

Group

Consolidated Financial Statements 2015

Landsvirkjun  
Háaleitisbraut 68  
103 Reykjavík

Id.no. 420269-1299

## Contents

---

|   |    |
|---|----|
| Key figures .....                                   | 3  |
| Endorsement by the Board of Directors and CEO ..... | 5  |
| Independent Auditors' Report .....                  | 7  |
| Income Statement .....                              | 8  |
| Statement of Comprehensive Income .....             | 9  |
| Balance Sheet .....                                 | 10 |
| Statement of Equity .....                           | 11 |
| Statement of Cash Flow .....                        | 12 |
| Notes .....   | 13 |
| Appendix: Statement of Corporate Governance .....   | 40 |

## Key figures - Unaudited

### Management's presentation of the operation of Landsvirkjun

Amounts are in USD thousand

|   | 2015           | 2014           | 2013             | 2012           | 2011           |
|---|----------------|----------------|------------------|----------------|----------------|
| <b>Operation</b>                                      |                |                |                  |                |                |
| Operating revenues .....                              | 410,496        | 428,655        | 407,676          | 389,499        | 419,708        |
| Realised aluminium hedges .....                       | 10,956         | 9,629          | 15,228           | 18,325         | 16,488         |
| <b>Total operating revenues .....</b>                 | <b>421,452</b> | <b>438,284</b> | <b>422,904</b>   | <b>407,824</b> | <b>436,196</b> |
| Operating expenses .....                              | ( 99,932)      | ( 106,126)     | ( 93,768)        | ( 86,488)      | ( 90,993)      |
| <b>EBITDA .....</b>                                   | <b>321,520</b> | <b>332,158</b> | <b>329,136</b>   | <b>321,336</b> | <b>345,203</b> |
| Depreciation and impairment loss .....                | ( 115,554)     | ( 114,045)     | ( 117,670)       | ( 112,288)     | ( 108,200)     |
| <b>EBIT .....</b>                                     | <b>205,966</b> | <b>218,113</b> | <b>211,466</b>   | <b>209,048</b> | <b>237,003</b> |
| Financial items .....                                 | ( 73,418)      | ( 69,838)      | ( 86,988)        | ( 103,093)     | ( 126,877)     |
| Associated companies .....                            | ( 1,921)       | ( 1,419)       | ( 2,647)         | ( 2,229)       | ( 4,014)       |
| <b>Profit before unrealised financial items .....</b> | <b>130,627</b> | <b>146,856</b> | <b>121,831</b>   | <b>103,726</b> | <b>106,112</b> |
| <b>Unrealised financial items:</b>                    |                |                |                  |                |                |
| Fair value changes in embedded derivatives .....      | ( 59,925)      | ( 88,484)      | ( 174,641)       | ( 3,391)       | ( 93,197)      |
| Fair value changes in other derivatives .....         | 5,466          | ( 8,426)       | 5,014            | 13,653         | 6,959          |
| Unrealised foreign exchange difference .....          | 47,657         | 60,271         | ( 16,658)        | ( 12,675)      | 22,711         |
|   | ( 6,802)       | ( 36,639)      | ( 186,285)       | ( 2,413)       | ( 63,527)      |
| <b>Profit (loss) before income tax .....</b>          | <b>123,825</b> | <b>110,217</b> | <b>( 64,454)</b> | <b>101,313</b> | <b>42,585</b>  |
| Income tax .....                                      | ( 39,652)      | ( 31,797)      | 25,913           | ( 45,995)      | ( 16,135)      |
| <b>Net Profit (loss) .....</b>                        | <b>84,173</b>  | <b>78,420</b>  | <b>( 38,541)</b> | <b>55,318</b>  | <b>26,450</b>  |
| <b>Balance sheet</b>                                  |                |                |                  |                |                |
| Total assets .....                                    | 4,284,703      | 4,270,098      | 4,568,965        | 4,518,534      | 4,635,989      |
| Equity .....  | 1,916,634      | 1,704,724      | 1,658,134        | 1,697,152      | 1,661,312      |
| Liabilities .....                                     | 2,368,069      | 2,565,374      | 2,910,831        | 2,821,382      | 2,974,677      |
| Net debt * .....                                      | 1,985,411      | 2,190,459      | 2,429,176        | 2,435,571      | 2,502,873      |
| <b>Cash flow</b>                                      |                |                |                  |                |                |
| Funds from operations (FFO) .....                     | 240,354        | 258,226        | 257,704          | 241,584        | 255,592        |
| Cash flow from operating activities .....             | 248,955        | 233,816        | 258,485          | 236,178        | 267,172        |
| Investing activities .....                            | ( 77,486)      | ( 88,271)      | ( 149,455)       | ( 122,979)     | ( 107,689)     |
| Financing activities .....                            | ( 235,465)     | ( 220,687)     | ( 12,893)        | ( 151,670)     | ( 185,328)     |
| <b>Liquidity</b>                                      |                |                |                  |                |                |
| Cash and cash equivalents at year end .....           | 142,127        | 207,070        | 287,987          | 187,916        | 229,942        |
| Undrawn loans .....                                   | 360,824        | 200,000        | 301,947          | 409,979        | 415,767        |
| Total liquidity .....                                 | 502,951        | 407,070        | 589,934          | 597,895        | 645,709        |
| <b>Key ratios</b>                                     |                |                |                  |                |                |
| Return on equity .....                                | 4.9%           | 4.7%           | (2.3%)           | 3.3%           | 1.6%           |
| Equity ratio .....                                    | 44.7%          | 39.9%          | 36.3%            | 37.6%          | 35.8%          |
| Interest cover (EBITDA/net interest expense) .....    | 4.60x          | 3,76x          | 3,51x            | 3,27x          | 3,06x          |
| FFO / net debt .....                                  | 12.1%          | 11.8%          | 10.6%            | 9.9%           | 10.2%          |
| FFO / interest expense .....                          | 3.27x          | 2,82x          | 2,66x            | 2,36x          | 2,19x          |
| Net debt / EBITDA .....                               | 6.18x          | 6.59x          | 7.38x            | 7,58x          | 7,25x          |
| <b>Credit rating at year end</b>                      |                |                |                  |                |                |
| Standard & Poor's .....                               | BBB-           | BB             | BB               | -              | -              |
| Moody's .....   | Ba1            | Ba2            | Ba2              | -              | -              |

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

# Quarterly statement 2015 - Unaudited

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

|   | Q1              | Q2               | Q3               | Q4               | Total            |
|---|-----------------|------------------|------------------|------------------|------------------|
| <b>Operating revenues</b>   |                 |                  |                  |                  |                  |
| Power sales .....   | 93,870          | 87,068           | 80,961           | 87,699           | 349,598          |
| Realised aluminium hedges .....                                   | 2,290           | 2,474            | 2,765            | 3,427            | 10,956           |
| Transmission .....  | 14,671          | 13,931           | 13,799           | 15,507           | 57,908           |
| Other income .....  | 834             | 605              | 718              | 833              | 2,990            |
|   | <u>111,665</u>  | <u>104,078</u>   | <u>98,243</u>    | <u>107,466</u>   | <u>421,452</u>   |
| <b>Operating expenses</b>   |                 |                  |                  |                  |                  |
| Energy production costs .....                                     | 8,420           | 9,332            | 9,767            | 11,691           | 39,210           |
| Transmission costs .....  | 4,514           | 5,186            | 3,883            | 7,540            | 21,123           |
| Cost of general research .....                                    | 1,618           | 1,784            | 2,942            | 2,620            | 8,964            |
| Other operating expenses .....                                    | 7,858           | 7,771            | 6,141            | 8,865            | 30,635           |
| Depreciation and impairment loss .....                            | 27,573          | 29,826           | 29,915           | 28,240           | 115,554          |
|   | <u>49,983</u>   | <u>53,899</u>    | <u>52,648</u>    | <u>58,956</u>    | <u>215,486</u>   |
| <b>Operating profit .....</b>                                     | <b>61,682</b>   | <b>50,179</b>    | <b>45,595</b>    | <b>48,510</b>    | <b>205,966</b>   |
| <b>Financial income and (expenses)</b>                            |                 |                  |                  |                  |                  |
| Interest income .....   | 1,310           | 705              | 745              | 713              | 3,473            |
| Interest expense .....  | ( 19,178)       | ( 20,551)        | ( 19,390)        | ( 14,306)        | ( 73,425)        |
| Realised foreign exchange difference .....                        | 8,954           | ( 2,002)         | ( 11,223)        | 804              | ( 3,467)         |
|   | <u>( 8,914)</u> | <u>( 21,848)</u> | <u>( 29,868)</u> | <u>( 12,789)</u> | <u>( 73,418)</u> |
| Associated companies .....  | ( 741)          | ( 319)           | ( 656)           | ( 205)           | ( 1,921)         |
| <b>Profit before income tax and unrealised items .....</b>        | <b>52,027</b>   | <b>28,012</b>    | <b>15,071</b>    | <b>35,516</b>    | <b>130,627</b>   |
| <b>Unrealised financial items:</b>                                |                 |                  |                  |                  |                  |
| Fair value changes in embedded derivatives .....                  | ( 4,679)        | ( 8,912)         | ( 12,646)        | ( 33,688)        | ( 59,925)        |
| Fair value changes in other derivatives .....                     | ( 7,306)        | 3,831            | 9,939            | ( 998)           | 5,466            |
| Unrealised foreign exchange difference .....                      | 44,791          | ( 10,661)        | 5,842            | 7,685            | 47,657           |
|   | <u>32,806</u>   | <u>( 15,742)</u> | <u>3,135</u>     | <u>( 27,001)</u> | <u>( 6,802)</u>  |
| <b>Profit before income tax .....</b>                             | <b>84,833</b>   | <b>12,270</b>    | <b>18,206</b>    | <b>8,515</b>     | <b>123,825</b>   |
| Income tax .....  | ( 29,253)       | ( 3,950)         | ( 5,809)         | ( 640)           | ( 39,652)        |
| <b>Net Profit (loss) .....</b>                                    | <b>55,580</b>   | <b>8,320</b>     | <b>12,397</b>    | <b>7,875</b>     | <b>84,173</b>    |
| <b>Attributable to:</b>   |                 |                  |                  |                  |                  |
| Owners of the parent company .....                                | 52,003          | 7,739            | 9,226            | 4,477            | 73,445           |
| Subsidiaries minority interest .....                              | 3,577           | 581              | 3,171            | 3,399            | 10,728           |
|   | <u>55,580</u>   | <u>8,320</u>     | <u>12,397</u>    | <u>7,876</u>     | <u>84,173</u>    |
| <b>From cash flow</b>   |                 |                  |                  |                  |                  |
| Cash flow from operating activities .....                         | 82,850          | 63,578           | 47,874           | 54,653           | 248,955          |
| <b>Other key metrics for Landsvirkjun (parent company)</b>        |                 |                  |                  |                  |                  |
| Installed capacity at year end (MW) .....                         | 1,957           | 1,957            | 1,862            | 1,860            | 1,860            |
| Average price for industrial users (incl. transm.) USD/MWh .....  | 24.5            | 25.9             | 25.8             | 26.2             | 28.7             |
| Average price for retail sales comp.(excl. transm.) ISK/kWh ..... | 4.4             | 4.3              | 4.0              | 3.9              | 3.6              |
| Sales in GWh .....  | 13,900          | 13,082           | 13,186           | 12,770           | 12,778           |
| Research and development .....                                    | 19,529          | 30,606           | 26,799           | 32,514           | 17,203           |
| Accident frequency: H200* .....                                   | 0.4             | 0.4              | 0.7              | 0.0              | 0.4              |

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

## 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 2015 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The functional currency of the Company is USD and amounts in the financial statements are rounded to the nearest thousand USD.

