

Research Update:

# Landsvirkjun Upgraded To 'A-' On Similar Action On Sovereign; Outlook Stable

November 15, 2023

## Rating Action Overview

- We raised the long-term rating on Iceland to 'A+' from 'A' on Nov. 10, 2023, because we estimate that a strong tourism season will support real GDP growth of 3.8% in the country this year, while domestic demand should also contribute to growth over the next few years.
- We believe there is a very high likelihood of extraordinary sovereign support for Landsvirkjun. The company represents an essential part of Iceland's national economy because its 100% renewable energy generation assets cover more than 70% of the country's total electricity demand.
- We therefore raised our long-term issuer and issue credit ratings on Landsvirkjun to 'A-' from 'BBB+' and affirmed the 'A-2' short-term issuer credit rating.
- The stable outlook mirrors that on the sovereign and reflects our expectation that Landsvirkjun's funds from operations (FFO) to debt will remain well above 30%.

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## Rating Action Rationale

**The upgrade of Landsvirkjun reflects a similar rating action on Iceland.** On Nov. 10, 2023, we raised the rating on Iceland because of the country's continued strong growth momentum and even though the economy surpassed its post-pandemic peak in the first quarter of 2022. We now forecast Iceland's GDP will increase by 3.8% in 2023. This increase is higher than that of other sovereigns we rate in Europe.

**Landsvirkjun posted strong results in the third quarter of 2023 and is off to a strong start into 2024.** The company's reported EBITDA increased to \$378 million in the third quarter of 2023, a year-on-year increase of by \$58 million. This is in line with our expectation that Landsvirkjun will generate S&P Global Ratings-adjusted EBITDA of about \$380 million-\$480 million by year-end 2023. The increase mainly results from favorable hedging prices that offset the substantial price decreases in international commodity and energy markets. Net reported debt decreased even by \$275 million to \$565 million, thanks to healthy cash flow generation and the management's continuous deleveraging efforts. Debt has decreased substantially over the last few years and

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stood at \$1.5 billion at year-end 2021. Due to these strong results, we forecast adjusted FFO to debt of about 40%-50%, which is well above our 30% threshold for a stand-alone credit profile (SACP) of 'bb+'.

### **Our rating is further supported by Landsvirkjun's 100% ownership by the Icelandic government.**

The company is fully owned by the Icelandic government. Landsvirkjun represents an essential part of the national economy because its 100% renewable energy generation assets cover more than 70% of Iceland's total electricity demand. We think it is very likely that Iceland would provide timely and sufficient extraordinary support to the company in the event of financial distress, given its very important role for the Icelandic government, its dominant position as the incumbent power company, and its central role in the promotion of power-intensive industries. Our long-term rating on Landsvirkjun factors in four notches of uplift for extraordinary government support.

## Outlook

The stable outlook mirrors that on the sovereign. It also reflects our expectation that Landsvirkjun will maintain credit metrics commensurate with the current rating level and the SACP of 'bb+', with FFO to debt well above 30% in the next two years, absent any development capital expenditure (capex).

## Downside scenario

A downgrade of Landsvirkjun could stem from a similar rating action on the sovereign or a downward revision of the SACP to 'bb'. We see the latter as unlikely at this point, given credit metrics will likely remain comfortably above our 30% FFO-to-debt downside threshold over the next two years. We could also lower the rating if we think the likelihood of extraordinary sovereign support has diminished.

## Upside scenario

The likelihood of an upgrade is currently very remote as we would have to revise the SACP to 'bbb', which is two notches above the current SACP of 'bb+'. A further upgrade of Iceland would affect the rating on Landsvirkjun.

## Company Description

Landsvirkjun is fully owned by the Icelandic government and has a 100% renewable energy generation portfolio. It meets 70% of Iceland's power needs at a low marginal cost, with hydroelectricity contributing 91% and geothermal energy accounting for 9%. The company operates 18 power stations (15 hydroelectric and three geothermal power plants) and two wind turbines across Iceland, with an installed capacity of about 2,150 megawatts and an annual electricity generation of about 15.0 terawatt hours. Electricity generation was 14.6 terawatt hours in 2022. Landsvirkjun sells most of the power it generates to power-intensive corporations, primarily aluminum smelters. It sells approximately 86% of the energy to large end-users in the industrial market and 14% on the wholesale market. Landsvirkjun sold its 64.7% subsidiary Landsnet, the national power transmission system, to the Icelandic government at year-end 2022.

## Liquidity

We view Landsvirkjun's liquidity as strong. We project that available liquidity sources should exceed our forecast of near-term cash outflows by about 2.2x over the next 12 months and by more than 1.6x over the next 24 months. We also expect that liquidity sources will exceed liquidity uses even if EBITDA declines by 30%. In addition, we consider that the company benefits from a generally high standing in the credit markets and prudent risk management. Furthermore, as critical infrastructure operator and government-owned entity, Landsvirkjun has a strong relationship with local and international banks. Near-term debt maturities amount to less than \$100 million, which the company will likely be able to meet.

Landsvirkjun's principal liquidity sources over the 12 months from June 30, 2023, include:

- Cash of about \$157 million;
- Committed facility of \$125 million, expiring in July 2026;
- Working capital inflows of about \$15 million-\$20 million; and
- FFO of about \$300 million-\$310 million.

Principal liquidity uses over the 12 months from June 30, 2023, include:

- Debt maturities of about \$60 million and \$90 million in the subsequent 12 months;
- Capex of \$35 million; and
- Annual dividends of about \$150 million.

## Issue Ratings – Subordination Risk Analysis

### Capital structure

100% of the debt is issued by Landsvirkjun. We therefore do not see any significant risk of subordination and align our rating on Landsvirkjun's senior unsecured debt with the issuer credit rating.

### Analytical conclusions

The issue rating on Landsvirkjun's senior unsecured debt is 'A-', in line with the issuer credit rating, since no significant elements of subordination risk are present in the capital structure.

## Ratings Score Snapshot

Issuer credit rating	A-/Stable/A-2
Business risk:	Fair
Country risk	Low
Industry risk	Moderately high
Competitive position	Fair

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Issuer credit rating	A-/Stable/A-2
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	bb+
Modifiers:	Neutral
Diversification/Portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Satisfactory
Comparable rating analysis	Neutral
Stand-alone credit profile:	bb+
Related government rating	A+/Stable/A-1
Likelihood of government support	Very high (+4 notches)

### Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Related Research

- Iceland Ratings Raised To 'A+' On Strong Growth and Fiscal Consolidation; Outlook Stable, Nov. 10, 2023

## Ratings List

### Upgraded; Ratings Affirmed

	To	From
<b>Landsvirkjun</b>		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2

### Upgraded

	To	From
<b>Landsvirkjun</b>		
Senior Unsecured	A-	BBB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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