Orkuveita Reykjavikur

Full Rating Report

Rating

Foreign Currency

Long-Term IDR	BB–

Outlook

Foreign-Currency Long-Term Rating	Stable

Financial Data

Orkuveita Reykjavikur

	Dec 14	Dec 13
Revenue (ISKm)	38.5	38.6
Operating EBITDA (ISKM)	24.8	25.5
Operating EBITDA margin (%)	64.4	66.0
Funds from operations (ISKm)	20.7	20.4
FFO interest cover (x)	4.76	5.04
FFO adjusted net leverage (x)	6.88	7.40

Related Research

Orkuveita Reykjavikur - Ratings Navigator (August 2015)

Iceland (July 2015)

Fitch Publishes First-Time 'BB–' IDR for Reykjavik Energy; Outlook Stable (February 2015)

2015 Outlook: EMEA Utilities (December 2014)

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Key Rating Drivers

Majority Regulated, Benign Regulation: Orkuveita Reykavikur (Reykjavik Energy, RE) earns 65% of its EBITDA from regulated networks and can regularly propose index-linked tariff increases (CPI or BCI linked) to cover all efficiently incurred costs and provide a return on investment of at least 5%, up to 2016. Tariffs are monitored and approved by government bodies, rather than a fully independent regulator.

High Leverage: FFO net adjusted leverage is forecast to average around 6.6x to 2017. The maturity of the aluminium-linked bond asset in 2016, increases in tariffs, cost efficiencies, continued dividend freeze and capex restraints are the main drivers of the expected deleveraging to 2016.

Strong Coverage, Significant FX Risk: Interest coverage is strong thanks to RE's access to well-priced funding across a basket of currencies. However, this has exposed the company to significant FX risk, which is managed through RE's US dollar-denominated power generation earnings and hedged over a five-year horizon.

The company has significantly reduced balance-sheet exposure to FX fluctuations by denominating the generation subsidiary in US dollars, but the cash flow exposure remains a rating risk. We expect FX volatility may increase when capital controls in Iceland are lifted, but this will be mitigated by the company’s ability to hedge its exposure.

Weaker Standalone Credit Profile: RE's rating is based on Fitch Ratings’ view of its standalone credit profile, which we assess as weaker than that of its majority shareholder, the City of Reykjavik. Our view of the moderate to strong link between the company and its three municipality parents supports a one-notch uplift, included in the IDR.

Risk of Political Interference: There is scope for political interference due to RE's board being elected by the Reykjavik and Akranes city councils, and due to tariffs and investment plans being subject to influence from government bodies rather than an independent regulator.

Rating Sensitivities

Leverage and Parent Support: Restrictions on tariff increases and higher investments, or lack of proceeds on the 2016 bond asset, leading to FFO net adjusted leverage above 7x from end-2016 and FFO interest cover persistently below 4x could lead to a negative rating action. Weaker parent support, including reinstatement of dividend payments or withdrawal of other support would also be rating negative.

Improved Cash Flow: Continued tariff increases and operational outperformance resulting in stronger cash flow generation leading to FFO net-adjusted leverage below 6x and FFO interest cover over 5x on a sustained basis and increased support from the parent could lead to a positive rating action.

Liquidity and Debt Structure

Adequate Liquidity: At 30 June 2015 RE had ISK9.95bn in cash and cash equivalents and ISK8.3bn of undrawn committed facilities against short-term debt maturities of ISK14.5bn. We assess the company's current liquidity as adequate to cover operational requirements over the next 24 months due to our expectation that it will remain significantly free cash flow positive over the rating horizon.

This document focuses on the key credit issues relating to the issuer, and assumes background knowledge of both Orkuveita Reykavikur and its industry.

Key Contents

Key Rating Issues

Majority of EBITDA from Regulated Networks

- RE's majority proportion of regulated EBITDA is the main positive key rating driver.

RE is a regional publicly owned utility operating in Iceland (BBB+/Stable) with 65% of 2014 EBITDA from its regulated electricity, hot water, cold water and sewage networks. The remaining 35% of 2014 EBITDA was from electricity generation (predominantly geo-thermal) and its fibreoptic network. The company operates in 20 communities, covering 67% of Iceland's population.

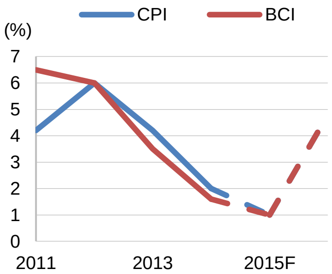
The company's subsidiary, OR-Utilities, operates the electricity distribution network for Reykjavik households, the network distribution for hot water harnessed from geothermal fields, the district heating network from its geothermal plants at Hellisheidi and Nesjavellir, and the water and sewage network.

Orka Natturunnar (ON Power) is RE's power generation subsidiary. The company's geothermal plants provide 98.1% of installed capacity of electrical power, while 1.9% comes from its Andakilsa hydropower plant. Installed thermal capacity from both geothermal plants is 433MW. ON Power is the second-largest producer of energy in Iceland, with 19% of total national production, after Landsvirkjun, which has a 71% market share.

Figure 1

Evolution of Consumer Price Index and Building Cost Index

Annual average



Source: Fitch

Of the 33% of earnings in the electricity generation segment, around 42% were from retail operations in 2014, and 58% from wholesale (54.3% long-term contracted generation to aluminium producers, and the rest related to hot water and street lighting installation and maintenance services). The contracted generation contains take-or-pay contracts in US dollars, which are linked to the price of aluminium. Therefore, if the price of aluminium is low, revenues would decrease although costs would remain the same. This introduces price risk, which is only partially offset in the short to medium term by RE's active hedging on the price of aluminium.

