

Orkuveita Reykjavíkur

Update

Rating

Foreign Currency

Long-Term IDR BB-

Outlook

Foreign-Currency Long-Term IDR Stable

Financial Data

Orkuveita Reykjavíkur

	31 Dec 14	31 Dec 13
Revenue (ISKm)	38.5	38.6
Operating EBITDA (ISKm)	24.8	25.5
Operating EBITDA margin (%)	64.4	66.0
Funds from operations (ISKm)	20.7	20.4
FFO interest cover (x)	4.9	5.1
FFO adjusted net leverage (x)	6.9	7.4

Key Rating Drivers

Shareholder Support: Shareholders have provided supportive measures to help improve the financial position of Orkuveita Reykjavíkur (Reykjavik Energy; OR) over the business plan period to 2016. In January 2016 OR's shareholders approved a revised dividend policy from 2017 including financial targets that need to be met simultaneously before and after any dividends are paid, and a maximum payout of 50%.

Fitch Ratings expects shareholder support and fully cost-reflective tariffs to continue after 2016. The IDR incorporates a single-notch uplift over OR's standalone rating reflecting moderate to strong links between OR and its three municipality shareholders.

Regulated Earnings Dominant: For 2015 we expect the share of regulated networks to increase to 68% of EBITDA from 65% in 2014 as a result of a steep increase in the Building Cost Index (BCI), to which some of the regulated tariffs are linked. Fitch estimates the contribution from the regulated networks will decrease to 64% of EBITDA by 2019 as a result of lower expected tariff increases over the forecast period and the expectation that tariffs will continue to be index-linked.

Expected Deleverage: We forecast funds from operations (FFO) net adjusted leverage at 7.2x in 2015. We expect leverage to decrease to 6.3x in 2016 due to the maturity of the aluminium-linked bond asset in 2016, increases in aluminium prices and in tariffs, and no dividend payments. The company's ability to continue deleveraging beyond 2016 will be dependent on measures agreed by shareholders following the completion of the 2011- 2016 business plan including dividend payments from 2017.

Hedging Mitigates Market Risk: OR's cash flows are exposed to currency fluctuations, interest rates, and to aluminium prices, to which some of the company's generation contracts are linked. In our view, this exposure, though mitigated through hedging, may affect the pace at which OR will deleverage as the fluctuations can be substantial.

Lifting Icelandic Capital Controls: In June 2015 the Icelandic government announced its strategy for the liberalisation of capital controls that have been in place since 2008. We believe there is a risk of exchange-rate volatility as a result, the magnitude of which may depend on the speed of implementation and the resulting effect on the country's economy.

Rating Sensitivities

Leverage and Parent Support: Restrictions on tariff increases and higher investments, or lack of proceeds from the 2016 bond asset, leading to FFO net adjusted leverage above 7x from end-2016 and FFO interest cover persistently below 4x could lead to a negative rating action. Weaker parent support, including the removal of the tariff linkage with inflation or the withdrawal of other support would also be rating negative.

Liquidity and Debt Structure

Adequate Liquidity: As of 30 September 2015, the company had ISK10.86bn in cash and cash equivalents and ISK8.3bn of undrawn committed facilities against short-term debt maturities of ISK14.3bn. This liquidity position is adequate to cover operational requirements over the next 24 months due to our expectation that it will remain significantly FCF positive over the rating horizon. Fitch considers 24 months of available liquidity as appropriate due to the high market volatility OR faces on its aluminium, interest-rate and foreign-exchange exposures.

