relation to the application of accounting methods that significantly affect the financial statements are presented in the following notes:

- notes 8 and 50 property, plant and equipment
- notes 10 and 51 intangible assets
- notes 12, 28, 30, 31, 32 derivative financial instruments
- notes 7 and 49 income tax
- note 23 pension fund obligations

Notes, contd.

2. Basis of preparation, contd.:

e. Determination of fair value

The Group's accounting policies and disclosures can require measurement of fair values, for both financial and non-financial assets and liabilities.

To the extent possible the Group uses market information in determining fair values but if such information is not available management's evaluation is used.

For derivatives, other than embedded derivatives, counterparty information is used where applicable to measure fair values. Then treasury division compares this to its own assessment and confirms that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Fair values are categorised into different levels in the fair value hierarchy based on assumptions used in the valuation techniques as follows.

- Level 1; quoted prices in active markets for identical assets or liabilities.
- Level 2; assumptions based on other than quoted prices included in Level 1 that can be acquired for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3; assumptions for value of asset or liability that are not based on available market data.

If the assumptions used to measure fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, the fair value measurement is categorised in the lowest level.

If the categorisation of fair value during the accounting period changes, it is transferred between levels at the end of the period.

Further information on the assumptions made in measuring fair values is included in the following notes:

- note 12 derivative financial instruments
- note 30 aluminium price risk, embedded derivatives
- note 35 long-term debt
- note 50 property, plant and equipment

3. Segment reporting

Segment information is presented according to the nature of the operation and is based on the Group's organisation and internal disclosure.

Landsvirkjun Group's operating segments are specified as follows:

Electricity production

The operations of the Parent Company fall under the segment electricity production but Landsvirkjun's objective according to law is to operate in the energy sector and operate other business and financial operations according to decision of the Board of Directors at each time. Landsvirkjun's electricity production is based on hydroelectric power and geothermal heat. Landsvirkjun sells all its electricity production in Iceland, on the one hand to retail sales companies, and on the other to energy intensive industrial users. Furthermore, the operation of Icelandic Power Insurance Ltd. falls under this segment. The purpose of Icelandic Power Insurance Ltd. is to take care of insurances for Landsvirkjun's power stations.

Electricity transmission

The operations of Landsnet hf. fall under the segment electricity transmission. The purpose of Landsnet hf. is to operate the electricity transmission network and system management in Iceland according to provisions of Chapter III of the Energy Act No. 65/2003 and may thus not carry out other operations than are necessary in order to fulfill its obligations according to the Energy Act.

3. Segment reporting, contd.:

Other segments

Other segments include the operations of Orkufjarskipti hf. and Landsvirkjun Power ehf. The purpose of Orkufjarskipti hf. is to own and operate a telecommunications system which is necessary for the shareholders' electricity operations throughout the country and to rent access thereto in accordance with availability and law. Landsvirkjun Power ehf. takes care of sales of technical and operational advisory services to third parties and general research work, harnessing researches and projects for Landsvirkjun and related companies.

Almost all the operations of the Group are based in Iceland.

Operating segments year 2017	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	400,091	81,669	1,317	0	483,077
Income within the Group	21,699	65,657	5,200	(92,556)	0
Segment income	421,790	147,326	6,517	(92,556)	483,077
Segment operating expenses	(164,151)	(60,972)	(4,936)	92,556	(137,503)
EBITDA	257,639	86,354	1,581	0	345,574
Depreciation and impairment loss	(97,782)	(28,483)	(1,230)	409	(127,086)
Segment earnings, EBIT	159,857	57,871	351	409	218,488
Segment assets 2017	4,025,516	843,935	22,893	(397,731)	4,494,613
Associated companies	11,616	7,367	162	(7,367)	11,778
Total assets 2017	4,037,132	851,302	23,055	(405,098)	4,506,392
Segment liabilities 2017	2,076,465	514,339	4,351	(151,875)	2,443,280
Total liabilities 2017	2,076,465	514,339	4,351	(151,875)	2,443,280
Investing activities	182,473	74,722	1,484	0	258,679
Operating segments year 2016					
Income from third party	353,961	64,910	1,499	0	420,370
Income within the Group	14,904	64,832	4,294	(84,030)	0
Segment income	368,865	129,742	5,793	(84,030)	420,370
Segment operating expenses	(147,951)	(50,602)	(4,107)	84,030	(118,630)
EBITDA	220,914	79,140	1,686	0	301,740
Depreciation and impairment loss	(88,501)	(29,450)	(1,032)	412	(118,571)
Segment earnings, EBIT	132,413	49,690	654	412	183,169
Segment assets 2016	3,975,620	764,155	21,346	(438,877)	4,322,244
Associated companies	10,395	6,662	225	(6,663)	10,619
Total assets 2016	3,986,015	770,817	21,571	(445,540)	4,332,864
Segment liabilities 2016	2,106,828	462,407	4,462	(209,921)	2,363,776
Total liabilities 2016	2,106,828	462,407	4,462	(209,921)	2,363,776
Investing activities	125,486	48,243	1,775	0	175,504

4. Total number of employees

Total number of employees is specified as follows:	2017	2016
Average number of employees during the year, full-time equivalents	464	450
Full-time equivalent units at year-end	422	402

Consolidated Financial Statements of Landsvikjun 2017 18 Amounts are in USD thousand

Notes, contd.

5. Total salaries of employees

Total salaries of employees are specified as follows:

	2017	2016
Salaries	54,276	44,151
Contribution to defined contribution plans	7,579	5,762
Defined pension benefit payments	2,853	2,218
Other change in pension obligations	(1,795)	(1,356)
Other salary related expenses	5,249	4,323
	68,162	55,098

Salaries and salary related expenses are allocated as follows in the income statement:

	2017	2016
Energy production costs	22,143	18,131
Transmission costs	12,657	10,605
Other operating expenses	33,362	26,362
	68,162	55,098

Salaries of the Boards of Directors, CEO, Deputy CEO and Executive Directors are specified as follows:

	2017	2016
Salaries of the Board of Directors of the parent company	189	127
Salaries of the Boards of Directors of two subsidiaries (same as in 2016)	158	103
Salaries and benefits of the CEO of the parent company	304	204
Salaries of five Directors and the Deputy CEO (same as in 2016)	1,702	1,354
Salaries and benefits of the CEO and 7 Man. Dir. of subsid. (increase by one from 2016)	1,435	1,124

6. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

	2017	2016
Interest income	2,548	3,323
Interest expenses	(69,881)	(58,647)
Guarantee fee	(7,452)	(9,025)
Indexation	(1,883)	(4,306)
Capitalised interest costs	14,156	10,035
Total interest expenses	(65,060)	(61,943)
Realised foreign exchange difference	(2,332)	(1,425)
Unrealised foreign exchange difference	(60,745)	(23,314)
Total foreign exchange difference	(63,077)	(24,739)
Fair value changes in embedded derivatives	84,494	21,164
Fair value changes in other derivatives	(12,990)	(1,269)
Total financial income and (expenses)	(54,085)	(63,464)

Capitalised finance cost amounted to 3.8% (2016: 4.4%) of invested cash in power stations under construction in the year 2017 and 5.2% (2016: 6.5%) of invested cash in transmission under construction.

7. Income tax

Income tax is specified as follows:

	2017	2016
Change in income tax asset / liability	(36,737)	(31,697)
Income tax payable	(18,038)	(14,121)
Income tax recognised among comprehensive income	(1,489)	(1,749)
Foreign exchange and translation difference	100	149
Other changes	(46)	(20)
Income tax expensed	(56,211)	(47,437)

Consolidated Financial Statements of Landsvikjun 2017 19 Amounts are in USD thousand

Notes, contd.

