

**Rating Action: Moody's upgrades Orkuveita Reykjavikur's rating to Ba1; stable outlook**

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Global Credit Research - 23 Mar 2018

London, 23 March 2018 -- Moody's Investors Service, ("Moody's") has today upgraded to Ba1 from Ba2 the corporate family rating of Orkuveita Reykjavikur (OR). Concurrently, the outlook has been changed to stable from positive.

**RATINGS RATIONALE**

The upgrade of OR's rating to Ba1 reflects the continuous progress the company has made with regard to reducing its financial leverage and improving its liquidity position and diversifying its funding sources. It also takes into account Moody's expectation that OR should be able to maintain its improved financial profile and continue to benefit from the positive macroeconomic dynamics in Iceland, which should drive demand growth for utility services.

The standalone credit strength of OR, which is represented by a ba2 baseline credit assessment (BCA), upgraded from ba3, positively reflects (1) the company's strong market position and strategic importance to Reykjavik, and Iceland more broadly, as the provider of essential utility services to almost 70% of Iceland's population; (2) the low business risk profile associated with regulated activities, which account for around 60% of the company's EBITDA and provide a good degree of cash flow predictability; and (3) its asset base with predictable and low levels of capital expenditure requirements.

At the same time, the Ba1 rating / ba2 BCA also incorporates OR's exposure to the unregulated business and long-term power contracts with aluminium smelters, which exposes OR's revenue to some degree of volatility of the price of aluminium. Albeit materially improved from the past, OR continues to have a significant foreign currency exposure given that the majority of its revenues are generated in Icelandic krona but more than half of its debt balance is denominated in foreign currency. Whilst Moody's does not expect a material depreciation of the Icelandic krona in the next two years, OR remains exposed to exchange rate movements, albeit against a background of lower exchange rate volatility. More positively, Moody's expects that the company will continue to reduce its foreign currency exposure, as it has done over the last years, through issuance of bonds in the local market and refinancing of its debt portfolio.

OR is considered a government-related issuer under Moody's methodology because of its ownership by municipal authorities, which include the City of Reykjavik (93.5%), the Town of Akranes (5.5%) and the Municipality of Borgarbyggð (1%). The owners provide a guarantee of collection in support of OR, which currently covers almost 70% of the total outstanding debt. OR's Ba1 rating incorporates one notch of uplift for potential extraordinary support to the company's ba2 BCA. This recognises that despite the very strong incentives of the owners to provide timely financial support to OR its ability to do so in potential stress case scenarios may be constrained, given OR's significant debt burden relative to the financial resources of its shareholders. Therefore, considering the critical nature of utility services that OR provides to the City of Reykjavik and the surrounding communities, Moody's would expect the central government to try and coordinate with the local governments to arrange timely intervention, if necessary.

The corporate family rating is an opinion of the OR group's ability to honour its financial obligations and is assigned to OR as if it had a single class of debt and a single consolidated legal structure.

**RATIONALE FOR STABLE OUTLOOK**

The stable outlook reflects Moody's expectation that OR will continue to prudently manage its liquidity position and its financial profile will remain aligned with our ratio guidance for a Ba1 CFR / ba2 BCA, namely the maintenance of an Funds from operations (FFO)/ Net debt ratio in the mid to high-teens in percentage terms.

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

Moody's could consider an upgrade of OR's rating if its financial profile were to continue to improve resulting in FFO / Net debt sustainably in the low-twenties in percentage terms, provided that the company does not

increase its business risk or exposure to foreign exchange fluctuations, and it maintains a liquidity position that will allow it to cover more than twelve months cash requirements. This would also assume no change to the assumption of support from the owner incorporated into OR's rating.

Conversely, downward pressure on OR's rating could develop (1) as a consequence of a weakening of the company's financial profile, such that FFO/Net debt was expected to remain consistently in the low teens in percentage terms; or (2) it would appear likely that the company's liquidity was not sufficient to insulate it from market risks, particularly in relation to exchange rates, aluminium prices or interest rates.

## CORPORATE PROFILE

Headquartered in Reykjavik, Orkuveita Reykjavíkur is the largest multi-utility in Iceland. The company operates its own power plants, electricity distribution system, geothermal district heating system and provides cold water and waste services in 20 communities in the southwest of the country, covering almost 70% of the Icelandic population. For the fiscal year ending 2017, the company had revenues of ISK44 billion (c.USD440 million) and EBITDA of ISK26.7 billion (c.USD267 million).

## PRINCIPAL METHODOLOGY

The methodologies used in this rating were Regulated Electric and Gas Utilities published in June 2017, and Government-Related Issuers published in August 2017. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

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