Related Research

[Fitch Affirms Reykjavik Energy at 'BB-'; Outlook Stable \(December 2015\)](#)
[Orkuveita Reykjavíkur Full Rating Report \(September 2015\)](#)
[Orkuveita Reykjavíkur - Ratings Navigator \(August 2015\)](#)
[2016 Outlook: EMEA Utilities \(December 2015\)](#)
[Iceland \(July 2015\)](#)

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Peer Group

Issuer	Country
BBB- Linea Group Holding S.p.A.	Italy
BB Melton Renewable Energy UK PLC	United Kingdom
BB- Orkuveita Reykjavikur	Iceland
B+ Viridian Group Investments Limited	Cayman Islands

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
21 Dec 15	BB-	Stable
17 Jun 15	BB-	Stable
11 Feb 15	BB-	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Power generation is generally a higher-risk and more volatile segment than electricity transmission and distribution, and water and sewerage network services, due to its exposure to changes in fuel and electricity prices and electricity demand. For OR it also includes exposure to aluminium prices. However, some business and financial risks in generation may be mitigated through hedging strategies. Renewable electricity generators are also exposed to regulatory framework risk and the variation in output.

Financial Risks

Utilities are typically capital-intensive businesses that during investment cycles can be significantly free cash-flow negative, raising debt to fund capex expansion. Financial risk analysis takes into account the adequacy of the utility's cash flow relative to fixed charges, debt obligations and capital expenditure and its capital structure, liquidity, profitability and dividend strategy. OR has high capital expenditure requirements but good free cash flow as we do not expect it to pay dividends until 2016.

Peer Group Analysis (FY14^a)

(EURm)	Linea Group BBB-/Stable	Melton Renewable Energy BB/Stable	Orkuveita Reykjavikur BB-/Stable ^b	Viridian B+/Stable
Country of operation	Italy	UK	Iceland	UK
Revenues	611	156	250	1,964
Operating EBITDAR	91	60	162	131
Funds from operations	65	40	134	65
FFO adjusted net leverage (x)	4.8	3.3	6.9	3.7
FFO interest coverage (x)	4.3	3.2	4.9	2.0
Average 2015-2018				
FFO adjusted net leverage (x)	5.1	3.4	6.1	5.1
FFO interest coverage (x)	4.1	3.3	5.8	2.1

^a 31 March 2014 for Melton Renewable Energy and 31 March 2015 for Viridian

^b Includes one-notch uplift for parent links

Source: Fitch, companies

Key Credit Characteristics

Utilities with solid business profiles and strong to medium financial profiles tend to have strong investment-grade ratings. The ratings depend on business factors including market presence, the degree of vertical integration, generation mix and earnings diversification. Utility ratings also depend on financial factors such as policy, leverage, profitability and capex plans. Single-fuel or single-site concentration can constrain an entity to a lower rating category.

Overview of Companies

Linea Group Holding S.p.A. (BBB-/Stable) – an Italian regional multi-utility. The rating reflects its well-diversified profile, with regulated and quasi-regulated activities accounting for more than 60% of EBITDA. Its waste management business is supported by a diversified customer base and a vertically integrated service portfolio

Melton Renewable Energy UK PLC (BB/Stable) – operates five biomass-fired power stations and 25 landfill sites in the UK, with total installed capacity of 174MW.

Viridian Group Investments Limited (B+/Stable) – is a Northern Ireland-based energy business. The Power NI division supplies nearly 800,000 homes and businesses in Northern Ireland with electricity. Viridian Power & Energy generates electricity through one power plant and wind assets, while Energy provides gas and electricity to commercial customers

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

Rating factor	Status ^a	Trend
Operations	Average	Improving
Market position	Weak	Improving
Finances	Average	Neutral
Governance	Average	Neutral
Geography	Weak	Neutral

^a Relative to peer group

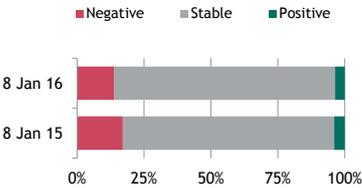
Source: Fitch

Related Criteria

[Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage \(August 2015\)](#)