The Group's operating income amounted to USD 421.5 million in the year 2015 compared to USD 438.3 million in the previous year. Thus, income decreased by USD 16.8 million. Operating expenses amounted to USD 215.5 million in the year 2015 compared to USD 220.2 million in the year 2014. Thus, the Company's operating profit amounted to USD 206.0 million in the year 2015 compared to USD 218.1 million in the previous year.

Landsvirkjun has entered into derivative agreements in order to manage risk. Agreements have been made due to interest rate risk and foreign currency risk. In addition, derivative agreements 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 80.2 million in the year 2015, compared to USD 106.5 million the previous year. The change between years amounts to USD 26.3 million. The main reason for this difference between years are lower interest expenses, 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 130.6 million during the year compared to USD 146.9 million in the year 2014. According to the income statement, profit for the year amounted to USD 84.2 million compared to USD 78.4 million in the previous year.

Equity at year end 2015 amounted to USD 1,916.6 million compared to USD 1,704.7 million at year end 2014 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 142.1 million and undrawn loans amounted to USD 360.8 million. Cash and cash equivalents and undrawn loans therefore amounted to USD 503.0 million at year end. Cash flow from operations amounted to USD 249.0 million. Landsvirkjun borrowed USD 108.5 million in the year and repaid debt amounting to USD 333.0 million. Cash and cash equivalents decreased by USD 64.9 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 2015, 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. Further information on the Parent Company's corporate governance and risk management is included in notes 27 to 36 and appendix to the financial statements. Landsnet hf. has disclosed information on corporate governance in an appendix in 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 financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Company's assets, liabilities and financial position as at 31 December 2015 and the Company's results and changes in cash in the year 2015.

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 2015 give a fair view of the Company's results, financial position and development and describe the main risk factors faced by the Company.

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

Reykjavik, 19 February 2016.

The Board of Directors:

Jónas Þór Guðmundsson

Jón Björn Hákonarson

Helgi Jóhannesson

Þórunn Sveinbjarnardóttir

Álfheiður Ingadóttir

The CEO:

Hörður Arnarson

# Independent Auditor's Report

---

## To the Board of Directors and owners of Landsvirkjun

We have audited the accompanying consolidated financial statements of Landsvirkjun for the year 2015, which comprise the endorsement of Board of Directors, statement of financial position as at 31 December 2015, and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

## Management's and the Board of Directors' Responsibility for the Financial Statements

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

## Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## Opinion

In our opinion, the financial statements give a true and fair view, of the financial position of Landsvirkjun as at 31 December 2015, its financial performance and changes in cash flow for the year then ended in accordance with International Financial Reporting Standards, as adopted by the EU.

Reykjavik, 19 February 2016.

### **Deloitte ehf.**

Þorsteinn Pétur Guðjónsson  
State authorized auditor

Lárus Finnbogason  
State authorized auditor

## Income Statement for the year 2015

|  | Notes | 2015             | 2014              |
|--|-------|------------------|-------------------|
| <b>Operating revenues</b>                        |       |                  |                   |
| Power sales .....                                |       | 349,598          | 348,476           |
| Realised aluminium hedges .....                  |       | 10,956           | 9,629             |
| Transmission .....                               |       | 57,908           | 59,010            |
| Other income .....                               |       | 2,990            | 21,169            |
|  |       | <u>421,452</u>   | <u>438,284</u>    |
| <b>Operating expenses</b>                        |       |                  |                   |
| Energy production costs .....                    |       | 126,310          | 131,047           |
| Transmission costs .....                         |       | 42,028           | 47,553            |
| Cost of general research .....                   |       | 13,449           | 7,698             |
| Other operating expenses .....                   |       | 33,699           | 33,873            |
|  |       | <u>215,486</u>   | <u>220,171</u>    |
| <b>Operating profit</b> .....                    | 3     | <u>205,966</u>   | <u>218,113</u>    |
| <b>Financial income and (financial expenses)</b> |       |                  |                   |
| Interest income .....                            |       | 3,473            | 3,239             |
| Interest expense .....                           |       | ( 73,425)        | ( 91,695)         |
| Foreign exchange difference .....                |       | 44,190           | 78,889            |
| Fair value changes in embedded derivatives ..... | 29    | ( 59,925)        | ( 88,484)         |
| Fair value changes in other derivatives .....    |       | 5,466            | ( 8,426)          |
|  | 6     | <u>( 80,220)</u> | <u>( 106,477)</u> |
| Associated companies .....                       | 13    | <u>( 1,921)</u>  | <u>( 1,419)</u>   |
| <b>Profit before income tax</b> .....            |       | 123,825          | 110,217           |
| Income tax .....                                 | 7     | <u>( 39,652)</u> | <u>( 31,797)</u>  |
| <b>Net profit for the year</b> .....             |       | <u>84,173</u>    | <u>78,420</u>     |
| <b>Attributable to:</b>                          |       |                  |                   |
| Owners of the Parent Company .....               |       | 73,445           | 67,051            |
| Minority interest in subsidiaries .....          |       | 10,728           | 11,369            |
|  |       | <u>84,173</u>    | <u>78,420</u>     |

Notes 1 to 56 are an integral part of these financial statements.



## Statement of Comprehensive Income for the year 2015

|   | 2015           | 2014          |
|---|----------------|---------------|
| <b>Net profit for the year</b> .....                                      | 84,173         | 78,420        |
| <b>Items that will not be reclassified subsequently to profit or loss</b> |                |               |
| Pension obligation after income tax, change .....                         | ( 1,795)       | ( 1,838)      |
| Revaluation of transmission .....   | 180,737        | 0             |
| Income tax effects of revaluation of transmission .....                   | ( 36,147)      | 0             |
| Other items .....   | ( 50)          | 0             |
| <b>Items that may be reclassified subsequently to profit or loss</b>      |                |               |
| Translation difference due to subsidiaries and associated companies ..... | ( 3,980)       | ( 16,600)     |
| Total operating items moved to equity                                     | 138,765        | ( 18,438)     |
| <b>Total profit for the year</b> .....                                    | <u>222,938</u> | <u>59,982</u> |
| <b>Profit attributable to:</b>  |                |               |
| Owners of the Parent Company .....  | 162,185        | 53,958        |
| Minority interest in subsidiaries .....                                   | 60,753         | 6,024         |
|   | <u>222,938</u> | <u>59,982</u> |

Notes 1 to 56 are an integral part of these financial statements.

## Balance Sheet as at 31 December 2015

| Assets   | Notes | 2015                    | 2014                    |
|--|-------|-------------------------|-------------------------|
| <b>Non-current assets</b>                        |       |                         |                         |
| Property, plant and equipment .....              | 8     | 3,685,410               | 3,599,661               |
| Projects under construction .....                | 9     | 134,146                 | 6,377                   |
| Development cost .....                           | 10    | 141,799                 | 212,794                 |
| Other intangible assets .....                    | 10    | 48,469                  | 48,546                  |
| Derivative financial instruments .....           | 12    | 2,915                   | 15,313                  |
| Associated companies .....                       | 13    | 13,401                  | 17,012                  |
| Other non-current assets .....                   | 14    | 5,795                   | 11,454                  |
| Deferred tax asset .....                         | 7     | 34,733                  | 65,012                  |
| Total non-current assets                         |       | <u>4,066,668</u>        | <u>3,976,169</u>        |
| <b>Current assets</b>                            |       |                         |                         |
| Inventories .....                                | 16    | 4,582                   | 4,498                   |
| Accounts receivables and other receivables ..... | 17    | 64,472                  | 73,368                  |
| Derivative financial instruments .....           | 12    | 6,854                   | 8,993                   |
| Cash and cash equivalents .....                  | 18    | 142,127                 | 207,070                 |
| Total current assets                             |       | <u>218,035</u>          | <u>293,929</u>          |
| <b>Total assets</b>                              |       | <u><u>4,284,703</u></u> | <u><u>4,270,098</u></u> |
| <b>Equity and liabilities</b>                    |       |                         |                         |
| <b>Equity</b>                                    |       |                         |                         |
| Owners' contributions .....                      | 19    | 586,512                 | 586,512                 |
| Revaluation account .....                        | 20    | 182,553                 | 91,845                  |
| Translation difference .....                     | 20    | ( 42,844)               | ( 39,786)               |
| Other equity .....                               |       | 1,076,224               | 1,012,718               |
| Equity of the owners of the Parent Company       |       | <u>1,802,445</u>        | <u>1,651,289</u>        |
| Minority interest .....                          |       | 114,189                 | 53,435                  |
| Total equity                                     |       | <u>1,916,634</u>        | <u>1,704,724</u>        |
| <b>Long term liabilities</b>                     |       |                         |                         |
| Interest bearing liabilities .....               | 21    | 1,890,556               | 2,125,100               |
| Accrued pension liabilities .....                | 23    | 27,663                  | 26,345                  |
| Deferred income tax liability .....              | 7     | 57,553                  | 21,975                  |
| Obligation due to demolition .....               | 24    | 6,997                   | 6,460                   |
| Prepaid income .....                             |       | 2,936                   | 2,790                   |
| Derivative financial instruments .....           | 12    | 67,044                  | 22,053                  |
|  |       | <u>2,052,749</u>        | <u>2,204,723</u>        |
| <b>Current liabilities</b>                       |       |                         |                         |
| Accounts payable and other payables .....        | 25    | 58,342                  | 53,031                  |
| Interest bearing liabilities .....               | 22    | 236,982                 | 272,429                 |
| Income tax payable .....                         | 7     | 7,895                   | 4,657                   |
| Derivative financial instruments .....           | 12    | 12,101                  | 30,534                  |
|  |       | <u>315,320</u>          | <u>360,651</u>          |
| Total liabilities                                |       | <u>2,368,069</u>        | <u>2,565,374</u>        |
| <b>Total equity and liabilities</b>              |       | <u><u>4,284,703</u></u> | <u><u>4,270,098</u></u> |

Notes 1 to 56 are an integral part of these financial statements.

