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**Summary:**  
**Landsvirkjun**

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## Summary:

# Landsvirkjun

**Credit Rating:** BB/Stable/B-1

## Rationale

The 'BB' ratings on Iceland-based 100% state-owned utility Landsvirkjun reflect Standard & Poor's Ratings Services' opinion that there is a "very high" likelihood that the Republic of Iceland (foreign currency BBB-/Negative/A-3; local currency BBB+/Negative/A-2) would provide timely and sufficient extraordinary support to Landsvirkjun in the event of financial distress. Standard & Poor's assesses Landsvirkjun's stand-alone credit profile at 'B-'.

In accordance with our criteria for government-related entities (GREs), our view of a "very high" likelihood of extraordinary government support is based on our assessment of Landsvirkjun's:

- "Very important" role, given Landsvirkjun's dominant position as the incumbent power company and 64% owner and monopoly system operator of the national transmission grid; its strategic importance to the Icelandic economy; and its central role in the promotion of power-intensive industries.
- "Very strong" link with the Icelandic state, given Landsvirkjun's 100% ownership by the state and our expectation that Landsvirkjun will not be privatized in the medium term; the provision of ultimate state guarantees for the collection of all of Landsvirkjun's debt and the state's provision of a two-year \$300 million contingent credit facility for Landsvirkjun; and the risk to the sovereign reputation if Landsvirkjun were to default.

The four-notch differential with our long-term local currency rating on Iceland reflects a highly leveraged financial risk profile due to high leverage and weak cash flow coverage of debt, weak stand-alone liquidity, and a weak business risk profile due to customer concentration risks and exposure to inherently volatile aluminum price and foreign exchange fluctuations.

### Key business and profitability developments

Given the continued weakness in the global aluminum sector and the fact that the price of aluminum drives the price of electricity in Landsvirkjun's power sale agreements with the aluminum plants, we believe that Landsvirkjun's revenues and earnings will remain under pressure in the medium term. Sales to power-intensive industries accounted for more than 80% of total power sales in 2008.

### Key cash flow and capital-structure developments

Landsvirkjun's financial risk profile is highly leveraged due to debt-funded capital investments the company made in the \$1.1 billion Kárahnjúkar hydropower plant. We believe that capital expenditures will decline significantly given that the project is completed, but at the same time, we think that cash flow generation will improve only gradually. In combination, this would, in our opinion, prevent Landsvirkjun from reducing its leverage and strengthening its cash flow coverage of debt. At year-end 2008, Landsvirkjun's adjusted debt totaled \$3.0 billion, resulting in a debt-to-capital ratio of 69%. Landsvirkjun's ratio of adjusted FFO to debt was 6.9% in 2008 and the FFO interest

coverage was 1.8x.

### Liquidity

Landsvirkjun's immediate liquidity has strengthened significantly with the provision of a two-year \$300 million contingent credit facility with the Central Bank of Iceland. In addition, Landsvirkjun currently has about \$95 million in freely available cash and \$308 million in committed lines (excluding two Icelandic banks' participation), compared with about \$201 million of short-term debt. If Landsvirkjun's access to the debt capital markets remains limited, existing bank lines are fully drawn, and Landsvirkjun has no access to other funding sources, then the Central Bank would provide Landsvirkjun with foreign currency via a drawdown on the contingent credit facility in exchange for Icelandic krona or bonds. This is to ensure that all of Landsvirkjun's obligations are met on a full and timely basis as they fall due.

### Outlook

The stable outlook reflects our opinion that Landsvirkjun's stand-alone credit profile is unlikely to improve in the near to medium term. Our opinion is based on the downturn in the domestic economy, generally subdued demand and low price levels in the aluminum industry, and Landsvirkjun's dependency on this sector to increase earnings and strengthen its cash flow coverage of debt ratios. At the same time, Landsvirkjun's stand-alone liquidity position remains weak due to lower-than-expected revenues, limited access to capital markets, and Landsvirkjun's short-term debt service requirements, but the two-year contingent credit facility mitigates our immediate concerns in this respect.

The stable outlook also reflects that--given Landsvirkjun's 'B-' stand-alone credit profile--a lower or higher local currency rating on the Republic of Iceland would not necessarily lead to a change of the rating on Landsvirkjun.

### Related Research

"General Criteria: Enhanced Methodology And Assumptions For Rating Government-Related Entities," published June 29, 2009.

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