

Rating Action: Orkuveita Reykjavikur

Moody's downgrades Orkuveita Reykjavikur to A1, maintains review

London, 10 October 2008 -- Moody's Investors Service has downgraded to A1 from Aa2 the long term senior unsecured issuer rating of Orkuveita Reykjavikur (OR also known as "Reykjavik Energy".) The rating remains under review for further possible downgrade.

OR is a Government Related Issuer under Moody's methodology. The rating action reflects both a deterioration in Moody's view of the company's fundamental creditworthiness (the Baseline Credit Assessment or "BCA") as well as in the rating agency's assessment of the credit profile of the City of Reykjavik (unrated), its 93.5% shareholder. This deterioration has been principally driven by the current difficult financial and economic conditions in Iceland, reflected in the recent sovereign downgrade to A1 from Aa1 and continuing review for downgrade.

The BCA of OR has been downgraded from 11 to 12 (equivalent to a Ba2 from a Ba1) and is subject to further downward pressure. The company's financial profile has weakened mainly due to the company's exposure to unhedged foreign currency debt, the company's primary source of funding. Conversely, most of its revenues today are in Icelandic krona derived from its operations as Reykjavik's primary multi-utility. The rapidly depreciating krona this year, accelerated by Iceland's financial crisis, has exposed the company to significantly higher debt and interest levels on a fair value basis, although Moody's notes that the company's well-spread debt maturity schedule is a partial mitigant to pressure on the company's cash flow. Nonetheless, the ability of the company to shore up its current, rather tight, liquidity position will be a key consideration in Moody's evaluation of the further development of the company's BCA.

A secondary consideration has been an increase in, and acceleration of, the company's investment programme, although steps are being taken to scale this back via a reduction in uncommitted capex and divestments. OR recently purchased a 16.6% stake in Hitaveita Sudurnesa, a neighbouring utility for ISK8.7 billion. Whilst OR had initially committed to increase its stake to 33%, the competition authorities subsequently ruled that OR could not hold more than 10%. The means to best satisfy the competition authorities' requirement is currently under discussion.

Given the guarantee of collection from the City of Reykjavik and its partners, the Town of Akranes and the Municipality of Borgabyggd, Moody's factors very high support into the rating. The downgrade to A1 factors the weakened profile of the City of Reykjavik reflecting a more complicated operating environment in Iceland and exposure to OR's worsening debt profile. Moody's notes however that OR's A1 rating, which continues to be significantly above its BCA, continues to be driven primarily by the rating agency's credit assessment of the City of Reykjavik, and the importance of Iceland's major city to the sovereign.

The rating of OR remains under review given the current financial instability and pressure on the Icelandic krona. Further rating developments are likely to be significantly influenced by developments at the sovereign level and its ability to restore financial stability. The recent sovereign downgrade has been prompted by the unprecedented seizing up of global credit markets compounding the difficulties of Icelandic banks and complicating the task of the government to restore financial stability. The long term credit standing of the country will depend on the authorities' crisis management skills and the extent to which the government's balance sheet will be durably impaired, both in absolute and comparative terms.

The last rating action on OR was on 10 July 2008 when its Aa2 rating was put under review for possible downgrade.

Orkuveita Reykjavikur, based in and around Reykjavik, Iceland is the country's largest multi-utility, providing electricity, hot water heating, cold water and waste services to more than 50% of the Icelandic population. The company focuses on generating environmentally friendly energy from geothermal sources. As at FYE 2007, the company had revenues of ISK21 billion.

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