Distribution of Sector Outlooks

Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

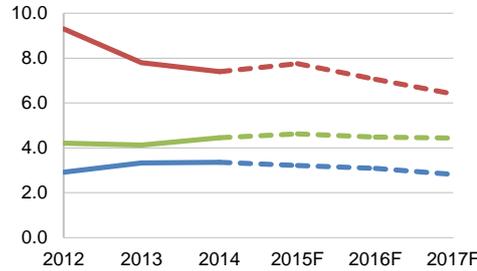
- majority of wholesale electricity generation earnings are linked to aluminium forward prices;
- retail earnings, including from the regulated business, are inflation-linked over the rating horizon;
- EBITDA on average of ISK26bn for 2015-2018;
- capex is forecast to average ISK12bn a year for 2015-2018 following capex deferrals since 2012;
- positive free cash flow (FCF) of ISK9.8bn on average for 2015-2018;
- an inflow of ISK8.9bn is forecast in 2016 due to the maturity of the bond asset that OR owns;
- no dividends in 2015-2016, dividend payout of 30% in 2017-2018.

Definitions

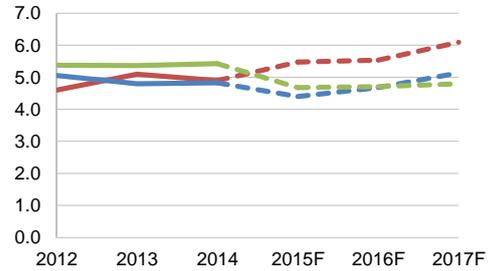
- Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover:** FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FFO profitability:** FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

Orkuveita Reykjavíkur — Utilities Median — Emerging BB Cat Median —

Leverage including Fitch expectations



Interest Cover including Fitch expectations

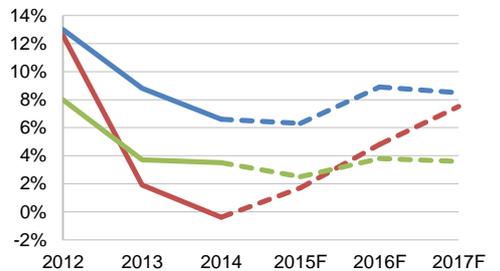


Debt Maturities and Liquidity at 30 Sep 15

Debt maturities	(ISKbn)
2015	4.2
2016	19.3
2017	15.0
2018	15.9
After 2018	115.4
Cash and equivalents	10.9
Undrawn committed facilities (expiry)	8.3

