

May 8, 2009

Research Update:

**Ratings On Iceland-Based Utility
Landsvirkjun On CreditWatch
Negative Due To Weak Liquidity
And Business Outlook**

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Rationale

On May 8, 2009, Standard & Poor's Ratings Services placed its 'BBB-' long-term and 'A-3' short-term foreign and local currency corporate credit ratings on Iceland-based utility Landsvirkjun on CreditWatch with negative implications.

The CreditWatch placement reflects Standard & Poor's opinion of deterioration in Landsvirkjun's stand-alone credit profile because of a weakening in Landsvirkjun's liquidity and business outlook as well as uncertainties about the ability and willingness of the Icelandic state to provide timely financial support if necessary. Our concerns about Landsvirkjun's liquidity include: the funding sources for Landsvirkjun's short-term debt service requirements are uncertain; access to capital markets is limited; a credit support agreement (CSA) counterparty could require Landsvirkjun to post more collateral; and Landsvirkjun's cash resources have declined following debt repayments in March 2009. Uncertainties about Landsvirkjun's business outlook reflect, in our view, its exposure to a weakened domestic economy and the aluminum industry, which is experiencing less demand and lower price levels.

Standard & Poor's analyzes Landsvirkjun using its criteria for government-related entities. The ratings on Landsvirkjun are currently based on a top-down methodology, which reflects the following facts and opinions: Landsvirkjun's 100% ownership by the state, the Republic of Iceland (foreign currency BBB-/Negative/A-3; local currency BBB+/Negative/A-2); the provision of state guarantees for the collection of all of Landsvirkjun's debt; our expectation that Landsvirkjun will not be incorporated and privatized in the medium term; its strategic importance to the Icelandic economy; its central role in the promotion of power-intensive industries; and the risk to the sovereign reputation if Landsvirkjun were to default.

The debt guarantees are ultimate--but not timely--and our review of the ratings on Landsvirkjun will assess the ability, willingness, and formal mechanisms for the Icelandic government to provide timely financial support to Landsvirkjun if needed. If we perceive more uncertainties than so far expected about the state's ability and willingness to provide timely support, we would consider whether to alter our ratings approach to one in which the ratings are derived from Landsvirkjun's stand-alone credit quality. Adopting such an approach could lead to a lowering of the ratings on Landsvirkjun by more than one notch.

In our opinion, Landsvirkjun's stand-alone credit quality has further deteriorated, and we now assess Landsvirkjun's stand-alone credit profile as 'B-', reflecting a weak and highly leveraged financial risk profile and a weak liquidity position. It also reflects customer concentration risks and exposure

to inherently volatile aluminum prices and foreign exchange fluctuations. Landsvirkjun's stand-alone creditworthiness also reflects our view of the company's dominant position in the Icelandic electricity market, ownership of the transmission grid, and modern asset base.

Liquidity

Landsvirkjun's liquidity position is weak. Landsvirkjun currently has \$40 million in freely available cash and \$290 million in committed lines (excluding the Icelandic banks' participation), compared with \$201 million of short-term debt. Landsvirkjun's liquidity position weakened during the first quarter of 2009 because of revenue weakness and the use of cash to repay debt. In addition to debt service requirements, we understand that a CSA counterparty could require Landsvirkjun to post an increased amount of collateral depending on how the fair value of its derivative positions changes and that Landsvirkjun also needs to fund capital expenditures in 2009.

CreditWatch

A resolution of the CreditWatch placement is likely this month after discussions with Landsvirkjun's management and owners to determine whether we have sufficient evidence that the state would indeed provide timely support to Landsvirkjun if needed. We will also continue to monitor Landsvirkjun's progress to secure funding via the capital markets.

We could lower the ratings if we determine that timely financial support remains uncertain. An upgrade is unlikely at present, given Landsvirkjun's weak financial profile and weak liquidity position.

Ratings List

CreditWatch/Outlook Action

	To	From
Landsvirkjun		
Corporate Credit Rating	BBB-/Watch Neg/A-3	BBB-/Negative/A-3
Senior Unsecured*	BBB-/Watch Neg	BBB-/Negative

*Guaranteed by the Republic of Iceland.

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