## Statement of Equity for the year 2015

|  | Owners' contribution | Revaluation account | Translation difference | Other equity | Equity attributable to the owners of the Parent Company | Minority interest | Total equity |
|--|----------------------|---------------------|------------------------|--------------|---|-------------------|--------------|
| <b>Changes in equity year 2014</b>           |                      |                     |                        |              |   |                   |              |
| Equity at 1 January 2014.....                | 586,512              | 94,898              | (28,531)               | 957,845      | 1,610,724   | 47,410            | 1,658,134    |
| Translation difference.....                  |                      |                     | (11,255)               |              | (11,255)  | (5,345)           | (16,600)     |
| Pension obligation, change....               |                      |                     |                        | (1,838)      | (1,838)   |                   | (1,838)      |
| Net profit for the year.....                 |                      |                     |                        | 67,051       | 67,051  | 11,369            | 78,420       |
| Total profit.....                            |                      |                     | (11,255)               | 65,213       | 53,958  | 6,024             | 59,982       |
| Revaluation transferred to other equity..... |                      | (3,053)             |                        | 3,053        | 0   | 0                 | 0            |
| Dividend paid to owners.....                 |                      |                     |                        | (13,393)     | (13,393)  | 0                 | (13,393)     |
| Equity at 31 December 2014.                  | 586,512              | 91,845              | (39,786)               | 1,012,718    | 1,651,289   | 53,435            | 1,704,724    |
| <b>Changes in equity year 2015</b>           |                      |                     |                        |              |   |                   |              |
| Equity at 1 January 2015 .....               | 586,512              | 91,845              | (39,786)               | 1,012,718    | 1,651,289   | 53,435            | 1,704,724    |
| Revaluation of transmission .                |                      | 116,991             |                        |              | 116,991   | 63,746            | 180,737      |
| Income tax effects of revaluation .....      |                      | (23,398)            |                        |              | (23,398)  | (12,749)          | (36,147)     |
| Translation difference .....                 |                      |                     | (3,058)                |              | (3,058)   | (922)             | (3,980)      |
| Other items .....                            |                      |                     |                        |              |   | (50)              | (50)         |
| Pension obligation, change....               |                      |                     |                        | (1,795)      | (1,795)   |                   | (1,795)      |
| Net profit for the year .....                |                      |                     |                        | 73,445       | 73,445  | 10,728            | 84,173       |
| Total profit.....                            |                      | 93,593              | (3,058)                | 71,650       | 162,185   | 60,753            | 222,938      |
| Revaluation transferred to other equity..... |                      | (2,885)             |                        | 2,885        | 0   | 0                 | 0            |
| Dividend paid to owners.....                 |                      |                     |                        | (11,029)     | (11,029)  | 0                 | (11,029)     |
| Equity at 31 December 2015                   | 586,512              | 182,553             | (42,844)               | 1,076,224    | 1,802,445   | 114,189           | 1,916,634    |

Notes 1 to 56 are an integral part of these financial statements.

## Statement of Cash Flow for the year 2015

|   | 2015       | 2014       |
|---|------------|------------|
| <b>Operating activities</b>   |            |            |
| Operating profit .....  | 205,966    | 218,113    |
| Adjustments for:  |            |            |
| Depreciation and impairment loss .....                                  | 115,554    | 114,045    |
| Pension obligation, change .....  | ( 963)     | ( 910)     |
| Obligation due to demolition, change .....                              | 659        | 374        |
| Other changes .....   | ( 71)      | 3,491      |
| Working capital from operation before financial items                   | 321,145    | 335,113    |
| Operating assets, change .....  | 10,620     | ( 18,886)  |
| Operating liabilities, change .....                                     | 3,128      | ( 4,552)   |
| Cash flow from operating activities before financial items              | 334,893    | 311,675    |
| Interest income received .....  | 3,464      | 3,261      |
| Interest expense and foreign exchange difference paid .....             | ( 83,870)  | ( 81,082)  |
| Taxes paid .....  | ( 5,532)   | ( 38)      |
| Cash flow from operating activities                                     | 248,955    | 233,816    |
| <b>Investing activities</b>   |            |            |
| Hydropower stations in operation .....                                  | ( 7,983)   | ( 10,674)  |
| Hydropower stations under construction .....                            | ( 28,509)  | ( 26,380)  |
| Transmission .....  | ( 29,517)  | ( 22,887)  |
| Power plant preparation cost .....                                      | ( 9,546)   | ( 23,111)  |
| Purchased shares .....  | ( 106)     | ( 139)     |
| Dividend received from associated company .....                         | 84         | 99         |
| Other capital expenditure .....   | ( 5,830)   | ( 12,969)  |
| Assets sold .....   | 316        | 929        |
| Other receivables, change .....   | 3,605      | 6,861      |
| Investing activities  | ( 77,486)  | ( 88,271)  |
| <b>Financing activities</b>   |            |            |
| Dividend paid to owners .....   | ( 11,029)  | ( 13,393)  |
| New loans .....   | 108,534    | 97,644     |
| Amortisation of long-term debt .....                                    | ( 332,970) | ( 304,938) |
| Financing activities  | ( 235,465) | ( 220,687) |
| <b>Change in cash and cash equivalents</b> .....                        | ( 63,996)  | ( 75,142)  |
| <b>Effect of exchange difference on cash and cash equivalents</b> ..... | ( 947)     | ( 5,775)   |
| <b>Cash and cash equivalents at the beginning of the year</b> .....     | 207,070    | 287,987    |
| <b>Cash and cash equivalents at the end of the year</b> .....           | 142,127    | 207,070    |

Notes 1 to 56 are an integral part of these financial statements.

# Notes

---

## Reporting entity

### 1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavik. Landsvirkjun operates on the basis of the Act on Landsvirkjun No. 42/1983. The Company's main 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 compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU.

The Company's Board of Directors approved the financial statements on 19 February 2016.

Note 39 includes information on the Group's 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, 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. Use of estimates 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. Revisions to accounting estimates are recognised 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 the 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 48 property, plant and equipment
- notes 10 and 49 intangible assets
- notes 12, 27, 29, 30, 31 derivative financial instruments
- notes 7 and 47 income tax
- note 23 accrued pension liabilities

## Notes, contd.,

---

### 2. Basis of preparation, contd.

#### e. Determination of fair value

A number of the Group's accounting policies and disclosures require the 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 to measure fair values. Then treasury division assesses the evidence obtained from the third parties to support the conclusion 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 a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1; quoted prices in active markets for identical assets or liabilities.
- Level 2; inputs 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; inputs for the asset or liability that are not based on market data which can be acquired.

If the inputs used to measure the 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 29 embedded derivatives
- note 34 long-term loans
- note 48 property, plant and equipment

### 3. Statement of segments

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 objectives according to law is to operate in the energy sector and operate other business and financial operations according to the 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 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 the insurances of Landsvirkjun's power stations.

#### Electricity transmission

The operations of Landsnet hf. fall under the segment electricity transmission, but the company was established in August 2004 on the basis of the Energy Act approved by Parliament in spring 2003. The purpose of Landsnet hf. is to operate electricity transmission 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.

## Notes, contd.,

### 3. Statement of segments, contd.:

#### Other segments

Other segments include the operation of the companies Orkufjarskipti hf. and Landsvirkjun Power ehf. together with Landsvirkjun Power ehf.'s subsidiary. 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 2015        | Electricity production | Electricity transmission | Other segments | Adjustments | Total      |
|-------------------------------------|------------------------|--------------------------|----------------|-------------|------------|
| Income from third party .....       | 360,819                | 58,395                   | 2,238          | 0           | 421,452    |
| Income within the Group .....       | 16,532                 | 64,340                   | 3,453          | ( 84,325)   | 0          |
| Segment income .....                | 377,351                | 122,735                  | 5,691          | ( 84,325)   | 421,452    |
| Segment operating expenses .....    | ( 135,530)             | ( 44,415)                | ( 4,312)       | 84,325      | ( 99,932)  |
| EBITDA .....                        | 241,821                | 78,320                   | 1,379          | 0           | 321,520    |
| Depreciation and impairment loss .. | ( 92,868)              | ( 22,164)                | ( 935)         | 413         | ( 115,554) |
| Segment earnings, EBIT .....        | 148,953                | 56,156                   | 444            | 413         | 205,966    |
| Segment assets 2015 .....           | 4,011,643              | 788,999                  | 17,924         | ( 547,264)  | 4,271,302  |
| Associated companies .....          | 13,072                 | 5,610                    | 329            | ( 5,610)    | 13,401     |
| Total assets 2015 .....             | 4,024,715              | 794,609                  | 18,253         | ( 552,874)  | 4,284,703  |
| Segment liabilities 2015 .....      | 2,203,621              | 470,852                  | 3,701          | ( 310,105)  | 2,368,069  |
| Total liabilities 2015 .....        | 2,203,621              | 470,852                  | 3,701          | ( 310,105)  | 2,368,069  |
| Investing activities .....          | 47,417                 | 33,044                   | 924            | 0           | 81,385     |
| <b>Operating segments year 2014</b> |                        |                          |                |             |            |
| Income from third party .....       | 376,021                | 59,501                   | 2,762          | 0           | 438,284    |
| Income within the Group .....       | 14,399                 | 63,415                   | 3,968          | ( 81,782)   | 0          |
| Segment income .....                | 390,420                | 122,916                  | 6,730          | ( 81,782)   | 438,284    |
| Segment operating expenses .....    | ( 138,324)             | ( 44,986)                | ( 4,598)       | 81,782      | ( 106,126) |
| EBITDA .....                        | 252,096                | 77,930                   | 2,132          | 0           | 332,158    |
| Depreciation and impairment loss .. | ( 88,025)              | ( 25,420)                | ( 1,020)       | 420         | ( 114,045) |
| Segment earnings, EBIT .....        | 164,071                | 52,510                   | 1,112          | 420         | 218,113    |
| Segment assets 2014 .....           | 4,086,657              | 639,498                  | 17,872         | ( 490,941)  | 4,253,085  |
| Associated companies .....          | 16,582                 | 5,573                    | 430            | ( 5,573)    | 17,012     |
| Total assets 2014 .....             | 4,103,239              | 645,071                  | 18,302         | ( 496,514)  | 4,270,098  |
| Segment liabilities 2014 .....      | 2,433,266              | 493,703                  | 3,801          | ( 365,397)  | 2,565,374  |
| Total liabilities 2014 .....        | 2,433,266              | 493,703                  | 3,801          | ( 365,397)  | 2,565,374  |
| Investing activities .....          | 62,978                 | 30,905                   | 2,139          | 0           | 96,022     |

