

# **ScanArc ASA**

(former Gras ASA)

## Corporate Consolidated Financial Statements

as of

31 December 2006

## Consolidated balance sheet

		As at 31 December	
	Note	2006	2005
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	9	96 984	102 777
Deferred income tax assets	8	1 424	2 504
		<u>98 408</u>	<u>105 281</u>
<b>Current assets</b>			
Inventories	10	5 240	1 292
Trade and other receivables	11	14 791	2 702
Cash and cash equivalents	12	1 059	3 324
		<u>21 090</u>	<u>7 318</u>
<b>Total assets</b>		<u>119 497</u>	<u>112 599</u>
<b>EQUITY</b>			
<b>Capital and reserves attributable to equity holders of the Company</b>			
Ordinary shares	14	8 000	8 000
Equity ratio subordinated loans	13	1 040	802
Retained earnings	13	-2 935	-4 296
		<u>6 105</u>	<u>4 506</u>
<b>Minority interest in equity</b>		<u>11 417</u>	<u>10 386</u>
<b>Total equity</b>	13	<u>17 522</u>	<u>14 892</u>
<b>LIABILITIES</b>			
<b>Non-current liabilities</b>			
Borrowings	16	41 827	46 765
Pension liability	15	15	0
Other liabilities and charges	16	34 554	39 988
		<u>76 396</u>	<u>86 753</u>
<b>Current liabilities</b>			
Trade and other payables	17	8 573	4 841
Borrowings	12, 17	8 629	5 000
Other liabilities and charges	5, 6, 17	8 378	1 113
		<u>25 580</u>	<u>10 954</u>
<b>Total liabilities</b>		<u>101 975</u>	<u>97 707</u>
<b>Total equity and liabilities</b>		<u>119 497</u>	<u>112 599</u>

The notes presented on page 5 to 33 are an integral part of these consolidated financial statements.

## Consolidated income statements

		Year ended 31 December	
	Note	2006	2005
Revenue	3	56 075	749
<b>Total revenue</b>		<u>56 075</u>	<u>749</u>
Raw materials and consumables used	10	16 206	998
Salaries and Employee benefits expense	6, 15	8 295	911
Depreciation and amortisation expenses	9	6 329	1 702
Other operating expenses	6, 19	16 214	2 706
<b>Total operating expenses</b>		<u>47 044</u>	<u>6 318</u>
<b>Operating profit/(loss)</b>		9 030	(5 569)
Finance income	20	301	64
Finance costs	20	(5 858)	(2800)
Finance costs – net		<u>(5 558)</u>	<u>(2 735)</u>
<b>Profit before income tax</b>		3 474	(8 304)
Income tax expense	8	(1 080)	2 672
<b>Profit for the year</b>		<u>2 393</u>	<u>(5 632)</u>
<b>Attributable to:</b>			
Equity holders of the Company	13, 14	1 031	(2 816)
Minority interest	13	1 361	(2 815)
		<u>2 393</u>	<u>(5 632)</u>
<b>Earnings per share</b> (expressed in NOK per share)		<u>29,9</u>	<u>(70,4)</u>

The notes presented on page 5 to 33 are an integral part of these consolidated financial statements.

## Consolidated cash flow statement

	<u>Year ended 31 December</u>	
	2006	2005
<b>Cash flows from operating activities</b>		
Net Profit before income taxes	3 472	(8 304)
Ordinary depreciation	6 329	1 702
Changes in inventories, trade receivables and trade creditors	(11 277)	(7 512)
Changes in other accrued entries	6 251	1 567
Net cash generated from operating activities	<u>4 775</u>	<u>(12 547)</u>
<b>Cash flows from investing activities</b>		
Purchase of tangible non current assets	(5 736)	(41 556)
Grants received related to non current assets	5 200	0
	<u>(536)</u>	<u>(41 556)</u>
<b>Cash flows from financing activities</b>		
Proceeds from recent debt raised (long term)	528	55 486
Payment of overdue liabilities	(5 700)	(1 333)
Change in equity ratio subordinated loans	238	802
Remission of debt Norsk Hydro	(5 200)	0
Net change in bank overdraft	3 629	0
Net cash used in financing activities	<u>(6 505)</u>	<u>54 955</u>
<b>Net change in cash and cash equivalents</b>	(6 505)	852
Cash and cash equivalents at 01.01	<u>3 324</u>	<u>2 472</u>
<b>Cash and cash equivalents at 31.12</b>	<u>1 058</u>	<u>3 324</u>

The notes presented on page 5 to 33 are an integral part of these consolidated financial statements.

# Notes to the consolidated financial statements (continued)

## 1 General information

### 1.1 Operations

ScanArc ASA (former GRAS ASA) is a limited liability company registered in Norway and its registered office is in Høyanger, Norway. The Company's name was resolved changed from GRAS ASA to ScanArc ASA in a general meeting held on 16 February 2007. On 26 January 2007, the general meeting of ScanArc resolved to convert the Company from a private limited liability company (AS) to a public limited liability company (ASA). The conversion took effect upon registration in the Norwegian Register of Business Enterprises on 21 March 2007.

ScanArc is a holding/parent company for two subsidiaries, Eras Metal AS (88.75%) ("Eras Metal AS") and ScanArc Plasma Technology AB (100%) ("SPT AB") in Sweden. Eras Metal AS, org. no 984 333 102 ("Eras Metal"), was founded in February 2002. The Company was established as Eras Metal's holding company in January 2004. ScanArc Plasma Technology AB ("SPT AB") was founded in 1988, and acquired by ScanArc through a contribution in kind in February 2007 (see 1.4 "Relation with ScanArc Plasma Technologies AB").

The Group's main activity is to own and operate thermal processes for recovery of valuables (e.g. energy and metals) from secondary material (waste streams) or other sources. Eras Metal operates a plant in Høyanger for treatment of Electric Arc Furnace Dust (EAFD) and other secondary residuals with high zinc content for production of zinc oxide. The zinc oxide is used as raw material in zinc production, and is of high quality compared with other input materials. The EAFD is a residue from steel recycling plants, and represents an environmental hazard, that has to be recycled thermally or deposited.

ScanArc ASA has through the subsidiary ERAS Metal AS built up the first submerged-plasma furnace in the world. This concept is expected to give considerable cost reductions and environment advantages. The furnace in Høyanger was launched in August 2005, and in December 2006 it reached a production capacity of approximately 80% of expected full capacity. The plant is expected to achieve full capacity during the first half-year of 2007.

In February 2007, ScanArc ASA acquired ScanArc Plasma Technologies AB, ensuring the continuing growth of the technological platform. Further, the Group is planning to build four new furnaces, based on the technology used in Høyanger; one in Høyanger and three in Calais (France), reaching 250,000 tonnes in treatment capacity within three to four years.

The consolidated financial statements comprise of the parent company ScanArc ASA and the subsidiary, ERAS Metal AS. ScanArc ASA has controlling interest over ERAS Metal AS with an ownership share of 52.32% as of 31.12.2006. The consolidated accounts are prepared such that the Group of companies are presented as a single economic entity. Intercompany transactions have been eliminated from the consolidated accounts.

As of 31.12.06, the largest minority shareholder was the municipality of Høyanger with 36.43% of the shares in ERAS Metal AS. See discussion below.