7. Income tax, contd.:

Effective tax rate

		2017		2016
Profit for the year		107,964		66,820
Income tax for the year		56,211		47,437
Profit before income tax		164,175		114,257
Income tax acc. to the parent company's tax rate	36.0%	59,103	36.0%	41,132
Effect of different tax rates within the Group	(3.5%)	(5,819)	2.0%	2,278
Effect of incr. in tax rate in 2018 from 36% to 37.6%	1.0%	1,650	-	-
Non-taxable and non-deductible items	0.8%	1,268	1.9%	2,207
Other items	0.0%	9	1.6%	1,819
Effective income tax	34.2%	56,211	41.5%	47,437

Income tax due to items recognised in other comprehensive income is specified as follows:

	2017	2016
Income tax due to pension obligation recognised in other comprehensive income	(1,489)	(1,749)
	(1,489)	(1,749)

Changes in the tax asset / liability during the year is specified as follows:

	Deferred tax asset		Deferred tax liability	
	2017	2016	2017	2016
Balance at the beginning of the year	0	34,733	(54,517)	(57,553)
Reclass from deferred tax asset to deferred tax liability	(4)	0	4	0
Change in temporary difference	4	(23,247)	(36,778)	3,100
Change in carry forward loss	14	(11,486)	122	85
Foreign exchange and translation difference	0	0	(100)	(149)
Balance at year end	14	0	(91,268)	(54,517)

The Group's deferred tax asset / liability is specified as follows:

Carry forward loss	14	0	363	218
Property, plant and equipment and intangible assets	0	0	(110,692)	(77,405)
Derivative financial instruments	0	0	(13,989)	12,348
Other items	0	0	33,050	10,322
Balance at year end	14	0	(91,268)	(54,517)

The Group's carry forward tax losses may be utilised for 10 years from when it is incurred and are specified as follows:

Carry forward loss of the year 2013, usable until the year 2023	18	17
Carry forward loss of the year 2014, usable until the year 2024	138	128
Carry forward loss of the year 2015, usable until the year 2025	532	492
Carry forward loss of the year 2016, usable until the year 2026	491	455
Carry forward loss of the year 2017, usable until the year 2027	706	-
Carry forward loss at year end	1,885	1,091

Deferred tax asset is recognised as assets as management considers it likely that it will be utilised against future taxable profit. Carry forward loss is recognised in Icelandic krona and, therefore, the exchange rate of the USD affects the carry forward loss at each year end.

Consolidated Financial Statements of Landsvikjun 2017 20 Amounts are in USD thousand

8. Property, plant and equipment

Property, plant and equipment is specified as follows:

Cost value	Power stations	Trans-mission	Communi-cation equipment	Other assets	Total
Total value at 1.1.2016	5,064,506	862,838	19,957	70,679	6,017,980
Effect of exchange rate changes	0	0	3,079	40	3,119
Additions during the year	14,926	4,467	1,628	2,221	23,242
Transferred from projects under construction	0	21,678	0	0	21,678
Sold and disposed of	0	0	(11)	(1,250)	(1,261)
Total value at 31.12.2016	5,079,432	888,983	24,653	71,690	6,064,758
Effect of exchange rate changes	0	0	2,016	17	2,033
Additions during the year	8,978	11,353	1,463	2,681	24,475
Transferred from projects under construction and developm. cost	205,662	81,675	0	0	287,337
Sold and disposed of	0	0	(1)	(1,209)	(1,210)
Total value at 31.12.2017	5,294,072	982,011	28,131	73,179	6,377,393
Depreciation and impairment loss					
Total value at 1.1.2016	2,065,297	230,905	6,629	29,739	2,332,570
Effect of exchange rate changes	0	0	1,058	2	1,060
Depreciation for the year	86,363	27,272	1,042	2,866	117,543
Sold and disposed of	0	0	0	(1,119)	(1,119)
Total value at 31.12.2016	2,151,660	258,177	8,729	31,488	2,450,054
Effect of exchange rate changes	0	0	730	0	730
Depreciation for the year	86,681	26,301	1,246	2,922	117,150
Sold and disposed of	0	0	0	(798)	(798)
Total value at 31.12.2017	2,238,341	284,478	10,705	33,612	2,567,136
Book value					
1.1.2016	2,999,209	631,933	13,328	40,940	3,685,410
31.12.2016	2,927,772	630,806	15,924	40,202	3,614,704
31.12.2017	3,055,731	697,533	17,426	39,567	3,810,257
Book value without revaluation					
1.1.2016	2,999,209	355,696	12,719	40,940	3,408,564
31.12.2016	2,927,772	367,655	15,305	40,202	3,350,934
31.12.2017	3,055,731	446,573	16,844	39,567	3,558,715

Official assessment of fixed assets and insurance value

The official assessment of the Company's real estates amounted to USD 501 million at year end 2017 (2016: USD 438 million). Insurance value of the Company's assets amounts to USD 5,270 million (2016: USD 4,607 million) and catastrophe insurance value amounts to USD 1.148 million (2016: USD 996 million).

Consolidated Financial Statements of Landsvikjun 2017 21 Amounts are in USD thousand

Notes, contd.

8. Property, plant and equipment, contd.:

Assumptions relating to revaluation of property, plant and equipment

In accordance with provision of IFRS the Group's transmission network and communication equipment were revalued during the year 2008 and powerlines and connection masts of Landsnet hf. at year end 2015. Two methods were applied when performing the revaluation. On one hand it is done by looking at the assets' replacement cost which was calculated by independent experts at the beginning of the year 2015 and projected to the end of the year 2015. On the other hand the value of the asset in operation is calculated by cash flow analysis. The forcast period was from the year 2016 until 2025 and after that terminal value of the operations was calculated. The revaluation was based on operational value of the current assets and assumed the investments would be equal to depreciations of current assets. Discounting of future cash flows was based on weighted average cost of capital (WACC) which Landsnet hf. is allocated for large industrial users and distribution companies. The revaluation is classified at level 3 in the fair value hierarchy.

9. Projects under construction

Projects under construction are specified as follows:

	2017	2016
Balance at 1.1.	282,318	134,146
Transferred (to) from development costs	(7,305)	8,090
Additions during the year	242,777	161,760
Transferred to property, plant and equipment	(285,365)	(21,678)
Balance at 31.12.	232,425	282,318

10. Development cost and other intangible assets

Development cost and other intangible assets are specified as follows:

	Capitalised development costs	Water and geothermal rights	Software	Total
Cost value				
Total value at 1.1.2016	217,308	45,611	9,308	272,227
Additions during the year	7,961	0	991	8,952
Transf. to projects under construction	(8,090)	0	0	(8,090)
Sold and disposed of	0	0	(267)	(267)
Total value at 31.12.2016	217,179	45,611	10,032	272,822
Additions during the year	9,742	0	427	10,169
Transf. to projects under construction	(18,908)	0	0	(18,908)
Sold and disposed of	7,305	0	0	7,305
Total value at 31.12.2017	215,318	45,611	10,459	271,388
Depreciation and impairment loss				
Total value at 1.1.2016	75,510	0	6,450	81,960
Amortisation during the year	0	0	759	759
Impairment loss during the year	269	0	0	269
Sold and disposed of	0	0	(267)	(267)
Total value at 31.12.2016	75,779	0	6,942	82,721
Amortisation during the year	0	0	715	715
Impairment loss during the year	9,221	0	0	9,221
Total value at 31.12.2017	85,000	0	7,657	92,657

Consolidated Financial Statements of Landsvikjun 2017 22 Amounts are in USD thousand

Notes, contd.

10. Development cost and other intangible assets, contd.:

Book value

1.1.2016	141,799	45,611	2,858	190,269
31.12.2016	141,401	45,611	3,090	190,102
31.12.2017	130,319	45,611	2,802	178,732

Development cost is reviewed every year by management and checked whether there are indications of impairment. In testing for possible impairment the Parent Company's forecast on expected cash flow over the useful life of the assets was used. In the evaluation expected cash flow was discounted with the rate of 5.0% (2016: 5.3%) of weighted average required rate of return. If management concludes that impairment has occurred the relevant development cost is expensed as impairment.

11. Depreciation and impairment loss

The Group's depreciation and impairment is specified as follows:	**2017**	**2016**
Power stations	86,681	86,363
Transmission	26,301	27,272
Telecommunication equipment	1,246	1,042
Other assets	2,922	2,866
Depreciation of assets in operation	117,150	117,543
Impairment loss on development cost	9,221	269
Amortisation of software	715	759
	127,086	118,571

The Group's depreciation and impairment is allocated as follows by sectors:

Energy production costs	87,514	87,236
Transmission costs	27,258	28,241
Cost of general research	8,995	0
Other operating expenses	3,319	3,094
	127,086	118,571

12. Derivative financial instruments

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

Assets:		
Embedded derivatives in electricity sales agreements	54,390	4,858
Aluminium hedges	1,141	2,854
Currency swaps	18,940	5,025
	74,471	12,737
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	66,200	9,528
Short-term component of derivative agreements	8,271	3,209
	74,471	12,737

Liabilities:		
Embedded derivatives in electricity sales agreements	946	35,908
Aluminium hedges	17,251	2,651
Currency swaps	693	20,164
Interest rate swaps	679	3,363
	19,569	62,086

Consolidated Financial Statements of Landsvikjun 2017 23 Amounts are in USD thousand

Notes, contd.

12. Derivative financial instruments, contd.:

Derivative financial instruments are divided as follows:

	2017	2016
Long-term component of derivative agreements	4,110	33,690
Short-term component of derivative agreements	15,459	28,396
	19,569	62,086

The assumptions for valuation of embedded derivatives are discussed in note 30.

The fair value of other derivatives than embedded derivatives is based on Landsvirkjun's evaluation and available evaluation of counterparties, where applicable, and verified by the treasury department with comparative calculations based on market information.

