

April 18, 2008

Research Update:

Landsvirkjun Ratings Lowered To 'A' And 'AA-' On Iceland Downgrade; Outlook Negative

Primary Credit Analyst:

Peter Kernan, London (44) 20-7176-3618; peter_kernan@standardandpoors.com

Secondary Credit Analysts:

Karin Erlander, London (44) 20-7176-3584; karin_erlander@standardandpoors.com

Mark Schindele, Stockholm (46) 8-440-5918; mark_schindele@standardandpoors.com

Table Of Contents

Rationale

Outlook

Ratings List

Research Update:

Landsvirkjun Ratings Lowered To 'A' And 'AA-' On Iceland Downgrade; Outlook Negative

Rationale

On April 18, 2008, Standard & Poor's Ratings Services lowered its long-term foreign currency rating on Iceland-based electricity generation and transmission company Landsvirkjun to 'A' from 'A+' and its long-term local currency rating on the company to 'AA-' from 'AA'. We affirmed the 'A-1' short-term foreign currency and 'A-1+' short-term local currency ratings. The outlook on the long-term ratings is negative.

At the same time, Standard & Poor's lowered its senior unsecured debt ratings on Landsvirkjun to 'A' from 'A+'. The outlook on the debt ratings is negative.

We also removed all the ratings from CreditWatch with negative implications, where we placed them on April 1, 2008, mirroring the CreditWatch placement of the ratings on the Republic of Iceland.

The rating actions follow the downgrade of the Republic of Iceland (foreign currency A/Negative/A-1; local currency AA-/Negative/A-1+). (Please refer to the related article titled "Research Update: Iceland Sovereign Ratings Lowered On External Funding Risks; Outlook Negative" published April 17, 2008, on RatingsDirect.)

The ratings on Landsvirkjun reflect the ultimate guarantee for all its existing and new debt obligations provided by the utility's owner, the Republic of Iceland; the company's dominant position in the Icelandic electricity market (generating 75% of supplies and controlling the transmission grid); and its modern asset base. Weaknesses include customer concentration (with three customers accounting for about 65% of Landsvirkjun's revenues) as well as exposure to foreign exchange, aluminum price, and interest rate risks. The ratings are also constrained by Landsvirkjun's highly leveraged financial position.

The ratings on government-guaranteed debt are linked to the sovereign ratings and reflect our expectations that existing and new debt will continue to benefit from government guarantees and would be grandfathered if the company's status changes. Formally, the guarantee is ultimate. That said, Standard & Poor's expects the government to provide timely financial support if needed. Our expectation is based on Landsvirkjun's strategic importance to electricity supply, the company's central role in the promotion of power-intensive industry in Iceland, and the sovereign reputation risk if Landsvirkjun were to default.

Although progress of government plans to merge Landsvirkjun with two other state-owned distribution companies and to incorporate the combined group has been limited, we expect the government guarantee to be abolished for new debt issued after incorporation.

Landsvirkjun's heavy capital expenditure program is largely complete, with investments relating to the \$1.1 billion Kàrahnjúkar plant gradually decreasing over the next two years. At the same time, internally generated cash flow should improve as the hydro plant starts generating earnings.

Liquidity

Landsvirkjun's liquidity position is adequate. At the end of March 2008, liquid assets totaled \$350 million). At the same time, Landsvirkjun has access to an undrawn committed credit facility of about \$350 million, maturing in 2012. This compares with short-term debt maturities of about \$230 million in 2008 and \$60 million in 2009.

Outlook

The negative outlook on the local and foreign currency corporate credit ratings reflects the negative outlook on the sovereign ratings as well as our expectation that government support could decrease in the longer term, which would adversely affect Landsvirkjun's credit quality and result in the ratings reflecting the company's significantly weaker standalone qualities. However, this risk has diminished following the inauguration of a new government last year. Ratings downside could also come from a weakening of the company's financial structure, debt protection measures, or business profile.

The negative outlook on the senior unsecured debt ratings mirrors the outlook on the sovereign ratings. This reflects our expectation that existing and new debt will continue to benefit from the government guarantee and be grandfathered if the company's status changes. In the absence of any signs of reduced willingness or ability to honor liabilities in a timely manner, the ratings on the debt should move in line with those on the sovereign.

An upgrade is unlikely in the medium term.

Ratings List

	To	From
Landsvirkjun		
Foreign currency corporate credit rating	A/Negative/A-1	A+/Watch Neg/A-1
Local currency corporate credit rating	AA-/Negative/A-1+	AA/Watch Neg/A-1+
Senior unsecured debt	A/Negative	A+/Watch Neg

Additional Contact:

Infrastructure Finance Ratings Europe;InfrastructureEurope@standardandpoors.com

Research Update: Landsvirkjun Ratings Lowered To 'A' And 'AA-' On Iceland Downgrade; Outlook Negative

Ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Credit Ratings Search. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office Hotline (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4017. Members of the media may also contact the European Press Office via e-mail on: media_europe@standardandpoors.com.

Copyright © 2008, Standard & Poors, a division of The McGraw-Hill Companies, Inc. (S&P?). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscriber's or others' use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.9823 or by e-mail to: research_request@standardandpoors.com.