### 4. Total number of employees

| Total number of employees is specified as follows:                       | 2015 | 2014 |
|--|------|------|
| Average number of employees during the year, full-time equivalents ..... | 427  | 431  |
| Full-time equivalent units at year-end .....                             | 378  | 379  |

## Notes, contd.,

### 5. Total salaries of employees

| Total salaries of employees are specified as follows: | 2015          | 2014          |
|---|---------------|---------------|
| Salaries .....  | 36,755        | 37,480        |
| Contribution to defined contribution plans .....      | 4,638         | 4,747         |
| Defined pension benefit payments .....                | 1,582         | 1,578         |
| Other change in pension obligation .....              | ( 963)        | ( 910)        |
| Other salary related expenses .....                   | 3,591         | 3,864         |
|   | <u>45,603</u> | <u>46,759</u> |

Salaries are divided as follows in the income statement:

|                                |               |               |
|--------------------------------|---------------|---------------|
| Energy production costs .....  | 14,717        | 14,976        |
| Transmission costs .....       | 9,321         | 9,871         |
| Other operating expenses ..... | 21,564        | 21,912        |
|                                | <u>45,603</u> | <u>46,759</u> |

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

|   |       |       |
|---|-------|-------|
| Salaries of the Board of Directors of the parent company .....              | 104   | 115   |
| Salaries of Boards of Directors of two subsidiaries (same as in 2014) ..... | 87    | 91    |
| Salaries and benefits of the CEO of the parent company .....                | 167   | 174   |
| Salaries of five Directors and the Deputy CEO (same as in 2014) .....       | 1,151 | 1,198 |
| Salaries of the CEO and 6 Man. Dir. of subsid. (3 Man. Dir. in 2014) .....  | 692   | 636   |

Organizational changes were made at Landsnet hf. in the middle of the year 2015 where the number of executive directors was increased to five.

### 6. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

|  |           |            |
|--|-----------|------------|
| Interest income .....                            | 3,473     | 3,239      |
| Interest expense .....                           | ( 63,826) | ( 77,149)  |
| Guarantee fee .....                              | ( 10,322) | ( 11,982)  |
| Indexation .....                                 | ( 4,549)  | ( 4,622)   |
| Capitalised interest cost .....                  | 5,272     | 2,058      |
| Total interest expense .....                     | ( 73,425) | ( 91,695)  |
| Realised foreign exchange difference .....       | ( 3,467)  | 18,618     |
| Unrealised foreign exchange difference .....     | 47,657    | 60,271     |
| Total foreign exchange difference .....          | 44,190    | 78,889     |
| Fair value changes in embedded derivatives ..... | ( 59,925) | ( 88,484)  |
| Fair value changes in other derivatives .....    | 5,466     | ( 8,426)   |
| Financial income and (expenses) .....            | ( 80,220) | ( 106,477) |

Capitalised finance cost amounted to 5% of invested cash in hydropower stations under construction in the year 2015 (2014: 3.5%) and 5.7% of invested cash in transmission under construction (2014: 4.8%).



## Notes, contd.,

### 7. Income tax

| Income tax is specified as follows:                    | 2015             | 2014             |
|--|------------------|------------------|
| Change in income tax asset / liability .....           | ( 65,857)        | ( 25,423)        |
| Current tax .....                                      | ( 7,895)         | ( 4,657)         |
| Income tax recognised among comprehensive income ..... | 35,137           | ( 1,034)         |
| Foreign exchange and translation difference .....      | 22               | ( 673)           |
| Adjustments relating to subsidiaries .....             | ( 1,060)         | ( 11)            |
| Income tax expensed .....                              | <u>( 39,652)</u> | <u>( 31,797)</u> |

| Effective tax rate                                   | 2015                | 2014                |
|--|---------------------|---------------------|
| Profit for the year .....                            | 84,173              | 78,420              |
| Income tax for the year .....                        | <u>39,652</u>       | <u>31,797</u>       |
| Profit before income tax .....                       | <u>123,825</u>      | <u>110,217</u>      |
| Income tax acc. to the parent company's tax rate     | 36.0% 44,577        | 36.0% 39,678        |
| Effect of different tax rates within the Group ..... | (5.2%) ( 6,406)     | (6.2%) ( 6,862)     |
| Non-taxable and non-deductible items .....           | 0.7% 904            | (1.3%) ( 1,466)     |
| Other items .....                                    | 0.5% 576            | 0.4% 448            |
| Effective income tax .....                           | <u>32.0% 39,652</u> | <u>28.8% 31,797</u> |

| Income tax due to items recognised in other comprehensive income is specified as follows: | 2015          | 2014            |
|---|---------------|-----------------|
| Income tax due to pension liability recognised in other comprehensive income              | ( 1,010)      | ( 1,034)        |
| Income tax effects of revaluation of operating assets of subsidiary .....                 | 36,147        | 0               |
|   | <u>35,137</u> | <u>( 1,034)</u> |

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

|   | Deferred tax asset |               | Deferred tax liability |                  |
|---|--------------------|---------------|------------------------|------------------|
|   | 2015               | 2014          | 2015                   | 2014             |
| Balance at the beginning of the year .....        | 65,012             | 89,536        | ( 21,975)              | ( 21,076)        |
| Change in temporary difference .....              | ( 20,455)          | ( 26,545)     | ( 36,123)              | ( 1,506)         |
| Change in carry forward loss .....                | ( 9,480)           | 3,971         | 87                     | ( 1,613)         |
| Foreign exchange and translation difference ..... | ( 344)             | ( 1,951)      | 458                    | 2,221            |
| Balance at year end .....                         | <u>34,733</u>      | <u>65,012</u> | <u>( 57,553)</u>       | <u>( 21,975)</u> |

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

|  |               |               |                  |                  |
|--|---------------|---------------|------------------|------------------|
| Carry forward loss .....                       | 11,486        | 21,309        | 111              | 26               |
| Non-current assets and intangible assets ..... | 12,127        | 41,133        | ( 58,840)        | ( 22,932)        |
| Derivative financial instruments .....         | 19,510        | 8,005         | 0                | 0                |
| Other items .....                              | ( 8,390)      | ( 5,435)      | 1,176            | 932              |
| Balance at year end .....                      | <u>34,733</u> | <u>65,012</u> | <u>( 57,553)</u> | <u>( 21,975)</u> |

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

|   |               |               |
|---|---------------|---------------|
| Carry forward loss of the year 2009, usable until the year 2019 ..... | 10,924        | 36,319        |
| Carry forward loss of the year 2010, usable until the year 2020 ..... | 866           | 975           |
| Carry forward loss of the year 2011, usable until the year 2021 ..... | 851           | 958           |
| Carry forward loss of the year 2012, usable until the year 2022 ..... | 8,795         | 9,908         |
| Carry forward loss of the year 2013, usable until the year 2023 ..... | 15            | 15            |
| Carry forward loss of the year 2014, usable until the year 2024 ..... | 10,551        | 11,145        |
| Carry forward loss of the year 2015, usable until the year 2025 ..... | 482           | -             |
| Carry forward loss at year end .....                                  | <u>32,483</u> | <u>59,321</u> |

## Notes, contd.,

### 7. Income tax, cont.:

Deferred tax asset is recognised as an asset 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.

### 8. Property, plant and equipment

Property, plant and equipment is specified as follows:

|   | Power<br>stations | Trans-<br>mission | Communic<br>equipment | Other<br>assets | Total     |
|---|-------------------|-------------------|-----------------------|-----------------|-----------|
| <b>Cost value</b>                                     |                   |                   |                       |                 |           |
| Total value at 1.1.2014 .....                         | 4,866,205         | 653,214           | 19,567                | 71,488          | 5,610,474 |
| Effect of exchange rate changes .....                 | 0                 | ( 63,100)         | ( 1,995)              | ( 3,392)        | ( 68,487) |
| Additions during the year .....                       | 9,850             | 6,519             | 2,064                 | 4,287           | 22,720    |
| Transferred from projects under<br>construction ..... | 231,574           | 18,475            | 0                     | 979             | 251,028   |
| Sold and disposed of .....                            | ( 51,167)         | 0                 | ( 6)                  | ( 3,070)        | ( 54,243) |
| Total value at 31.12.2014 .....                       | 5,056,462         | 615,108           | 19,630                | 70,292          | 5,761,492 |
| Effect of exchange rate changes .....                 | 0                 | ( 9,416)          | ( 395)                | ( 682)          | ( 10,493) |
| Revaluation of Transmission .....                     | 0                 | 177,639           | 0                     | 0               | 177,639   |
| Additions during the year .....                       | 8,044             | 6,086             | 742                   | 1,969           | 16,841    |
| Transferred from projects under<br>construction ..... | 0                 | 8,498             | 0                     | 0               | 8,498     |
| Sold and disposed of .....                            | 0                 | 0                 | ( 20)                 | ( 900)          | ( 920)    |
| Total value at 31.12.2015 .....                       | 5,064,506         | 797,915           | 19,957                | 70,679          | 5,953,057 |
| <b>Depreciation and impairment loss</b>               |                   |                   |                       |                 |           |
| Total value at 1.1.2014 .....                         | 1,938,826         | 143,338           | 5,383                 | 27,316          | 2,114,863 |
| Effect of exchange rate changes .....                 | 0                 | ( 15,148)         | ( 585)                | ( 1,003)        | ( 16,736) |
| Depreciation for the year .....                       | 86,117            | 21,316            | 1,020                 | 3,310           | 111,763   |
| Sold and disposed of .....                            | ( 45,988)         | 0                 | ( 6)                  | ( 2,066)        | ( 48,060) |
| Total value at 31.12.2014 .....                       | 1,978,955         | 149,506           | 5,812                 | 27,557          | 2,161,830 |
| Effect of exchange rate changes .....                 | 0                 | ( 2,761)          | ( 104)                | ( 184)          | ( 3,049)  |
| Depreciation for the year .....                       | 86,342            | 19,237            | 939                   | 3,086           | 109,604   |
| Sold and disposed of .....                            | 0                 | 0                 | ( 18)                 | ( 720)          | ( 738)    |
| Total value at 31.12.2015 .....                       | 2,065,297         | 165,982           | 6,629                 | 29,739          | 2,267,647 |
| <b>Book value</b>                                     |                   |                   |                       |                 |           |
| 1.1.2014 .....  | 2,927,379         | 509,876           | 14,184                | 44,172          | 3,495,611 |
| 31.12.2014 .....                                      | 3,077,507         | 465,602           | 13,818                | 42,735          | 3,599,661 |
| 31.12.2015 .....                                      | 2,999,209         | 631,933           | 13,328                | 40,940          | 3,685,410 |
| <b>Book value without revaluation</b>                 |                   |                   |                       |                 |           |
| 1.1.2014 .....  | 2,927,379         | 390,038           | 13,155                | 44,172          | 3,374,744 |
| 31.12.2014 .....                                      | 3,077,507         | 362,561           | 13,084                | 42,735          | 3,495,887 |
| 31.12.2015 .....                                      | 2,999,209         | 355,696           | 12,719                | 40,940          | 3,408,564 |

#### Official assessment of fixed assets and insurance value

The official assessment of the Company's real estates amounted to USD 330 million at year end 2015 (2014: USD 311 million). Insurance value of the Company's assets amounts to USD 4,731 million (2014: USD 4,614 million) and catastrophe insurance value amounts to USD 850 million (2014: USD 891 million).