13. Associated companies

Shares in associated companies recognised according to the equity method are specified as follows:

		2017	
	Share	Share in return	Book value
Farice ehf., Kopavogur, Iceland	33.2%	(130)	11,202
SER eignarhaldsfélag ehf., Reykjavik, Iceland	35.4%	(13)	398
Sjávarorka ehf., Reykjavik, Iceland	33.6%	(1)	15
LP-Verkis, Georgia	40.0%	(31)	18
Hecla SAS, France	28.5%	(53)	145
		(228)	11,778

		2016	
	Share	Share in return	Book value
Farice ehf., Kopavogur, Iceland	33.2%	(5,339)	9,999
SER eignarhaldsfélag ehf., Reykjavik, Iceland	35.4%	21	381
Sjávarorka ehf., Reykjavik, Iceland	33.6%	(4)	15
LP-Verkis, Georgia	40.0%	10	47
Hecla SAS, France	28.5%	(136)	177
		(5,448)	10,619

14. Other non-current assets

Other long-term assets in the balance sheet are specified as follows:

	2017	2016
Shares in other companies	163	150
	163	150

15. Landsvirkjun's subsidiaries

Landsvirkjun's subsidiaries are the following:

	Share	
Icelandic Power Insurance Ltd., Bermuda	100.0%	100.0%
Landsnet hf., Reykjavik, Iceland	64.7%	64.7%
Landsvirkjun Power ehf., Reykjavik, Iceland	100.0%	100.0%
Orkufjarskipti hf., Reykjavik, Iceland	100.0%	100.0%

16. Inventories

Inventories are specified as follows:

Spare parts and consumables	5,625	5,101
	5,625	5,101

Consolidated Financial Statements of Landsvikjun 2017 24 Amounts are in USD thousand

17. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:

	2017	2016
Accounts receivables	61,098	60,512
Other short term receivables	5,285	12,087
	66,383	72,599

At year-end 2017, 93% of accounts receivables were under 30 days old (2016: 85%).

18. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2017	2016
Bank deposits	106,536	141,568
Market securities	20,008	2,966
	126,544	144,534

19. Equity

The Parent Company is a partnership owned by the Icelandic State and Eignarhlutir ehf. The Icelandic State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%. Eignarhlutir ehf. is owned by the State. Landsvirkjun is an independent taxable entity. The Group's equity ratio at year end 2017 was 45.8% compared to 45.4% at year end 2016.

20. Revaluation account, translation difference and restricted reserves

The revaluation account consists of a revaluation of the transmission network and telecommunication equipment after income tax effects. The translation difference is the foreign exchange difference arising due to Landsvirkjun's subsidiaries and associated companies with other functional currencies than the Parent Company's. Restricted reserves contain the share in profit of equity accounted investees, from 1 January 2016, (subsidiaries and associated companies) recognised in the income statement which excess dividends from these companies, or the dividend that has been decided to distribute.

21. Liabilities

Interest bearing long term debt is specified as follows:

	2017	2016
Interest bearing long term debt 1.1.	2,105,031	2,127,538
New loans	209,218	241,480
Amortisation of long-term debt	(227,708)	(288,842)
Foreign exchange changes	75,085	20,212
Changes in CPI indexation and amortisation of discount	7,560	4,643
Interest bearing long term debt 31.12.	2,169,186	2,105,031

Interest bearing long term debt is specified as follows by currencies:

		2017		2016	
	Maturity date	Average interest	Remaining balance	Average interest	Remaining balance
Liabilities in ISK	2018-2034	3.7%	295,793	3.8%	269,815
Liabilities in CHF	2018-2022	0.0%	27,044	0.0%	31,661
Liabilities in EUR	2018-2026	0.9%	392,671	0.6%	483,486
Liabilities in USD	2018-2035	3.3%	1,453,678	2.9%	1,320,069
			2,169,186		2,105,031
Current maturities of long-term debt			(279,814)		(221,982)
Total long-term debt			1,889,372		1,883,049

Interest rate terms on loans at year end are from 0.0-5.6%. Nominal interest rates for the period were on average 3.5% (2015: 3.3%), taking into account the state guarantee fee. The Company's payments due to guarantees for long-term loans are calculated according to the Act No. 121/1997 on state guarantees.

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22. Maturities of long-term debt

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

	2017	2016
2017	-	221,982
2018	279,814	274,547
2019	193,063	183,256
2020	338,640	304,833
2021	209,145	205,636
2022	106,736	-
Later	1,041,788	914,777
	2,169,186	2,105,031

23. Pension fund obligations

The Company's obligation to refund the indexation charges on retirement payments to current and former employees, which hold pension rights with state and communal pension funds amounted to USD 40.6 million at year end 2017 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest rates in excess of price increase are assessed at 3.5% and salary increase in excess of price increase is assessed at 1.5% per year on average. Premises on life expectancy and mortality are in accordance with the provisions of Regulation No. 391/1998 on obligatory pension benefits and operation of pension funds. The calculated retirement age is 68 years for current employees and 65 years for non-employees with vested benefits. This is consistent with criterion used by the Pension Fund for State Employees.

Change in the obligation is specified as follows:	2017	2016
Balance at 1.1.	35,383	27,663
Expensed during the year	887	825
Payments during the year	(2,683)	(2,181)
Actuarial change	4,137	4,859
Effect of foreign exchange rate changes	2,873	4,217
Balance at 31.12.	40,597	35,383

Pension fund obligation, 5 year statement:	2017	2016	2015	2014	2013
Present value of the obligation	40,597	35,383	27,663	26,345	27,007

24. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:	2017	2016
Balance at 1.1.	7,023	6,997
Reversal of discount in the year	1,467	26
Increase in obligation	61	0
Balance at 31.12.	8,551	7,023

In accordance with IFRS, the initial value of fixed operating assets shall include estimated cost of their demolition after their use. Estimated demolition cost of power lines has been assessed and discounted on the basis of the useful life. In return, an obligation has been written up among long-term liabilities. A change in the obligation is recognised in the income statement amounting to the discounted value.

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Notes, contd.

25. Accounts payable and other payables

Accounts payable and other payables are specified as follows:

	2017	2016
Accounts payable	52,611	45,662
Accrued interests	20,870	16,846
Other short term liabilities	19,547	20,245
	93,028	82,753

26. Related parties

Definition of related parties

Owners, associated companies, members of Boards of Directors, key management and companies and institutions owned by them are among the Company's related parties.

Transactions with related parties	**2017**	**2016**
Other income		
Associated companies	54	80
Interest income		
Associated companies	0	925
Expenses		
Associated companies	0	0
Receivables		
Associated companies	15	80

Transactions with related parties are on the same basis as transactions with non-related parties. Transactions with the State or companies or institutions owned by the State are not specified as a separate item but such transactions are comparable to transactions with non related parties. The Group applies an exemption from disclosure requirements of IAS 24 as the Parent Company is owned by the State. See further information in note 19.

27. Fees to auditors

Fees to auditors of the Group in the year 2017 amounted to USD 341 thousand (2016: USD 263 thousand), whereof USD 212 thousand (2016: USD 173 thousand) was for the audit of financial statements.

28. Risk management

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
- Generally accepted methods are used in evaluating risk
- Effective management is applied in accordance with authorisations
- Effective monitoring of 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

The Company has implemented a formal process in risk management in order to identify the most important factors. Management and key employees of Landsvirkjun identify financial and non-financial risks for Landsvirkjun and evaluate their significance. The results are registered in the Company's risk portfolio and used to decide on appropriate action and management, with respect to possible effects on image, financial position, health and safety, environment and compliance.

Consolidated Financial Statements of Landsvikjun 2017 27 Amounts are in USD thousand

28. Risk management contd.:

The Board of Directors appoints the board risk committee, which consists of three board members, that confirms the effectiveness of the Company's risk management and assists the Board with supervision of key risks and the Company's actions in managing risks.

The Company's executive risk committee revalues and approves processes relating to the Company's risk management. It is a venue for consultation regarding risk management and ensures that the Company operates in accordance with risk policy. The executive risk committee consists of the CEO, Deputy CEO and CFO. The CEO is chairman of the executive risk committee.

29. Financial risk

The treasury division is entrusted with analysing, managing and providing information regarding Landsvirkjun's financial risks. The Company's financial risk is divided into market risk, liquidity risk and counterparty risk, but the Company's market risk consists mainly of three risk categories:

- Aluminium price risk due to fluctuations in the global market price of aluminium
- Interest rate risk due to the Company's liabilities
- Foreign exchange risk due to liabilities and cash flow

Landsvirkjun has been focused on reducing market risk in the last few years. For this purpose the ratio of USD and fixed interests has been significantly increased. Efforts have been made to reduce the ratio of aluminium linked revenue in electricity sales and new sales agreements have not been linked to aluminum price. Further efforts will be made in the year 2018 in reducing Landsvirkjun's market risk.