The following subsidiaries are included in the consolidated financial statement:

<b>Company</b>	<b>Location</b>	<b>Major business</b>	<b>Share ownership</b>	<b>Voting rights</b>
ERAS Metal AS	Norway	Production of Zink bloom	52,32 %	52,32 %

These group consolidated financial statements were authorised for issue by the Board of Directors on 23.03.2007.

## Notes to the consolidated financial statements (continued)

### 1.2 Relationship with Norsk Hydro

Eras Metal AS was established in Høyanger after an assessment of the input factors related to the production.

Norsk Hydro was in an adoption process where workforce reductions were decided. Norsk Hydro had available premises and infrastructure together with qualified personnel with respect to the planned production for Eras Metal AS. Norsk Hydro thereby offered an outlet agreement for premises and infrastructure, in addition to loan financing (free of interest until 01.01.2007) related to building of the production plant. Furthermore, Norsk Hydro offered Eras Metal AS compensation for each of the former Norsk Hydro employees that Eras Metal AS employed permanently. The compensation fee for such employees in 2006 amounted to MNOK 5.2. This amount has reduced the original loan granted by Norsk Hydro.

### 1.3 Relationship with the municipality of Høyanger

In 2002 and 2003, the municipality of Høyanger had available power, at concession terms and Eras Metal AS was offered to acquire such power. The power from the municipality of Høyanger was competitive in price and volume compared to other available offers. ERAS Metal AS therefore decided to enter into a 10 year contract as of 1 October 2003 regarding delivering of power at a price corresponding with the municipality's cost of the power. The contracted price was set based on the average level of the last 5 years spot price. The agreement can be prolonged based on commercial conditions at the time of renewal. Further, the contract contains a mutual renegotiation clause if the agreed price substantially deviates from the spot price. The contract was renegotiated at the end of 2005 and the new price was the municipality's full concession cost including a fixed mark-up of NOK 40 per MWH. Eras Metal AS is allowed to resell unused power, but the municipality receives the profit from such re-sales. Also, the buyer has the risk of tax and price increases.

In 2004, the municipality of Høyanger became a 36% shareholder in Eras Metal AS, through a contribution in kind, with the intention of temporarily ownership in order to realize the project. Hence, ScanArc ASA was granted an option to repurchase these shares. The option was exercisable as of 1 January 2007 and ScanArc ASA decided to repurchase these shares.

### 1.4 Relationship with ScanArc Plasma Technologies AB

ScanArc Plasma Technologies AB (SPT AB) has developed the technology and main processes applied by ERAS Metal AS at the plant in Høyanger. SPT AB was founded in 1988 and, beside research, the activities are to supply and maintain plasma torches for existing plants in operation. SPT AB owns a research facility with 3 furnaces for pilot testing and development of new process. In addition, the pilot plants treat some waste streams on commercial basis.

In 2002, Eras Metal AS entered into a licensing contract with SPT AB. This license contract secures ERAS Metal AS global rights to use SPT AB's processes/technologies within the marked of production of zinc bloom from EAFD. The contract is infinite and requires that ERAS Metal AS either pay an annual royalty fee or acquire technology from SPT AB. The latter requires payment of a nonrecurring duty per tonne production capacity installed.

SPT AB has delivered engineering and technology (plasma generators and control systems) to the plant in Høyanger. Additionally, production process engineers from SPT AB participated in the start-up. SPT AB has developed promising processes for production of metal and energy from secondary materials and SPT AB will, within the company, continue to develop basic design guides of new plants/process. Several of these processes will be commercialized by ScanArc at a later stage.

ScanArc ASA has, as of 16 February 2007, through a contribution in kind, achieved 100% ownership of SPT AB.

# Notes to the consolidated financial statements (continued)

## 2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as set out by EU. The date of implementation is 1 January 2006 with corresponding figures from 2005. In note 26, an explanation of the transition to IFRS is given. The consolidated financial statements are presented in NOK, which is the Company's and the Group's functional and presentation Currency and all figures are rounded to nearest NOK 1000, unless otherwise stated. The consolidated financial statements have been prepared under the historical cost convention. The consolidated financial statements have been prepared with uniform accounting principles for similar transactions and events. The principal accounting principles adopted are set out below.

### 2.2 Consolidation

#### *(a) Subsidiaries*

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights, that are currently exercisable or convertible, are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

#### *(b) Transactions and minority interests*

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that is recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

## Notes to the consolidated financial statements (continued)

### 2.3 Amendments to published standards

#### *a) Amendments to published standards effective 1 2006*

IAS 19 (Amendment), Employee Benefits, is mandatory for the Group's accounting periods beginning on or after 1 January 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Group does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment only impacts the format and extent of disclosures presented in the accounts.

#### *b) Standards mandatory from 1 January 2007, but might be early adopted*

The Group has not implemented IFRS 7, Financial Instruments: Disclosures, and the complementary amendment to IAS 1, Presentation of Financial Statements. IFRS 7 introduces new disclosures relating to financial instruments. This standard does not have any impact on the classification and valuation of the Group's financial instruments.

#### *c) Standards, amendments and interpretations effective in 2006 but not relevant*

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- IAS 21 (Amendment), Net Investment in a Foreign Operation;
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 (Amendment), The Fair Value Option;
- IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts;
- IFRS 6, Exploration for and Evaluation of Mineral Resources;
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment;
- IFRIC 4, Determining whether an Arrangement contains a Lease; and
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.

#### *d) Interpretations to existing standards that are not yet effective and have not been early adopted by the Group*

The following published interpretations of existing standards are mandatory for the Group's accounting periods beginning on or after 1 May 2006. The Group has not yet adopted these standards:

- IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006). IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. The Group will apply IFRIC 8 from 1 January 2007, but it is not expected to have any impact on the Group's accounts; and
- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply IFRIC 10 from 1 January 2007, but it is not expected to have any impact on the Group's accounts.

#### *e) Interpretations to existing standards that are not yet effective and not relevant for the Group's operations*

The following interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 May 2006 but are not relevant for the Group's operations:

## Notes to the consolidated financial statements (continued)

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). IFRIC 7 provides guidance on how to apply requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional Currency, when the economy was not hyperinflationary in the prior period. As none of the group entities have a Currency of a hyperinflationary economy as its functional Currency, IFRIC 7 is not relevant to the Group's operations; and
- IFRIC 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006). IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. As none of the group entities have changed the terms of their contracts, IFRIC 9 is not relevant to the Group's operations.

### 2.4 Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies and accounting of assets and liabilities, income and expenses. Estimates and presumptions are based upon best estimate. Future events may lead to reassessment of estimates. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 5.

### 2.5 Foreign currency translation

Foreign Currency transactions are translated into the functional Currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

### 2.6 Revenue recognition

The Group recognises revenue when the amount of revenue can be reliably measured and, it is probable that future economic benefits will flow to the Group. Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group.

Revenue from sale of goods are not recognised until the products have been shipped and the material risks and return is transferred.

### 2.7 Borrowing costs

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost. Interest and costs related to funds that are borrowed for the purpose of obtaining a qualifying asset of property and plant are capitalized and depreciated together with the plant. See note 9 and 26.

