

**Rating Action: Moody's affirms ratings of Landsvirkjun; outlook stable**

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London, 25 April 2016 -- Moody's Investors Service, ("Moody's") has today affirmed all of Landsvirkjun's unguaranteed ratings, including the (P)Ba1/(P)NP ratings of the \$1 billion EMTN programme and the company's Ba1 senior unsecured debt ratings. In addition Moody's has affirmed the (P)Baa2/(P)P-2 backed senior unsecured ratings of the \$2.5 billion EMTN programme and the Baa2 ratings of the debt issued thereunder, all benefitting from a guarantee of collection from the Government of Iceland (Baa2 stable). Concurrently, Moody's has raised Landsvirkjun's standalone credit quality, expressed as a baseline credit assessment (BCA) to ba3 from b1. The outlook on the rating is stable.

**RATINGS RATIONALE**

Moody's has raised Landsvirkjun's BCA to ba3 from b1 to reflect (1) the material strengthening in Landsvirkjun's financial profile; (2) the implementation of hedging agreements, which provides greater visibility of cash flows and helps the company to reduce its foreign currency and interest rate risks in the short to medium term; and (3) the reduction in exposure to aluminium prices and the consequent reduction in the volatility of profit and cash flows. Over the next years, Moody's expects that Landsvirkjun will also benefit from positive developments in the macroeconomic conditions of the country, which could translate into higher electricity demand from local utilities and new businesses.

More specifically, the ba3 BCA of Landsvirkjun factors in positively (1) the company's dominant position in the Icelandic energy market; (2) its low-cost renewable generation asset base and modest levels of capital expenditure; and (3) its ability to generate relatively stable cash flows through long-term power contracts. However, the company's assessment is constrained by (1) its high financial leverage; (2) its concentrated exposure to a small number of counterparties, mainly in the aluminium industry; and (3) a degree of exposure to aluminium prices.

Given Landsvirkjun's 100% direct and indirect ownership by the state, the company is considered a government-related issuer under Moody's methodology. Therefore, its rating is determined by an assessment of the BCA and factors pertaining to the likelihood of extraordinary support being provided by the Government of Iceland.

The (P)Ba1/(P)NP unguaranteed ratings of Landsvirkjun's USD1 billion EMTN programme benefit from two notches of uplift from the BCA reflecting Moody's assessment of the likelihood of extraordinary support being provided by the Government of Iceland in the event this was needed to avoid a payment default. This uplift incorporates the commitment that the government has shown in the past to support Landsvirkjun's debt and the strategic importance of the company to the Icelandic economy, given the role it plays in the provision of electricity to power intensive industries, which directly contribute to about 40% of Icelandic exports.

The (P)Baa2/(P)Prime-2 guaranteed ratings of Landsvirkjun's USD2.5 billion EMTN backed programme are at par with the sovereign rating and reflect the additional credit support provided by the guarantee of collection from the Icelandic government. Despite the fact that a guarantee of collection is not a timely payment guarantee, Moody's believes that there are strong incentives for the owners to provide timely support to Landsvirkjun.

**RATIONALE FOR STABLE OUTLOOK**

The stable outlook is in line with the outlook of the Icelandic government's ratings. It also reflects Moody's expectation that Landsvirkjun will continue to prudently manage its exposure to market risks and improve its financial position, such that credit metrics will be comfortably positioned within the ratio guidance for a ba3 BCA, namely the maintenance of an FFO/ Net debt ratio in the low double digits in percentage terms.

**WHAT COULD CHANGE THE RATING UP/ DOWN**

Moody's could consider an upgrade of Landsvirkjun's ratings (1) following any upgrade of the sovereign rating; or (2) if the company continues to demonstrate the ability to withstand significant volatility in the commodity

markets and credit metrics were to materially improve above ratio guidance on a sustainable basis without increasing its business risk profile. This would also assume no change to the assumption of support from the owner incorporated into Landsvirkjun's rating.

Conversely, downward pressure on Landsvirkjun's ratings could develop (1) after a downgrade of the Icelandic government's ratings; or (2) as consequence of a substantial deterioration in Landsvirkjun's business risk profile or weakening in the financial position, such that FFO/Net debt in percentage terms was expected to remain consistently below 10%. The ratings would also come under downward pressure if Moody's were to revise the current assumption of timely support from the government.

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

Headquartered in Reykjavik, Landsvirkjun is Iceland's dominant power producer. It is responsible for about 75% of Iceland's total electricity production of 18 terawatt hours (TWh) and owns the majority of the transmission grid. 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.

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