

**Rating Action: Moody's upgrades Landsvirkjun's ratings to Baa2/Ba1; stable outlook**

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**No action on Orkuveita Reykjavikur's B1 rating with a positive outlook**

London, 01 July 2015 -- Moody's Investors Service, ("Moody's") has today upgraded the guaranteed debt ratings of Landsvirkjun, including the backed senior unsecured rating of the \$2.5 billion EMTN programme to (P)Baa2/(P)P-2 from (P)Baa3/(P)P-3 and the ratings of the debt issued thereunder to Baa2 from Baa3, all benefitting from a guarantee of collection from the Government of Iceland (Baa2 stable). Concurrently, Moody's has upgraded the company's long-term unguaranteed ratings, including the ratings of the \$1 billion EMTN programme to (P)Ba1 from (P)Ba2 and the company's senior unsecured debt ratings to Ba1 from Ba2. Landsvirkjun's (P)NP short-term rating of the unguaranteed \$1 billion EMTN programme was affirmed. All ratings have a stable outlook.

There is no action on the ratings of Orkuveita Reykjavikur. An overview of this entity is provided later on in this press release.

RATINGS RATIONALE

-LANDSVIRKJUN

Today's rating action follows Moody's upgrade of Iceland's government bond rating to Baa2 with a stable outlook from Baa3 with a stable outlook (please refer to Press Release, published on 29th June 2015 for more information [https://www.moody.com/research/--PR\\_327549](https://www.moody.com/research/--PR_327549)).

Given its 100%-ownership by the Government of Iceland, Landsvirkjun is considered a government-related issuer (GRI) under Moody's methodology. Moody's believe that extraordinary financial support to Landsvirkjun from the Icelandic government would be forthcoming if needed. The upgrade of both the guaranteed and unguaranteed debt ratings reflects Moody's view that the government's ability to support Landsvirkjun has strengthened.

The "very high" support assumption incorporated in Landsvirkjun's ratings reflects the high level of commitment that the government has shown in the past by the provision of guarantees of collection to support the company's debt and the strategic importance of Landsvirkjun to Iceland, given the company's position as the country's dominant power producer and the role it plays in the provision of electricity to the aluminium smelting industry, which directly contributes to about 40% of Icelandic exports.

Moody's notes that guarantees of collection do not offer bondholders the same degree of protection as a timely payment guarantee. There is a potential risk of non-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. However, given Landsvirkjun's strategic role for Iceland and other incentives for the shareholders (such as its liability for penalty interest), Moody's expects that the state would intervene in a timely fashion and provide financial or other assistance to ensure timely payments under the guaranteed bonds.

The company's ratings incorporate an uplift for potential government support to its standalone credit quality (BCA), which Moody's continues to assess at b1. Landsvirkjun's BCA factors in positively (1) the company's dominant position in the Icelandic energy market; (2) its low-cost renewable generation asset base and minimal levels of capital expenditure; and (3) its ability to generate relatively stable cash flows. However, the company's assessment is constrained by (1) Landsvirkjun's still high financial leverage; (2) its concentrated exposure to a comparatively small number of counterparties, mainly in the aluminium industry; (3) its degree of exposure to aluminium prices in a weak commodity market; (4) its foreign exchange risk; and (5) a considerable proportion of outstanding debt linked to floating interest rates.

Landsvirkjun's (P)Ba1/(P)NP unguaranteed ratings incorporate three notches of uplift from the company's BCA of b1 to reflect the high level of commitment that the Government of Iceland has shown in the past to support Landsvirkjun's debt and the strategic importance of the company to the Icelandic economy.

The (P)Baa2/(P)P-2 guaranteed ratings reflect the additional credit support provided by the guarantee of collection from its owner and the expectation that the state is highly likely to intervene in a timely fashion and provide financial or other assistance to support notes issued thereunder if needed to ensure timely payments.

#### RATIONALE FOR STABLE OUTLOOK

The stable outlook on Landsvirkjun reflects the stable outlook on Iceland. It also reflects Moody's view that a likely improvement of the BCA by one notch will not by itself lead to an upgrade of the final ratings.

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

An improvement in the Government of Iceland's rating would be required before Moody's would consider an upgrade of Landsvirkjun's backed senior unsecured ratings that benefit from a guarantee of collection from the state. Additionally, Moody's would consider an upgrade of the unguaranteed debt ratings if (1) Landsvirkjun continues to demonstrate the ability to withstand significant volatility in commodity and financial markets and maintain its strong operational performance; and (2) the company makes substantial progress in reducing its leverage.

The guaranteed ratings would be downgraded if the rating of the Government of Iceland is downgraded. Equally, the unguaranteed ratings would come under downward pressure if Moody's were to revise the current assumption of a very high probability of timely support from the government. Downward rating pressure could also arise as a result of (1) a substantial deterioration in Landsvirkjun's operating performance, which would cause financial metrics to materially deviate from Moody's expectations or considerably increase funding requirements; and/or (2) if it appears likely that the company's available liquidity were not sufficient to insulate it from market risks, particularly in relation to sudden movements in exchange rates, aluminium prices or interest rates.

#### CORPORATE PROFILE

Landsvirkjun is Iceland's dominant power producer, responsible for around 72% of Iceland's total electricity production of 18.1 TWh in 2014. The company currently operates 14 hydropower plants, 2 geothermal plants and 2 wind turbines with total installed capacity of 1,960 MW. 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. Additionally, Landsvirkjun is the majority owner (64.7%) of Landsnet, which owns and operates the country's electricity transmission system and is a fully regulated company.

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Unregulated Utilities and Unregulated Power Companies published in October 2014. Other methodologies used include the Government-Related Issuers methodology published in October 2014. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

#### - ORKUVEITA REYKJAVIKUR

There is no action on the B1 issuer rating with a positive outlook of Orkuveita Reykjavikur. The rating reflects Moody's expectation that the company will continue to improve its financial position and strengthen its standalone credit profile, which would be required before Moody's would consider an upgrade of the company's issuer rating. Orkuveita Reykjavikur is considered a government-related issuer (GRI) because of its ownership by sub-sovereign entities, which include the City of Reykjavik (93.5%) and its Icelandic municipal partners, the Town of Akranes (5.5%) and the Municipality of Borgarbyggð (1%). The company's B1 rating incorporates two notches of uplift for potential extraordinary support to the company's baseline credit assessment (BCA) of b3. However, there is not direct ownership from the Government of Iceland in this entity, therefore, the company's ratings are not directly affected by the upgrade of Iceland's government bond ratings.

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