### 2.8 Deferred income tax

Income tax expense consists of tax payable and change in deferred income tax.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the

## Notes to the consolidated financial statements (continued)

time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

### 2.9 Research and development

Costs related to project development are classified and capitalized as property, plant and equipment and depreciated on a straight-line basis over the estimated useful life of the asset.

### 2.10 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated amortisations and depreciations. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

The Group's costs relating to construction management, engineering and other internal work are capitalized providing that a future economic benefit associated with development of the tangible asset can be identified. Otherwise, the costs are expensed as incurred. As for the Group's construction of production plants, the Group has capitalized directly and indirectly attributable expenses, including construction management, engineering and other internal work. Capitalized project development is amortised linearly over the economic lifetime together with related machinery and equipment. Borrowing costs are capitalized until the production plant starts its production activity. In connection with the IFRS transition, previous interests on building loan are capitalized and depreciated together with the plant. See explanation of the transition to IFRS in note 26.

Depreciation of assets is calculated using the straight-line method to allocate their cost over their estimated useful lives, as follows:

- |                                     |            |
|-------------------------------------|------------|
| – Machinery                         | 4-20 years |
| – Furniture, fittings and equipment | 3-5 years  |

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable.

The Group has acted in accordance with the requirement of considering residual values and costs for decomposition and removal. The values of property, plant and equipment at the end of their useful lives have been assessed to zero. The net present value of liabilities regarding removals of chemical disposal is regarded as immaterial.

Assets under construction are classified as fixed assets and are not depreciated before the asset is utilized by the company.

## Notes to the consolidated financial statements (continued)

### 2.11 Finance and operating leases

#### (a) Finance leases

Leases of fixed assets where the net present value of the Group's cost of the lease over the leasing period amounts to substantially all of the fair value of the asset, is classified as financial lease. Financial lease is capitalized using the implicit interest rate deriving from the contract. Each instalment is allocated as an instalment amount and interest amount. This ensures that a constant cost of interest of the amount outstanding as lease obligation is achieved. The lease obligation is classified as other long term liability. Fixed assets purchased through financial lease are depreciated according to the term of lease.

#### (b) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Lease payments are classified as operating costs and recognised in the income statement during the contract period.

### 2.12 Intangible assets

#### (a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and tested for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The group allocates goodwill to each business segment in each country in which it operates.

#### (b) Other intangible assets

Other intangible assets have limited useful lives and are capitalised at historical cost less amortisation and depreciation. Depreciation is calculated using the straight-line method to allocate the cost over their estimated useful lives.

### 2.13 Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date. At each balance date, impairment is assessed, and losses recognised in the income statements for previous periods are reversed when there is information that the need for the impairment loss no longer exists or is reduced.

## Notes to the consolidated financial statements (continued)

### 2.14 Government grants

Grants or subsidies from the authorities are not recognised until it is reasonably certain that the company will meet the conditions stipulated in connection with the receipt of the grants and that the grants will be granted. Grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate. Grants are recognised as deductions from the cost that the Grant is meant to cover.

Grants received to buy non-current assets are capitalised and recognised on a straight-line basis over the expected lives of the expected assets. Grants are either recognised as deferred income or deducted from the cost of the assets' capitalised value.

### 2.15 Inventories

Inventories are valued at the lower of cost and net realisable value. The net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion, marketing and distribution. The initial cost is determined using the first-in, first-out (FIFO) method and includes purchase expenses and other accrued expenses required to bring the goods to the prevailing state and placement.

Produced goods comprise of variable and fixed costs allocated based on a normal capability utilisation.

### 2.16 Trade receivables

Trade receivables and other receivables are initially capitalised at par value, and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Trade receivables are continually assessed with respect to the probability and risk of expected losses.

### 2.17 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings (as current liabilities) in the balance sheet.

### 2.18 Equity and liability

Ordinary shares are classified as equity.

Financial instruments are classified as liabilities or equity consistent with the underlying substance of the instrument

Interest, dividends, gains and losses relating to a financial instrument classified as a liability will be presented as an expense or revenue. Payments to equity holders are classified as equity transactions and are recognised directly in equity. If the classification is dependent on certain types of contingent events in the future and lie outside both the issuer's and holder's control, such as convertible loans, classifications depend on whether it is likely or not that cash or financial assets must be paid or issued. If the probability of the issuer having to pay cash or other financial assets is remote at the time of issuance, the financial instrument is classified as equity.

### 2.19 Employee benefits

#### (a) Pension obligations

The Group has both defined benefit (AFP) and defined contribution plans. The subsidiary, Eras

## Notes to the consolidated financial statements (continued)

Metal AS, offers its employees defined benefit schemes through an early pension retirement scheme (AFP).

The net liability recognised in the balance sheet related to the defined benefit plans is the present value of the defined benefit obligation at the balance sheet date, less the fair value of plan assets, plus adjustments for unrecognised actuarial gains and losses and past services cost. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of 10 year government bond. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method.

The introduction of a new defined benefit plan or any improvement to the present defined benefit plan leads to changes in the pension commitments. These are recognised as expenses in a straight line until the effect of the changes has been accrued. The introduction of new schemes or changes to existing schemes that take place with retroactive force so that the employees have immediately accrued a paid-up policy (or a change in a paid-up policy) is recognised in the income statement immediately. Gains or losses linked to reductions in or terminations of pension plans are recognised in the income statement when they arise. Actuarial gains or losses are amortised over the remaining average accrual period.

### Defined contribution plan

In addition to the defined benefit plan described above, the Group's companies pay fixed contributions to a separate legal entity. These contributions have been made to the pension plan for full-time employees, and comprise of 2% of salaries above 1G. The contributions are recognised as a payroll expense when due.

### *(b) Success based directors' fee*

The chairman of the board is guaranteed a success fee of 2 MNOK provided a successful capitalization of the company.

## **2.20 Provisions**

Provisions are recognised when, the company has a valid liability (legal or estimated) as a result of events that have taken place and it can be proven probable (more probable than not) that a financial settlement will take place as a result of this liability, and that the size of the amount can be measured reliably.

## **2.21 Contingent liabilities and assets**

Contingent liabilities are not recorded in the financial statement. Material contingent liabilities are enlightened unless the liability is unlikely to occur.

The chairman of the board is guaranteed a success fee of 2 MNOK provided a successful capitalization of the company. Refer to 2.19 (b).

## **2.22 Events after the balance sheet date**

New information about events after the balance sheet date regarding the Group's financial position is included in the annual financial statements. Events after the balance sheet date that do not effect the Group's financial position on the balance sheet date, but will effect the Group's financial position in the future are stated, if material.

# Notes to the consolidated financial statements (continued)

## 3. Segment reporting

### 3.1 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and return that are different from those of segments operating in other economic environments.

The group is currently only operating in one business segment and one geographical segment.

## 4. Financial risk management

### 4.1 Generally

The Group's overall risk management policy focuses on all areas in which the Group operates, and seeks to identify, measure and handle risk occurred during the planning, assembly and management of the plant.

Financial risk is monitored and handled through standard criteria's such as "mark to marked", stress tests and "value at risk" models. Technical and operational risk is handled through a quality assurance program (QA manual). Additionally, risk is quantified by stress testing and estimation of the probability of defects for each part of the plants processes. Areas that are identified as uncertain are quantified and monitored..