30. Aluminium price risk

The Company is exposed to market risk due to possible aluminium price fluctuations as around a quarter of its income is linked to the aluminium price. Thus, the Company has entered into derivative agreements in order to secure its income base and reduce fluctuations. Such agreements consist in most cases of fixing the aluminium price at a certain level. Therefore, the Company can lose income if the aluminium price goes up, but at the same time guarantees income should the aluminium price come down. About 64% of the estimated cash flow of 2018 and 22% of 2019 has been hedged. At year end 2017, fair value of the hedges was negative by USD 16.1 million (2016: positive USD 0.2 million).

Embedded derivatives

Landsvirkjun's contracts for sale and purchase of electricity are linked to aluminium prices and form embedded derivatives which are recognised in the Company's financial statements. Embedded derivatives in electric power contracts are recognised in the balance sheet at fair value on the reporting date. Fair value changes are recognised in the income statement among financial income and expenses.

	2017	2016
Fair value of embedded derivatives is specified as follows:		
Fair value of embedded derivatives at the beginning of the year	(31,050)	(52,214)
Fair value changes during the year	84,494	21,164
Fair value of embedded derivatives at year end	53,444	(31,050)
Division of embedded derivatives is specified as follows:		
Long term component of embedded derivatives	47,194	(25,229)
Short term component of embedded derivatives	6,250	(5,821)
Total embedded derivatives	53,444	(31,050)

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30. Aluminium price risk contd.:

The main assumptions Landsvirkjun uses in the evaluation of embedded derivatives are as follows:

Calculations are based on the forward price of aluminium, as disclosed in the LME and are based up on the maximum time length of forward aluminium prices, or 123 months. Management's opinion is that aluminium price expectations after ten years will reflect the aluminium price at the time the agreements were made and therefore fair value changes will not arise for that period.

The calculations are limited to the revision time of electric power sales agreements or length of agreements. The time length can though never be more than the aforementioned 123 months.

According to provisions on energy buyers' purchase obligation the calculation is based on a secured minimum purchase.

Expected cash flow of contracts is discounted at USD rates according to Bloomberg, no spread added. At year end 2017, rates for discounting were in the range of 1.6 - 2.4% (2016: 0.8 - 2.4%).

Sensitivity analysis of aluminium price risk

The following tables show effects of changes in aluminium prices on fair value of financial instruments linked to aluminium prices. Amounts are in thousands of USD, pre tax.

31/12/2017	**Aluminum price USD/ton**	
	-100	+100
Embedded derivatives	(13,667)	13,667
Aluminium hedges	5,695	(5,917)
	(7,972)	7,750

31/12/2016	**Aluminum price USD/ton**	
	-100	+100
Embedded derivatives	(19,163)	18,859
Aluminium hedges	3,274	(3,412)
	(15,889)	15,447

31. Foreign exchange risk

Foreign exchange risk is the risk of loss due to unfavourable changes in foreign exchange rates. Landsvirkjun's foreign exchange risk is due to cash flows, assets and liabilities in addition to transactions in other currencies than the functional currency.

Landsvirkjun's functional currency is the USD and therefore a foreign exchange risk arises from the cash flow and open balances in currencies other than the USD. The Company's income is mainly in USD. Other income is mainly in ISK and NOK but foreign exchange risk due to those currencies is limited due to netting in the cash flow in ISK and income in NOK is relatively low. Currency risk due to amortisation and interest payments over the next years has been limited with derivative agreements.

The Company's reporting risk related to changes in exchange rate arises mainly due to its debt in EUR and ISK which are mainly long-term loans. The following table shows Landsvirkjun's open balance in currencies other than the functional currency.

Notes, contd.

31. Foreign exchange risk contd.:

Landsvirkjun's foreign exchange risk relating to monetary assets and liabilities at year end is specified as follows:

2017	EUR	ISK	CHF	Other currencies
Accounts receivables and other receivables	736	24,420	0	1,994
Cash and cash equivalents	2,903	18,310	199	3,172
Long term loans	0	2,214	0	0
Interest bearing liabilities	(392,671)	(295,793)	(27,044)	0
Derivatives	57,483	255,307	0	0
Accounts payable and other payables	(3,980)	(81,396)	(1)	(352)
Risk in balance sheet	(335,529)	(76,938)	(26,846)	4,814

2016	EUR	ISK	CHF	Other currencies
Accounts receivables and other receivables	354	17,903	0	1,868
Cash and cash equivalents	555	9,944	4,828	493
Long term loans	0	2,129	0	0
Interest bearing liabilities	(483,486)	(267,686)	(31,661)	0
Derivatives	161,557	42,978	0	0
Accounts payable and other payables	(3,187)	(75,142)	0	(465)
Risk in balance sheet	(324,207)	(269,874)	(26,833)	1,896

Exchange rates of the main currencies against the USD for the years 2017 and 2016 are specified as follows:

	Average rate		Rate at year end	
	2017	2016	2017	2016
EUR	0.89	0.90	0.84	0.95
GBP	0.78	0.74	0.74	0.81
CHF	0.98	0.99	0.98	1.02
JPY	112.26	108.65	112.55	116.84
NOK	8.27	8.40	8.20	8.61
ISK	106.78	120.67	104.42	112.82

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31. Foreign exchange risk contd.:

Sensitivity analysis

The change of the USD by 10% against the following currencies, would have changed the Group's results and equity by the following amounts before tax. Sensitivity against ISK has decreased due to cross currency swaps entered into this year. The analysis includes monetary assets and liabilities and assumes that all other variables, especially interest rates, remain unchanged.

	Profit (loss) / Equity	
2017	Strengthening	Weakening
EUR	33,553	(33,553)
ISK	7,694	(7,694)
CHF	2,685	(2,685)
Other currencies	(468)	468
2016	Strengthening	Weakening
EUR	32,380	(32,377)
ISK	27,085	(27,085)
CHF	2,683	(2,683)
Other currencies	(87)	87

The fair value of currency swaps was positive by USD 18.2 million at the end of December 2017 (2016: negative by USD 15.1 million).

32. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's interest bearing assets and liabilities carry both fixed and floating interest rates and interest rate derivatives and currency swaps are used in order to manage interest rate risk. The fair value of interest rate swaps was negative by USD 0.7 million at year end 2017 (2016: negative by USD 3.4 million). The Company's risk consists of a possible increase in floating interest rates on loans which can lead to an increase in finance expenses.

At year end 2017, the proportion of loans with fixed interest rates including swap agreements was 68% (2016: 60%). At year end 2017, the estimated market value of the Company's long-term liabilities was USD 173 million higher than their book value (2016: USD 151 million higher) discounted by the underlying currencies yield curve without spread. The following table shows the division of financial assets and liabilities between floating and fixed interests.

Financial instruments with fixed interest	**2017**	**2016**
Interest bearing liabilities	(1,125,864)	(934,826)
Currency and interest rate swaps	(339,124)	(343,543)
	(1,464,988)	(1,278,369)
Financial instruments with floating interest		
Cash and cash equivalents	126,544	144,534
Interest bearing liabilities	(1,043,322)	(1,170,205)
Currency and interest rate swaps	357,662	321,909
	(559,116)	(703,762)

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32. Interest rate risk, contd.,

Sensitivity analysis of interest risk

The following tables show the effect of changes in interest rates on book value and cash flows for one year. The amounts are in USD thousand before tax.

31/12/2017	**Cash flow**		**Book value**	
	-100 bps	+100 bps	-100 bps	+100 bps
Embedded derivatives	0	0	2,887	(2,690)
Other derivatives	(3,301)	3,525	(247)	848
Interest bearing liabilities	6,885	(9,645)	0	0
Cash and cash equivalents	(1,265)	1,265	0	0
	2,319	(4,855)	2,640	(1,842)

31/12/2016	**Cash flow**		**Book value**	
	-100 bps	+100 bps	-100 bps	+100 bps
Embedded derivatives	0	0	(979)	938
Other derivatives	(1,604)	2,793	(375)	1,041
Interest bearing liabilities	7,136	(10,639)	0	0
Cash and cash equivalents	(1,445)	1,445	0	0
	4,087	(6,401)	(1,354)	1,979

33. Liquidity risk

Liquidity risk consists of risk of losses should the Company not be able to meet its obligations at maturity date. Landsvirkjun limits liquidity risk with effective liquidity management by ensuring that there is sufficient cash at each time in order to be able to meet obligations. In order to keep balance between liabilities and expected revenues an emphasis is placed on a secure liquidity position in the form of cash and access to revolving credit facilities.

The Company's cash and cash equivalents amounted to USD 127 million at year end 2017 (2016: USD 145 million) but when taking into account undrawn short term credit facilities (USD 250 million and ISK 12,000 million) and undrawn long term credit facilities amounting to USD 56 million Landsvirkjun has access to a total of USD 548 million (2016: USD 617 million). Cash flow from operations, well organised maturity profile with strong liquidity, and access to credit facilities secure the Company's liquidity at least throughout the year 2019.

