

# Orkuveita Reykjavíkur consolidated budget 2010

Approved by the board of  
directors

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## *1 Introduction*

The main emphasis of the consolidated budget of Reykjavík Energy for 2010 is extensive restraint in operations with the objective of safeguarding the delivery reliability of the basic systems and the jobs with the company. The investment plan seeks to maintain employment levels and to complete projects that are well advanced in order for them to start generating revenues or improving service. The budget is prepared and presented on grounds of an unchanged organization; however, work is taking place on the division of monopoly and competition operations, effective as of January 1<sup>st</sup> 2010, all in conformity with the provisions of Act no. 58/2008. Every effort is made for this separation meeting all requirements of law with as limited costs in the operation of Reykjavík Energy.

### *Restraint in operations - increased transparency*

The extensive economizing as seen in recent years in the operation of Reykjavík Energy only materializes to a limited degree in the closing figures of the budget and the company's annual accounts. The reason for this is that in recent years the company has shouldered various cost increases in its operations without this being specifically mentioned, or such costs being shifted over to consumers. Many such increases are outside the company's scope of influence, for example increased tariffs of Landsnet for transmission to power intensive users, increased power prices of the National Power Company (Landsvirkjun), more unfavourable bids by contractors during the period of the economic rise, and increased prices for acquisitions as a result of the currency collapse during the economic recession.

The economizing in the operation of Reykjavík Energy has been aimed at shielding the customers against such cost increases to the extent possible. An example of this is that the electricity price to Reykjavík Energy's own operating units has not increased since 2005.

Significant achievements were made in 2009 in terms of cutting expenditures, all of which will show the desired results in 2010 and also in part in the long run. Reykjavík Energy initiated and generated brainstorming and idea development among its personnel regarding expenditure cuts, and it is fair to say that many possibilities of such cost reductions were found in the course of detailed examination of operations. It is assumed that the economizing in 2009 will amount to as much as ISK 250 million, and that the measures taken in connection with this special effort will certainly result in expenditure cuts in 2010 amounting to about ISK 400 million. This achievement is indeed a feather in the cap of the employees who were involved in the idea development and also for the management who carried out the suggestions.

Subject to an agreement with the employees on general wage decreases that took effect around the middle of 2009, a considerable reduction of wage costs were achieved during the year. This applied to wages that were higher than ISK 300,000 per month and the decrease was proportionally higher up the wage ladder. It is fair to say that general understanding exists over this measure among the personnel of Reykjavík Energy.

### *Investments*

In 2010 Reykjavík Energy is expected to be the largest single developer in Iceland. The company's investments are estimated to be about ISK 18 billion. The largest portion of the investments relate to the Hellisheidi Power Plant, where the plan is to launch the generation of hot water in the second part of 2010, and to complete the structuring of the electricity production at the plant one year later. Most of the investments in these phases fall on the years 2009 and 2010, whereas the company's investments in new harnessing projects thereafter decrease considerably. Additionally, extensive investments are currently taking place in the drainage systems in West Iceland, constituting revolutionary measures from an environmental perspective in this part of Iceland. Reykjavík Energy's total investments in these projects in 2010 are greater than those which, for example, the National Treasury and its institutions are planning, according to the new national budget. Hence, this is an indication of the important role of Reykjavík Energy in maintaining a construction level in Iceland in these current times of economic recession.

There still exists a degree of uncertainty over the financing of these planned projects. More than a one-year delay occurred in the finalizing of a EUR 170 million loan from the European Investment Bank in the wake of the collapse of the world's financial markets. Icelandic undertakings were immediately placed on the bank's caution list as a result of Iceland being the first nation to suffer total collapse of the financial system. In order to avoid damages caused by the stoppage of the projects that were to be financed with this loan, less favorable short-term loans had to be taken for financing purposes. Cost calculations of individual projects have therefore changed considerably in respect of financial items. Increased acquisition costs in the wake of the currency collapse in Iceland played a role in this development. A loan agreement with the bank was signed on 20 November 2009. This long-term loan has more favorable terms than those available in Iceland.

Reykjavík Energy's foreign revenues from power sale to power intensive users have increased due to the low exchange rate. Additionally, there are indications that the aluminum price on the international market will become more favorable than it currently is.