The remaining 2% of EBITDA is derived from the fibreoptic network. We view the overall quality of earnings, especially the 65% of EBITDA from regulated networks, as a credit positive despite the small generation activities, which are also negatively affected by volume risk and market volatility.

Benign Regulation but Risk of Political Interference

We view the regulatory environment for the regulated businesses as less robust and transparent than in other European countries. However, it is relatively benign, with some predictability due to RE's ability to propose tariffs linked to inflation, and an efficiently incurred full-cost pass-through tariff mechanism including a return on investment.

The tariffs for cold water and sewerage are set by RE and approved by the Orkustofnun (the National Energy Authority, NEA), the national independent regulatory authority under the Ministry of Industry and Innovation. RE can regularly set index-linked tariffs (tied to BCI) to cover all costs incurred by RE and provide a return on investment of at least 5% until 2016.

Returns are generally high for cold water and sewerage because operating costs are extremely low due to the level of fresh water reserves in Iceland. In addition, water and sewerage tariffs

Related Criteria

Corporate Rating Methodology (August 2015) are generally very low compared to other European countries, and consequently proposed tariff increases are generally approved by the regulator.

Tariffs for hot water distribution are also set by RE and approved directly by the Ministry of Industry. These are index linked to CPI, but returns are slightly below the company's targets due to large capital investment and additional costs recently on reinforcing the network.

A more traditional regulatory framework applies to the electricity distribution network, where there is a revenue cap and tariffs are set by the NEA for three-year periods. Costs are pass through and an efficiency challenge is in place on "reasonable" costs. Although the return on investment is aimed to be close to the market yield of non-indexed five-year treasury bonds (6.25%), the company has historically been able to achieve returns above that.

The electricity sector is regulated by the Electricity Act No 65/2003. The NEA and the Competition Authority, which is under the Ministry of Economic Affairs, monitor compliance with the Act.

Figure 2

Overview of Regulatory Environment

	Hot water	Cold water	Sewerage	Electricity distribution
	Urban Rural	Fixed tariff Usage	Fixed tariff	Distribution tariff
Legal framework	Law 58/1967	Law 33/2004	Law 9/2009	Law 65/2003
Regulatory body	Ministry of Industries and Innovation	NEA	NEA	NEA
Tariff mechanism	No revenue cap Tariff set by company Tariff approved by ministry	No revenue cap Tariff set by company Tariff approved by NEA	No revenue cap Tariff set by company Tariff approved by NEA and should cover all costs	Revenue cap Tariff set by NEA for three years (2013-2015)
Indexation of tariffs	CPI semi annual	BCI annual BCI quarterly	BCI annual	CPI semi annual
Last Tariff increase	July 2015	July 2015	January 2015	April 2015
Reason for increase	CPI change	BCI change	BCI change	Flexibility on returns limits

Source: Fitch, company

- The rating is constrained by concentrated Icelandic operations, large exposure to currency risk and aluminium price risk.

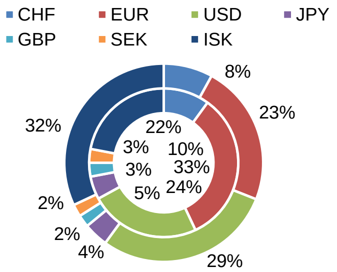
We view the regulatory environment as benign, but we also believe there is scope for political interference because RE's board is elected by the Reykjavik and Akranes city councils, and tariffs and investment plans being subject to influence from government bodies rather than an independent regulator. Although the risk is low, it may increase after 2016 when approvals from the shareholders lapse. The approvals include no dividend payments, costs and investment reductions, at least 5% return on investments, and inflation linking of tariffs. In addition, capital repayments are due to start on shareholder loans after 2016.

Iceland has some of the lowest water and electricity tariffs in Europe due to the purity of the available water, and low electricity prices due to the abundance and low running costs of hydro and geothermal power sources. Therefore, it does not face the same energy affordability issues as other European countries. This could make parental support and continuation of fully cost-reflective tariffs after 2016 more tenable.

Figure 3

Loan Porfolio and Hedged FX Exposure

As of 31 December 2014
Inner circle: Exposed loan porftolio
Outer circle: Hedged loan portfolio



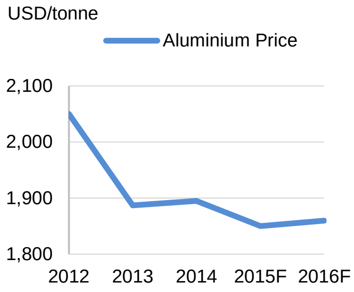
Source: Company

High Market Risk Exposure Mitigated By Hedging Policies

Despite the high proportion of regulated earnings, RE's cash flow profile is highly volatile for a largely network-based western European public utility due to currency exchange fluctuations (largest exposure being US dollar/Icelandic krona) and due to the link of electricity generation contracts to the aluminium price. This may affect the pace at which RE will deleverage as the fluctuations can be substantial. RE has significantly reduced balance-sheet exposure to FX fluctuations by denominating the generation subsidiary in US dollars, but the cash flow exposure remains a risk. Around 75% of the company's debt is denominated in foreign currency, compared to around 83% of the company's revenues in krona, while the rest are in US dollars.

The company manages exposure to other currencies through currency hedges to smooth volatility. Cash flow risk is also mitigated by the company maintaining enough liquidity to meet cash outflow in each currency six months in advance. The exposure to the aluminium prices, to which 17% of the revenues are linked, is also mitigated through hedging. RE has hedged around 67% for FY15, 43% for FY16 and around 22% for both FY17 and FY18.