In order to ensure access to capital and maintain flexible funding possibilities, Landsvirkjun has used different types of funding such as from the Nordic Investment Bank (NIB), European Investment Bank (EIB) and through export credit financing. However, financing has mostly been through issuance of bonds under the Euro Medium Term Note Programme (EMTN).

- At year end 2017, the balance of loans under the EMTN with state guarantee was USD 904 million (2016: USD 1.0 billion). The total amount can at maximum be USD 2.5 billion.
- At year end 2017, the balance of loans under the EMTN without state guarantee was USD 115 million (2016: USD 115 million). The total amount can at maximum be USD 1.0 billion.

The Company's risk related to refinancing is reduced with an even maturity profile and long loan terms of outstanding loans. Weighted average life of the loan portfolio is 5.3 years and the proportion of loans with maturity within 12 months is 13%.

33. Liquidity risk, contd.,

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

2017	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Cash and cash equiv.	126,544	126,544	126,544	0	0	0
Short term receiv.	66,383	66,383	66,383	0	0	0
Interest bearing liabilities ..	(2,169,186)	(2,554,443)	(315,905)	(249,237)	(780,515)	(1,208,786)
Current liabilities	(111,066)	(111,066)	(111,066)	0	0	0
	(2,087,325)	(2,472,582)	(234,044)	(249,237)	(780,515)	(1,208,786)
Derivative financial instruments						
Currency swaps	18,247	15,576	(610)	1,716	14,470	0
Interest rate swaps	(679)	(696)	(696)	0	0	0
Aluminium derivatives	(16,110)	(14,804)	(13,068)	(1,736)	0	0
Embedded derivatives in electr. sales agr.	53,444	60,451	6,319	6,771	13,866	33,495
	54,902	60,527	(8,055)	6,751	28,336	33,495

2016	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Cash and cash equiv.	144,534	144,534	144,534	0	0	0
Short term receiv.	72,599	72,599	72,599	0	0	0
Interest bearing liabilities ..	(2,105,031)	(2,447,520)	(254,563)	(320,139)	(813,553)	(1,059,265)
Current liabilities	(96,874)	(96,874)	(96,874)	0	0	0
	(1,984,772)	(2,327,261)	(134,304)	(320,139)	(813,553)	(1,059,265)
Derivative financial instruments						
Currency swaps	(15,139)	(16,458)	(19,659)	(895)	4,096	0
Interest rate swaps	(3,363)	(3,082)	(2,464)	(618)	0	0
Aluminium derivatives	203	309	83	226	0	0
Embedded derivatives in electr. sales agr.	(31,050)	(32,891)	(5,860)	(5,771)	(14,813)	(6,447)
	(49,349)	(52,122)	(27,900)	(7,058)	(10,717)	(6,447)

34. 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, derivative contracts and cash and cash equivalent. Though the amounts involved can be considerably high, the risk is limited by the Company´s requirements for take or pay clauses in power agreements and also through requirements for counterparty guarantees. Landsvirkjun requires that counterparties have an investment grade credit rating when it comes to keeping cash and cash equivalents and entering into derivative contracts.

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Notes, contd.

34. Counterparty risk contd.:

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

	2017	2016
Derivative financial instruments	74,471	12,737
Accounts receivables and other receivables	66,383	72,599
Cash and cash equivalents	126,544	144,534
	267,398	229,870

35. Comparison of fair value and book value of long-term debt

	2017		2016	
	Book value	Fair value	Book value	Fair value
Interest bearing long term liabilities	2,169,186	2,342,525	2,105,031	2,255,797

The fair value of other financial assets and liabilities is measured at book value.

Fair value of interest bearing long term liabilities of the parent is calculated by discounting the expected cash flows with the underlying currencies yield curve.

Interest rates are specified as follows:	2017	2016
Interest bearing liabilities in ISK	1.9 - 2.0%	2.6 - 2.9%
Interest bearing liabilities other than in ISK	-0.7 - 2.6%	-0.8 - 2.6%

36. Fair value classification

The table shows the level categorisation for items in the financial statements recognised at fair value.

	Level 2	Level 3	Total
2017			
Embedded derivatives		53,444	53,444
Other derivatives	(13,228)	14,686	1,458
Revaluation of property, plant and equipment		250,960	250,960
Shares in other companies		163	163
	(13,228)	319,253	306,025
2016	**Level 2**	**Level 3**	**Total**
Embedded derivatives		(31,050)	(31,050)
Other derivatives	(23,324)	5,025	(18,299)
Revaluation of property, plant and equipment		263,770	263,770
Shares in other companies		150	150
	(23,324)	237,895	214,571

Main assumptions for valuation of derivatives can be seen in notes 12 and 30 and for revaluation of property, plant and equipment in note 8.

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Notes, contd.

37. Classification of financial instruments

Financial assets and liabilities are divided into defined groups. The classification affects how evaluation of the relevant financial instrument is measured. Those groups to which the Company's financial assets and liabilities pertain and their basis for evaluation are specified as follows:

- Assets and liabilities held for trading - are recognised at fair value through profit and loss.
- Financial assets and liabilities - are denominated at fair value and recognised at fair value through p&l.
- Loans and receivables - are recognised at amortised cost.
- Other financial liabilities - are recognised at amortised cost.

Financial assets and liabilities are divided into the following groups of financial instruments:

2017	Assets and liabilities held for trading	Financial assets and liabilities	Loans and receivables	Other financial liabilities	Book value
Derivative financial instruments	74,471				74,471
Shares in other companies		163			163
Accounts receivables and other receivables			66,383		66,383
Cash and cash equivalents			126,544		126,544
Total assets	74,471	163	192,927	0	267,561
Interest bearing long term liabilities				2,169,186	2,169,186
Derivative financial instruments	19,569				19,569
Accounts payable and other payables				111,066	111,066
Total liabilities	19,569	0	0	2,280,252	2,299,821
2016					
Derivative financial instruments	12,737				12,737
Shares in other companies		150			150
Accounts receivables and other receivables			72,599		72,599
Cash and cash equivalents			144,534		144,534
Total assets	12,737	150	217,133	0	230,020
Interest bearing long term liabilities				2,105,031	2,105,031
Derivative financial instruments	62,086				62,086
Accounts payable and other payables				96,874	96,874
Total liabilities	62,086	0	0	2,201,905	2,263,991

38. Capital management

Landsvirkjun places emphasis on maintaining a strong equity base supporting further development of the Company.

39. Other matters

EFTA Surveillance Authority (ESA) initiated an investigation in May 2017 in order to examine whether the Icelandic government has provided illegal state aid to Landsvirkjun through a state guarantee on derivative agreements. ESA has received comments from the Icelandic government and Landsvirkjun regarding the matter which is still under review by ESA.

40. Subsequent events

Nothing has come forth after the balance sheet date, which would require adjustments or changes to the financial statements for the year 2017.

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41. Significant accounting policies

The Group has adopted all International Financial Reporting Standards, amendments thereto and interpretations adopted by the EU at year end 2017. It is the opinion of management that the implementation of new and amended standards and interpretations did not have significant effects on the consolidated financial statements. The Group has not adopted new or amended standards which have been issued but not entered into effect.

New standards and interpretations

A number of new standards are effective for annual periods beginning after 1 January 2017 and earlier application is permitted; however, the Group has not early adopted the new or amended standards in preparing these consolidated financial statements. The new standards that are expected to be relevant to the Group's financial statements are described below.

IFRS 9 a new standard which sets out requirements for recognising and measuring financial assets and financial liabilities. IFRS 9 was published in July 2014 and replaces IAS 39. The standard included significant changes from IAS 39 regarding financial assets. IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, FVOCI and FVTPL. A financial asset is measured at amortised cost if the business model assumes it is held to collect contractual cash flows and the provision of the contract describe cash flows on fixed dates which are only payment related to principal and interest of principal. All other financial assets are measured at fair value. The new standard assumed that one impairment model is used, adds guidance relating to classification and measurement of financial liabilities and sets a new general standard for hedge accounting. The standards' effective date is January 1, 2018 but earlier adoption is permitted. The Group has assessed the effects of the new standards and has concluded that they are insignificant.

IFRS 15, Revenue from Contracts with Customers, is a new standard which replaces IAS 18, Revenue, IAS 11, Construction Contracts and related interpretations. The purpose of the standard is to establish a new framework for recognition of revenue and changes how to decide whether revenue are recognised over a period or at a certain point of time. IFRS 15 establishes a framework regarding disclosure of information such as nature, amount, timing and uncertainty relating to revenue and cash flow of contracts with customers to the users of the financial information. IFRS 15 does not apply to income from financial instruments and lease income.

