

**Rating Action: Moody's upgrades Landsvirkjun's unguaranteed debt ratings to Baa2; stable outlook**

---

Global Credit Research - 23 Mar 2018

London, 23 March 2018 -- Moody's Investors Service, ("Moody's") has today upgraded Landsvirkjun's unguaranteed senior unsecured debt ratings to Baa2 from Baa3, and the ratings of the \$1 billion EMTN programme to (P)Baa2 from (P)Baa3. Concurrently, Moody's has affirmed Landsvirkjun's Baa1 debt ratings that are supported by a guarantee of collection issued by the Government of Iceland (A3 stable), and the (P)Baa1 guaranteed senior unsecured rating of the \$2.5 billion EMTN programme. The (P)P-3 short term rating of the unguaranteed EMTN programme and the (P)P-2 short term rating of the guaranteed EMTN programme were also affirmed. All ratings have a stable outlook.

**RATINGS RATIONALE**

The upgrade of the unguaranteed debt rating reflects (1) Landsvirkjun's track record of stable operating performance and ability to withstand significant volatility in the commodity markets without increasing its financial risk profile; (2) the progress the company has made in reducing its exposure to foreign exchange, interest rate and aluminium price risk; and (3) the expectation that after the completion of two major projects in 2018, Landsvirkjun's cash flow will substantially reduce its financial leverage.

Over the last two years, Landsvirkjun has renegotiated two power contracts that expire in 2019 and signed a few new contracts with power intensive industries in the silicon and data center sectors. These long-term power contracts will increase the amount of volume sold by around 5%, but most importantly will reduce Landsvirkjun's exposure to aluminium price fluctuations, as the percentage of total revenues linked to aluminium prices is expected to decrease to around 20% by 2020. Moody's also expects Landsvirkjun to maintain its prudent financial policy and continue to implement hedging agreements that provide greater visibility of cash flow and help the company to further reduce its aluminium price exposure and decrease its foreign currency and interest rate risks over the medium term.

Landsvirkjun's recent investments in the construction of Theistareykir geothermal plant and the expansion of Burfell Hydropower station had restricted the ability of the company to deleverage. Following the completion of both projects in the first half of 2018, Moody's expects Landsvirkjun's capital expenditure levels to reduce considerably with annual spend averaging less than 3% of total assets over the next three to five years. Moody's expects Landsvirkjun to reduce its financial leverage, such that the Funds from operations (FFO) / Net debt ratio will be comfortably positioned in the mid-teens in percentage terms.

Overall, the standalone credit strength of Landsvirkjun, which is represented by a ba2 baseline credit assessment (BCA), upgraded from ba3, factors in positively (1) the company's dominant position in the Icelandic energy market; (2) its low-cost renewable generation asset base with minimal levels of capital expenditure needed for maintenance; and (3) its ability to generate relatively stable cash flows through long-term power contracts. At the same time, the BCA also incorporates (1) Landsvirkjun's concentrated exposure to a small number of counterparties, mainly in the aluminium industry; and (2) some degree of exposure to aluminium price volatility that will remain in the business over the long-term.

Given Landsvirkjun's ownership by the Government of Iceland (A3 stable), the company's Baa2 unguaranteed debt rating incorporates three notches of uplift for potential extraordinary support to Landsvirkjun's ba2 BCA. The high level of government support incorporated in Landsvirkjun's unguaranteed debt ratings reflects the strategic importance of the company as the national power producer and the role it plays in the provision of electricity to the aluminium smelting industry, which directly contributes to about 34% of Icelandic exports. Moreover, it also considers the high level of commitment that the government has shown in the past by the provision of guarantees of collection to support Landsvirkjun's debt.

The Baa1 and (P)Baa1/(P)P-2 guaranteed ratings of Landsvirkjun's USD2.5 billion EMTN programme and notes issued thereunder reflect the value of the guarantee of collection issued by the Government of Iceland. Moody's notes that guarantees of collection do not offer bondholders the same contractual protection as a timely payment guarantee. Albeit small, there is a potential risk that the Government would not step in with

timely repayment should the company fail to meet its obligations, as exhaustive administrative and legal procedures must be followed before the shareholders are obliged to pay. The Baa1 rating reflects a very high likelihood that the Government would pay on a timely basis, but the positioning of the guaranteed debt ratings at one notch below that of the Government of Iceland reflects this residual uncertainty of payment from a single A rated sovereign.

#### RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Landsvirkjun will continue to prudently manage its exposure to market risks and improve its financial position, such that credit metrics will be comfortably positioned within the ratio guidance for a Baa2 unguaranteed debt rating / ba2 BCA, namely the maintenance of a FFO/ Net debt ratio in the mid-teens in percentage terms.

#### WHAT COULD CHANGE THE RATING UP/ DOWN

Moody's could consider an upgrade of Landsvirkjun's unguaranteed debt ratings if its financial profile were to materially improve resulting in FFO / Net debt in the high-teens to low-twenties per cent on a sustainable basis, provided that the company continues to demonstrate the ability to withstand significant volatility in the commodity markets and maintains a strong liquidity position. This would also assume no change to the assumption of support from the owner incorporated into Landsvirkjun's rating. In addition, Landsvirkjun's guaranteed debt ratings could be upgraded following an upgrade of the Icelandic sovereign rating.

Conversely, downward pressure on Landsvirkjun's ratings could develop as a consequence of a substantial deterioration in the company's business risk profile or weakening of its financial position, such that FFO/Net debt in percentage terms was expected to remain consistently in the low teens. The guaranteed debt ratings would come under downward pressure if Moody's were to downgrade the Icelandic government's ratings.

#### CORPORATE PROFILE

Headquartered in Reykjavik, Landsvirkjun is Iceland's dominant power producer. It is responsible for about 70% of Iceland's total electricity production of 18 terawatt hours and owns the majority of the transmission grid. It provides 100% renewable energy for domestic users via electricity sales to public utilities, although the majority of sales are to power intensive industries, mostly for aluminium smelting, under long-term take-or-pay contracts.

#### PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017, and Government-Related Issuers published in August 2017. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

#### REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on [www.moodys.com](http://www.moodys.com).

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related

rating outlook or rating review.

Please see [www.moody's.com](http://www.moody's.com) for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for additional regulatory disclosures for each credit rating.

Erica Gauto Flesch  
Asst Vice President - Analyst  
Infrastructure Finance Group  
Moody's Investors Service Ltd.  
One Canada Square  
Canary Wharf  
London E14 5FA  
United Kingdom  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

Andrew Blease  
Associate Managing Director  
Infrastructure Finance Group  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

Releasing Office:  
Moody's Investors Service Ltd.  
One Canada Square  
Canary Wharf  
London E14 5FA  
United Kingdom  
JOURNALISTS: 44 20 7772 5456  
Client Service: 44 20 7772 5454

**Moody's**  
INVESTORS SERVICE

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

**CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE**

**ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.**

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moodys.com](http://www.moodys.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian

Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.