## Notes, contd.,

### 8. Property, plant and equipment, cont.:

#### Assumptions relating to revaluation of property, plant and equipment

In accordance with provision of IFRS the Group's transmission network and communication equipment was revalued during the year 2008 and powerlines and connection masts of Landsnet hf. at year end 2015. When performing the revaluation two methods were applied. 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 assets in operation is calculated by cash flow analysis. The forecast period was from the year 2016 until 2025 and after that a terminal value of the operations was calculated. The revaluation for the year 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 mass users and distributors. The revaluation is classified as Level 3 in the fair value hierarchy.

### 9. Projects under construction

| Projects under construction are specified as follows: | 2015           | 2014         |
|---|----------------|--------------|
| Balance at 1.1. ....                                  | 6,377          | 221,820      |
| Effect of exchange rate changes .....                 | 160 (          | 694)         |
| Transferred from development costs .....              | 78,846         | 981          |
| Additions during the year .....                       | 57,261         | 34,319       |
| Transferred to property, plant and equipment .....    | ( 8,498)       | ( 250,049)   |
| Balance at 31.12. ....                                | <u>134,146</u> | <u>6,377</u> |

### 10. Development cost and other intangible assets

Development cost and other intangible assets are specified as follows:

|  | Capitalised<br>development<br>costs | Water and<br>geothermal<br>rights | Software     | Total          |
|--|-------------------------------------|-----------------------------------|--------------|----------------|
| <b>Cost value</b>                                |                                     |                                   |              |                |
| Total value at 1.1.2014 .....                    | 264,738                             | 45,611                            | 8,530        | 318,879        |
| Effect of exchange rate changes .....            | ( 1,423)                            | 0 (                               | 404)         | ( 1,827)       |
| Additions during the year .....                  | 25,845                              | 0                                 | 912          | 26,757         |
| Transf. to transmission under construction ..... | ( 981)                              | 0                                 | 0 (          | 981)           |
| Total value at 31.12.2014 .....                  | <u>288,179</u>                      | <u>45,611</u>                     | <u>9,038</u> | <u>342,828</u> |
| Effect of exchange rate changes .....            | ( 254)                              | 0 (                               | 75)          | ( 329)         |
| Additions during the year .....                  | 13,290                              | 0                                 | 647          | 13,937         |
| Transf. to projects under construction .....     | ( 83,907)                           | 0                                 | 0 (          | 83,907)        |
| Sold and disposed of .....                       | 0                                   | 0 (                               | 302)         | ( 302)         |
| Total value at 31.12.2015 .....                  | <u>217,308</u>                      | <u>45,611</u>                     | <u>9,308</u> | <u>272,227</u> |
| <b>Depreciation and impairment loss</b>          |                                     |                                   |              |                |
| Total value at 1.1.2014 .....                    | 73,959                              | 0                                 | 5,883        | 79,842         |
| Effect of exchange rate changes .....            | ( 385)                              | 0 (                               | 249)         | ( 634)         |
| Amortisation during the year .....               | 0                                   | 0                                 | 471          | 471            |
| Impairment loss during the year .....            | 1,811                               | 0                                 | 0            | 1,811          |
| Total value at 31.12.2014 .....                  | <u>75,385</u>                       | <u>0</u>                          | <u>6,105</u> | <u>81,490</u>  |
| Effect of exchange rate changes .....            | ( 71)                               | 0 (                               | 46)          | ( 117)         |
| Amortisation during the year .....               | 0                                   | 0                                 | 693          | 693            |
| Impairment loss during the year .....            | 5,257                               | 0                                 | 0            | 5,257          |
| Sold and disposed of .....                       | 0                                   | 0 (                               | 302)         | ( 302)         |
| Transferred to projects under construction ..... | ( 5,061)                            | 0                                 | 0 (          | 5,061)         |
| Total value at 31.12.2015 .....                  | <u>75,510</u>                       | <u>0</u>                          | <u>6,450</u> | <u>81,960</u>  |

## Notes, contd.,

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

#### Book value

|                  |         |        |       |         |
|------------------|---------|--------|-------|---------|
| 1.1.2014 .....   | 190,779 | 45,611 | 2,648 | 239,038 |
| 31.12.2014 ..... | 212,794 | 45,611 | 2,935 | 261,340 |
| 31.12.2015 ..... | 141,799 | 45,611 | 2,858 | 190,268 |

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% (2014: 4.9%) 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:

|   | 2015    | 2014    |
|---|---------|---------|
| Power stations .....                      | 86,342  | 86,117  |
| Transmission .....                        | 19,237  | 21,316  |
| Telecommunication equipment .....         | 939     | 1,020   |
| Other assets .....                        | 3,086   | 3,310   |
| Depreciation of assets in operation ..... | 109,604 | 111,763 |
| Impairment loss on development cost ..... | 5,257   | 1,811   |
| Amortisation of software .....            | 693     | 471     |
|   | 115,554 | 114,045 |

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

|                                |         |         |
|--------------------------------|---------|---------|
| Energy production costs .....  | 87,100  | 86,784  |
| Transmission costs .....       | 20,905  | 24,070  |
| Cost of general research ..... | 4,486   | 0       |
| Other operating expenses ..... | 3,063   | 3,191   |
|                                | 115,554 | 114,045 |

### 12. Derivative financial instruments

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

#### Assets:

|  |       |        |
|--|-------|--------|
| Embedded derivatives in electricity sales agreements ..... | 3,047 | 13,620 |
| Aluminium hedges .....                                     | 6,722 | 10,437 |
| Other derivatives .....                                    | 0     | 249    |
|  | 9,769 | 24,306 |

Derivative financial instruments are divided as follows:

|   |       |        |
|---|-------|--------|
| Long-term component of derivative agreements .....  | 2,915 | 15,313 |
| Short-term component of derivative agreements ..... | 6,854 | 8,993  |
|   | 9,769 | 24,306 |

#### Liabilities:

|  |        |        |
|--|--------|--------|
| Embedded derivatives in electricity sales agreements ..... | 55,261 | 5,909  |
| Aluminium hedges .....                                     | 1,755  | 2,939  |
| Currency swaps .....                                       | 14,929 | 5,695  |
| Interest rate swaps .....                                  | 7,200  | 33,630 |
| Other derivatives .....                                    | 0      | 4,414  |
|  | 79,145 | 52,587 |

## Notes, contd.,

### 12. Derivative financial instruments, contd.

|  |               |               |
|--|---------------|---------------|
| Derivative financial instruments are divided as follows: | <b>2015</b>   | <b>2014</b>   |
| Long-term component of derivative agreements .....       | 67,044        | 22,053        |
| Short-term component of derivative agreements .....      | 12,101        | 30,534        |
|  | <u>79,145</u> | <u>52,587</u> |

The assumptions for valuation of embedded derivatives are discussed in note 29.

The fair value of other derivatives than embedded derivatives is based on available evaluation of counterparties and verified by the treasury division with comparative calculations based on market information.

### 13. Associated companies

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

|   |              | <b>2015</b>            |                   |
|---|--------------|------------------------|-------------------|
|   | <b>Share</b> | <b>Share in return</b> | <b>Book value</b> |
| Farice ehf., Kópavogur, Iceland .....               | 28.9%        | ( 1,952)               | 12,842            |
| SER eignarhaldsfélag ehf., Reykjavík, Iceland ..... | 34.9%        | 24                     | 214               |
| Sjávarorka ehf., Reykjavík, Iceland .....           | 33.6%        | ( 17)                  | 16                |
| Hecla SAS, France .....                             | 28.5%        | 24                     | 329               |
|   |              | <u>( 1,921)</u>        | <u>13,401</u>     |
|   |              | <b>2014</b>            |                   |
|   | <b>Share</b> | <b>Share in return</b> | <b>Book value</b> |
| Farice ehf., Kópavogur, Iceland .....               | 28.9%        | ( 1,477)               | 16,455            |
| SER eignarhaldsfélag ehf., Reykjavík, Iceland ..... | 33.3%        | 0                      | 93                |
| Sjávarorka ehf., Reykjavík, Iceland .....           | 33.6%        | ( 38)                  | 34                |
| Hecla SAS, France .....                             | 28.5%        | 96                     | 430               |
|   |              | <u>( 1,419)</u>        | <u>17,012</u>     |

### 14. Other non-current assets

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

|                                 |              |               |
|---------------------------------|--------------|---------------|
| Shares in other companies ..... | 128          | 120           |
| Long-term receivables .....     | 5,667        | 11,334        |
|                                 | <u>5,795</u> | <u>11,454</u> |

### 15. Landsvirkjun's subsidiaries

Landsvirkjun's subsidiaries are specified as follows:

|   |              |        |
|---|--------------|--------|
|   | <b>Share</b> |        |
| Icelandic Power Insurance Ltd., Bermuda .....     | 100.0%       | 100.0% |
| Landsnet hf., Reykjavík, Iceland .....            | 64.7%        | 64.7%  |
| Landsvirkjun Power ehf., Reykjavík, Iceland ..... | 100.0%       | 100.0% |
| Orkufjarskipti hf., Reykjavík, Iceland .....      | 100.0%       | 100.0% |

### 16. Inventories

Inventories are specified as follows:

|                                   |              |              |
|-----------------------------------|--------------|--------------|
| Spare parts and consumables ..... | 4,582        | 4,498        |
|                                   | <u>4,582</u> | <u>4,498</u> |

## Notes, contd.,

### 17. Accounts receivables and other receivables

|  |               |               |
|--|---------------|---------------|
| Accounts receivables and other receivables are specified as follows: | <b>2015</b>   | <b>2014</b>   |
| Accounts receivables .....   | 52,808        | 59,763        |
| Other short term receivables .....                                   | 11,664        | 13,573        |
| Assets available for sale .....                                      | 0             | 32            |
|  | <u>64,472</u> | <u>73,368</u> |

At year-end 2015, 95% of accounts receivables were under 30 days old (2014: 95%).