The principle of IFRS 15 is that revenue shall be recognised in a way which reflects the transfer of goods and service to customers in relation to the amount which the Company expects to receive in trade for those goods and service. Revenues shall be recognised according to that principle by applying the five step model of the standard in order to determine when to recognise revenues and by which amount.

The standard is effective for annual periods which begin on or after January 1, 2018. The management of Landsvirkjun has assessed the effects of the new standards and has concluded that they are insignificant. Disclosures in the Company’s financial statements for the year 2018 relating to revenue will however change is accordance with the new standard.

Notes, contd.

41. Significant accounting policies, contd.:

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard - i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The standard is effective for annual periods beginning on or after 1 January 2019. The Group expects that the implementation of the standard will not have significant effects on its financial statements.

42. Basis of consolidation

Subsidiaries are entities controlled by the Company. A company controls an entity when it has the power to govern the investment, is exposed to, or has rights to variable returns from its involvement in the investment and has the ability to affect those returns through its power over the investment. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Financial performance of subsidiaries have been taken into account. When the Company's share of losses exceeds its interest in a subsidiary, the carrying amount of that interest 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 subsidiary. In case of a profit on the operation of a subsidiary in subsequent periods, a share in their profit is not recognised until the share in a loss has been fully set off.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Company's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Assets and liabilities of subsidiaries with another functional currency than the Parent Company are translated to USD at the exchange rate ruling at the accounting date. Income and expenses of that operation are translated to USD at the average exchange rate of the year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of comprehensive income and under equity. Amounts in the statement of cash flow are translated to USD at the average exchange rate of the year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of cash flow.

43. Associated companies

Associated companies are those companies in which the Group has significant influence, but not control, over financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50% of the voting power of another entity, including any other possible voting power.

The consolidated financial statements include share in the profit or loss of associated companies accounted for using the equity method, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds the book value of an associated company the book value is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the associated company. If in subsequent periods there is a profit on the operation of associated companies, the share in the profit is not recognised until the previous share in losses has been set off.

Notes, contd.

44. Operating revenues

Revenues from sales and transmission of electricity consists of sales to power intensive industries and public utilities based on measured delivery of electricity during the period. Other service income is recognised when earned or upon delivery.

45. Interest income and expenses

Interest income and expenses are recognised in the income statement using the effective interest method. Interest income and expenses include bank rates, premium, realised interest rate swaps and other differences arising on initial book value of financial instruments and amounts on the date of maturity using the effective interest method.

Effective interest is the imputed rate of interest used in determining the current value of estimated cash flow over the estimated useful life of a financial instrument or a shorter period if applicable, so that it equals the book value of the financial asset or liability in the balance sheet. When calculating the effective interest rate, the Company estimates cash flow taking into account all contractual aspects of the financial instrument.

46. Other financial income and expenses

Other financial income and expenses include profit or loss on assets and liabilities held for trading and all realized and unrealized fair value changes and changes in foreign exchange rates.

47. Foreign currency transactions

Transactions in foreign currencies are recognised at the exchange rate ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are recognised at the exchange rate ruling at the end of the year. The foreign currency gain or loss thereon relating to USD is recognised in the income statement. Non-monetary assets and liabilities measured at cost value in a foreign currency are translated to USD at the exchange rate ruling at the date of the transactions. Tangible assets and liabilities recognised in foreign currencies at fair value are translated to USD at the exchange rate ruling at the date of determination of fair value.

48. Impairment

a) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of a financial asset available for sale is calculated by reference to its fair value at each time.

Impairment loss on financial assets is recognised in the income statement. Accumulated loss on financial assets available for sale previously recognised among equity, is recognised in the income statement when the impairment loss has incurred.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and debt securities which are financial assets available for sale, the reversal is recognised in the income statement. For equity securities which are financial assets available for sale, the reversal is recognised in the statement of comprehensive income.

48. Impairment, contd.:

b) Other assets

The carrying amounts of the Company's other 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. Intangible assets with unspecified useful lives are tested annually for impairment.

An impairment loss is expensed if the carrying amount of the asset or its cash generating unit exceeds its recoverable amount. A cash generating unit is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or cash generating units. Impairment loss is first recognised in the income statement and then to reduce the carrying amounts of the fixed assets in the cash generating unit.

The recoverable amount of an asset or cash generating unit is the greater of its value in use and its net fair value. Value in use is based on the estimated future cash flows, 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 assets.

For other assets, 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.

49. Income tax

Income tax on the results for the year consists of current income tax and deferred income tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity or in statement of comprehensive income, in which case income tax is recognised among those items.

Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, in addition to adjustments made to current income tax of previous years.

A deferred income tax asset (liability) is recognised in the financial statements. Its calculation is based on the difference in balance sheet items, according to the tax return, on the one hand, and the consolidated financial statements, on the other hand. The difference thus arising is due to the fact that the tax assessment is based on premises other than the Group's financial statements and is in main respect a temporary difference as expenses are entered in the financial statement in another period than in the tax return. Calculation of deferred tax is based on the expected tax ratio when temporary differences are estimated to be reversed based on current law at the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against the asset. The tax asset is calculated at each reporting date and decreased to the extent that is considered likely that it will not be utilised against future taxable profit.

50. Property, plant and equipment

Property, plant and equipment are initially measured at cost.

The cost of renewing single items of fixed asset is capitalised if it is considered likely that the proceeds on the asset will revert to the Company and the cost can be measured reliably. All other cost is expensed in the income statement as it is incurred.

The Group's transmission and telecommunication systems are recognised at a revalued cost in the balance sheet, which is their fair value less depreciation from the date of revaluation. The revaluation of those assets is carried out on a regular basis. All value increase due to the revaluation is recognised in the revaluation account among equity after income tax effect. Depreciation of the revalued cost is recognised in the income statement. Upon the sale, depreciation or disposal of an asset, the part of the revaluation account pertaining to the asset is transferred to retained earnings.

Other operating assets are capitalised at cost less accumulated depreciation and impairment.

Initial value of fixed assets includes the estimated cost of demolition following their use. Estimated demolition cost of power lines has been measured at a discounted value based on the useful life and an obligation in relation thereto has been recognised among long-term liabilities. A change in the obligation due to the discounted value is recognised through the income statement in addition to depreciation of demolition cost.

Cost value consists of all cost incurred due to the acquisition of the asset. Cost value of fixed assets constructed in own account is the aggregate cost of construction, such as cost of material and salaries in addition to all other costs the Company incurs in making the asset operative.

If single items of fixed assets have different estimated useful lives, they are divided in accordance with their different useful lives.

Interest expense on loans used to finance the cost value of projects are capitalised at the time of construction.

Profit or loss on the sale of fixed assets is the difference between the sales value and the book value of the asset and is recognised in the income statement.

Notes, contd.

Depreciation

Depreciation is calculated as a fixed annual percentage based on the estimated useful lives of the operating assets.

Depreciation method, estimated useful life and residual value are revalued at each accounting date.

Depreciation ratios and useful life are specified as follows:

	Depreciation	Useful life
Power stations:		
Power houses and other structures	1.67%	60 years
Machinery	2.5-6.67%	15-40 years
Dams and waterways	1.67-3.33%	30-60 years
Thermal stations	1.67-6.67%	15-60 years
Windmills	5.00%	20 years
Substations	2.5-5%	20-40 years
Power lines	1.67-5%	20-60 years
Optical fibre	2.5-5%	20-40 years
Masts	7.00%	15 years
Telecommunication buildings	6.00%	17 years
Other telecommunication equipment	14-15%	7 years
Office buildings	2.00%	50 years
Equipment	10-25%	4-10 years
Vehicles	10-20%	5-10 years

51. Intangible assets

Intangible assets are recognised at cost value, less accumulated impairment loss and amortisation.

Expenditure for general research cost is expensed in the period it incurs. Development cost for future power projects is capitalised among fixed assets, such as cost of materials, salary cost and all cost incurred by the Company in relation to capitalised development cost. Development cost is only capitalised if there is probability of future economic benefit and the Company intends and is able to conclude, use or sell it. The useful life of development cost is assessed to be unlimited until a decision is made concerning its use or sale, thus the cost is not depreciated at this stage but account is taken for possible impairment loss if a project changes.

Water and geothermal rights are capitalised in the balance sheet at cost value as intangible assets with unlimited useful life since it cannot be determined when these rights will no longer be financially viable.

Other intangible assets are stated at cost less accumulated amortisation and impairment loss.

Subsequent cost is only capitalised if it increases the estimated future economic benefit of the asset it relates to. All other cost is expensed in the income statement when incurred.

Depreciation is calculated on a straight line basis, based on the estimated useful lives of intangible assets from the date that they become applicable. Amortisation and estimated useful life is specified as follows:

	Depreciation	Useful life
Software	25%	4 years

Consolidated Financial Statements of Landsvikjun 2017 41 Amounts are in USD thousand

Notes, contd.