Figure 4
Evolution of Aluminium Price



Source: Fitch

In September, RE signed a power purchase agreement (PPA) for 40MW with Silicor Materials, a US producer of solar-grade silicon. This contract was favourable to the company as the electricity price charged by RE is not linked to aluminium prices and is more in line with household retail prices. The company has also re-negotiated PPAs with Landsvirkjun that it entered into in 1997 and 2000 and that are due to expire in the coming months.

In June, the Icelandic government announced its strategy for the liberalisation of capital controls. In our opinion there is a risk of devaluation of the krona against other currencies, the magnitude of which will depend on the speed of implementation and resulting effect on the country's economic activities. We expect the government to be able to implement its strategy by the end of this year and this to be followed by the lifting of capital controls at a later date. This could have a negative impact on RE's debt and the scope for deleveraging.

At 30 June 2015, the company's total debt was ISK177.5bn (USD1.41bn), of which 74.9% was denominated in foreign currencies (ISK183.9bn; 75% at end-2014), while variable-rate debt was 77.8% and interest rate hedges covered around 89% of the loans one year ahead (76.2% at end-2014 and interest rate hedges covering 87% of loans for one year ahead). The company has also hedged around 61% of its exposure to aluminium prices one year ahead.

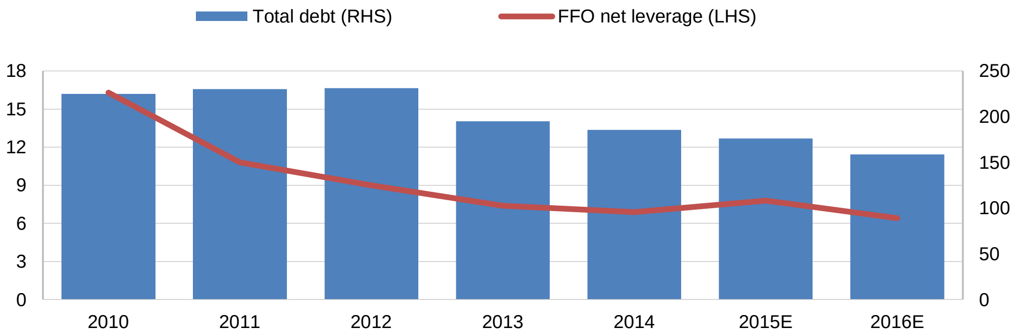
High Leverage

In our view, the company's ability to continue deleveraging beyond 2016 will depend on measures agreed by shareholders following the completion of the 2011-2016 business plan.

We forecast FFO net adjusted leverage to average around 6.6x to 2017. Our expectations for deleveraging to 2016 are based on a number of factors, including the expected cash inflow at maturity of the aluminium-linked bond asset in 2016, the increasing price of aluminium on the forward markets, increases in tariffs, continued dividend freeze and capex restraints.

FFO net adjusted leverage peaked at end-2010 during the financial crisis, when the price of aluminium fell to around USD1,200/tonne and the krona was rapidly devalued. In 2011 the shareholders decided to implement a plan to strengthen RE's financial profile, which led to FFO net adjusted leverage improving from 16x at end-2010 to 6.9x at end-2014.

Figure 5
Evolution of Total Debt (ISKbn) and FFO Net Levarage (x)



Source: Fitch

Strong Progress Against Five-Year Business Plan Likely to Lead to Deleveraging

The company achieved its targets under the 2011-2016 business plan a year and a half ahead of its completion in December 2016. The business plan was agreed in March 2011 between the company and its shareholders in an effort to improve the company's cash balance by ISK50bn by end-2016, as well as helping with large debt maturities from 2013. This included sales of assets, reduction of investments, tariff corrections and reductions in operational costs.

Fitch forecasts RE to continue to deleverage to end-2016 and beyond. However, this will depend on market movements on the aluminium price and currency exchange that are outside the company's control.

Standalone Credit Profile and Moderate to Strong Parent Linkage

RE's rating is based on our view of its standalone credit profile, which we assess as weaker than that of its majority shareholder, the City of Reykjavik. The company has three municipality shareholders: the City of Reykjavik (93.5%), the Municipality of Akranes (5.5%) and the Municipality of Borgarbyggd (1.0%).

Our moderate to strong linkage assessment reflects conditional parent guarantees of over 75% of outstanding debt (expected to decrease in future) and subordinated shareholder loans from its municipality shareholders representing a further 7% of outstanding debt. There is also strong operational control from RE's shareholders and high strategic importance as Reykjavik's foremost public utility.