### 18. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

|                         |                |                |
|-------------------------|----------------|----------------|
| Bank deposits .....     | 91,712         | 135,375        |
| Market securities ..... | 50,415         | 71,695         |
|                         | <u>142,127</u> | <u>207,070</u> |

### 19. Equity

The Parent Company is a partnership owned by the State and Eignarhlutir ehf. The State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%. Eignarhlutir ehf. is owned by the State. The Company is an independent taxable entity. The Group's equity ratio at year end 2015 was 44.7% compared to 39.9% at year end 2014.

### 20. Revaluation account and translation difference

The revaluation account consists of revaluation of fixed assets of subsidiaries after income tax effect. 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.

### 21. Liabilities

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

|  | <b>Maturity date</b> | <b>2015</b>             |                          | <b>2014</b>             |                          |
|--|----------------------|-------------------------|--------------------------|-------------------------|--------------------------|
|  |                      | <b>Average interest</b> | <b>Remaining balance</b> | <b>Average interest</b> | <b>Remaining balance</b> |
| Liabilities in ISK .....                   | 2016-2034            | 3.8%                    | 230,643                  | 3.8%                    | 320,758                  |
| Liabilities in CHF .....                   | 2016-2022            | 0.0%                    | 38,364                   | 0.3%                    | 44,439                   |
| Liabilities in EUR .....                   | 2016-2026            | 0.6%                    | 548,376                  | 0.9%                    | 611,294                  |
| Liabilities in USD .....                   | 2016-2032            | 2.4%                    | 1,310,155                | 2.9%                    | 1,421,038                |
|  |                      |                         | <u>2,127,538</u>         |                         | <u>2,397,529</u>         |
| Current maturities of long-term debt ..... |                      |                         | ( 236,982)               |                         | ( 272,429)               |
| Total long-term debt .....                 |                      |                         | <u>1,890,556</u>         |                         | <u>2,125,100</u>         |

Interest rate terms on loans at year end are from 0.0-5.6%. Nominal interest rates for the period were on average 3.3% (2014: 3.5%), taking into account the government guarantee fee.

The Company's payments due to guarantees for long-term loans are calculated according to the Act No. 121/1997 on government guarantees.

## Notes, contd.,

### 22. Maturities of long-term debt

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

|             | 2015      | 2014      |
|-------------|-----------|-----------|
| 2015 .....  | -         | 272,429   |
| 2016 .....  | 236,982   | 242,640   |
| 2017 .....  | 226,566   | 242,863   |
| 2018 .....  | 324,791   | 325,818   |
| 2019 .....  | 184,594   | 208,717   |
| 2020 .....  | 266,876   | -         |
| Later ..... | 887,729   | 1,105,062 |
|             | 2,127,538 | 2,397,529 |

### 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 27.7 million at year end 2015 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest rates in excess of price increases are assessed at 3.5% and salary increase in excess of price increases are 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: | 2015     | 2014     |
|---|----------|----------|
| Balance at 1.1. ....                              | 26,345   | 27,007   |
| Expensed during the year .....                    | 610      | 606      |
| Payments during the year .....                    | ( 1,573) | ( 1,516) |
| Actuarial change .....                            | 2,805    | 2,872    |
| Effect of foreign exchange rate differences ..... | ( 524)   | ( 2,624) |
| Balance at 31.12. ....                            | 27,663   | 26,345   |

| Pension fund obligation, 5 years:     | 2015   | 2014   | 2013   | 2012   | 2011   |
|---------------------------------------|--------|--------|--------|--------|--------|
| Present value of the obligation ..... | 27,663 | 26,345 | 27,007 | 23,228 | 23,238 |

### 24. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:

|   |        |        |
|---|--------|--------|
| Balance at 1.1. ....                              | 6,460  | 6,739  |
| Reversal of discount in the year .....            | 659    | 374    |
| Increase in obligation .....                      | 0      | 8      |
| Effect of foreign exchange rate differences ..... | ( 122) | ( 661) |
| Balance at 31.12. ....                            | 6,997  | 6,460  |

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.

## Notes, contd.,

### 25. Accounts payable and other payables

| Accounts payable and other payables are specified as follows: | 2015          | 2014          |
|---|---------------|---------------|
| Accounts payable .....  | 24,708        | 20,153        |
| Accrued interests .....                                       | 14,229        | 18,029        |
| Other short term liabilities .....                            | 19,404        | 14,849        |
|   | <u>58,342</u> | <u>53,031</u> |

### 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**

##### *Other income*

|                            |    |   |
|----------------------------|----|---|
| Associated companies ..... | 29 | 7 |
|----------------------------|----|---|

##### *Interest income*

|                            |   |   |
|----------------------------|---|---|
| Associated companies ..... | 0 | 0 |
|----------------------------|---|---|

##### *Expenses*

|                            |   |   |
|----------------------------|---|---|
| Associated companies ..... | 0 | 6 |
|----------------------------|---|---|

##### *Receivables*

|                            |   |   |
|----------------------------|---|---|
| Associated companies ..... | 0 | 9 |
|----------------------------|---|---|

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 defined as transactions with non related parties. The Group applies an exemption from disclosure requirements of IAS 24 as the Parent Company is owned by the government, see note 19.

### 27. 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 to evaluate risk
- Effective management is applied in accordance with authorisations
- Effective monitoring on risk factors is ensured
- That information provided to the risk committee and the Board of Directors is accurate and provided on a regular basis

Decisions and supervision of risk management are entrusted to a risk management committee. The risk management committee consists of the CEO, Deputy CEO and the CFO. The CEO is the chairman of the risk management committee.

The treasury division is entrusted with analysing and managing Landsvirkjun's risks in order to stabilise operating return by reducing operating fluctuations. Financial risk is divided into market risk, liquidity risk and counterparty risk. The Company's market risk consists mainly of three risk categories:

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



## Notes, contd.,

### 28. Financial risk

Landsvirkjun has focused on reducing market risk in the last few years by both increasing the weight of USD and the ratio of fixed interests in the Company's loan portfolio. For this purpose, Landsvirkjun has in the last few years paid up loans, changed the terms of loans from EUR to USD and further decreased the risk with swap agreements. Therefore, the Company's debt is now only in USD, EUR, CHF and ISK. During the year 2016, Landsvirkjun will continue to work on changes on the Company's debt portfolio for the purpose of reducing currency risk.

Landsvirkjun's financing was successful in 2015 where the Company signed new RCFs for an amount of USD 200 million and ISK 12 billion replacing previous syndicated bank facilities. The Company issued securities under the EMTN without government guarantee for the amount of USD 85 million and also signed an ECA loan agreement without government guarantee for the amount of USD 68 million. The maturity profile, strong liquidity, and access to loans secure the Company's liquidity at least until year end 2017.

### 29. Aluminium price risk

The Company is exposed to market risk due to possible changes in aluminium price as around one third of its income is linked to the price of aluminium. 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 aluminium price at a certain level. Therefore, the Company can lose income if aluminium price increases, but at the same time guarantees better cash flow should aluminium price decrease. Treasury division may hedge up to 100% of aluminium price risk for the next year and proportionally less over the next years but is not limited by minimum hedges. Around 50% of 2016 estimated cash flow and 5% of 2017 estimated cash flow has been hedged. At year end 2015, fair value of the hedges was positive by USD 5.0 million (2014: USD 7.5 million), but the agreements are in effect over the next two years.

#### 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 sales agreements are recognised in the balance sheet at fair value on the reporting date. Fair value changes of the agreements during the year are recognised in the income statement among financial income and expenses.

|   | 2015      | 2014      |
|---|-----------|-----------|
| The fair value of embedded derivatives is specified as follows:       |           |           |
| Fair value of embedded derivatives at the beginning of the year ..... | 7,711     | 96,195    |
| Fair value changes during the year .....                              | ( 59,925) | ( 88,484) |
| Fair value of embedded derivatives at year end .....                  | ( 52,214) | 7,711     |
| Division of embedded derivatives is specified as follows:             |           |           |
| Long term component of embedded derivatives .....                     | ( 42,233) | 7,728     |
| Short term component of embedded derivatives .....                    | ( 9,981)  | ( 17)     |
| Total embedded derivatives .....                                      | ( 52,214) | 7,711     |

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

Calculations are based on the futures price of aluminium, as disclosed by the LME and are based up on the maximum time length of forward aluminium prices, or 123 months. The 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.

## Notes, contd.,

### 29. Aluminium price risk, contd.

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.

Contracts are discounted at USD rates from Bloomberg, no spread added. At year end 2015, rates for discounting were in the range of 0.5 - 2.2% (2014: 0.2 - 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.

|                            | Aluminum price USD/ton |          |
|----------------------------|------------------------|----------|
|                            | -100                   | +100     |
| <b>31/12/2015</b>          |                        |          |
| Embedded derivatives ..... | ( 19,967)              | 19,967   |
| Aluminium hedges .....     | 3,653                  | ( 3,704) |
|                            | ( 16,314)              | 16,263   |
| <b>31/12/2014</b>          |                        |          |
| Embedded derivatives ..... | ( 11,811)              | 11,811   |
| Aluminium hedges .....     | 4,109                  | ( 4,358) |
|                            | ( 7,702)               | 7,453    |

### 30. Foreign exchange risk

Foreign currency 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 all general transactions in other currencies than the functional currency.

The Company'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 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 in EUR 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, which are mainly long-term loans. Foreign currency risk due to open positions in EUR was at the end of December 2015 about 16% of the Company's interest bearing debt (2014: 20%). The following table shows Landsvirkjun's open balance in currencies other than the functional currency.