52. Financial instruments

a) Non-derivative financial assets

Non-derivative financial assets are recognised when the Company becomes a part of contractual provisions of the relevant financial instrument.

Financial assets are derecognised if the Company's contractual right to cash flow due to the asset expires or the Company transfers the assets to another party without holding back control or almost all the risk and gain involved in the ownership. The component of the transferred financial assets arising or retained by the Company is recognised as a specific asset or liability.

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

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

i) Financial assets measured at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is classified as held-for-trading or is designated as such on initial recognition. Upon initial recognition attributable transaction costs are recognised in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value in the balance sheet, and changes therein are recognised in the income statement.

Financial assets at fair value through profit or loss are shares in other companies and marketable securities.

ii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially measured at fair value plus all direct transaction costs. Subsequent to initial recognition, loans and receivables are recognised at the amortised cost value based on effective interests, less impairment if detected.

Loans and receivables comprise cash and cash equivalents, trade and other receivables. Cash and cash equivalents consist of cash and deposits on demand within three months.

iii) Assets available for sale

Assets available for sale are non-derivative financial assets held for sale and are not categorised in the aforementioned groups. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment loss and foreign exchange differences, are recognised among other income and expenses in the statement of comprehensive income and stated as a separate item in equity.

b) Non-derivative financial liabilities

Non-derivative financial liabilities are initially measured at fair value plus all direct transaction costs. Subsequent to initial recognition the liabilities are recognised at the amortised cost value based on effective interests.

The Group derecognises a financial liability when the contractual obligations due to the debt instrument expire.

The Company's non-derivative financial liabilities are loans, accounts payables and other payables.

52. Financial instruments, contd.

c) Derivative financial instruments

The Company enters into derivative financial instruments to hedge its foreign currency, interest rate and aluminium price risk exposures. Derivative financial instruments are recognised initially at fair value. Direct transaction cost is recognised in the income statement as it incurs. Subsequent to initial recognition, derivative financial instruments are recognised at fair value in the balance sheet and fair value changes are recognised in the income statement among financial income and expenses. Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies.

i) Separable embedded derivatives

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, other instruments with the same provisions as the embedded derivative would be defined as a derivative and the hybrid contract is not stated at fair value in the income statement.

Changes in the fair value of separable embedded derivatives are recognised in the income statement among financial income and expenses.

53. Inventories

Inventories are stated at the lower of the cost value or the net sales value. Cost value of inventories is based on “the First In First Out method” and includes cost incurred upon the purchase of the inventories and in bringing them to the sales location and in a saleable state.

54. Cash and cash equivalents

Cash and cash equivalents consist of cash, short-term market securities and demand deposits.

55. Equity

The Group’s equity is divided into owners’ contribution, revaluation account, translation difference, restricted reserves, other equity and minority interest. The Parent Company’s initial capital amounts to USD 587 million.

56. Employees’ benefits

a) Defined contribution plan

Cost due to contribution to defined benefit plans is expensed in the income statement among salaries and salary related expenses when incurred.

b) Defined benefit plan

The Company’s obligation due to defined benefit plans is calculated by estimating the future value of defined pension benefits accrued by current and former employees in current or previous periods. The benefits are discounted in order to determine their present value. An actuary has calculated the obligation on the basis of a method, which is based on accrued benefits. Actuarial changes in the obligation are recognised among operating items under equity in the statement of comprehensive income. Other changes are recognised in the income statement.

57. Provisions

Obligations are recognised in the balance sheet when the Company has a legal obligation or entered into obligations due to past events, it is considered probable that they will be settled and they can be reliably measured. The obligation is assessed on the basis of estimated future cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

58. Operating segments

A segment is a distinguishable component of the Group, which is subject to risks and returns, including income and expenses related to other segments of the Group. In determining the distribution of resources to segments and evaluating the results, the return of the segments is reviewed by management on a regular basis.

Segment operating results, assets and liabilities consist of items that can be directly linked to each segment, in addition to the items that can be reasonably divided into segments.

Appendix I: Statement of Corporate Governance

Corporate Governance

Organisation

Landsvirkjun's operation is subject to Act No. 42/1983, with subsequent amendments. The Board of Directors of Landsvirkjun has established working procedures for the Board for further compliance with the law.

Role, aim, vision and values

Landsvirkjun is an energy company owned by the Icelandic State. Landsvirkjun's role is to maximise the yield of energy resources entrusted to the Company with emphasis on sustainable use, valuable products and efficiency. In order to uphold its role with ambition the Company has defined the following goals: Practise efficient electricity production and development, serve a diverse client base, connect prices to European electricity markets, constantly develop skills and capabilities of the employees, and to encourage unity and support from stakeholders via open and clear communication.

Landsvirkjun's future vision is to be a progressive electricity company in the field of renewable energy. The company wants to be amongst the best in generating and selling energy.

The values of the company are progressiveness, prudence and reliability.

The Board of Directors

According to law, the Board of Directors of Landsvirkjun is appointed by the Minister of Finance for a one year term at a time and it is responsible for the financial matters and operation of Landsvirkjun. The Board of Directors of Landsvirkjun consists of the following Directors: Jónas Þór Guðmundsson, Supreme Court Attorney, who is also the Chairman of the Board, Haraldur Flosi Tryggvason, District Court Attorney, Vice Chairman of the Board, Álfheiður Ingadóttir, biologist, Ragnheiður Elín Árnadóttir, political scientist, and Kristín Vala Ragnarsdóttir, professor.

Audit committee

Chapter IX of the Financial Statements Act No. 3/2006, cf. Act No. 80/2008, applies to the audit committee of Landsvirkjun. The working procedures for the committee are established by the Company's Board of Directors for further compliance with the law. The audit committee of Landsvirkjun exercises advisory functions for the Board and operates on the basis of the Board's authorisation. The committee has no executive power. The Company's audit committee consists of three individuals; two board members, Jónas Þór Guðmundsson and Álfheiður Ingadóttir, and Heimir Haraldsson, auditor and chairman of the committee.

Remuneration committee and risk management committee

The remuneration committee consist of three board members, Jónas Þór Guðmundsson, Haraldur Flosi Tryggvason and Ragnheiður Elín Árnadóttir. The risk management committee consists of Jónas Þór Guðmundsson, Haraldur Flosi Tryggvason and Kristín Vala Ragnarsdóttir.

Internal audit

The Company has entered into an agreement with KPMG for provision of internal audit services. The role of internal auditor is to perform analysis of certain aspects of internal audit in accordance with a plan approved by the audit committee.

Appendix I: Statement of Corporate Governance, contd.

CEO, Deputy CEO and Executive Directors

The CEO is Hörður Arnarson. The Board of Directors and the CEO exercise executive power in the Company. Deputy CEO is Ragna Árnadóttir. The Deputy CEO’s roles is to stand in for the CEO in his absence and manages the CEO's office, which handles collective matters of the Company and policy development, and ensures good corporate governance. The CEO's office consists of supporting departments which are responsible for processing collective matters of Landsvirkjun.

Executive Board consists of the CEO, Deputy CEO and heads of each division. There were five heads of divisions at the end of the year.

Finance division. The Company’s CFO is Rafnar Lárusson. The role of the division is to create basis for profitable operation and contribute to maximum results in all units of the Group.

Project planning division. The Head of project planning division is Gunnar Guðni Tómasson. The role of the division is to manage Landsvirkjun’s power plant constructions from development to fully operative power plants. The division monitors costs, quality and work progress and ensures that projects are delivered fully operative in accordance with the Company’s presumptions, estimates and needs.

Marketing and business development division. Head of marketing and business development is Birna Ósk Einarsdóttir. The role of the division is to maximise the Company’s revenue by analysing new business opportunities, product development, promotion and sales of products and services, negotiating contracts and follow up of existing contracts. Birna Ósk left her position in the beginning of 2018 and Stefanía B. Halldórsdóttir took over the role in the beginning of February.

Energy division. Head of the energy division is Einar Mathiesen. The role of the division is to guarantee that energy production and distribution is in accordance with agreements with customers, guided by safety and efficiency, as well as ensuring maximum output of Landsvirkjun's processing systems.

Development division. Head of development division is Óli Grétar Blöndal Sveinsson. The role of the division is to manage the preparation of new power projects and to conduct research and monitoring of the existing power system. The division shall ensure the economic implementation of new power projects, increase flexibility in power production, and manage innovation in power production and to have a long-term vision of utilisation of energy resources.

Appendix II: Non-financial information

Business model

Landsvirkjun is an energy production company owned by the Icelandic state and produces electricity from renewable energy sources, hydroelectric power, geothermal power and wind. The Company produces over 70% of the country's electricity and is by far the largest producer of electricity in Iceland.