### *Division of Reykjavík Energy*

Subject to new legislation in 2008, requirements were made on the full split of undertakings, i.e. the monopoly and competition factors in the operation of the power companies. These factors have been separately operated by Reykjavík Energy for several years, in fact more factors in the overall operations. The company's infrastructure is therefore well prepared for such changes being made as provided for by law. Reducing cost increases derived from this changed organization to the extent possible is a challenge. This work has progressed well.

After a detailed examination of the options the conclusion by the Owners Committee is that the arrangement of the split shall be that a new partnership entity will handle the conventional utility operations of the company. Work has taken place over the last few months on a detailed execution of the division, the economic and financial grounds, and on

the demands which the parent company and its owners will make regarding the activities and working methods of the utility operations. The work on this project will show results in other parts of operations as it has clarified the vision of Reykjavík Energy regarding its role towards other operating factors that are also in subsidiaries.

## 2 Assumptions

Prerequisites of the consolidated budget of Reykjavík Energy regarding price developments and the exchange rate

<u>Prerequisites</u>	<b>2010</b>
Consumer index change	5.0%
Building cost index	2.9%
Currency exchange index at year's end	235 points
<i>Quantity change in the sale of basic products:</i>	
Electricity	0.0%
Hot water	-1.0%
Cold water	0.0%
Sewage systems	0.0%

The wage changes are in conformity with the current collective agreement and the Stability Pact between the social partners, the government and the Association of Local Authorities in Iceland. All collective agreements will expire at yearend 2010.

Reykjavík Energy's tariffs for the retail sale of electricity and hot water are expected to remain unchanged.

The forecast on the development of aluminum prices is based on a three-month market price as published by the London Metal Exchange.

### **Exchange rate**

The latest version of the Icelandic macroeconomics forecast 2009-2010, dated 1 October 2010, states that the main factors of uncertainty in the forecasts published therein relate to the exchange rate of the Icelandic currency, the lifting of capital controls, loans by AGS and other countries, the restructuring of the bank system, the financial situation of households and businesses, the situation on the labor market, investment in power harnessing and industrial options. Current account deficit is expected to decrease rapidly and is expected to be 7% of GDP in 2009. A small surplus is forecasted in 2010 and 2011. The forecast assumes continued weak exchange rate.

The exchange rate of the Icelandic currency has dropped a bit during the year despite considerable interventions by the Central Bank of Iceland, a considerable surplus of the current account and more stringent capital-control rules. The main cause for the Icelandic currency not strengthening originates in the seasonal out-flux of the interest payments by foreign parties during the summer and hesitation by exporters in changing export revenues in foreign currencies into the Icelandic currency.

Considering the capital controls, the uncertainty about the economic developments and inefficient price formulation on the foreign exchange market, forecasting the foreign exchange developments in Iceland next year is very difficult. The Central Bank of Iceland aims at lifting the capital controls in steps over the next few years, provided favorable conditions exist for doing so; however, no timeframe has been set in this respect. It is assumed that the exchange rate of the Icelandic currency will continue being weak. Reykjavík Energy's Budget for 2010 assumes that the Icelandic exchange rate index will be 235 points at the end of 2009 and unchanged in 2010.

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### *3 Main conclusion*

#### **Income statement**

##### Revenues:

Operating revenues are estimated as ISK 26,282 million compared with ISK 25,503 million in 2009, or a 3.1% increase. The main cause for this difference is increased sale of electricity to intensive energy-consuming industry amounting to ISK 967 million, which is first and foremost due to a higher exchange rate and higher aluminum prices. Other operating income, for example, initial service charges and project sale, is expected to decrease considerably due to less construction by municipalities.