The Group's risk management policy shall assist the Group to protect investments against unexpected and unfortunate incidents. As such, when risks are present, , the Group will monitor and control the risk. The risk policy will contribute to the achievement of the return on investment in which the investment is based on.

A new risk manual describing the responsibility, reporting routines and the policy for measuring and handling risk is under development. This risk manual will be approved by the Board of Directors during the first half of 2007.

### 4.2 Market risk

The Group is exposed to price risk related to Zink bloom produced. The product is valued according to market prices and the price is exposed to trade cycles. Due to the uncertainty regarding the production volume in 2006, only a few deliveries of Zink bloom were hedged. High volume risk (risk related to available production capacity) did not make it reasonable to enter future fixed pricing hedge agreements of Zink bloom. Due to more stable production volumes In 2007, the Group will consider available hedging models and long term pricing contracts, where this is in accordance with the Group's risk policy.

The Group has agreed to sell the expected total production of Zink bloom to one customer. This customer has for a 5 year period (from 2005) the right to buy the Group's total yearly production. However, according to the agreement, the customer may cancel purchases of up to 50% of the annual expected production.

The Group has a long term power contract with the main power supplier. When full production capacity is achieved, the Group expects to purchase additional power requirements in the spot market.

### 4.3 Foreign exchange risk

The Groups accounts are presented in NOK.

## Notes to the consolidated financial statements (continued)

The Group has foreign exchange risk exposure as it is operating internationally, particularly with respect to US dollar as Zink Bloom is denominated in this currency. Further, the Group is exposed to EUR through purchases of goods and services. .

As of today, management has not hedged their foreign exchange exposure. However, foreign exchange risk hedging will be performed in connection with hedging of the Zink price.

### 4.4 Credit risk

The Group trades with recognised creditworthy third parties and thus, has no material risk exposure related to single customers or a group of customers that can be seen as one unit bases on similarities in credit risk. However, almost all sales are towards one customer.

### 4.5 Capital risk management

The Group has financed the construction of the production plant with equity, subordinated loan, unsecured debt and ordinary bank financing. There are covenants related to the Group's bank loan, requiring a 25% equity level compared to total assets. (Subordinates loans and unsecured debt are considered as equity in this equity calculation). Further, the bank requires that the operating cash flow is at least equal to, or greater than the agreed instalments of all the long term debt in a rolling 12 month period.

In 2006, the Group utilises approximately 35% of its yearly potential production capacity. Based on 2006 production and the corresponding net results, the Group will be able to fulfil its financial obligations even with considerable negative fluctuations in volume, exchange rates and price of Zink bloom.

The first production plant is fully financed. However, further expansion requires additional equity funded by share issues or funds from other sources.

## 5. Critical accounting estimates and judgments

### 5.1 Critical accounting estimates and assumptions

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### *(a) Inventories*

Inventories are stated at the lower of cost and net realisable value. The cost of inventory includes direct and indirect cost that can be allocated to goods based on normal production. Cost is calculated as the cost per produced tonne Zink bloom in the period from March to December 2006 (direct costs related to resold power is not included). Overheads and other indirect costs are calculated for the period from March to December 2006 based on normal production. However, indirect production costs that exceeded related normal costs in this period have been expensed as the Group did not reach a normal level of production.

An estimate is applied in order to calculate the level of the inventory as it is difficult to measure the volume/weight of Zink bloom. Sales in the following period are used to verify the level of the inventory and the accuracy of the Group's internal production-statistics.

#### *(b) Finance lease*

The Group has entered into a lease agreement with Norsk Hydro to rent production plant until 2019 with option for renewal. The total cost of the rent compared to the value of the building makes this a finance lease contract. See note 9 and 25.

## Notes to the consolidated financial statements (continued)

### *(c) Grant from Norsk Hydro*

The Group has received a grant from Norsk Hydro amounted to NOK 400 000 per employee offered a regular position at ERAS Metal AS within 31.12.2006. The employees received from Norsk Hydro have in the start-up period been hired to develop and design the production process. The grant is considered as a contribution to build the plant and utilise the premises which gives activity and covers Norsk Hydro's infrastructure costs in Høyanger. Based on this, the grant is considered as contribution to the development of the new plant and thus, is capitalized as a reduction of the investment. See note 9.

### *(d) Loan establishment expenses*

Loan establishment expenses are capitalized together with interests related to the building loan and added to the plant's cost price. Start-up costs are depreciated in conjunction with the plant.

### *(e) Removal costs*

Removal costs related to chemical residue are considered as immaterial. The chemical residue is continuously removed and will not be a material cost if the production is shut down. The lease contract does not include a clause to remove the plant if the production is shut down.

### *(f) Maintenance and investments*

Direct maintenance costs are expensed as incurred, whereas improvements and upgrading are assigned to the acquisition cost and depreciated along with the asset. The distinction between running maintenance cost and investments in plant after production start is relative easy-to-follow.

### *(g) Depreciation and remaining value*

Depreciation is calculated based on the knowledge of the economical lifetime of the plant and technology applied. The period of depreciation is determined based on the estimated economical and technical lifetime for the plant in Høyanger. The plant is not considered to have material remaining value at the end of depreciation.

### *(h) Pension obligation*

The pension obligation and corresponding assumptions applied is determined and calculated by an actuarial. See note 15.

### *(i) Convertible loan*

The Group has a convertible loan agreement. The face value of the loan is 2 MNOK carrying an interest rate of 15%. The interest will be released if the loan is converted to shares. As of 31.12. 2006, the loan is converted and the interest is calculated as its net present value and thus, recorded as equity. See note 14 and 25.

### *(j) Power agreement with the municipality of Høyanger*

The power supply agreement with the municipality of Høyanger was entered on conditions available in the market for this kind of industry at the time of establishment. As the Group carries the risk related to changes in the price, this agreement is not considered as a grant.

## Notes to the consolidated financial statements (continued)

### 6. Employee benefit expense and key management compensation

<i>(a) Employee benefit</i>	2006	2005
Wages and salaries	7 182	2 284
Development contribution	0	(1 860)
Social security costs	777	382
Pension costs – defined contribution plans (Note 15)	80	0
Pension costs – defined benefit plans (Note 15)	77	14
Other	179	91
<b>Total</b>	<b>8 295</b>	<b>911</b>

Number of employees	22	7
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#### *(b) Key management compensation*

Name/position	director's fees	salary	payment in kind	Pension	Invoiced	Total
Christian Landaas (1, 2)					992	992
Bror Magnus Heegaard (2)		283	6			289
Arnfinn Thomassen (2,3)			6		810	816
Harald Hvidsten (2)		13				13
Richard Olav Aa (4)	250					250
Dag Flaa (2)	50					50
Erik Prytz (2)						
Terje Birger Hannisdahl (2)						
Per A Øren (2)						
<b>Total</b>	<b>300</b>	<b>296</b>	<b>12</b>		<b>1 802</b>	<b>2 397</b>

- 1 General manager
- 2 Board member
- 3 Project manager
- 4 Chairman of the board

#### *(c) Loan form related parties*

The board members, Christian Lansdaas, Terje Birger Hannisdal (through Alyla AS) and Arnfinn Thomassen have granted a guaranteed loan amounted to 2 MNOK. The interest of the loan is set to "skjermingsrente" (average 2.5%). The interest is not payable before it is approved by the lenders and the Board of Directors. The loan is classified as current liability and will be repaid when the liquidity is satisfactory and Equity ratio exceeds 35%.