At the same time the Company is leading in sustainable use of energy resources and contributes to increased knowledge, innovation and technical development.

Landsvirkjun operates in an international competition market, where various industrial companies are offered competitive agreements, with a long-term secure delivery of electricity. The Company's share in this world market is negligible.

Furthermore, Landsvirkjun operates in the local wholesale market, where the customers are companies which resell electricity to homes and business entities.

Landsvirkjun's objective is to maximise the yield of energy resources entrusted to the Company with emphasis on sustainable use, valuable products and efficiency. Landsvirkjun's vision is to be a progressive electricity company in the field of renewable energy, which operates in an international environment. The values of the Company are progressiveness, prudence and reliability.

Social responsibility – policy and emphasis 2017

Landsvirkjun has defined that the Company's social responsibility is to create profit, treat resources and the environment properly and encourage that knowledge and positive effect of the Company's operations are returned to the community. The Company's policy for the field is divided into the following focus groups; corporate governance, environment, value chain, society, human resources and knowledge dissemination. Goals are developed annually in order to ensure that the policy on social responsibility is enforced. Landsvirkjun actively participates in UN Global Compact, a United Nation's project and annually produces a progress report. In 2017 a report was issued on Landsvirkjun's corporate social responsibility for the year 2016 which also served as a progress report for UN Global Compact.

In the year 2017 Landsvirkjun started to implement three of the United Nations sustainable development goals which conform well to Landsvirkjun's emphasis. These are Principles No. 5 on gender equality, No. 7 on affordable and clean energy and No. 13 on climate action.

Among key projects during the year relating to the UN goals are Landsvirkjun's cooperation with SEforAll (Sustainable Energy for All), revision of policy on energy change in transportation and campaign project regarding gender equility within the Company (see chapter on human resources).

Communication with stakeholders – risk management

The operation of Landsvirkjun can have an extensive effect on the society, in particular in communities close to the Company's power stations. One of the Company's aims is to create support and solidarity with open communication with stakeholders. In all segments and in all construction projects, a stakeholders' analysis is performed and a communication plan developed with the aim to have the optimal communication relating to the operation.

Landsvirkjun follows a formal risk management procedure for identifying and managing financial and non-financial risks in the Company's operations. The effects of the operations can be significant but by mapping the main risk factors of the Company and appropriate management, efforts are made to reduce the probability of incidents and their possible effects on image, financial position, health and security and environment.

Appendix II: Non-financial information, contd.

<u>Non-financial key indicators</u>

In developing goals and approach to the Company's corporate social responsibility, Landsvirkjun has relied on the ISO 26000 standard, Guidance on social responsibility. Progress of the previous year is reported annually and new goals developed for the coming year on the Company's website. By participating in the UN Global Compact project of the United Nations, Landsvirkjun commits to following the project's ten principles and provides progress reports regarding the individual fields. The Company is obligated to annually return progress report before a specific date and it is published on the project's website, but otherwise is included in a published list of companies which have not provided information. Furthermore, Landsvirkjun utilises selected indicators from the international standard of GRI for reports on corporate social responsibility.

Following are the main non-financial indicators for 2017:
• The ratio of women within management is above 30% (goal achieved)
• Annual accident frequency is 0 (goal achieved - no absence due to accidents in the year)

Environment

Landsvirkjun has a certified environmental control system in accordance with ISO 14001. The Company approved an environmental policy in 2006 and systematically works at preventing and reducing the environmental effects of the operations. Furthermore, the Company follows a plan of implementation in accordance with the Company's environmental policy. According to it, Landsvirkjun's environmental goals in 2017 pertain to the following factors.

• Better utilisation of resources
• Carbon neutral operations
• Operations in cohesion with nature and image
• Communications with stakeholders
• Operations without environmental incidents

Progress of the implementation plan and environmental goals was satisfactory in 2017. The Company set among others the goal that 40% of hydroelectric production would have been assessed in accordance with Hydropower Sustainability Assessment Protocol, HSAP, by an independent external party and would measure up to good practice at the end of 2017, this goal has been achieved. Furthermore, the goals on reduction of fuel use, decrease of waste and increase in sorting of waste. In 2017 a goal was set that Landsvirkjun would be carbon neutral in 2030, by increasing the share of electric cars owned by the Company, investments in renewable energy and research on multi-use of geothermal energy, in addition to that adherence to action plan on carbon binding has been successful.

The goal regarding operations without environmental incidents was not achieved in 2017, but environmental incidents decreased and were half of the incidents in the previous year.

The Company's green accounting, which has been issued annually since 2007, includes numerical information on environmental effect of the Company's operations. Green accounts of Landsvirkjun are as usual issued with the Company's annual report.

Appendix II: Non-financial information, contd.

Landsvirkjun is an active participant in international cooperation regarding renewable energy and environmental matters. This includes active participation of the Company's management in discussions on climate issues, a nordic project on the effect of climate changes on electrical power systems in the Nordic Countries and Baltic states, along with development and use of an international key index on sustainable production of hydroelectric and geothermal energy.

Human resources

Equal Opportunity Policy

A remuneration committee has been appointed according to the decision of the Board. Landsvirkjun's equal opportunity policy and action plan are in accordance with the Gender Equality Act No. 10/2008 regarding equal status and equal rights of women and men. The equal opportunity committee, which is appointed by the CEO for a term of two years, is responsible for implementing the equal opportunity policy. The committee oversees annual review of the policy and action plan. Implementation of the action plan is the responsibility of management and human resources division with assistance from the equal opportunity committee.

In 2017 Landsvirkjun received PwC's golden badge of equal pay certification for the third year in a row, and all employees participated in a workday where gender equality issues were discussed. Landsvirkjun's goal for 2017 on that the ratio of women within management is above 30% was achieved during the year. Women are now a third of the Executive Board.

In order to enhance further the success regarding equal opportunities, Landsvirkjun's CEO took a seat in the equal opportunity committee as chairman and an action plan was developed in cooperation with Capacent Consulting. Capacent's equal opportunity index is utilised in implementing the action plan. Equal opportunity index emphasises progress in the following categories; gender position in various management levels, promotion and mentoring systems, hiring procedures, culture and environment, role models and education and events. In the beginning of 2018 equal opportunity goals will be implemented with regards to the equal opportunity index for all divisions of Landsvirkjun and management will be responsible for developing equal opportunity within their divisions.

Policy on occupational safety, health and protection

Landsvirkjun is at the forefront with regards to occupational safety, health and protection. Landsvirkjun's policy is an accident free operation. Furthermore, the Company is certified in accordance with Occupational Health and Safety Assessment Series OHSAS 18001, but companies with this certification are required to constantly work on reforms relating to safety, health and general wellbeing of employees. In 2017 there was no absence due to accidents.

Human rights

Increased protection of workforce

Landsvirkjun has implemented rules regarding chain responsibility, which the Board of Directors of Landsvirkjun approved in August 2016, and these rules are aimed at ensuring that every person working for Landsvirkjun indirectly, at contractors, subcontractors or temporary work agencies, will enjoy rights and salaries in accordance with law and collective agreements on wages and working conditions. Provisions regarding chain responsibility have mainly been added to Landsvirkjun's purchase agreements, i.e. project contracts, product purchase contracts and service contracts. According to the provision, a contractor shall ensure and be responsible for that all employees, whether they are employed by the contractor, subcontractor or a temporary work agency, shall receive salaries, benefits, sickness and accident insurances and other rights in accordance with the contract, collective agreements and law in effect at each time.

Appendix II: Non-financial information, contd.

In addition, the contractor is responsible for and must have valid insurances for damages for the contractor's employees caused by accidents, illness, disease, medical costs or death which can be traced to constructions. The contractor is responsible for that subcontractors and temporary work agencies and their employees have comparable insurances.

There are penalties stipulated regarding breach of chain responsibility or if the counterparty does not provide the requested information. This enables Landsvirkjun to effectively ensure that the rules are enforced. This is an important addition to increased protection of workforce at Landsvirkjun.

The Company's policies on corruption and bribery matters

Code of Ethics for Landsvirkjun's employees was issued and implemented in December 2013. It contains nine categories, including employee safety, importance of honesty and respect in communication, treatment of confidential information and conflict of interest. Following this, code of ethics for suppliers and service providers were implemented, which are based on the code of ethics for employees and principles of UN Global Compact on human rights, labor, environment and anti-corruption. The code provides clear guidelines on what is expected with regards to sound operating and management governance and were implemented into the relevant procedures in 2015, but there were no deviations detected from these procedures in the year.

Electronic annual report at landsvirkjun.com

Further information regarding Landsvirkjun's operations, projects and events is provided in an electronic annual report which is published at www.landsvirkjun.com. It contains among others environmental report and the Company's green accounts, report on corporate social responsibility and further information about goals in these categories.