##### Expenditures:

Operating expenditures are estimated as ISK 14,047 million compared with ISK 13,443 million in 2009, or a 4.5% increase. The most significant factor here is an increase in power purchasing and transmission costs, i.e. an increase amounting to about ISK 310 million between the years, or 6.2%, and an increase in the social security charge amounting to ISK 70 million. The year saw various measures for economizing being taken, for example, decreasing the amount of purchased services, travel expenses, and generally improved acquisition prices. Two units at the Hellisheidi Power Plant are expected to undergo extensive preventive maintenance, which in turn leads to increased operating costs during the year, as well as higher expenditures because of power purchases by the National Power Company. Work will continue in 2010 on decreasing expenditures without jeopardizing the reliability of the basic systems. The economizing measures are expected to reduce operating costs in 2010 by about ISK 400 million.

##### Financial items:

The weakening of the Icelandic currency in 2009 is expected to be around 8%, however, no further weakening is assumed in 2010. There are fluctuations in the exchange rate between the years affecting external long-term debts and embedded derivatives in electricity sale contracts that fall under other financial assets. These are calculated statistics and much uncertainty exists regarding the grounds.

The percentage of the guarantee fee to owners is expected to increase by 50%, i.e. from 0.25% to 0.375%.

Profit in 2010 is expected to be ISK 27 million, compared with a deficit in 2009 amounting to ISK 11,379 million.

## Balance sheet

### Assets:

Total assets are expected to amount to ISK 286,359 million by the end of 2010, compared with ISK 277,048 million according to the performance forecast for 2009, constituting an increase of about 3.4%.

### Equity capital:

Equity capital is expected to amount to ISK 35,415 at the end of 2010 compared with ISK 36,188 according to the performance forecast for 2009. Equity ratio is estimated as 12.4% at the end of 2010 compared with 13.1% in the performance forecast for 2009.

### Debt:

Debts are expected to amount to ISK 250,944 at the end of 2010 compared with ISK 240,860 according to the performance forecast, constituting an increase of about 4.2%.

## Cash flow

Liquid assets from operations are estimated as ISK 8,788 million compared with ISK 7,584 in 2009. The increase may particularly be traced to lower interest payments because of more favorable financing and lower interest level.

### Investment activities:

Investment during the year in operational assets is estimated as ISK 18,086 million in 2010 compared with ISK 19,384 million in 2009. The largest investments are as follows:

#### Hellisheidi Power Plant

4th phase, hot-water plant	ISK 2,471 million
5th phase, electricity plant	ISK 9,872 million
Low-temperature area	ISK 225 million thereof modernization of the Reykir-pipe II ISK 93 million
Distribution system	ISK 3,799 million, thereof data center ISK 1,181 Million and sewage system ISK 994 million
Unforeseeable	ISK 400 million

Cash flows from financing activities:

New borrowing is expected to amount to ISK 19,600 million during 2010. The down payment of long-term debts is estimated to be ISK 10,208 million; hence long-term debt is expected to increase by ISK 9,392 million.

Estimated payment of dividend to owners amounts to ISK 800 million, which is in accordance with the three-year plan.

Orkuveita Reykjavíkur, consolidated Key figures	Actual 2008	pr. 03.07.09	pr. 25.11.09	pr. 25.11.09
		Budget 2009	Estimate 2009	Budget 2010
EBITDA .....	11.651.618	11.499.718	12.059.777	12.234.982
Net cash from operating activities .....	8.380.136	8.590.489	7.584.284	8.787.740
Net cash from operating activities - dividends .....	6.812.160	7.790.489	6.784.284	7.987.740
Investment activities .....	32.372.512	15.971.760	18.246.832	18.213.250
EBITDA/Operating income .....	48,2%	46,2%	47,3%	46,6%
EBITDA/Investment activities .....	36,0%	72,0%	66,1%	67,2%
Net cash from operating act./ (interest b. Debts and assets) .....	4,1%	4,0%	3,4%	3,7%
Net cash from operating act.-dividends/(interest b. Debts and assets) .	3,3%	3,6%	3,0%	3,4%
Net cash from operating activities/investments .....	25,9%	53,8%	41,6%	48,2%
Equity ratio .....	18,6%	17,8%	13,1%	12,4%
EBITDA / (Paid interest expenses - paid interest income)	4,4	3,0	2,7	3,6
EBITDA / (Paid interest expenses + capitalized interest - paid interest income)	2,9	2,0	2,0	2,1