Rating Issues Register

Issue	Fitch view	Likelihood, timescale, rating impact	More information
Majority regulated, benign regulation: 65% of RE's EBITDA comes from its regulated networks.	RE's rating reflects the company's regulated nature with 65% of 2014 EBITDA coming from its regulated electricity, hot water, cold water and sewage networks.	Likelihood: Medium to High Timescale: Long term Rating impact: Positive	The remaining EBITDA comes from the company's electricity generation business (predominantly geothermal) and its fibreoptic network.
High leverage: FFO net adjusted leverage is forecast to average around 6.6x to 2017.	In our view, the company's ability to continue deleveraging beyond 2016 will depend on measures agreed by shareholders following the completion of the 2011-2016 business plan.	Likelihood: Medium Timescale: Short to Medium Rating impact: Negative	Our expectations for deleveraging to 2016 are based on a number of factors including the company's expected cash inflow at maturity of the aluminium-linked bond asset in 2016, an increasing price of aluminium on the forward markets, increases in tariffs, continued dividend freeze and capex restraints.
Strong coverage, significant FX risk: Interest coverage is strong thanks to RE's access to well-priced funding across a basket of currencies.	The company has significantly reduced balance-sheet exposure to FX fluctuations by denominating the generation subsidiary in US dollars, but the cash flow exposure remains a rating risk. We expect the FX volatility to remain muted by the continuing capital controls in Iceland.	Likelihood: Medium to High Timescale: Long term Rating impact: Positive for coverage, Negative for FX risk	
Standalone credit profile and links to parent: RE's rating is based on our view of its standalone credit profile, which we assess as weaker than that of its majority shareholder, the City of Reykjavik. The company has three municipality shareholders: the City of Reykjavik (93.5%), the Municipality of Akranes (5.5%) and the Municipality of Borgarbyggd (1.0%).	Our view of the moderate to strong link between the company and its three municipality parents supports a one-notch uplift included in the IDR.	Likelihood: Maintained Timescale: Ongoing Rating impact: Positive (already embedded in the rating as one notch uplift) To be reassessed after 2016.	Our moderate to strong linkage assessment reflects conditional parent guarantees of over 75% of outstanding debt (expected to decrease in future) and subordinated shareholder loans from its municipality shareholders representing a further 7% of outstanding debt. There is also strong operational control from RE's shareholders and high strategic importance as Reykjavik's foremost public utility.
Political risk: There is scope for political interference due to RE's board being elected by the Reykjavik and Akranes city councils.	Tariffs and investment plans are subject to influence from government bodies rather than an independent regulator. Although the risk is low, it may increase after 2016 when approvals by the shareholders lapse.	Likelihood: Medium Timescale: Ongoing Rating impact: Negative (already embedded in the rating) To be reassessed post 2016.	Current shareholder support includes no dividend payments, costs and investment reductions, at least 5% return on investments, and inflation linking of tariffs. In addition, capital repayments are due to start on shareholder loans after 2016.

Source: Fitch

Sector Performance and Expectations

	2014	2015F	Expectation
Utilities			
Revenue	27.7	27.6	We expect slightly lower EBITDA for 2015 for the regulated networks followed by an increase in FY6 based on higher expectations for inflation.
EBITDA	16.3	15.4	
EBITDA (%)	58.8	56.6	
% contribution to total EBITDA	65.6	66.6	
Our nature			
Revenue	14.7	12.4	Our expectations for the power generation division are for a modest reduction in earnings as a result of a lower assumption for the average price of aluminium.
EBITDA	8.1	7.3	
EBITDA (%)	54.8	58.8	
% contribution to total EBITDA	32.5	31.5	
Other			
Revenue	5.9	4.9	We expect minimal impact from the fibreoptic division due to the small contribution to the company's earnings.
EBITDA	0.5	0.4	
EBITDA (%)	7.9	8.8	
% contribution to total EBITDA	1.9	1.9	

Numbers above include inter-company sales but exclude profit from the sale of assets
Source: Company/Fitch

On 1 January 2014, as a result of the voluntary implementation of EU directives aimed at the opening of competition in the electricity market, RE unbundled its competitive operations from its regulated operations. Therefore, comparable data for 2013 is not available.

Fitch's internally generated expectations for key leverage and coverage metrics are shown on the next page.

Cash Flow and Expected Deleveraging

Fitch expects moderate increases in EBITDA on average, mainly reflecting our expectations for continued linking of regulated tariffs to inflation over the forecast period.

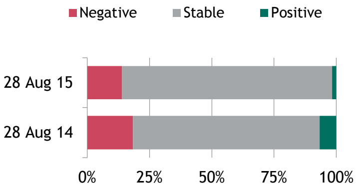
Funds from operations (FFO) net leverage is calculated at 6.9x for 2014. The lower than previously forecast leverage results from positive inflows related to the aluminium price hedges associated with the company's electricity sales contracts. We expect leverage to be slightly higher for 2015 due to lower expected FFO. The reduction in FFO for 2015 is largely due to increased capital expenditure in the regulated networks, although it is also subject to fluctuations in the inflows/outflows related to aluminium price hedges. Our expectations of lower leverage also include the assumption that no dividends will be paid to shareholders until 2016 and that RE will receive inflows related to the bond asset that matures in that year.

Debt Structure

The company's debt at 30 June 2015 mainly consisted of bank debt and shareholder loans/bonds. Most of the company's debt is at RE's level, with the exception of ISK4.75bn of debt at the fibreoptic subsidiary, which is also consolidated. Total debt of ISK177.5bn comprised ISK158.99bn of senior unsecured loans and bonds, the majority of which are guaranteed by shareholders, and ISK13.81bn of subordinated shareholders bonds/loans. Current covenants included in bank facilitates (EBITDA to repayments of principal on interest-bearing debt and net interest paid of no less than 1:1, and EBITDA to net interest of no less than 2:1).

The company also has a US dollar-denominated bond asset (ISK8.5bn at 31 December 2014) with a 1.5% coupon that matures in 2016 and relates to the sale of the company's HS Orka plant to Alterra Power Corp. Since the implementation of the business plan in 2011, the company has repaid ISK57.7bn of loans. It plans to repay debt of around ISK15bn on average in each of the next five years.

Distribution of Sector Outlooks
Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

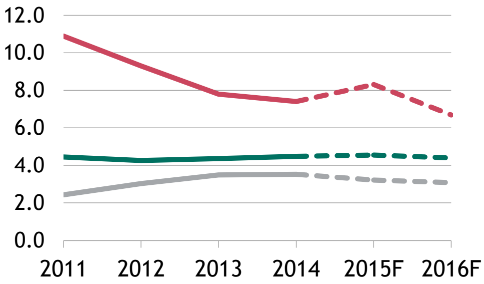
- wholesale electricity generation earnings linked to the aluminium forward curve and retail earnings, including earnings from the regulated business, inflation linked throughout the rating horizon;
- capex to average ISK9bn a year over the rating horizon, following capex deferrals in 2012 and 2013, which restricts the degree to which RE can deleverage.
- inflow of ISK8.9bn in 2016 due to the maturity of the bond asset that RE owns;
- No dividends over the rating horizon.