Lender	Principal amount	Interest	Total
Alyla AS (Terje Birger Hannisdahl)	1450	26	1 476
Christian Landaas	400	3	403
Arnfinn Thomassen	150	7	157
<b>Total</b>	<b>2 000</b>	<b>36</b>	<b>2 036</b>

## Notes to the consolidated financial statements (continued)

(d) Audit fee

Specification of audit fee:	2006	2005
Statutory Audit	39	19
Other assurance services	16	0
Other advisory services	46	34
<b>Total</b>	<b>101</b>	<b>53</b>

## 7. Related-party transactions

(a) Purchases of goods and services

	2006	2005
Intel Sampling AS (management services by Christian Landaas)	992	655
Fabel Services (management services by Arnfinn Thomassen)	810	715
Per A Øren AS (transport services)	6 230	2 058
Høyanger Local Government (power due to concession conditions)	4 735	0
<b>Total</b>	<b>12 767</b>	<b>3 428</b>

Goods and services are rendered from related parties and companies controlled by key management. All agreements are based on arm's length principles. See note 1.3 for comments regarding "Transactions with the municipality of Høyanger".

(b) Year-end balances arising from sales/purchases of goods/services

Payables to related parties:	2006	2005
Accounts payable	2 054	722
Other current liabilities	4 735	0
<b>Total</b>	<b>6 789</b>	<b>722</b>

## 8. Tax

(a) Income tax expense

	2006	2005
Current tax	0	0
Deferred tax	1 080	(2 672)
<b>Total</b>	<b>1 080</b>	<b>(2 672)</b>

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	2006	2005
Profit before tax	3 472	(8 304)
Tax calculated (28%)	972	(2 325)
Income not subject to tax	0	0
Expenses not deductible for tax purposes	9	7
Tax losses for which no deferred income tax asset was recognised	0	-440
Other differences	99	86
<b>Tax charge</b>	<b>1 080</b>	<b>(2 672)</b>

## Notes to the consolidated financial statements (continued)

Applicable tax rate	31,1%	32,2%
<i>(b) Deferred income tax assets and liabilities</i>		
	<b>2006</b>	<b>2005</b>
Deferred income tax assets:		
– Loss put forward	4 325	2 840
– Lease	597	327
– Other	266	0
– Gross deferred tax assets	5 188	3 267
Deferred tax liabilities:		
– property, plant and equipment	3 748	626
– Other	0	0
– Gross deferred tax liability	3 748	626
<b>Deferred income tax asset (net)</b>	<b>1 440</b>	<b>2 541</b>
<b>Capitalized deferred income tax asset</b>	<b>1 424</b>	<b>2 504</b>

### 9. Property, plant and equipment including finance leases

	Land & build-ings	Machin-ery	Project develop	Furni., fittings & equip	2006	2005
<b>Year ended 31 December 2006</b>						
Opening net book amount	23 333	62 699	16 625	110	102 777	62 960
Contribution Norsk Hydro		(5 200)			(5 200)	
Additions		5 000	682	54	5 736	41 566
Disposals						
Depreciation charge	(1 667)	(3 669)	(946)	(47)	(6 329)	(1 702)
<b>Closing net book amount</b>	<b>23 333</b>	<b>62 699</b>	<b>16 371</b>	<b>117</b>	<b>96 984</b>	<b>102 777</b>
<b>At 1 January 2005</b>						
Cost or valuation	25 000	62 699	16 635	173	104 507	62 950
Accumulated depreciation	(1 667)			(63)	(1 730)	(27)
<b>Net book amount</b>	<b>23 333</b>	<b>62 699</b>	<b>16 635</b>	<b>110</b>	<b>102 777</b>	<b>62 923</b>
<b>At 31 December 2006</b>						
Cost or valuation	25 000	62 499	17 317	227	105 043	104 507
Accumulated depreciation	(3 334)	(3 669)	(946)	(110)	(8 059)	(1 730)
<b>Net book amount</b>	<b>21 666</b>	<b>58 830</b>	<b>16 371</b>	<b>117</b>	<b>96 984</b>	<b>102 777</b>
Depreciation %	6,67%	5-25%	6,67%	20-30%		
Years	15	4-20	15	3-5		
	linear	linear	linear	linear		

1) Interests on building loan are capitalized until start up of the production. See note 25.

2) Depreciation of the plant in Høyanger started 1 March 2006 when the Group had normal operations. There has

## Notes to the consolidated financial statements (continued)

not been any change in useful lives or depreciation rates.

3) Capitalized project development costs consist of the following:

Location	Capitalized cost	Comment
Høyanger phase 1	13 597	Depreciated from 1. March 2006
Calais	227	
Høyanger phase 2	67	

4) ERAS Metal AS has received a loan from Norsk Hydro where 5.2 MNOK is released due to it is considered as a compensation of employing Norsk Hydro personnel in the start-up phase. The amount of 5.2 MNOK reduces the annual depreciation of the assets as the amount is recorded as a reduction of capitalised assets related to work performed internally

5) Fixed assets are pledged, see note 16 and 17.

6) Fixed assets have not been impaired during the period.

### 10. Inventories and cost of sales

<i>(a) Inventories</i>	2006	2005
Finished goods	5 100	1 292
Spare parts	140	0
<b>Total</b>	<b>5 240</b>	<b>1 292</b>

Inventories are pledged. See note 16 and 17

The cost of inventory is calculated as the Group's direct and indirect cost at normal production. Direct cost is calculated as cost per ton Zink bloom in the period from March to December 2006. Indirect costs are calculated for the period March-December 2006, but adjusted since the production was less than at what would be regarded as normal capacity. As of 31.12.2006, indirect cost amounts to 25,5% of total value of inventory of finished goods.

<i>(b) Cost of sales</i>	2006	2005
Power	9 687	307
Gas and coke	2 654	586
Transport	4 797	1 215
Other	3 017	181
Change in inventories	(3 949)	(1 291)
<b>Total</b>	<b>16 206</b>	<b>998</b>

Cost of sales comprises the Group's direct cost related to purchases of goods, adjusted for changes in inventory. Resold surplus of power has been included in cost of sales amounting to TNOK 5,402. The power has been resold at full cost.

### 11. Trade and other receivables

	2006	2005
Trade receivables	10 943	314
Other receivable	3 848	2 388
Less: provision for impairment of trade receivables	0	0
<b>Receivables – net</b>	<b>14 791</b>	<b>2 702</b>

## Notes to the consolidated financial statements (continued)

Credit risk and currency risk se note 4.

Other receivables consists of:	2006	2005
Pre-payments	952	185
Current receivables	404	648
VAT	2 492	1 555
<b>Total</b>	<b>3 848</b>	<b>2 388</b>

### 12. Cash and cash equivalents

	2006	2005
Cash at bank and on hand	1 059	3 324
Tax withholdings	515	233

Cash, cash equivalents and bank overdrafts include the following:

	2006
Bank overdrafts Limit	7 500
Bank overdrafts used as of 31.12.06	(3 629)
Bank overdrafts unused as of 31.12.06	3 871

Bank overdraft is classified as current liabilities.