## Notes, contd.,

### 30. Foreign exchange risk, contd.

Landsvirkjun's foreign exchange risk at year end is specified as follows:

|   | EUR        | ISK        | CHF       | Other currencies |
|---|------------|------------|-----------|------------------|
| <b>2015</b>                                     |            |            |           |                  |
| Accounts receivables and other receivables..... | 315        | 16,810     | 0         | 1,695            |
| Cash and cash equivalents.....                  | 814        | 42,179     | 12,717    | 929              |
| Derivatives.....                                | 215,922    | 0          | 0         | 0                |
| Interest bearing liabilities.....               | ( 548,376) | ( 230,643) | ( 38,364) | 0                |
| Accounts payable and other payables .....       | ( 1,115)   | ( 54,116)  | 0         | ( 523)           |
| Risk in balance sheet.....                      | ( 332,440) | ( 225,770) | ( 25,647) | 2,101            |
| <b>2014</b>                                     |            |            |           |                  |
| Accounts receivables and other receivables..... | 358        | 18,689     | 0         | 2,227            |
| Cash and cash equivalents.....                  | 848        | 33,088     | 44        | 2,193            |
| Derivatives.....                                | 139,688    | 0          | 0         | 0                |
| Interest bearing liabilities.....               | ( 611,294) | ( 320,758) | ( 44,439) | 0                |
| Accounts payable and other payables.....        | ( 1,542)   | ( 42,091)  | ( 44)     | ( 494)           |
| Risk in balance sheet.....                      | ( 471,942) | ( 311,072) | ( 44,439) | 3,926            |

Exchange rate of the main currencies against the USD, for the years 2015 and 2014 are specified as follows:

|          | Average rate |        | Rate at year end |        |
|----------|--------------|--------|------------------|--------|
|          | 2015         | 2014   | 2015             | 2014   |
| EUR..... | 0.88         | 0.75   | 0.91             | 0.82   |
| GBP..... | 0.64         | 0.61   | 0.67             | 0.64   |
| CHF..... | 0.94         | 0.92   | 0.98             | 0.99   |
| JPY..... | 117.63       | 105.84 | 118.95           | 119.48 |
| NOK..... | 7.85         | 6.31   | 8.68             | 7.40   |
| ISK..... | 131.85       | 116.75 | 129.59           | 126.90 |

#### 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. The analysis is based on that all variables, especially interest rates, remain unchanged.

| 2015       | Profit (loss) |           | Equity        |           |
|------------|---------------|-----------|---------------|-----------|
|            | Strengthening | Weakening | Strengthening | Weakening |
| EUR .....  | 34,467        | ( 33,021) | 33,183        | ( 31,737) |
| ISK .....  | ( 11,178)     | 11,178    | ( 45,009)     | 45,009    |
| CHF .....  | 2,565         | ( 2,565)  | 2,565         | ( 2,565)  |
| USD* ..... | ( 4,146)      | 4,146     | ( 4,146)      | 4,146     |
| 2014       | Strengthening | Weakening | Strengthening | Weakening |
| EUR .....  | 45,630        | ( 49,194) | 43,984        | ( 47,549) |
| ISK .....  | ( 8,247)      | 8,247     | ( 24,829)     | 24,829    |
| CHF .....  | 4,444         | ( 4,444)  | 4,444         | ( 4,444)  |
| USD* ..... | ( 9,025)      | 9,025     | ( 9,025)      | 9,025     |

(\*) Risk in USD is due to assets and liabilities of subsidiaries which do not have USD as their functional currency.

The fair value of currency swaps was negative by USD 14.9 million at the end of December 2015 (2014: negative by USD 5.7 million). There were no open currency options at the end of December 2015 (2014: negative by USD 4.2 million).

## Notes, contd.,

### 31. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's liabilities carry both fixed and floating interest rates and interest rate derivatives are used in order to manage interest rate risk. The Company's risk relates to a possible increase in floating interest and an increased interest expense.

At year end 2015, the proportion of loans with floating interest rates including swap agreements was 51% (2014: 57%). At year end 2015, the estimated market value of the Company's long-term liabilities was USD 144 million higher than their book value (2014: 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.

| <i>Financial instruments with fixed interest</i>        | <b>2015</b>         | <b>2014</b>         |
|---|---------------------|---------------------|
| Financial liabilities .....                             | ( 1,048,876)        | ( 1,028,164)        |
|   | <u>( 1,048,876)</u> | <u>( 1,028,164)</u> |
| <br><i>Financial instruments with floating interest</i> |                     |                     |
| Financial assets .....                                  | 142,127             | 207,070             |
| Financial liabilities .....                             | ( 1,078,662)        | ( 1,369,365)        |
|   | <u>( 936,535)</u>   | <u>( 1,162,295)</u> |
| <br><i>Derivative financial instruments</i>             |                     |                     |
| Embedded derivatives .....                              | ( 52,214)           | 7,711               |
| Other derivatives .....                                 | ( 17,162)           | ( 35,992)           |
|   | <u>( 69,376)</u>    | <u>( 28,281)</u>    |

The fair value of interest rate swaps was negative by USD 7.2 million at year end 2015 (2014: negative by USD 33.6 million).

#### Sensitivity analysis

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

| <b>31/12/2015</b>                  | <b>Cash flow</b> |                 | <b>Fair value</b> |              |
|------------------------------------|------------------|-----------------|-------------------|--------------|
|                                    | -100 bps         | +100 bps        | -100 bps          | +100 bps     |
| Embedded derivatives .....         | 0                | 0               | ( 1,859)          | 1,765        |
| Derivatives .....                  | ( 1,192)         | 3,164           | ( 3,373)          | 4,506        |
| Interest bearing liabilities ..... | 8,348            | ( 13,921)       | 0                 | 0            |
| Financial assets .....             | ( 1,421)         | 1,421           | 0                 | 0            |
|                                    | <u>5,735</u>     | <u>( 9,336)</u> | <u>( 5,232)</u>   | <u>6,271</u> |

| <b>31/12/2014</b>                  | <b>Cash flow</b> |                  | <b>Fair value</b> |              |
|------------------------------------|------------------|------------------|-------------------|--------------|
|                                    | -100 bps         | +100 bps         | -100 bps          | +100 bps     |
| Embedded derivatives .....         | 0                | 0                | 587               | ( 541)       |
| Derivatives .....                  | ( 1,943)         | 1,943            | ( 4,336)          | 4,576        |
| Interest bearing liabilities ..... | 8,805            | ( 15,779)        | 0                 | 0            |
| Financial assets .....             | ( 2,071)         | 2,071            | 0                 | 0            |
|                                    | <u>4,791</u>     | <u>( 11,765)</u> | <u>( 3,749)</u>   | <u>4,035</u> |

## Notes, contd.,

### 32. Liquidity risk

Liquidity risk consists of risk of losses should the Company not be able to meet its obligations at maturity date. The Company limits liquidity risk by ensuring that there is sufficient cash at each time in order to be able to meet the Company's obligations. In order to provide balance between obligations and expected income an emphasis is placed on ensuring access to cash and Revolving Credit Facilities.

The Company's cash and cash equivalents amounted to USD 142 million at year end 2015 (2014: USD 207 million) but taking into account undrawn credit facilities (USD 200 million and ISK 12,000 million) and undrawn ECA facility amounting to USD 68 million the Company has access to a total of USD 503 million (2014: USD 407 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 2017.

In order to ensure access to capital and maintain flexible funding possibilities, Landsvirkjun has used different types of funding. Financing has mostly taken place through a government guaranteed Euro Medium Term Note Programme (EMTN).

- At year end 2015, the balance of loans under the EMTN with government guarantee was USD 1.3 billion (2014: USD 1.6 billion). The total amount the Company can borrow under the programme is USD 2.5 billion.
- At year end 2015, the balance of loans under the EMTN without government guarantee was USD 115 million (2014: USD 30 million). The total amount the Company can borrow under the programme is USD 1.0 billion.

The Company's risk related to refinancing is reduced with a well organised maturity profile and long loan terms. Weighted average life of the loan portfolio is 5.1 years and the proportion of loans with maturity within 12 months is 11.1%.

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

| 2015  | Book value          | Contractual cash flow | Within one year   | 1 - 2 years       | 2 - 5 years       | More than 5 years   |
|---|---------------------|-----------------------|-------------------|-------------------|-------------------|---------------------|
| <i>Non-derivative financial instruments</i> |                     |                       |                   |                   |                   |                     |
| Long term receiv. ....                      | 5,667               | 5,667                 | 0                 | 5,667             | 0                 | 0                   |
| Cash and cash equiv. .                      | 142,127             | 142,127               | 142,127           | 0                 | 0                 | 0                   |
| Short term receiv. ....                     | 64,472              | 64,472                | 64,472            | 0                 | 0                 | 0                   |
| Interest bearing liab. .                    | ( 2,127,538)        | ( 2,448,096)          | ( 268,593)        | ( 271,463)        | ( 887,652)        | ( 1,020,388)        |
| Current liabilities .....                   | ( 66,237)           | ( 66,237)             | ( 66,237)         | 0                 | 0                 | 0                   |
|   | <u>( 1,981,509)</u> | <u>( 2,302,067)</u>   | <u>( 128,231)</u> | <u>( 265,796)</u> | <u>( 887,652)</u> | <u>( 1,020,388)</u> |

## Notes, contd.,

### 32. Liquidity risk, contd.

| 2015   | Book value       | Contractual<br>cash flow | Within one year  | 1 - 2 years      | 2 - 5 years      | More than<br>5 years |
|--|------------------|--------------------------|------------------|------------------|------------------|----------------------|
| <i>Derivative financial instruments</i>            |                  |                          |                  |                  |                  |                      |
| Currency swaps .....                               | ( 14,929)        | ( 19,198)                | ( 3,122)         | ( 15,122)        | ( 954)           | 0                    |
| Interest rate swaps ...                            | ( 7,201)         | ( 7,074)                 | ( 3,893)         | ( 2,473)         | ( 708)           | 0                    |
| Aluminium derivat. ...                             | 4,967            | 5,361                    | 5,361            | 0                | 0                | 0                    |
| Embedded derivatives<br>in electr. sales agr. .... | ( 52,214)        | ( 55,453)                | ( 10,027)        | ( 9,185)         | ( 21,113)        | ( 15,128)            |
|  | <u>( 69,376)</u> | <u>( 76,364)</u>         | <u>( 11,681)</u> | <u>( 26,780)</u> | <u>( 22,775)</u> | <u>( 15,128)</u>     |

#### 2014

##### *Non-derivative financial instruments*

|                           |                     |                     |                  |                   |                   |                     |
|---------------------------|---------------------|---------------------|------------------|-------------------|-------------------|---------------------|
| Long term receiv. ....    | 11,334              | 11,334              | 0                | 5,666             | 5,668             | 0                   |
| Cash and cash equiv. .    | 207,070             | 207,070             | 207,070          | 0                 | 0                 | 0                   |
| Short term receiv. ....   | 73,368              | 73,368              | 73,368           | 0                 | 0                 | 0                   |
| Interest bearing liab. .  | ( 2,397,529)        | ( 2,758,841)        | ( 310,905)       | ( 287,554)        | ( 900,961)        | ( 1,259,421)        |
| Current liabilities ..... | ( 57,688)           | ( 57,688)           | ( 57,688)        | 0                 | 0                 | 0                   |
|                           | <u>( 2,163,445)</u> | <u>( 2,524,757)</u> | <u>( 88,155)</u> | <u>( 281,888)</u> | <u>( 895,293)</u> | <u>( 1,259,421)</u> |

##### *Derivative financial instruments*

|  |                  |                  |                  |                 |                 |              |
|--|------------------|------------------|------------------|-----------------|-----------------|--------------|
| Currency swaps .....                               | ( 9,861)         | ( 10,862)        | ( 3,777)         | ( 726)          | ( 6,359)        | 0            |
| Interest rate swaps ...                            | ( 33,630)        | ( 33,816)        | ( 27,606)        | ( 3,716)        | ( 2,494)        | 0            |
| Aluminium derivat. ...                             | 7,499            | 10,244           | 7,027            | 3,217           | 0               | 0            |
| Embedded derivatives<br>in electr. sales agr. .... | 7,711            | 9,030            | ( 17)            | 154             | 1,924           | 6,969        |
|  | <u>( 28,281)</u> | <u>( 25,404)</u> | <u>( 24,373)</u> | <u>( 1,071)</u> | <u>( 6,929)</u> | <u>6,969</u> |

### 33. Credit risk

Credit 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 power contracts, derivative contracts and cash and cash equivalents. Though the amounts involved are considerably high, the risk is limited by the Company's requirements for counterparty quality.

