

Rating Action: Orkuveita Reykjavikur

Moody's downgrades Orkuveita Reykjavikur to Baa1, negative outlook

London, 11 December 2008 -- Moody's Investors Service has downgraded to Baa1 from A1 the long term senior unsecured issuer rating of Orkuveita Reykjavikur (OR also known as "Reykjavik Energy".) The rating has a negative outlook.

OR is a Government Related Issuer under Moody's methodology. The rating action reflects both a deterioration in Moody's view of the company's fundamental creditworthiness (the Baseline Credit Assessment or "BCA") as well as in our assessment of the credit profile of the City of Reykjavik (unrated), its 93.5% shareholder. This deterioration has been principally driven by the current difficult financial and economic conditions in Iceland, reflected in the recent sovereign downgrade to Baa1 from A1 with a negative outlook.

The BCA of OR has been downgraded to 15 from 12 (equivalent to a B2 from a Ba2). The company's financial profile has continued to weaken during the course of the year, mainly due to the company's exposure to unhedged foreign currency debt, the company's primary source of funding. Conversely, 80% of its revenues today are in Icelandic krona derived from its operations as Reykjavik's primary multi-utility. The rapid depreciation of the krona this year, accelerated by Iceland's financial crisis, has exposed the company to significantly higher debt and interest levels on a fair value basis and is expected to result in very weak CFO/net debt levels for the year. Moody's notes that the company's well-spread debt maturity schedule and revenues in US dollars (20% of total) act as a partial mitigant. Moody's understands that, in the current difficult operating and financing environment, the company plans to significantly reduce its large capex programme to focus primarily on maintenance capex in its core business until the environment improves. This should help preserve liquidity and allow the company to meet relatively moderate maturing debt repayments in 2009 from core cash flows under most scenarios. As and when the krona appreciates, this should help the company's debt levels to improve, although this could be offset by increasing capex as the funding environment eases.

Given the guarantee of collection from the City of Reykjavik and its partners, the Town of Akranes and the Municipality of Borgabyggd, Moody's factors very high support into the rating. The downgrade to Baa1, with a negative outlook, factors the weakened profile of the City of Reykjavik reflecting a deterioration in the operating environment in Iceland and exposure to OR's worsening debt profile, although the City continues to have limited direct debt. Moody's notes however that OR's Baa1 rating, which continues to be significantly above its BCA, continues to be primarily driven by our credit assessment of the City of Reykjavik, and our view of the importance of Iceland's major city to the sovereign.

The downgrade of the sovereign rating to Baa1 has been prompted by Moody's view that the Icelandic government's financial strength has been irreparably damaged by the banking and currency crisis forcing the government to assume significant amounts of debt that will weigh on the public sector balance sheet. Moody's base case scenario is that there will be a gradual economic recovery, possibly in 2010-11, allowing government debt ratios to recover quickly. The negative outlook reflects a degree of execution risk in stabilising the country's currency, which if not achieved could delay Iceland's recovery.

The negative outlook of OR mirrors the concerns expressed in the sovereign outlook. Given the high support assumption, the evolution of OR's rating, either positive or negative, is expected to remain closely tied to that of Iceland.

The last rating action on OR was on 10 October 2008 when it was downgraded to A1 and maintained under review for possible downgrade following a similar action on the sovereign.

The principal methodologies used in rating OR were The Application of Joint Default Analysis to Government Related Issuers, April 2005 (#92432) and the Rating Methodology: Global Regulated Electric Utilities, March 2005 (#91730), which can be found at www.moody.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

Orkuveita Reykjavikur, based in and around Reykjavik, Iceland is the country's largest multi-utility, providing electricity, hot water heating, cold water and waste services to more than 50% of the Icelandic population. The company focuses on generating environmentally friendly energy from geothermal sources. As at FYE 2007, the company had revenues of ISK21 billion.

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