## 4 Income statement

		pr. 03.07.09	pr. 25.11.09	pr. 25.11.09
Orkuveita Reykjavíkur, consolidated	Actual	Budget	Estimate	Budget
Income statement, ISK 1.000	2008	2009	2009	2010
<b>Retail</b>	<b>16.007.720</b>	<b>16.937.381</b>	<b>17.061.650</b>	<b>17.216.284</b>
Electricity .....	7.765.176	7.869.673	7.942.830	7.973.727
Hot water .....	5.642.275	6.112.708	5.873.504	5.811.051
Cold water .....	1.930.809	2.305.000	2.461.311	2.542.000
Fibre .....	669.459	650.000	784.005	889.506
<b>Wholesale</b>	<b>5.911.362</b>	<b>6.763.265</b>	<b>7.328.020</b>	<b>8.285.052</b>
Electricity .....	3.763.383	4.235.243	4.771.967	5.628.697
Hot water .....	98.191	109.266	37.325	39.191
Cold water .....	39.783	38.756	48.728	51.164
Sewage system .....	2.010.005	2.380.000	2.470.000	2.566.000
Other income .....	2.249.116	1.180.527	1.113.568	780.825
<b>Operating income total</b>	<b>24.168.198</b>	<b>24.881.173</b>	<b>25.503.239</b>	<b>26.282.161</b>
Energy .....	2.349.621	2.584.252	2.486.800	2.711.200
Transmission .....	2.013.960	2.250.372	2.477.871	2.563.081
Salaries and salary related expenses .....	3.973.674	3.651.469	3.735.470	3.971.476
Other operating expenses .....	4.179.325	4.895.362	4.743.321	4.801.423
Depreciation and amortization .....	6.952.772	8.762.129	9.236.931	9.393.368
<b>Results from operating activities</b>	<b>4.698.846</b>	<b>2.737.589</b>	<b>2.822.846</b>	<b>2.841.614</b>
Interest income .....	792.526	519.564	477.221	374.929
Interest expenses .....	( 5.334.365 )	( 4.668.462 )	( 6.074.959 )	( 4.206.639 )
Income (expenses) on financial assets and liabilities .....	( 87.981.637 )	1.551.257	( 11.281.666 )	1.032.524
<b>Profit (loss) before income tax</b>	<b>( 87.824.630 )</b>	<b>139.949</b>	<b>( 14.056.558 )</b>	<b>42.428</b>
Income tax .....	15.064.266	49.351	2.677.605	( 14.944 )
<b>Profit (loss) for the year</b>	<b>( 72.760.364 )</b>	<b>189.299</b>	<b>( 11.378.954 )</b>	<b>27.484</b>
Minority interest in subsidiaries .....	( 276.339 )	0	0	0
<b>Profit (loss) for the year</b>	<b>( 73.036.703 )</b>	<b>189.299</b>	<b>( 11.378.954 )</b>	<b>27.484</b>