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

|  | 2015           | 2014           |
|--|----------------|----------------|
| Derivative financial instruments .....           | 9,769          | 24,306         |
| Long term receivables .....                      | 5,667          | 11,334         |
| Accounts receivables and other receivables ..... | 64,472         | 73,368         |
| Cash and cash equivalents .....                  | 142,127        | 207,070        |
|  | <u>222,035</u> | <u>316,078</u> |

## Notes, contd.,

### 34. Comparison of fair value and book value of long-term debt

|  | 2015       |            | 2014       |            |
|--|------------|------------|------------|------------|
|  | Book value | Fair value | Book value | Fair value |
| Interest bearing long term liabilities ..... | 2,127,538  | 2,271,631  | 2,397,529  | 2,548,996  |

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

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

Interest rates are specified as follows:

|  | 2015     | 2014      |
|--|----------|-----------|
| Interest bearing liabilities in ISK .....            | 2,6-2,8% | 3,1%-4,7% |
| Interest bearing liabilities other than in ISK ..... | 0,0-2,5% | 0,0-2,6%  |

### 35. Fair value classification

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

|  | Level 2          | Level 3        | Total          |
|--|------------------|----------------|----------------|
| <b>2015</b>  |                  |                |                |
| Embedded derivatives .....                         |                  | ( 52,214)      | ( 52,214)      |
| Other derivatives .....                            | ( 17,162)        |                | ( 17,162)      |
| Revaluation of property, plant and equipment ..... |                  | 276,846        | 276,846        |
| Shares in other companies .....                    |                  | 128            | 128            |
|  | <u>( 17,162)</u> | <u>224,760</u> | <u>207,598</u> |
| <b>2014</b>  |                  |                |                |
| Embedded derivatives .....                         |                  | 7,711          | 7,711          |
| Other derivatives .....                            | ( 35,992)        |                | ( 35,992)      |
| Revaluation of property, plant and equipment ..... |                  | 103,774        | 103,774        |
| Shares in other companies .....                    |                  | 120            | 120            |
|  | <u>( 35,992)</u> | <u>111,605</u> | <u>75,613</u>  |

Main assumptions for valuation of derivatives is shown in notes 12 and 29 and for revaluation of property, plant and equipment in note 8.

## Notes, contd.,

### 36. Classification of financial instruments

Financial assets and liabilities are divided into defined groups. The classification affects how the evaluation of the relevant financial instrument is valued. 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:

|   | Assets and<br>liabilities<br>held for<br>trading | Financial<br>assets<br>and liabilities<br>at fair value<br>through p&l | Loans and<br>receiva-<br>bles | Financial<br>liabilities<br>recognised at<br>amortised cost | Book value       |
|---|--|--|-------------------------------|---|------------------|
| <b>2015</b>   |  |  |                               |   |                  |
| Derivative financial instruments .....              | 9,769  |  |                               |   | 9,769            |
| Shares in other companies .....                     |  | 128  |                               |   | 128              |
| Long-term receivables .....                         |  |  | 5,667                         |   | 5,667            |
| Accounts receivables and<br>other receivables ..... |  |  | 64,472                        |   | 64,472           |
| Cash and cash equivalents .....                     |  |  | 142,127                       |   | 142,127          |
| Total assets .....                                  | <u>9,769</u>                                     | <u>128</u>   | <u>212,266</u>                | <u>0</u>  | <u>222,163</u>   |
| Interest bearing long term debt .....               |  |  |                               | 2,127,538   | 2,127,538        |
| Derivative financial instruments .....              | 79,145   |  |                               |   | 79,145           |
| Accounts payable and<br>other payables .....        |  |  |                               | 66,237  | 66,237           |
| Total liabilities .....                             | <u>79,145</u>                                    | <u>0</u>   | <u>0</u>                      | <u>2,193,775</u>  | <u>2,272,920</u> |
| <b>2014</b>   |  |  |                               |   |                  |
| Derivative financial instruments .....              | 24,306   |  |                               |   | 24,306           |
| Shares in other companies .....                     |  | 120  |                               |   | 120              |
| Long-term receivables .....                         |  |  | 11,334                        |   | 11,334           |
| Accounts receivables and<br>other receivables ..... |  |  | 73,368                        |   | 73,368           |
| Cash and cash equivalents .....                     |  |  | 207,070                       |   | 207,070          |
| Total assets .....                                  | <u>24,306</u>                                    | <u>120</u>   | <u>291,772</u>                | <u>0</u>  | <u>316,198</u>   |
| Interest bearing long term debt .....               |  |  |                               | 2,397,529   | 2,397,529        |
| Derivative financial instruments .....              | 52,587   |  |                               |   | 52,587           |
| Accounts payable and<br>other payables .....        |  |  |                               | 57,688  | 57,688           |
| Total liabilities .....                             | <u>52,587</u>                                    | <u>0</u>   | <u>0</u>                      | <u>2,455,217</u>  | <u>2,507,804</u> |

### 37. Capital management

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

### 38. Subsequent events

Nothing has come forth after the balance sheet date, which would require adjustments or changes to the financial statements for the year 2015.



## Notes, contd.,

---

### 39. Significant accounting policies

The Group has adopted all International Financial Reporting Standards, amendments thereto and interpretations adopted by the EU at year end 2015 and apply to its operation. 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. It is the opinion of management that implementation of new and amended standards and interpretations which have not entered into effect will not have significant effect on the consolidated financial statements.

### 40. 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 statements 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 a subsidiary 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.

### 41. 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.,

---

### 42. Operating revenues

Revenues from sales and transmission of electricity consists of sales to power intensive industries and public utilities based on the delivery of electricity during the year. Other service income is recognised when earned or upon delivery. In 2014, other revenues increased by USD 17 million due to an agreement with Rio Tinto Alcan in Iceland.

### 43. Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method. Interest income and expense 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.

### 44. Other financial income and expenses

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

### 45. 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 period. The foreign currency gain or loss thereon 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.

### 46. 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 an available-for-sale financial asset is calculated by reference to its fair value.

Impairment loss on financial assets is recognised in the income statement. Accumulated loss on available for sale financial assets, previously recognised among equity, is recognised in the income statement when the impairment loss has been 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 available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised in the statement of comprehensive income.

## Notes, contd.,

---

### 46. 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, if no impairment loss had been recognised.

### 47. Income tax

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

Current 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 tax of previous years.

A deferred 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.

## Notes, contd.,

### 48. 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.

#### 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 reassessed at each accounting date.

Depreciation ratios and useful life are specified as follows:

|   | <b>Depreciation</b> | <b>Useful life</b> |
|---|---------------------|--------------------|
| 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 .....                       | 2-5%                | 20-50 years        |
| Optical fibre .....                     | 5.00%               | 20 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         |

## Notes, contd.,

---

### 49. Intangible assets

Intangible assets are recognised at cost value, less 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. The 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:

|                | <b>Depreciation</b> | <b>Useful life</b> |
|----------------|---------------------|--------------------|
| Software ..... | 25%                 | 4 years            |

### 50. 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 available-for-sale financial assets.

#### 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.

## Notes, contd.,

---

### 50. Financial instruments, contd.

#### 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.

#### 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.

### 51. 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 location and in a usable state.

### 52. Cash and cash equivalents

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

## Notes, contd.,

---

### 53. Equity

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

### 54. Employees' benefits

#### a) Defined contribution plan

Cost due to contribution to defined benefit plans is expensed in the income statement 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.

### 55. Provisions

Obligations are recognised 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 cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

### 56. 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.

# 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.

### Objective, aim, vision and values

Landsvirkjun is an energy company owned by the Icelandic State. Landsvirkjun's objective is to maximise the yield of the energy resources entrusted to the Company with emphasis on sustainable use, creation of values and efficiency. In order to uphold its objectives with ambition the Company has defined the following goals: Practise efficient electricity generation and advancement, serve a diverse customer base, connect prices to European electricity markets, constantly develop skills and capabilities of the employees, and to create support and solidarity by open communication with stakeholders.

Landsvirkjun's vision is to be a progressive international electricity company in the field of renewable energy. We want to be among the best who generate and sell energy.

The values of the employees of Landsvirkjun 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 the Company. 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, Jón Björn Hákonarson, Chairman of the Municipal Board of Fjarðabyggð, Vice Chairman of the Board, Helgi Jóhannesson, Supreme Court Attorney, Þórunn Sveinbjarnardóttir, CEO of the Association of Academics (BHM), and Álfheiður Ingadóttir, biologist.

### Audit committee

Chapter IX of the Act No. 3/2006 on Financial Statements, 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 Þórunn Sveinbjarnardóttir, and Heimir Haraldsson, auditor and chairman of the committee.

### CEO, Deputy and Executive Directors

The Board of Directors of Landsvirkjun hires a CEO. The CEO of the Company is Hörður Arnarson. The Board of Directors and the CEO exercise executive power in the Company. Landsvirkjun's Deputy CEO is Ragna Árnadóttir. The Deputy CEO's roles is to handle collective matters of the Company in addition to policy development, such as ensuring good corporate governance. At the end of the year the Company's executive directors were five.

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.



## Statement of Corporate Governance, contd.

---

Marketing and business development division. Head of marketing and business development is Björgvin S. Sigurðsson. The role of the division is to maximise the Company's revenue by analysing different business opportunities, product development, promotion, and sales of products and services, negotiating new power contracts and follow up on the execution of existing contracts.

Energy division. Head of the energy division is Einar Mathiesen. The role of the division is to ensure efficient energy production and to maximise the output of Landsvirkjun's processing systems. The division shall guarantee that energy production and distribution is in accordance with agreements with customers.

Research and development division. Head of research and development 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, manage innovation and to have a long-term vision of utilisation of energy resources.