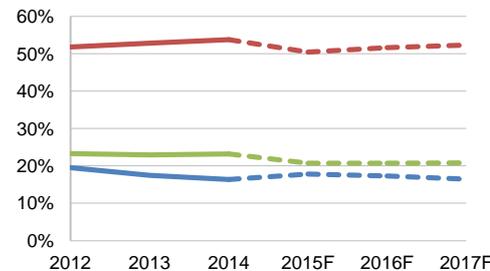
Source: Fitch

Revenue Growth including Fitch expectations



FFO Profitability including Fitch expectations

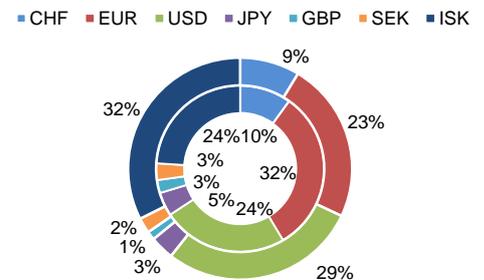
including Fitch expectations



Loan Portfolio and Hedged FX Exposure

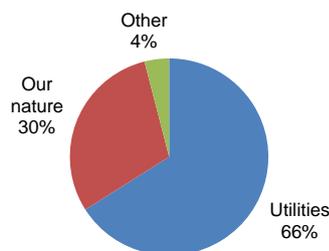
As of 30 September 2015

Inner circle: Exposed loan portfolio
Outer circle: Hedged loan portfolio



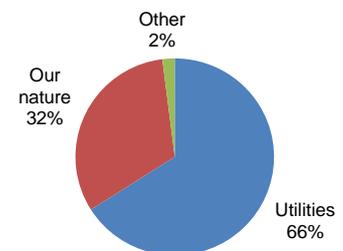
Source: Company

Revenues by Division FY14



Source: Company info

EBITDA by Division FY14

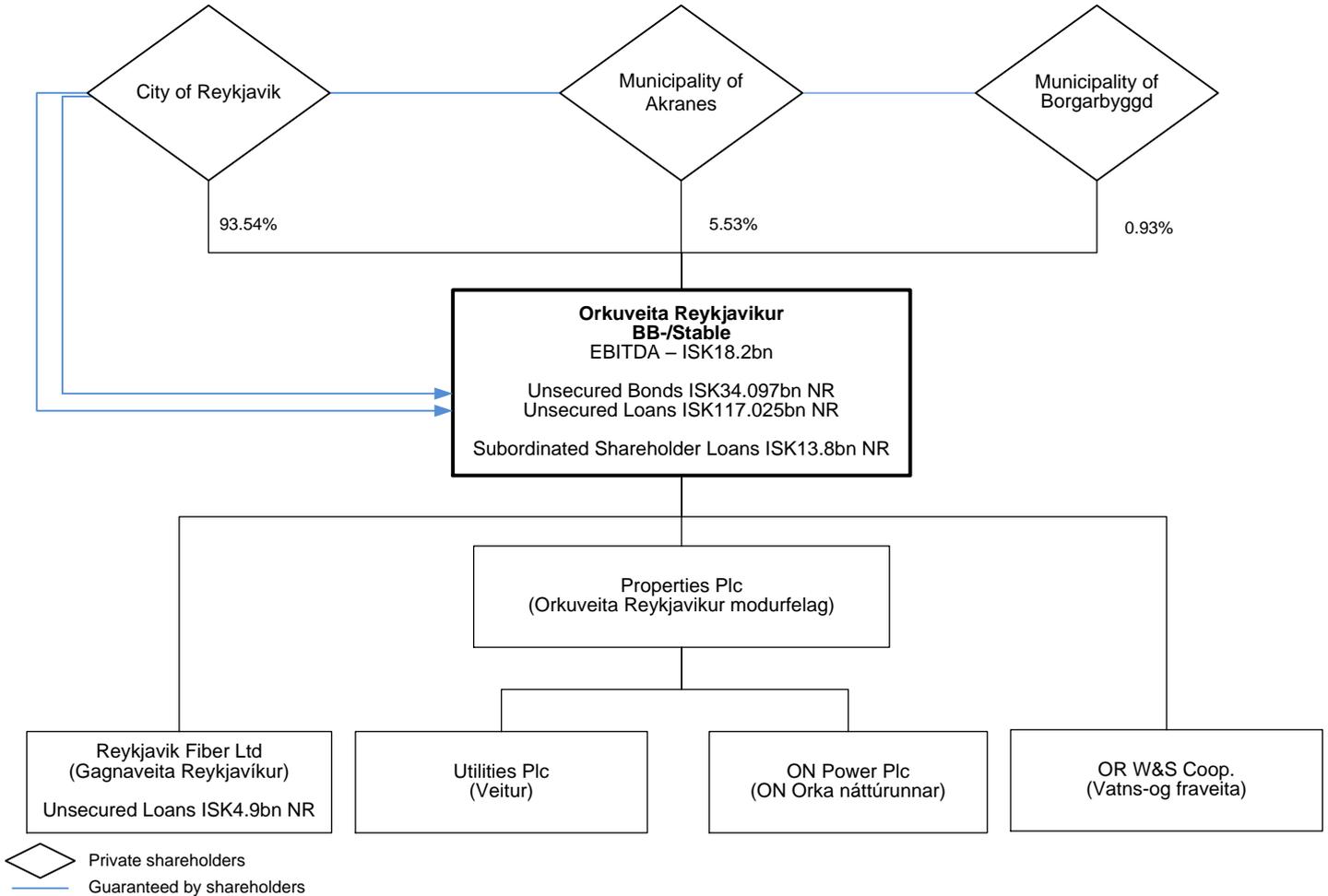


Source: Company info

Group Structure Diagram

Figure 1

Simplified Group & Debt Structure Diagram as at 30 September 2015



Source: Fitch, Company, As at December 2015

Orkuveita Reykjavíkur

FINANCIAL SUMMARY

	31 Dec 2014	31 Dec 2013	31 Dec 2012	31 Dec 2011	31 Dec 2010
	ISKth	ISKth	ISKth	ISKth	ISKth
	Year End				
Profitability					
Revenue	38,448,260	38,587,479	37,863,227	33,626,215	27,915,590
Revenue Growth (%)	(0.40)	1.90	12.60	20.50	0
Operating EBIT	15,614,906	16,534,350	14,631,531	12,354,495	5,988,674
Operating EBITDA	24,767,245	25,461,694	25,002,616	21,235,231	13,951,121
Operating EBITDA Margin (%)	64.40	66.00	66.00	63.20	50.00
FFO Return on Adjusted Capital (%)	9.10	9.20	8.60	7.30	5.00
Free Cash Flow Margin (%)	42.50	42.80	41.60	19.80	(12.90)
Coverages (x)					
FFO Gross Interest Coverage	4.90	5.10	4.60	5.60	4.20
Operating EBITDA/Gross Interest Expense	4.90	5.10	4.60	5.60	4.30
FFO Fixed Charge Coverage (inc. Rents)	4.80	5.00	4.60	5.60	4.20
FCF Debt-Service Coverage	0.90	0.90	0.60	0.50	0.00
Cash Flow from Operations/Capital Expenditures	3.90	5.70	6.00	1.60	0.80
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/Operating EBITDA	7.40	7.70	9.30	10.80	16.10
Total Debt Less Unrestricted Cash/Operating EBITDA	6.90	7.30	9.00	10.80	16.00
Debt Leverage Including Rentals (x)					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	218,157	32,685	0	0	0
Gross Lease Adjusted Debt/Operating EBITDAR	7.40	7.70	9.30	10.80	16.10
Gross Lease Adjusted Debt /FFO+Int+Rentals	7.40	7.80	9.30	10.90	16.40