Definitions

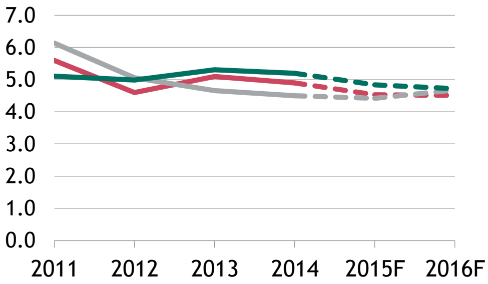
- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "*Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format*" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

Orkuveita Reykjavikur — Utilities Median — Emerging BB Cat Median — Source: Company data; Fitch

Leverage
including Fitch expectations



Interest Cover
including Fitch expectations

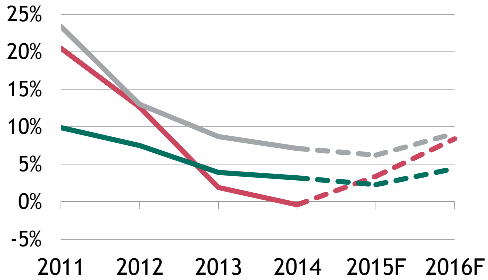


Debt Maturities and Liquidity at 30 June 2015

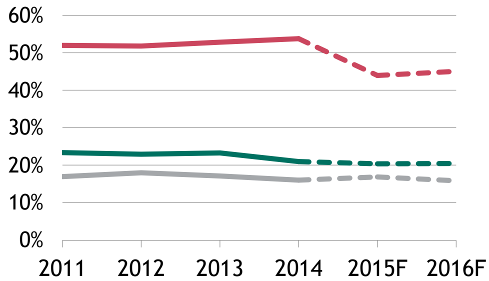
Debt maturities	**(ISKbn)**
2015	14.5
2016	18.9
2017	14.7
2018	15.6
After 2019	113.8
Cash and equivalents	9.9
Undrawn committed facilities	8.3
Undrawn committed credit facility due December 2016	4.0
Undrawn committed credit facility due April 2017	0.3
Undrawn committed credit facility due August 2020	4.0

Source: Fitch

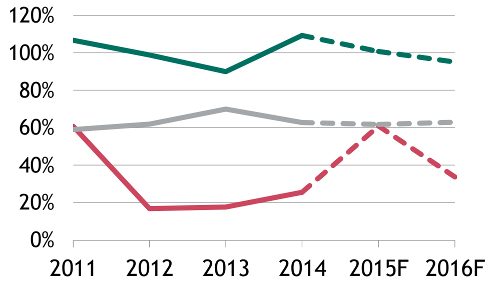
Revenue Growth
including Fitch expectations



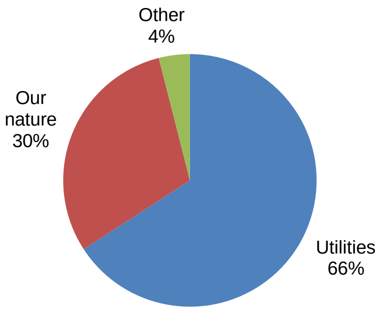
FFO Profitability
including Fitch expectations



Capex/CFO
including Fitch expectations

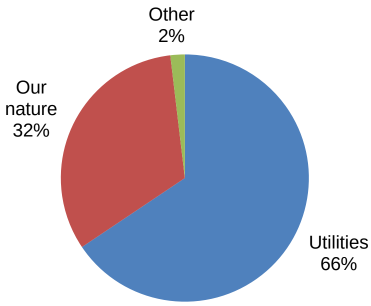


2014 Revenues by Division



Source: Fitch

2014 EBITDA by Division



Source: Fitch

Peer Group

Issuer	Country
BBB−	
Linea Group Holding S.p.A.	Italy
BB	
MEIF Renewable Energy UK PLC	United Kingdom
BB−	
Orkuveita Reykjavikur	Iceland
B+	
Viridian Group Investment Limited	United Kingdom

Issuer Rating History

Date	FC LT IDR	Outlook/ Watch
17 Jun 15	BB−	Stable
11 Feb 15	BB−	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Power generation is generally a higher-risk and more volatile segment than electricity transmission and distribution, and water and sewerage network services, due to its exposure to changes in fuel and electricity prices and electricity demand. For RE it also includes exposure to aluminium prices. However, some business and financial risks in generation may be mitigated through hedging strategies. Renewable electricity generators are also exposed to regulatory framework risk and the variation in output.

Financial Risks

Utilities are typically capital-intensive businesses that during investment cycles can be significantly free cash flow negative, raising debt to fund capex expansion. Financial risk analysis takes into account the adequacy of the utility's cash flow relative to fixed charges, debt obligations and capital expenditure and its capital structure, liquidity, profitability and dividend strategy. RE has high capital expenditure requirements but good free cash flow as we do not expect it to pay dividends at least until 2016.