## 5 Balance sheet

		pr. 03.07.09	pr. 25.11.09	pr. 25.11.09
<b>Orkuveita Reykjavíkur, consolidated</b>	<b>Actual</b>	<b>Budget</b>	<b>Estimate</b>	<b>Budget</b>
<b>Balance Sheet, ISK 1.000</b>	<b>2008</b>	<b>2009</b>	<b>2009</b>	<b>2010</b>
<b>Assets</b>				
<b>Fixed assets</b>				
Property, plant and equipment .....	227.457.110	234.963.723	237.486.781	245.871.229
Intangible assets .....	1.680.693	1.873.853	1.798.544	2.106.739
Investment in associated companies .....	574.470	612.149	152.813	152.813
Other financial assets .....	19.222.793	21.063.684	24.829.258	25.784.021
Deferred tax assets .....	4.170.631	4.218.793	6.849.055	6.833.291
	<b>253.105.697</b>	<b>262.732.202</b>	<b>271.116.451</b>	<b>280.748.093</b>
<b>Current assets</b>				
Inventories .....	1.057.886	920.886	807.886	807.886
Trade receivables .....	3.299.220	3.380.007	3.349.012	3.525.029
Other financial assets .....	111.374	111.374	87.035	20.074
Other receivables .....	563.279	566.264	514.914	518.726
Cash and cash equivalents .....	1.243.638	340.820	1.172.264	739.242
	<b>6.275.397</b>	<b>5.319.351</b>	<b>5.931.111</b>	<b>5.610.957</b>
<b>Total assets</b>	<b>259.381.094</b>	<b>268.051.552</b>	<b>277.047.561</b>	<b>286.359.050</b>
<b>Equity and liabilities</b>				
<b>Equity</b>				
Revaluation reserve .....	55.842.385	55.842.385	55.842.385	55.842.385
Retained earnings .....	( 7.509.591 )	( 8.051.821 )	( 19.688.545 )	( 20.461.061 )
Equity attributable to equity holders of the Company .....	48.332.794	47.790.564	36.153.840	35.381.324
Minority interest .....	33.771	5.082	33.771	33.771
<b>Total equity</b>	<b>48.366.565</b>	<b>47.795.646</b>	<b>36.187.611</b>	<b>35.415.095</b>
<b>Long term liabilities and obligations</b>				
Long term liabilities .....	196.098.759	200.903.936	220.207.200	222.600.177
Retirement benefit obligation .....	456.027	485.927	473.027	501.027
Other financial liabilities .....	34.468	34.468	34.468	34.468
Deferred tax liabilities .....	0	0	819	0
	<b>196.589.254</b>	<b>201.424.331</b>	<b>220.715.514</b>	<b>223.135.672</b>
<b>Current liabilities</b>				
Accounts payable .....	2.443.338	2.132.570	2.499.750	2.455.967
Loans and borrowings .....	4.251.132	4.651.132	5.126.132	5.526.132
Current portion on non-current liabilities .....	5.430.478	8.382.444	10.207.512	17.620.141
Other financial liabilities .....	17.645	17.645	17.645	17.645
Other current liabilities .....	2.282.682	3.647.784	2.293.397	2.188.398
	<b>14.425.275</b>	<b>18.831.575</b>	<b>20.144.436</b>	<b>27.808.283</b>
<b>Total liabilities</b>	<b>211.014.529</b>	<b>220.255.906</b>	<b>240.859.950</b>	<b>250.943.955</b>
<b>Total equity and liabilities</b>	<b>259.381.094</b>	<b>268.051.553</b>	<b>277.047.561</b>	<b>286.359.050</b>