FFO Adjusted Net Leverage	6.90	7.40	9.00	10.80	16.30
FCF/Lease Adjusted Debt (%)	8.80	8.50	6.80	2.90	(1.60)
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	7.40	7.70	9.30	10.80	16.10
Balance Sheet Summary					
Readily Available Cash	12,147,257	8,993,410	6,885,693	1,652,484	2,343,648
Restricted/Not Readily Available Cash	0	0	0	0	0
Short-Term Debt	19,766,122	19,619,524	29,956,923	16,384,762	17,273,990
Long-Term Senior Debt	164,157,105	175,319,930	201,546,363	213,838,494	207,916,911
Subordinated debt	0	0	0	0	0
Equity Credit	0	0	0	0	0
Total Debt with Equity Credit	183,923,227	194,939,454	231,503,286	230,223,256	225,190,901
Off-Balance-Sheet Debt	1,745,256	261,480	0	0	0
Lease-Adjusted Debt	185,668,483	195,200,934	231,503,286	230,223,256	225,190,901
Fitch- identified Pension Deficit	0	0	0	0	0
Pension Adjusted Debt	185,668,483	195,200,934	231,503,286	230,223,256	225,190,901
Cash Flow Summary					
Operating EBITDA	24,767,245	25,461,694	25,002,616	21,235,231	13,951,121
Gross Cash Interest Expense	(5,079,307)	(4,966,841)	(5,411,118)	(3,777,307)	(3,230,597)
Cash Tax	0	0	0	0	0
Associate Dividends	1,268	52,124	54,475	43,840	16,159
Other Items before FFO (incl. interest receivable)	975,297	(163,296)	(12,718)	(34,866)	(125,659)
Funds from Operations	20,664,503	20,383,681	19,633,255	17,466,898	10,611,024
Change in Working Capital	1,267,494	(350,935)	(698,729)	(536,763)	977,239
Cash Flow from Operations	21,931,997	20,032,746	18,934,526	16,930,135	11,588,263
Total Non-Operating/Non-Recurring Cash Flow	0	0	0	0	0
Capital Expenditures	(5,608,688)	(3,530,173)	(3,172,530)	(10,284,091)	(14,402,796)
Dividends Paid	0	0	0	0	(800,000)
Free Cash Flow	16,323,309	16,502,573	15,761,996	6,646,044	(3,614,533)
Net (Acquisitions)/Divestitures	1,603,807	5,968,478	423,893	761,268	(145,292)
Net Equity Proceeds/(Buyback)	0	0	0	0	0
Other Cash Flow Items	(3,757,042)	16,200,498	(12,232,710)	(13,130,831)	6,052
Total Change in Net Debt	14,170,074	38,671,549	3,953,179	(5,723,519)	(3,753,773)
Working Capital					
Accounts Receivable Days	49	49	43	43	24
Inventory Days	15	15	17	21	11
Accounts Payable Days	72	65	60	77	37