Peer Group Analysis

	Linea Group BBB−/Stable	MEIF BB/Stable	Orkuveita Reykjavikur BB−/Stable[b]	Viridian B+/Stable
Country	Italy	UK	Iceland	UK
2014[a]				
Revenues (EURm)	611	156	250	1.964
Operating EBITDAR (EURm)	91	60	162	131
Funds flow from operations (EURm)	65	40	134	65
FFO adjusted net leverage (x)	4.8	3.3	6.9	3.7
FFO interest coverage (x)	4.3	3.2	4.9	2.0
Average 2015-2017				
FFO adjusted net leverage (x)	5.4	3.5	6.8	4.9
FFO interest coverage (x)	4.7	3.3	4.5	2.1

[a] 31 March 2014 for MEIF and 31 March 2015 for Viridian
[b] Includes one-notch uplift for parent links
Source: Fitch, companies

Key Credit Characteristics

Utilities with solid business profiles and strong to medium financial profiles tend to have strong investment-grade ratings. The ratings depend on business factors including market presence, the degree of vertical integration, generation mix and earnings diversification. Utility ratings also depend on financial factors such as policy, leverage, profitability and capex plans. Single-fuel or single-site concentration can constrain an entity to a lower rating category.

Overview of Companies

Linea Group Holding S.p.A. (BBB−/Stable) – is an Italian regional multi-utility. The rating reflects its well-diversified profile, with regulated and quasi-regulated activities accounting for more than 60% of EBITDA. Its waste management business is supported by a diversified customer base and a vertically integrated service portfolio.

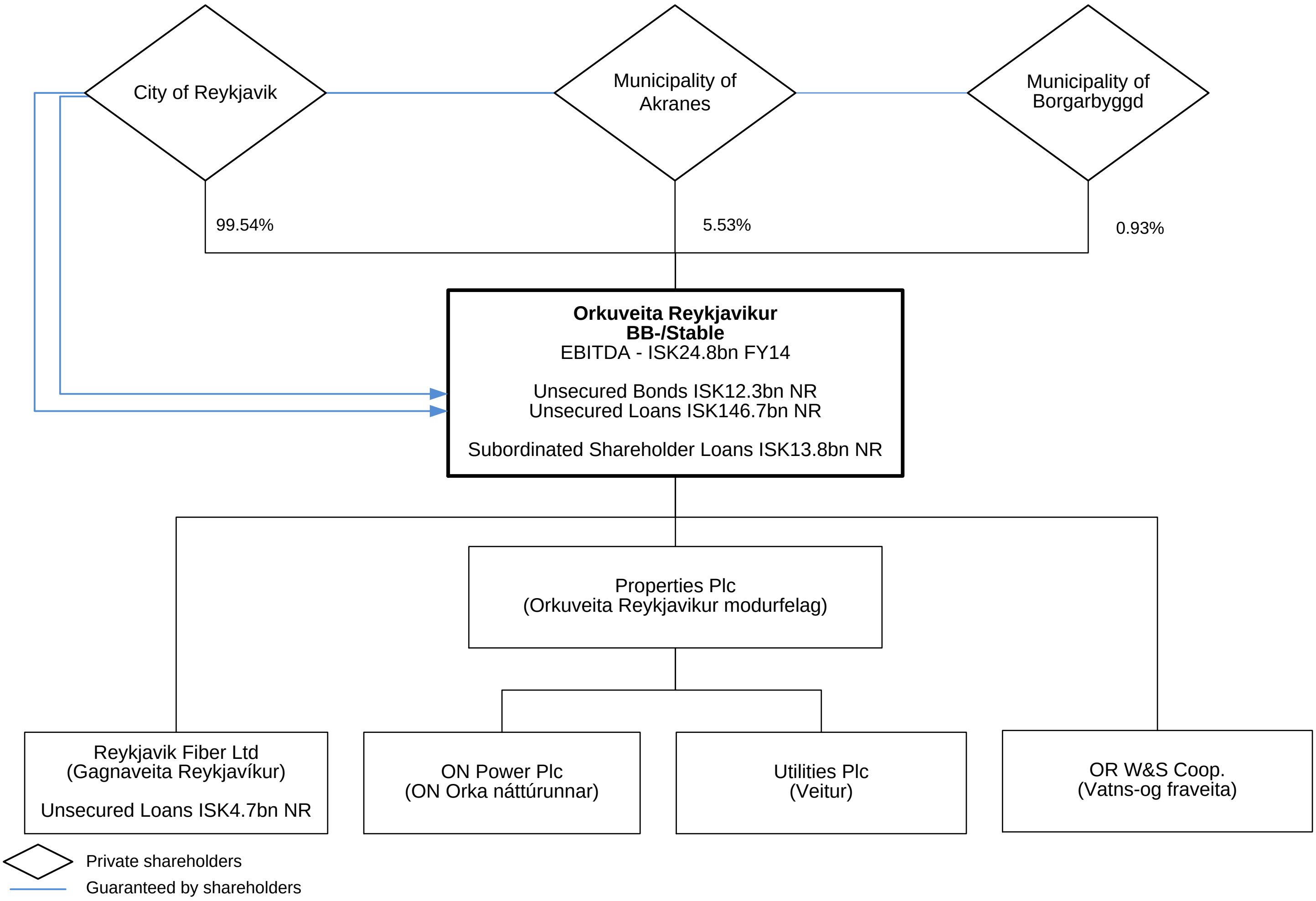
MEIF Renewable Energy UK (BB/Stable) – operates five biomass-fired power stations and 25 landfill sites in the UK, with total installed capacity of 174MW.

Viridian Group Investments Limited (B+/Stable) – is a Northern Ireland-based energy business. The Power NI division supplies nearly 800,000 homes and businesses in Northern Ireland with electricity. Viridian Power & Energy generates electricity through one power plant and wind assets, while Energy provides gas and electricity to commercial customers.

Group Structure Diagram

Figure 6

Simplified Group & Debt Structure Diagram as at 30 June 2015



Source: Fitch, Company, As at September 2015

This diagram is a stylised summary of Fitch's understanding of the key features of the issuer group's legal structure at the date of publication. It is based on publicly available information. It cannot include all relevant details, or all subsidiaries, and may change over time.