## 6 Statement of cash flow

	pr. 03.07.09	pr. 25.11.09	pr. 25.11.09	
<b>Orkuveita Reykjavíkur, consolidated</b>	<b>Actual</b>	<b>Budget</b>	<b>Estimate</b>	
<b>Statement of Cash Flows, ISK 1.000</b>	<b>2008</b>	<b>2009</b>	<b>2009</b>	
			<b>Budget</b>	
			<b>2010</b>	
<b>Cash flows from operating activities</b>				
Results from operating activities .....	4.698.846	2.737.589	2.822.846	2.841.614
Depreciation and amortization .....	6.952.772	8.762.129	9.236.931	9.393.368
Retirement benefit obligation, increase (decrease) .....	71.198	29.900	17.000	28.000
	<b>11.722.816</b>	<b>11.529.618</b>	<b>12.076.777</b>	<b>12.262.982</b>
<b>Working capital from operation before interest and taxes</b>				
Inventories (increase) decrease .....	( 575.473 )	437.000	250.000	0
Accounts receivables (increase) decrease .....	( 232.098 )	504.967	( 224.289 )	( 117.957 )
Other receivables (increase) decrease .....	24.905	( 3.000 )	31.721	5.000
Payables and other current liabilities, increase (decrease) .....	( 444.897 )	( 294.394 )	( 150.138 )	80.483
	<b>10.495.253</b>	<b>12.174.191</b>	<b>11.984.071</b>	<b>12.230.508</b>
<b>Cash generated from operations before interest and taxes</b>				
Received interest income .....	763.307	519.564	147.751	100.000
Dividend received .....	101.615	0	0	0
Paid interest expenses .....	( 3.424.342 )	( 4.403.266 )	( 4.554.636 )	( 3.542.768 )
Paid due to other financial income and expenses .....	444.302	300.000	7.098	0
	<b>8.380.135</b>	<b>8.590.489</b>	<b>7.584.284</b>	<b>8.787.740</b>
<b>Net cash from operating activities</b>				
<b>Cash flows from investing activities</b>				
<b>Power plants</b>	<b>( 22.501.839 )</b>	<b>( 12.024.902 )</b>	<b>( 14.357.369 )</b>	<b>( 13.428.270 )</b>
Mutual .....	0	122.000	0	0
Hydropower plants .....	( 24.408 )	( 20.000 )	( 63.920 )	0
Hot water .....	( 661.795 )	( 294.000 )	( 181.479 )	( 224.500 )
Cold water .....	( 141.768 )	( 103.000 )	( 54.383 )	( 34.500 )
Nesjavellir Geothermall Power Plant .....	( 749.418 )	( 295.000 )	( 88.241 )	( 22.000 )
Hellisheiði Geothermall Power Plant, equipments .....	0	( 10.000 )	0	( 6.000 )
<b>Hellisheiði Power Plant</b>	<b>( 18.224.536 )</b>	<b>( 10.390.934 )</b>	<b>( 11.781.157 )</b>	<b>( 12.407.555 )</b>
<b>Other power plants</b>	<b>( 2.699.914 )</b>	<b>( 1.033.968 )</b>	<b>( 2.188.189 )</b>	<b>( 733.715 )</b>
<b>Distribution systems</b>	<b>( 7.897.806 )</b>	<b>( 4.157.000 )</b>	<b>( 4.665.957 )</b>	<b>( 3.799.216 )</b>
Geothermal .....	( 1.888.390 )	( 600.000 )	( 507.000 )	( 409.000 )
Cold water .....	( 640.946 )	( 300.000 )	( 268.730 )	( 430.500 )
Electricity .....	( 1.741.129 )	( 700.000 )	( 698.320 )	( 725.000 )
Operations .....	( 28.472 )	( 34.000 )	( 9.500 )	( 11.500 )
Sewerage system .....	( 1.811.918 )	( 2.363.000 )	( 2.468.000 )	( 993.500 )
Fibre .....	( 1.523.749 )	( 420.000 )	( 655.107 )	( 1.180.716 )
New areas .....	( 263.202 )	( 40.000 )	( 59.300 )	( 49.000 )
<b>Other investment</b>	<b>( 2.971.304 )</b>	<b>( 580.000 )</b>	<b>( 361.127 )</b>	<b>( 858.525 )</b>
<b>Acquisition of property, plant and equipment</b> .....	<b>( 33.370.949 )</b>	<b>( 16.761.902 )</b>	<b>( 19.384.453 )</b>	<b>( 18.086.011 )</b>
Change in unpaid investment .....	2.047.471	722.606	244.606	( 205.000 )
Acquisition of associated companies .....	( 1.136.583 )	0	9.201.355	0
Installment on long term receivables .....	88.674	67.536	293.330	77.761
Investment in bonds .....	( 1.125 )	0	( 8.601.670 )	0
	<b>( 32.372.512 )</b>	<b>( 15.971.760 )</b>	<b>( 18.246.832 )</b>	<b>( 18.213.250 )</b>
<b>Cash flows from financing activities</b>				
Dividends paid .....	( 1.567.976 )	( 800.000 )	( 800.000 )	( 800.000 )
Repayment of borrowings .....	( 3.636.999 )	( 7.121.548 )	( 6.883.827 )	( 10.207.512 )
Proceed from new borrowing .....	25.233.418	14.000.000	17.400.000	19.600.000
Current liabilities, increase (decrease) .....	1.456.560	400.000	875.000	400.000
	<b>21.485.003</b>	<b>6.478.452</b>	<b>10.591.173</b>	<b>8.992.488</b>
Increase (decrease) in cash and cash equivalents .....	( 2.507.374 )	( 902.819 )	( 71.375 )	( 433.022 )
Cash and cash equivalents at year beginning .....	3.751.013	1.243.639	1.243.639	1.172.264
<b>Cash and cash equivalents at year end</b>	<b>1.243.639</b>	<b>340.820</b>	<b>1.172.264</b>	<b>739.242</b>