Figure 2
Orkuveita Reykjavíkur — Forecast Financial Information

(ISK 000)	Historical			Fitch forecast		
	31 Dec 12	31 Dec 13	31 Dec 14	31 Dec 15	31 Dec 16	31 Dec 17
Summary income statement						
Gross revenue	37,863,227	38,587,479	38,448,260	39,085,403	40,946,308	44,028,577
Revenue growth (%)	12.6	1.9	-0.4	1.7	4.8	7.5
Operating EBITDA	25,002,616	25,461,694	24,767,245	23,318,368	24,727,469	26,887,936
Operating EBITDA margin (%)	66.0	66.0	64.4	59.7	60.4	61.1
Operating EBITDAR	25,002,616	25,494,379	24,985,402	23,540,140	24,959,800	27,137,756
Operating EBITDAR margin (%)	66.0	66.1	65.0	60.2	61.0	61.6
Operating EBIT	14,631,531	16,534,350	15,614,906	13,530,027	14,545,374	16,257,161
Operating EBIT margin (%)	38.6	42.8	40.6	34.6	35.5	36.9
Gross interest expense	-7,092,787	-6,307,674	-4,574,146	-5,116,653	-6,823,203	-6,796,330
Pretax income	-3,830,455	10,921,715	10,874,711	8,997,723	5,457,220	8,688,990
Summary balance sheet						
Readily available cash	6,885,693	8,993,410	12,147,257	12,809,311	18,066,880	17,326,190
Total debt with equity credit	231,503,286	194,939,454	183,923,227	177,305,353	173,475,608	168,927,211
Total adjusted debt with equity credit	231,503,286	195,200,934	185,668,483	179,079,530	175,334,256	170,925,770
Net debt	224,617,593	185,946,044	171,775,970	164,496,042	155,408,728	151,601,020
Summary cash flow statement						
Operating EBITDA	25,002,616	25,461,694	24,767,245	23,318,368	24,727,469	26,887,936
Cash interest	-5,411,118	-4,966,841	-5,079,307	-4,181,098	-4,440,482	-4,341,227
Implied interest cost (%)	2.3	2.3	2.7	2.3	2.5	2.5
Cash tax				0	0	0
Associate dividends less distributions to NCI	54,475	52,124	1,268	-427,101	-126,272	-431,710
Other items before FFO	-12,718	-163,296	975,297	1,007,667	982,218	940,584
Funds flow from operations	19,633,255	20,383,681	20,664,503	19,717,836	21,142,933	23,055,583
FFO margin (%)	51.9	52.8	53.7	50.4	51.6	52.4
Change in working capital	-698,729	-350,935	1,267,494	1,112,536	8,223	-17,194
Cash flow from operations (Fitch defined)	18,934,526	20,032,746	21,931,997	20,830,372	21,151,157	23,038,388
Total non-operating/non-recurring cash flow						
Capital expenditure	-3,172,530	-3,530,173	-5,608,688			
Capital intensity (capex/revenue) (%)	8.4	9.1	14.6			
Common dividends	0	0	0			
Net acquisitions & divestitures	423,893	5,968,478	1,603,807			
Capex, dividends, acquisitions & oth. items before FCF	-2,748,637	2,438,305	-4,004,881	-11,618,356	-13,169,437	-13,348,957
Free cash flow after acquisitions & divestitures	16,185,889	22,471,051	17,927,116	9,212,015	7,981,720	9,689,431
Free cash flow margin (after net acquisitions) margin (%)	42.7	58.2	46.6	23.6	19.5	22.0
Other investing and financing cash flow items	-12,232,710	16,200,498	-3,757,042	2,000	8,885,309	1,000
Net debt proceeds	1,280,030	-36,563,832	-11,016,227	-8,551,961	-11,609,460	-10,431,121
Net equity proceeds				0	0	0
Total change in cash	5,233,209	2,107,717	3,153,847	662,054	5,257,569	-740,689
Coverage ratios (x)						
FFO interest coverage	4.6	5.1	4.9	5.5	5.5	6.1
FFO fixed charge coverage	4.6	5.0	4.8	5.3	5.3	5.8
Operating EBITDAR/gross interest expense + rents	4.6	5.1	4.7	5.3	5.3	5.9
Operating EBITDA/gross interest expense	4.6	5.1	4.9	5.6	5.6	6.2
Leverage ratios (x)						
Total adjusted debt/operating EBITDAR	9.3	7.7	7.4	7.6	7.0	6.3
Total adjusted net debt/operating EBITDAR	9.0	7.3	6.9	7.1	6.3	5.7
Total debt with equity credit/operating EBITDA	9.3	7.7	7.4	7.6	7.0	6.3
FFO adjusted leverage	9.3	7.8	7.4	7.7	7.1	6.4
FFO adjusted net leverage	9.0	7.4	6.9	7.2	6.3	5.8