### 13. Equity

	Share capital	Equity ratio subordinated loan	Retained earnings	Minority interest	Total
As of 01.01	8 000	802	(4 296)	10 386	14 892
Profit for the year			2 393		2 393
Minority interest			(1 031)	1 031	0
Change in Equity ratio subordinated loan		238			238
	8 000	1 040	(2 935)	11 417	17 522

### 14. Share capital, shareholders

#### ScanArc ASA

(a) Share capital	Number of shares	Face value	Book value
Shares	80 000	100	8,000,000

#### (b) Share holders as of 31.12.2006

	Number of shares	Share ownership	Voting ownership
Ayla AS (Terje Hanisdal)	26 000	32,5%	32,5%
Fabel Services (Arnfinn Thomassen)	6 000	7,5%	7,5%
Bror Magnus Heegard	16 000	20%	20%
Intel Invest AS (Christina Landaas)	16 000	20%	20%

## Notes to the consolidated financial statements (continued)

Hvidsten Invest AS (Harald Hvidsten)	16 000	20%	20%
<b>Total</b>	<b>80 000</b>	<b>100%</b>	<b>100%</b>

### *(c) Subordinated loan*

As of 31.12.2006, Anne Lise Sibbern converted a subordinated loan amounted to NOK 2 000 000 into 1 632 new shares each with face value of NOK 100 and share price of NOK 1 225.49. The capital increase has not been registered in the Register of Business Enterprises (Brønnøysund) as of year end 2006 and is thus, classified as a convertible loan. Please note that the capital increase was registered 23 March 2007 at the Brønnøysund Register Centre. As of the exercise date, the released interest amount has been recorded against Equity. The principal amount is classified as debt until the capital increase formally has been registered in Brønnøysund.

### *(d) Share dividends*

The company has not distributed any dividends.

## 15. Retirement benefit obligations

The Group is required to establish an occupational pension scheme in accordance with the Norwegian law regarding occupational pension schemes ("lov om obligatorisk tjenestepensjon"). The Group's pension scheme meets these requirements..

The Group has established a defined contribution plan for its fulltime employees, and therefore the Group does not have any pension obligations. The pension cost is the annual payments from the Group and is regarded as secure

Additionally, ERAS Metal AS has an early retirement scheme (AFP) which is part of the national wage negotiations. The pension scheme is unsecured and the employees have the right to retire at the age of 62 years given fulfillment of certain conditions.

In addition to the part of the pension that is calculated according to the National Insurance rules, the employees receive a tax-free AFP supplement of NOK 11.400 yearly.

The employer is required to pay an employer's contribution which amounts to 25% of the annual pension, including the AFP supplement. The remaining expense is shared between the government and LO/NHO.

As at 31 December 2006, the early retirement scheme included 21 members.

The accrued gross commitment for the unsecured pension plan as of 31 December 2006 was TNOK 15, including payroll tax.

<b>Actuarial assumptions:</b>	<b>2006</b>
Discount rate	4,4%
Expected return on plan assets	5,4%
Future salary increase	4,0%
G-increase	4,0%
Future pension increases	4,0%

The actuarial assumptions are based on assumptions of demographical factors normally used within the insurance industry (K63). However, the disability-share is improved compared to the original basis in K63 and

## Notes to the consolidated financial statements (continued)

is named IR73.

The gross obligation estimation also includes a voluntary retirement and disposition to leave AFP as follows:

### Voluntary retirement:

Yearly aged up to 45 years	2,5%
Yearly aged over 46 years	0,0%

### Estimated disposition to leave AFP:

The Group estimate the disposition to leave AFP to be 20% as of the age of 62, implying that the rest will work until normal pension age.

<b>Net pension expenses</b>	<b>2006</b>	<b>2005</b>
Service cost	11	0
AFP cost charged as an expense	62	14
OTP cost incurred	80	0
Differences/estimate changes charged to income	4	0
<b>Net pension expenses</b>	<b>157</b>	<b>14</b>

## Notes to the consolidated financial statements (continued)

<b>Change in pension liability:</b>	<b>2006</b>	<b>2005</b>
Beginning of the year	0	0
Current service cost	11	0
Interest cost	0	0
Actuarial losses/gains	0	0
Corrections beginning of year balance	4	0
<b>Capitalized pension obligation</b>	<b>15</b>	<b>0</b>

Payroll tax included.

### 16. Non-current borrowings

<b>Non-current debt secured by mortgage</b>	<b>Effective interest rate</b>	<b>Due date</b>	<b>Book value</b>	
			<b>2006</b>	<b>2005</b>
Bank borrowings	5,67%	2015	15 667	17 667
Business start-up loan (Innovasjon Norge)	6,09%	2012	8 000	9 000
Business start-up loan (Innovasjon Norge)	5,41%	2012	16 000	18 000
<b>Total non-current debt secured by mortgage</b>			<b>39 667</b>	<b>44 667</b>
<b>Non-current unsecured debt</b>				
Adaption loan		2014	10 752	15 486
Convertible loan		2006	2 160	2 098
Finance lease		2019	23 801	24 501
<b>Total non-current unsecured debt</b>			<b>36 713</b>	<b>42 085</b>
<b>Total non-current debt (excl 1.st year inst.)</b>			<b>76 381</b>	<b>86 753</b>
1.st year instalment			5 000	5 000
<b>Total non current debt</b>			<b>81 381</b>	<b>91 753</b>

Effective interest rate is calculated as average interest rate during the year.

#### *Bank borrowings*

Bank borrowings have been pledged with the Group's fixed assets, accounts payable and inventory.

#### *Business start-up loan*

Business start-up loans have been pledged by the Group's fixed assets and inventory.

#### *Adaption loan*

ERAS Metal AS has been granted an adaption loan from Norsk Hydro related to the establishment of its production plant in Høyanger. NOK 5 200 000 is released. See note 1 for further comments..

#### *Convertible loan*

Convertible loan to be exercised in ScanArc ASA shares in 2007.

#### *Finance lease*

The Group has classified the rent for the plant as finance lease. The building is capitalised and the corresponding debt is classified as long-term debt with an annual interest of 7,99% over the 15 years renting period

## Notes to the consolidated financial statements (continued)

### 17. Trade and other payables

<b>Accounts payable:</b>	<b>2006</b>	<b>2005</b>
Trade payables	5 654	3 484
Amounts due to related parties	2 121	991
<b>Total accounts payable:</b>	<b>7 775</b>	<b>4 475</b>
<b>Other current liabilities and public duties payable:</b>		
Wage liability and vacation allowance	672	365
Accrued interests	478	437
Social security and other taxes	798	366
Guaranteed loan	2 036	0
Accrued expenses	5 192	311
<b>Total other current liabilities and public duties payable:</b>	<b>9 176</b>	<b>1 479</b>
<b>Liabilities to finance institutions:</b>		
Bank overdraft	3 629	0
1.st year instalment non-current debt	5 000	5 000
<b>Total liabilities to finance institutions:</b>	<b>8 629</b>	<b>5 000</b>
<b>Total current liabilities:</b>	<b>25 580</b>	<b>10 954</b>

#### *Bank overdraft*

Bank overdraft has been pledged with the Group's fixed assets, accounts payable and inventory.

