

Research Update:

Icelandic Utility Landsvirkjun Downgraded To 'BB' After Similar Action On Iceland Local Currency Rating; Outlook Neg

Primary Credit Analyst:

Andreas Kindahl, Stockholm (46) 8-440-5907;andreas_kindahl@standardandpoors.com

Secondary Contact:

Karin Erlander, London (44) 20-7176-3584;karin_erlander@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

Icelandic Utility Landsvirkjun Downgraded To 'BB' After Similar Action On Iceland Local Currency Rating; Outlook Neg

Overview

- We have lowered our local currency sovereign credit rating on the Republic of Iceland to 'BBB-' from 'BBB' and affirmed our foreign currency ratings at 'BBB-/A-3'.
- In line with our criteria for government-related entities, we are lowering our long-term corporate credit rating on Icelandic utility Landsvirkjun to 'BB' from 'BB+'.
- The negative outlook mirrors that on the sovereign and reflects our opinion that a downgrade of the sovereign would likely result in us downgrading Landsvirkjun.

Rating Action

On May 18, 2011, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Iceland-based electricity generation and transmission company Landsvirkjun to 'BB' from 'BB+'. At the same time, we removed the long-term corporate credit rating from CreditWatch, where it was placed with negative implications on April 14, 2011. In addition, we affirmed the 'B-1' short-term rating on Landsvirkjun. The outlook is negative.

Rationale

The rating actions follow our downgrade of the long-term local currency rating on the Republic of Iceland (BBB-/Negative/A-3) on May 17, 2011. See "Republic of Iceland FC Ratings Affirmed On Nordic Support; LC Ratings Lowered To 'BBB-/A-3'; Outlook Negative."

The 'BB' rating on Landsvirkjun is based on the company's stand-alone credit profile (SACP), which we assess as 'b+', as well as on our opinion that there is a "very high" likelihood that the government of the Republic of Iceland would provide timely and sufficient extraordinary support to Landsvirkjun in the event of financial distress.

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 for the Icelandic government, given Landsvirkjun's dominant position as the incumbent power company and 64.7% owner and monopoly system operator of the national transmission grid; Landsvirkjun's 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 the state's 100% ownership of Landsvirkjun and our expectation that Landsvirkjun will not be privatized in the medium term; the provision of ultimate state guarantees for all of Landsvirkjun's debt; a two-year \$300 million contingent credit facility extended to Landsvirkjun by the Central Bank of Iceland in June 2009; and the risk to the sovereign's reputation if Landsvirkjun were to default.

Landsvirkjun's SACP continues to reflect our view of the company's high financial leverage and weak cash flow coverage ratios. The SACP also reflects Landsvirkjun's fair business risk profile, which is restricted by high customer concentration, the company's exposure to the aluminum sector for revenue and cash flow generation, and poor profitability. The company is, however, the dominant power producer in Iceland and has a modern and low-cost renewable generation asset base. We also note that Landsvirkjun operates in line with the strategic goals for the Republic of Iceland, providing relatively low-cost energy to power-intensive industries.

Landsvirkjun's financial performance continued to strengthen in 2010, with Standard & Poor's-adjusted funds from operations (FFO) to debt improving to 7.6% from 6.8% in 2009. Free operating cash flows also remained positive, which allowed the company to reduce debt. Although we believe that Landsvirkjun's financial risk profile is likely to continue to improve as a result of reduced debt, in our view the improvement starts from a low level, and is likely to only be gradual. We note, in particular, that investments in a new power plant are likely to reduce the pace of improvement. We anticipate that the company's ratio of adjusted FFO to debt will remain at less than 10% throughout 2011. Cash flow gearing remains high, as evidenced by an adjusted debt-to-EBITDA ratio of 10x in 2010.

Liquidity

Landsvirkjun's liquidity position is adequate under our criteria. This is due to Landsvirkjun's successful debt issuance to redeem expiring debt obligations in 2010 and its recently signed new credit facilities. Therefore, available liquidity sources in terms of cash, committed credit facilities, and operating cash flows should be well in excess (more than 1.2x) of forecast near-term cash outflows such as debt repayments and capital expenditures (capex). However, we continue to believe that Landsvirkjun is reliant on positive discretionary cash flow to support its debt service requirements in the medium term.

On March 31, 2011, Landsvirkjun had \$88 million in freely available cash and \$308 million available under a committed revolving credit facility that expires in December 2012, and which is free of covenants and other restrictions. Landsvirkjun also had access to committed Icelandic krona (ISK) 5.0 billion (\$43 million) credit facilities, expiring in March 2014.

In addition, Landsvirkjun recently signed a €70 million (\$100 million) loan

facility with the European Investment Bank (EIB; AAA/Stable/A-1+) maturing in 2031 and a \$70 million loan facility with the Nordic Investment Bank (AAA/Stable/A-1+) maturing in 2027. The company plans to use these funds to finance the \$225 million Búdarháls power plant project, construction of which is scheduled to commence in 2011. We note that the EIB loan facility includes a provision requiring a minimum credit rating on the Republic of Iceland. Landsvirkjun has also completed \$100 million of bond issuance--divided into a five-year \$50 million bond and a seven-year \$50 million bond--in order to secure funding for the power plant project regardless of the rating on Iceland.

Landsvirkjun generated FFO of \$270 million in 2010, and we believe that its FFO should remain fairly stable in the near term. We project capex of about \$100 million in 2011, and a further \$120 million in 2012. We understand from the company that it does not expect to pay dividends in the near to medium term. On March 31, 2011, Landsvirkjun had about \$204 million of short-term debt, with an additional \$220 million of debt due in 2012 and in the first quarter of 2013.

In our assessment of Landsvirkjun's adequate liquidity position, we assume that the company will address the replacement of the \$358 million back-up facility expiring in December 2012 in a timely manner. A failure to extend the facility in due course, evidence of restricted access to funding, or a negative deviation in FFO from our base-case assumptions could put pressure on the company's liquidity profile, and potentially on the ratings.

Outlook

The negative outlook reflects the negative outlook on the sovereign. It also reflects the likelihood of us lowering the ratings on Landsvirkjun following a negative rating action on the sovereign, provided our assessments of the company's SACP and the "very high" likelihood of extraordinary government support remain unchanged.

An outlook revision to stable would relate to a similar outlook revision on Iceland.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Republic of Iceland FC Ratings Affirmed On Nordic Support; LC Ratings Lowered To 'BBB-/A-3'; Outlook Negative, May 17, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity

Descriptors For Global Corporate Issuers, July 2, 2010

- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

Ratings List

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Landsvirkjun		
Corporate Credit Rating	BB/Negative/B-1	BB+/Watch Neg/B-1
Senior Unsecured Debt	BB	BB+/Watch Neg

Additional Contact:

Infrastructure Finance Ratings Europe;InfrastructureEurope@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2011 by Standard & Poors Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.