How to interpret the forecast presented

The forecast presented is based on the agency's internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch's own internal deliberations, where Fitch, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch may update the forecast in future reports but assumes no responsibility to do so

Source: Fitch

Figure 3
Reconciliation of Key Financial Metrics for Orkuveita Reykjavíkur

(ISK 000)	31 Dec 14	31 Dec 13
Interest bearing loans and borrowings	183,923,227	194,939,454
+ Subordinated debt	0	0
- Equity credit	0	0
= Total debt with equity credit	183,923,227	194,939,454
+ Total off-balance sheet debt (8 x long-term leases)	1,745,256	261,480
= Total lease-adjusted debt (a)	185,668,483	195,200,934
- Cash and equivalents (unrestricted)	12,147,257	8,993,410
= Net lease-adjusted debt (b)	173,521,226	186,207,524
Cash generated by operations	25,000,918	25,088,019
+ Change in working capital	1,267,494	-350,935
- Gross interest paid (c)	-5,079,307	-4,966,841
+ Interest received (d)	741,624	210,379
- Taxation paid	0	0
+ Dividend received from associates (recurring)	0	0
- Dividends paid to minorities	0	0
Cash From Operations (CFO)	21,931,997	20,032,746
- Change in working capital	1,267,494	-350,935
= Funds From Operations (FFO) (e)	20,664,503	20,383,681
Long-term (LT) lease multiple applied	8	8
LT rental expense (f)	218,157	32,685
Preferred dividends paid (g)	0	0
FFO adjusted net leverage (x)		
Net lease-adjusted debt/(FFO + net finance charge + LT leases) (b/(e+(-c-d)+f-g))	6.88	7.40
FFO adjusted gross leverage (x)		
lease-adjusted debt/(FFO + net finance charge + LT leases) (a/(e+(-c-d)+f-g))	7.36	7.75
FFO fixed charge cover (x)		
(FFO + net interest paid + LT leases)/(gross interest paid + LT leases) ((e+(-c-d)+f)/(-c+f))	4.76	5.04
FFO gross interest coverage (x)		
(FFO + net interest)/gross interest ((e+(-c-d))/c)	4.92	5.06

Source: Fitch based on company reports

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