#### *Liability to key management personnel*

Key management personnel have granted a guarantee loan amounted to 2 MNOK (see note 6).

### 18. Exchange rates

The following table presents the most frequent currencies applied during 2006

Currency	Exchange rate	Average exchange rate	Exchange rate
	01.01.2006	2006	31.12.2006
EURO	8,393	8,051	8,238
SEK	92,750	87,020	91,120
USD	6,666	6,418	6,255

See note 2 for further information related to the principles applied for foreign currency exposure..

### 19. Lease agreement

#### *(a) The Group as lessee - operating lease*

The Group has entered into several different operational lease agreements related to machinery, office building and other facilities. The majority of the lease agreements have options for renewal. The lease agreements do not include any restrictions for the Group's dividend policy.

The lease cost consists of:	<b>2006</b>	<b>2005</b>
Ordinary rent	3 976	2 403
Compensation from sublease	(202)	(50)
Total	3 774	2 353
Transferred to financial lease	(2 657)	(2 353)

## Notes to the consolidated financial statements (continued)

(b) The future minimum rent related to non- cancellable lease fall due as follows:

<b>Maturity</b>	<b>Amount</b>
Within 1 year	3 104
1 – 5 years	12 119
After 5 years	30 169
<b>Total</b>	<b>45 392</b>

The contracted 3 years lease agreement with Norsk Hydro regarding the rent of “slugbygget” in Høyanger may be terminated before the expiry date. However, in case of an early termination, ERAS Metal AS is committed to disburse the remaining part of the loan the lender has raised in order to upgrade the building. The estimated future minimum rent is calculated assuming an ongoing rent until 31.12.2019. The rent consists of two elements of which the first is compensation for agreed services related to the infrastructure and use of the areas surrounding the plant and the second is related to ordinary rent regarding buildings. The rent is classified as a financial lease.

ERAS Metal AS has rented an office in Karl Johansgt 13 (Oslo) which has been subleased. Both the lease agreement and the sublease agreement expire as of 31 December 2007. The Group expects to receive NOK 164 000 in future minimum rent during the period.

The company has entered into a lease agreement with Norsk Hydro to rent production plant and administration building until 2019 with option for renewal. The total cost of the rent compared to the value of the building makes this a finance lease contract. See note 9 and 25.

## 20. Finance income and cost

<b>Finance income:</b>	<b>2006</b>	<b>2005</b>
Income from interest	40	32
Currency gain	261	32
Total finance income	301	64
<b>Finance costs:</b>		
Interest costs	(5 240)	(2 774)
Currency loss	(618)	(26)
Total finance costs	(5 858)	(2 800)
<b>Finance cost - net</b>	<b>(5 558)</b>	<b>(2 735)</b>

## 21. Grants

The grant from Norsk Hydro through interest-free loan and corresponding release of debt represent a commercial relation related to the establishment and co-operation in Høyanger. The power supply agreement with the local government in Høyanger made in 2002 is not regarded as a government grant (see note 1).

## 22. Purchase liabilities

ERAS Metal AS has entered into contracts to purchase power and gas in Høyanger at concession terms. The power may be resold at full cost and has therefore not been presented as a liability in the balance sheet. The 5 year gas contract is without volume restrictions and the contractual price is currently below market price. The Group has no other significant purchase liabilities.

## Notes to the consolidated financial statements (continued)

### 23. Contingent liabilities and assets

ERAS Metal AS has been granted a license from Norwegian Pollution Control Authority to produce an annual production volume of 25 000 tonne of Zink Bloom at the plant in Høyanger. In case of close-down, chemical residue caused by the plant has to be removed. The Group consider the potential removing cost as immaterial and has therefore not provided for such in the financial statements.

### 24. Events after the balance sheet date

#### *(a) Acquisition of shares from Høyanger local government*

ScanArc ASA exercised its option to purchase the shares in ERAS Metal AS from the municipality of Høyanger.. The acquisition is financed through a bank loan where the shares in ERAS Metal AS are pledged as security. At the latest, the loan and corresponding interests will be repaid as of 30.12.2007.

As a compensation for this agreement, the Group has decided to support the community of Høyanger with TNOK 7,500. See further details in the table below:

<b>Activity</b>	<b>Amount</b>
Contribution to "youth-house"	3 000
Contribution to industrial and commercial development in Høyanger	4 500
<b>Total</b>	<b>7 500</b>

The donation is to be given within 1 July 2007. If the Group does not have enough liquidity to pay the amount, the repayment date will be renegotiated.

#### *(b) The Company's name was resolved changed from Gras ASA to ScanArc ASA in a general meeting held on 16 February 2007.*

#### *(c) Registration in Norwegian Registry of Securities*

The Group decided to register its shares in the Norwegian Registry of Securities and amend from an AS (private limited liability company) to an ASA (public limited liability company) in order to prepare for a listing of the shares of ScanArc ASA on the Oslo Stock Exchange (Oslo Børs). The Group anticipates that such an offering will be effective during spring 2007.

#### *(d) Capital increase*

As of February 2007, ScanArc ASA performed a private placement (contribution in kind) towards the shareholders in ScanArc Plasma Technologies AB (SPT). Subsequent to the share issue, SPT is a 100% owned subsidiary of ScanArc ASA. Based on this transaction, the Group has ownership to SPT's plasma technology which is used in the production at ERAS Metal AS.

#### *(e) Other*

There are no other material events after the balance sheet date that effects the 2006 financial statements.

### 25. Business Combinations

In note 1.3, 1.4 and 24, information are given regarding Business Combinations to be accounted for in 2007. However, IFRS 3.66 requires that an acquirer discloses information that enables users of its financial statements to evaluate the nature and financial effect also of business combinations that were effected after the balance sheet date but before the financial statements are authorised for issue.

The following transactions have been completed in 1Q 2007:

## Notes to the consolidated financial statements (continued)

### Purchase of shares from the municipality of Høyanger

The (re)purchase of the shares of the municipality of Høyanger is based on an option previously granted to ScanArc ASA.

The option gives ScanArc ASA the right to (re)purchase the shares at paid in value which was NOK 10,000,000. In addition, the payment of contribution to the municipality has been regarded as part of the purchase price then totalling NOK 17,500,000.

The fair value of the option exceeds the purchase price. However, it has been regarded as an equity instrument and has not been treated at fair value in the financial statements of the Group.

The transaction with the municipality of Høyanger results in an excess value of NOK 9.5 mill. The excess value has preliminary been allocated to goodwill.

### Contribution in kind towards the shareholders of ScanArc

An agreement was made with the shareholders of SPT AB inviting the shareholders to a 15% ownership in ScanArc ASA. The transaction represents a change of shares and no cash at fair value. However, the transaction shall be presented at fair value for the Group representing a purchase of SPT AB.

The valuation of the transaction was based on an external valuation of ERAS Metal AS as of August 2006, amounting to 92 million EURO. At the transaction date (16 February 2007), this equals NOK 740 mill. With regard to the shares in SPT AB, this equals a purchase price of 14,4 mill EURO or NOK 116,8 mill (net of deferred taxes).