Orkuveita Reykjavikur
FINANCIAL SUMMARY

	31 Dec 2014 ISKth Year End	31 Dec 2013 ISKth Year End	31 Dec 2012 ISKth Year End	31 Dec 2011 ISKth Year End	31 Dec 2010 ISKth Year End
Profitability					
Revenue	38,448,260	38,587,479	37,863,227	33,626,215	27,915,590
Revenue Growth (%)	(0.40)	1.90	12.60	20.50	0
Operating EBIT	15,614,906	16,534,350	14,631,531	12,354,495	5,988,674
Operating EBITDA	24,767,245	25,461,694	25,002,616	21,235,231	13,951,121
Operating EBITDA Margin (%)	64.40	66.00	66.00	63.20	50.00
FFO Return on Adjusted Capital (%)	9.10	9.20	8.60	7.30	5.00
Free Cash Flow Margin (%)	42.50	42.80	41.60	19.80	(12.90)
Coverages (x)					
FFO Gross Interest Coverage	4.90	5.10	4.60	5.60	4.20
Operating EBITDA/Gross Interest Expense	4.90	5.10	4.60	5.60	4.30
FFO Fixed Charge Coverage (inc. Rents)	4.80	5.00	4.60	5.60	4.20
FCF Debt-Service Coverage	0.90	0.90	0.60	0.50	0.00
Cash Flow from Operations/Capital Expenditures	3.90	5.70	6.00	1.60	0.80
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/Operating EBITDA	7.40	7.70	9.30	10.80	16.10
Total Debt Less Unrestricted Cash/Operating EBITDA	6.90	7.30	9.00	10.80	16.00
Debt Leverage Including Rentals (x)					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	218,157	32,685	0	0	0
Gross Lease Adjusted Debt/Operating EBITDAR	7.40	7.70	9.30	10.80	16.10
Gross Lease Adjusted Debt /FFO+Int+Rentals	7.40	7.80	9.30	10.90	16.40
FFO Adjusted Net Leverage	6.90	7.40	9.00	10.80	16.30
FCF/Lease Adjusted Debt (%)	8.80	8.50	6.80	2.90	(1.60)
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	7.40	7.70	9.30	10.80	16.10
Balance Sheet Summary					
Readily Available Cash	12,147,257	8,993,410	6,885,693	1,652,484	2,343,648
Restricted/Not Readily Available Cash	0	0	0	0	0
Short-Term Debt	19,766,122	19,619,524	29,956,923	16,384,762	17,273,990
Long-Term Senior Debt	164,157,105	175,319,930	201,546,363	213,838,494	207,916,911
Subordinated debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	183,923,227	194,939,454	231,503,286	230,223,256	225,190,901
Off-Balance-Sheet Debt	1,745,256	261,480	0	0	0
Lease-Adjusted Debt	185,668,483	195,200,934	231,503,286	230,223,256	225,190,901
Fitch- identified Pension Deficit	0	0	0	0	0
Pension Adjusted Debt	185,668,483	195,200,934	231,503,286	230,223,256	225,190,901
Cash Flow Summary					
Operating EBITDA	24,767,245	25,461,694	25,002,616	21,235,231	13,951,121
Gross Cash Interest Expense	(5,079,307)	(4,966,841)	(5,411,118)	(3,777,307)	(3,230,597)
Cash Tax	0	0	0	0	0
Associate Dividends	1,268	52,124	54,475	43,840	16,159
Other Items before FFO (incl. interest receivable)	975,297	(163,296)	(12,718)	(34,866)	(125,659)
Funds from Operations	**20,664,503**	**20,383,681**	**19,633,255**	**17,466,898**	**10,611,024**
Change in Working Capital	1,267,494	(350,935)	(698,729)	(536,763)	977,239
Cash Flow from Operations	**21,931,997**	**20,032,746**	**18,934,526**	**16,930,135**	**11,588,263**
Total Non-Operating/Non-Recurring Cash Flow	0	0	0	0	0
Capital Expenditures	(5,608,688)	(3,530,173)	(3,172,530)	(10,284,091)	(14,402,796)
Dividends Paid	0	0	0	0	(800,000)
Free Cash Flow	**16,323,309**	**16,502,573**	**15,761,996**	**6,646,044**	**(3,614,533)**
Net (Acquisitions)/Divestitures	1,603,807	5,968,478	423,893	761,268	(145,292)
Net Equity Proceeds/(Buyback)	0	0	0	0	0
Other Cash Flow Items	(3,757,042)	16,200,498	(12,232,710)	(13,130,831)	6,052
Total Change in Net Debt	14,170,074	38,671,549	3,953,179	(5,723,519)	(3,753,773)
Working Capital					
Accounts Receivable Days	49	49	43	43	24
Inventory Days	15	15	17	21	11
Accounts Payable Days	72	65	60	77	37

