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Research Update:

Landsvirkjun Ratings Cut To FC 'BBB/A-3', LC 'BBB+/A-2', Outlook Negative On Iceland Downgrade

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Rationale

On Oct. 7, 2008, Standard & Poor's Ratings Services lowered its long- and short-term foreign currency ratings on Iceland-based electricity generation and transmission company Landsvirkjun to 'BBB/A-3' from 'A-/A-2' and its local currency ratings to 'BBB+/A-2' from 'A+/A-1'. At the same time, Standard & Poor's removed its long-term ratings from CreditWatch, where they were placed on Sept. 30, 2008, with negative implications. In addition, Standard & Poor's lowered its foreign currency senior unsecured debt ratings on Landsvirkjun to 'BBB' from 'A-'. The outlook is negative.

The rating actions follow yesterday's downgrade of the Republic of Iceland (foreign currency BBB/Negative/A-3; local currency BBB+/Negative/A-2). (Please refer to the article titled "Research Update: Republic of Iceland Ratings Lowered And Removed From CreditWatch Negative" published Oct. 6, 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; its dominant position in the Icelandic electricity market and control of the transmission grid; and its modern asset base. Weaknesses include customer concentration; exposure to aluminum prices, which are inherently volatile; and an aggressive financial risk profile.

Standard & Poor's analyzes Landsvirkjun using its criteria for government-related entities. The ratings on the government-guaranteed debt are linked to the sovereign ratings and reflect our expectations that existing and new debt will continue to benefit from government guarantee and be grandfathered if the company's status changes. Although privatization is unlikely in the near to medium term, we expect that the guarantee would be abolished for new debt issued after a potential incorporation.

Formally, the debt guarantee is ultimate, but we expect the government to provide timely financial support, if needed. Our expectation is based on Landsvirkjun's strategic importance to electricity generation and supply, the company's central role in the promotion of power-intensive industry in Iceland, and the risk to the sovereign's reputation if Landsvirkjun were to default.

Landsvirkjun's financial risk profile is aggressive due to the heavy front-ended capital investments the company has made in the \$1.1 billion Kárahnjúkar hydropower plant project. However, as the investment program is largely complete and as the new power plant began to generate earnings last year, we expect that the decline in Landsvirkjun's debt protection ratios in 2007 will be short term and that debt and interest coverage ratios will improve over the 2008-2010 period. Adjusted funds from operations (FFO)

interest coverage and FFO to debt deteriorated to 0.9x and 2.7% in 2007, respectively, from 1.1x and 3.8% in 2006. Landsvirkjun's marginal level of cash flow coverage of debt underlines the importance of sovereign support for the ratings on Landsvirkjun.

Liquidity

Landsvirkjun's liquidity position is adequate. At the end of June 2008, liquid assets totaled \$85 million, compared with short-term debt of \$57 million. Further support is provided by a committed multicurrency revolving credit facility of about \$400 million, maturing in 2012, of which \$350 million was undrawn at the end of June 2008.

Outlook

The negative outlook on the local and foreign currency corporate credit ratings on Landsvirkjun reflects the negative outlook on the sovereign ratings. Given that incorporation appears unlikely in the near to medium term, we expect the ratings and outlook on Landsvirkjun to reflect those on the sovereign.

The negative outlook on the senior unsecured debt ratings mirrors the negative outlook on the sovereign ratings and 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. Absent any signs of reduced willingness or ability to honor liabilities in a timely manner, the ratings on this debt should move in line with those on the sovereign.

Ratings List

Downgraded/Outlook Action

	To	From
Landsvirkjun		
Corporate Credit Rating		
Foreign Currency	BBB/Negative/A-3	A-/Watch Neg/A-2
Local Currency	BBB+/Negative/A-2	A+/Watch Neg/A-1

Landsvirkjun

Senior Unsecured

Foreign Currency*	BBB/Negative	A-/Watch Neg
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*Guaranteed by the Republic of Iceland.

NB: This list does not contain all ratings affected.

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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 (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.

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