A preliminary Purchase Price Allocation is presented below (in SEK million):

Technology	37.8
Customer Relations	12.0
Tangible assets	16,5
Trade receivables	3.0
Other current assets	3.1
Cash and cash equivalents	1.3
Goodwill – assembled workforce	3.8
Goodwill	57.1
	134.6
Trade payables and other current liabilities	- 4.9
	129.7
Deferred taxes	18.1
Total goodwill	79.0

## 26. Explanation IFRS transition

The consolidated financial statements for the year ended 31 December 2006 will be the first annual financial statements that comply with IFRS (International Financial Reporting Standards).

The date of implementation is 1 January 2006 with corresponding figures from 2005. The preparation of the opening balance sheet is 1 January 2005 (which was the transition date for converting from NGAAP to IFRS). See note 2 for an explanation of accounting principles applied.

In preparing the IFRS opening balance sheet, the Group has performed some adjustments compared to previous presented NGAAP figures in accordance with the consolidated financial statements for 2005. The transition effects from NGAAP to IFRS with respect to the Group's financial position, net profit and cash flow are explained below:

### (a) Reconciliation of transition effects

## Notes to the consolidated financial statements (continued)

In NOK 1000	Note	NGAAP 31.12.04		Effect IFRS transition	IFRS 01.01.2005
<b>ASSETS</b>					
<b>FIXED ASSETS</b>					
Land, Buildings	1		25 000		25 000
Machinery and Equipment	5	25 848		600	26 448
Project development		11 414			11 414
Fixtures and fittings, tools, office machinery, etc.		61			61
<b>Total Fixed Assets</b>		<b>37 323</b>	<b>25 000</b>	<b>600</b>	<b>62 923</b>
<b>CURRENT ASSETS</b>					
Total Receivables		3 300			3 300
Cash and Cash Equivalents		2 472			2 472
<b>Total Current Assets</b>		<b>5 772</b>			<b>5 772</b>
<b>TOTAL ASSETS</b>		<b>43 095</b>			<b>68 695</b>
<b>EQUITY &amp; LIABILITIES</b>					
<b>EQUITY</b>					
Ordinary shares		8 000			8 000
Equity ratio subordinated loans	2			550	550
Retained earnings	5	(1 705)		314	(1 391)
<b>Total Equity</b>		<b>6 295</b>		<b>864</b>	<b>7 159</b>
<b>Minority interest</b>		<b>12 995</b>		<b>286</b>	<b>13 281</b>
<b>LIABILITIES</b>					
Other long term liabilities	1, 2	12 600	25 000	(550)	37 050
Accounts Payable		10 381			10 381
Public Duties Payable		18			18
Other Current Liabilities		806			806
<b>Total Liabilities</b>		<b>23 805</b>	<b>25 000</b>	<b>(550)</b>	<b>48 255</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>43 095</b>	<b>25 000</b>	<b>314</b>	<b>68 695</b>

## Notes to the consolidated financial statements (continued)

### (b) Reconciliation of balance sheet and profit & loss accounts 2005

In NOK 1000	Note	NGAAP 2005		Effect IFRS transition	IFRS 2005
<b>ASSETS</b>					
<b>FIXED ASSETS</b>					
Deferred income tax asset	1, 4, 5	2 667	(168)	5	2 504
Land, Buildings	1			23 333	23 333
Machinery and Equipment		62 699			62 699
Project development	4	14 397	600	1 637	16 634
Fixtures and fittings, tools, office machinery, etc.		111			111
<b>Total Fixed Assets</b>		<b>79 874</b>	<b>432</b>	<b>24 975</b>	<b>105 281</b>
<b>CURRENT ASSETS</b>					
Inventories		1 292			1 292
Accounts Receivables		313			313
Other Receivables		2 388			2 388
Cash and Cash Equivalents		3 324			3 324
<b>Total Current Assets</b>		<b>7 317</b>			<b>7 317</b>
<b>TOTAL ASSETS</b>					
<b>EQUITY &amp; LIABILITIES</b>					
<b>EQUITY</b>					
Ordinary shares		8 000			8 000
Equity ratio subordinated loans	2		802		802
Retained earnings	1, 4, 5	(4 515)	226	(6)	(4 295)
<b>Total Equity</b>		<b>3 485</b>	<b>1 028</b>	<b>(6)</b>	<b>4 507</b>
<b>Minority interest</b>	1, 4, 5	<b>10 185</b>	<b>206</b>	<b>(6)</b>	<b>10 385</b>
<b>LIABILITIES</b>					
Other long term liabilities	1, 2	2 900	(802)	24 501	26 599
Adaption loan	4	15 000	486		15 486
Business start-up loan	3	30 000		(3 000)	27 000
Debt to Credit institutions	3	19 667		(2 000)	17 667
Accounts Payable		4 475			4 475
Public Duties Payable		366			366
Other Current Liabilities	3	1 113		5 000	6 113
<b>Total Liabilities</b>		<b>73 521</b>	<b>(316)</b>	<b>24 501</b>	<b>97 706</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>87 191</b>	<b>712</b>	<b>24 495</b>	<b>112 598</b>

## Notes to the consolidated financial statements (continued)

In NOK 1000	Note	NGAAP 2005	Effect IFRS transition	IFRS 2005
<b>OPERATING REVENUE</b>				
Revenues		749		749
Cost of goods sold		(977)		(997)
<b>Gross earnings</b>		<b>(248)</b>		<b>(248)</b>
Salary related expenses		(911)		(911)
Depreciation / amortisation	1	(36)	(1 667)	(1 703)
Other operating expenses	1	(5 202)	2 496	(2 706)
<b>Net operating income</b>		<b>(6 397)</b>	<b>829</b>	<b>(5 568)</b>
Other interest income		64		64
Other finance expense	1, 4	(1 953)	(846)	(2 799)
<b>Net income before tax</b>		<b>(8 286)</b>	<b>(17)</b>	<b>(8 303)</b>
Tax expense-ordinary income		2 667	5	2 672
<b>NET INCOME AFTER TAX</b>		<b>(5 619)</b>	<b>(12)</b>	<b>(5 631)</b>

### Attributable to:

Equity holders of the Company		(5 619)	(12)	(5 631)
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Commentary regarding Transition

Effects:

1) *Finance lease*

The Group has considered the lease agreement for the plant as a finance lease. The plant is capitalised and recorded as fixed asset and the related liability is recorded as non-current liability. The lease agreement relates to the subsidiary ERAS Metal AS which reports according to the accounting principles of small enterprises. In the 2005 accounts, the lease agreement was not capitalised as this was optional for small enterprises.

2) *Convertible loan*

The Group has a convertible loan where the equity ratio is calculated and capitalized. According to the loan contract, 15% interest is calculated but the interest will be released if the loan is converted to shares. The equity ratio is calculated as net present value of accrued, but not paid interests.

3) *Non-current debt: 1.st year instalment*

The first year instalment of non-current debt is classified as current liabilities.

4) *Non-interest bearing loan*

The Group has a non-interest bearing loan granted from Norsk Hydro. The loan is interest-bearing from 01.01.2007. The interest gain is calculated and recorded as finance cost and capitalized as non-current liability. Capitalized interest gain is reversed during the term of the loan.

5) *Building loan interest*

Interest related to the building loan in the period until the Høyanger plant is in operation is capitalized in conjunction with the plant. Previously, the Group has recorded the interest as an expense. This interest expense is capitalized and the change is recorded to the Group's equity and thus, adjusted by deferred tax.