Figure 7

Orkuveita Reykjavikur – Forecast Financial Information

(ISK 000)	Historical			Fitch forecast	
	31 Dec 13	31 Dec 14	31 Dec 15	31 Dec 16	31 Dec 17
Summary income statement					
Gross revenue	38,587,479	38,448,260	39,747,203	43,092,728	45,618,395
Revenue growth (%)	1.9	-0.4	3.4	8.4	5.9
Operating EBITDA	25,461,694	24,767,245	23,122,109	25,309,632	26,954,070
Operating EBITDA margin (%)	66.0	64.4	58.2	58.7	59.1
Operating EBITDAR	25,494,379	24,985,402	23,347,637	25,554,142	27,212,911
Operating EBITDAR margin (%)	66.1	65.0	58.7	59.3	59.7
Operating EBIT	16,534,350	15,614,906	13,792,681	15,764,971	17,238,708
Operating EBIT margin (%)	42.8	40.6	34.7	36.6	37.8
Gross Interest expense	-6,307,674	-4,574,146	-5,990,670	-6,766,165	-6,427,246
Pretax income	10,921,715	10,874,711	6,372,390	8,616,799	10,834,712
Summary balance sheet					
Readily available cash	8,993,410	12,147,257	10,957,829	6,592,315	8,241,729
Total debt with equity credit	194,939,454	183,923,227	174,282,091	157,025,676	147,203,984
Total adjusted debt with equity credit	195,200,934	185,668,483	176,086,309	158,981,755	149,274,709
Net debt	185,946,044	171,775,970	163,324,261	150,433,361	138,962,254
Summary cash flow statement					
Operating EBITDA	25,461,694	24,767,245	23,122,109	25,309,632	26,954,070
Cash interest	-4,966,841	-5,079,307	-4,627,271	-5,216,664	-5,222,648
Implied interest cost (%)	2.5	2.7	2.6	3.1	3.4
Cash tax			0	0	-959,528
Associate dividends less distributions to NCI	52,124	1,268	-2,159,452	-1,791,641	-1,020,163
Other items before FFO	-163,296	975,297	1,143,291	1,113,179	934,099
Funds flow from operations	20,383,681	20,664,503	17,478,677	19,414,507	20,685,831
FFO margin (%)	52.8	53.7	44.0	45.1	45.3
Change in working capital	-350,935	1,267,494	-625,942	9,000	-27,000
Cash flow from operations (Fitch defined)	20,032,746	21,931,997	16,852,735	19,423,507	20,658,831
Total non-operating/non-recurring cash flow		-3,000,144			
Capital expenditure	-3,530,173	-5,608,688			
Capital intensity (capex/revenue) (%)	9.1	14.6			
Common dividends	0	0			
Net acquisitions & divestitures	5,968,478	1,603,807			
Capex, dividends, acquisitions & oth. items before FCF	2,438,305	-7,005,025	-10,265,399	-6,539,016	-9,187,724
Free cash flow after acquisitions & divestitures	22,471,051	14,926,972	6,587,337	12,884,491	11,471,107
Free cash flow margin (after net acquisitions) margin (%)	58.2	38.8	16.6	29.9	25.1
Other investing and financing cash flow items	16,200,498	-3,757,042	38,167	6,409	0
Net debt proceeds	-36,563,832	-11,016,227	-7,814,932	-17,256,415	-9,821,692
Net equity proceeds			0	0	0
Total change in cash	2,107,717	3,153,847	-1,189,428	-4,365,514	1,649,414
Coverage ratios (x)					
FFO interest coverage	5.1	4.9	4.5	4.5	4.8
FFO fixed charge coverage	5.0	4.8	4.4	4.4	4.6
Operating EBITDAR/gross interest expense + rents	5.1	4.7	4.8	4.7	5.0
Operating EBITDA/gross interest expense	5.1	4.9	5.0	4.9	5.2
Leverage ratios (x)					
Total adjusted debt/operating EBITDAR	7.7	7.4	7.5	6.2	5.5
Total adjusted net debt/operating EBITDAR	7.3	6.9	7.1	6.0	5.2
Total debt with equity credit/operating EBITDA	7.7	7.4	7.5	6.2	5.5
FFO adjusted leverage	7.8	7.4	8.3	6.7	5.9
FFO adjusted net leverage	7.4	6.9	7.8	6.4	5.6

How to interpret the forecast presented

The forecast presented is based on the agency's internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch's own internal deliberations, where Fitch, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch may update the forecast in future reports but assumes no responsibility to do so

Source: Fitch

Reconciliation of Key Financial Metrics

Figure 8

Reconciliation of Key Financial Metrics for Orkuveita Reykjavikur

(ISK 000)	31 Dec 14	31 Dec 13
Interest bearing loans and borrowings	183,923,227	194,939,454
+ Subordinated debt	0	0
- Equity credit	0	0
= Total debt with equity credit	183,923,227	194,939,454
+ Total off-balance sheet debt (8 x long-term leases)	1,745,256	261,480
= Total lease-adjusted debt (a)	185,668,483	195,200,934
- Cash and equivalents (unrestricted)	12,147,257	8,993,410
= Net lease-adjusted debt (b)	173,521,226	186,207,524
Cash generated by operations	25,000,918	25,088,019
+ Change in working capital	1,267,494	-350,935
- Gross interest paid (c)	-5,079,307	-4,966,841
+ Interest received (d)	741,624	210,379
- Taxation paid	0	0
+ Dividend received from associates (recurring)	0	0
- Dividends paid to minorities	0	0
Cash From Operations (CFO)	21,931,997	20,032,746
- Change in working capital	1,267,494	-350,935
= Funds from operations (FFO)	20,664,503	20,383,681
Long-term (LT) lease multiple applied (f)	8	8
LT rental expense	218,157	32,685
Preferred dividends paid (g)	0	0
FFO adjusted net leverage (x)		
Net lease-adjusted debt/(FFO + net finance charge + LT leases) (b/(e+c-d+f-g))	6.88	7.40
FFO adjusted gross leverage (x)		
lease-adjusted debt/(FFO + net finance charge + LT leases) (a/(e+c-d+f-g))	7.36	7.75
FFO fixed charge cover (x)		
(FFO + net interest paid + LT leases)/(gross interest paid + LT leases) ((e+c-d+f)/(c+f))	4.76	5.04
FFO gross interest coverage (x)		
(FFO + net interest)/gross interest ((e+c-d)/c))	4.92	5.06

Source: Fitch based on company reports

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.