

## Press Release

# Rating Action: Moody's revises Landsvirkjun outlook to positive from stable

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Moody's Investors Service, (Moody's) has today revised Landsvirkjun's rating outlook to positive from stable. Concurrently, Moody's has affirmed all the company's un-guaranteed ratings, including the (P)Ba2/(P)NP ratings of the \$1 billion EMTN programme and the company's Ba2 senior unsecured debt ratings. In addition Moody's has affirmed the (P)Baa3/(P)P-3 backed senior unsecured rating of the \$2.5 billion EMTN programme and the Baa3 ratings of the debt issued thereunder, all benefitting from a guarantee of collection from the Government of Iceland (Baa3 stable).

### RATINGS RATIONALE

The change of outlook to positive acknowledges the progress Landsvirkjun has made with regard to improving its business fundamentals and strengthening its financial profile over recent past and the increased likelihood that the company will meet Moody's ratio guidance for a Ba1 rating of the unguaranteed debt in the next 12 to 18 months.

The majority of Landsvirkjun's energy generation is sold to power intensive industrial customers through long-term take-or-pay US dollar-denominated contracts that provide valuable foreign currency earnings, but at the same time expose the company to an additional source of volatility as half of its contracted volume is directly linked to aluminium prices.

Moody's recognise that Landsvirkjun's financial profile has steadily improved over the last years, underpinned by solid operating performance and management efforts to reduce exposure to commodity and financial market risks. In particular, after the renegotiation of the long term contract with Rio Tinto in 2010, the implementation of a prudential pricing strategy for new signed contracts and consistent hedging activities, revenue from power sales has started to decouple from aluminium prices. Moreover, the company has also made progress to reduce the mismatch between its foreign currency income and its debt servicing obligations, as well as decreasing the proportion of liabilities with floating interest rates.

Since Landsvirkjun is 100% owned by the state, Moody's considers the company to be a government-related issuer. Therefore, its rating is determined by an assessment of its standalone credit quality (expressed as a baseline credit assessment, or "BCA"), and factors pertaining to the likelihood of extraordinary support being provided by the Government of Iceland in the event this was needed to avoid a payment default.

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) considerable foreign exchange risk; and (5) a significant proportion of outstanding debt linked to floating interest rates.

The company's (P)Ba2/(P)NP unguaranteed ratings incorporate two notches of uplift from the company's BCA of b1 to reflect the high level of commitment that Iceland has shown in the past to support Landsvirkjun's debt and the strategic importance of Landsvirkjun to the Icelandic economy.

The (P)Baa3/(P)P-3 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.

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### RATIONALE FOR POSITIVE OUTLOOK

The positive rating outlook reflects Moody's expectation that Landsvirkjun will continue to improve its financial profile, continue to reduce leverage and exposure to market risks and prudently manage its liquidity position and capex program.

### WHAT COULD CHANGE THE RATING UP/ DOWN

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 demonstrates a funds from operation (FFO)/ total debt ratio greater than 10% on a consistent and sustainable basis, while continuing to make progress in reducing leverage. Additionally, an improvement in the Government of Iceland 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.

Given the positive outlook, downward rating pressure on the unguaranteed ratings is not anticipated in the near term but could develop as a result of (1) a substantial deterioration in Landsvirkjun's operating performance, which would cause financial metrics to materially deviate from Moody's expectation 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. The unguaranteed ratings would also come under downward pressure if Moody's were to revise the current assumption of a very high probability of timely support from the government. Equally, the guaranteed ratings would be downgraded if the rating of the Government of Iceland is downgraded.

### PRINCIPAL METHODOLOGY

The principal methodologies used in rating Landsvirkjun were Unregulated Utilities and Unregulated Power Companies, published in October 2014, and Government-Related Issuers, also published in October 2014. Please see the Credit Policy page on [www.moody's.com](http://www.moody's.com) for a copy of these methodologies.

### 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.

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