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# Vier Gas Transport GmbH (Open Grid Europe Group)

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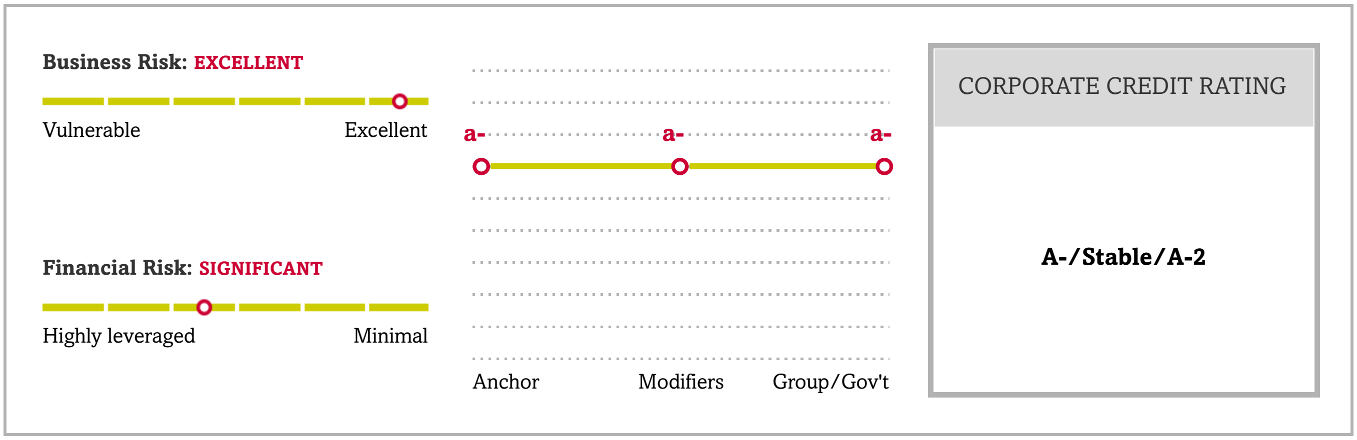


## Rationale

| Business Risk: Excellent | Financial Risk: Significant |
|---|---|
| • Largest gas transmission network and operator in Germany with a natural monopoly position in its service area.<br>• Very low risk and regulated earnings profile.<br>• All earnings generated in Germany, a very low risk country. | • Stable and predictable cash flow generation over the regulatory period.<br>• Relatively high leverage and some cash flow volatility triggered by volume risk.<br>• Long-dated debt, no material maturities until 2020, and strong liquidity. |

**Outlook: Stable**

The stable outlook on Germany-based Open Grid Europe Group (OGE), which comprises holding company Vier Gas Transport GmbH and its subsidiary Open Grid Europe GmbH, reflects S&P Global Ratings' expectation that OGE will maintain sound operating and financial performance over the next two to three years, thanks to OGE's very low risk regulated earnings profile.

According to our base case, we expect that OGE will maintain funds from operations (FFO) to debt of at least 12% on an equally weighted average basis, in line with our low volatility benchmark for a significant financial risk profile. We further expect that the shareholders of OGE are committed to injecting equity or reducing dividend payments to protect credit metrics in case of substantially lower remuneration in the new regulatory period.

### Downside scenario

We could lower the rating if we anticipated a sustained decline in consolidated FFO to debt to less than 12%. This could occur if OGE were unable to control costs due to poor operating performance and materially lower remuneration rates in the new regulatory period, while at the same time there was no capital injection by the shareholders; or if its efficiency factor, as assessed by the Federal Network Agency, were lower than we currently expect.

We could also lower the rating if OGE's business risk profile deteriorated to below our current excellent assessment. This could be triggered by a substantial negative change in the regulatory framework or a shift in the business mix toward what we regard as riskier industries and countries. However, we view this as very unlikely at the moment.

### Upside scenario

A positive rating action could result from a sustained improvement in credit metrics, such that the adjusted weighted-average FFO-to-debt ratio reached at least 15% and the financial risk profile improved to intermediate. Such a development could result from lower dividend payments and capital expenditures (capex), which would in turn lead to a reduction in adjusted debt. We do not see upside rating potential stemming from the business risk profile, given that we already regard it as excellent.

## Standard & Poor's Base-Case Scenario

**Assumptions**

- Increasing capex, in line with OGE's revised network development plan of €300 million-€450 million per year over the next three years.
- Negative discretionary cash flow from 2017.
- An increasing regulated asset base, in line with higher growth investments.
- Lower remuneration rates for the new regulatory period starting in 2018.
- A positive contribution from efficiency measures.

**Key Metrics**

| | 2014a | 2015a | 2016f | 2017f |
|---|---|---|---|---|
| FFO/debt(%)* | 17.3 | 11.5 | About 12 | >12 |
| Capex (mil. €)* | 173 | 199.7 | 270-300 | 430-450 |
| DCF | Positive | Positive | Neutral | Negative |
| Debt/EBITDA(x)* | 4,4 | 6.5 | 5-5.5 | 6.5 |

*Fully adjusted by S&P Global Ratings. a--Actual. f--Forecast. Capex--Capital expenditures. DCF--Discretionary cash flow.

## Company Description

OGE consists of the holding company Vier Gas Transport GmbH and its subsidiary Open Grid Europe GmbH, including the shareholdings in pipeline companies. The group provides natural gas transmission and associated services primarily in Germany.

The company transmits about 70% of Germany's annual gas volume through its network, which is about 12,000 kilometers long. Its pipeline systems connect the border-crossing points to cities, municipalities, and industrial users in German regions and to pipeline systems of neighboring countries, such as The Netherlands, Belgium, France, Switzerland, Austria, and Czech Republic.

Founded in 2004 as E.ON Gastransport GmbH, OGE took on its new name in September 2010, and is based in Essen, Germany.

## Business Risk: Excellent

Our assessment of OGE's business risk profile reflects the company's natural monopoly position in its service area and, in our view, very low risk regulated gas transmission activities and a strong regulatory framework. In our opinion, regulated operations generally present low operation risk and predictable revenue streams. Moreover, we regard country risk as very low for companies operating in Germany.

Additionally, our assessment is underpinned by our view of OGE's strong competitive position. The group has a monopolistic market position in its service area and operates in an incentive-based regulation framework with a revenue cap, which allows relatively stable and predictable revenues and EBITDA over the five-year regulatory period. The current regulatory framework was introduced in 2010 and, in our view, increasingly supports operators' credit profiles. We view the regulatory advantage as strong for Germany's regulated gas transmission operators. We do not expect any fundamental changes of the regulatory framework for the new regulatory period starting in 2018. OGE is exposed to volume risk, but if its revenues fall short of, or exceed, the revenue cap, the deficit or surplus is offset by the regulatory account mechanism, either with a two-year time lag when the difference exceeds 5% of allowed revenues or in the next regulatory period if the difference is below 5%. Nevertheless, in our view, profitability can be more volatile than peers' over the short term.

## S&P Global Ratings' Base-Case Operating Scenario

- No material impact from economic developments in Germany or other countries in Europe, given the regulatory framework OGE operates under.
- Only a short-term impact from volume fluctuations, which could stem from economic developments or which are weather related, because the regulatory account mechanism compensates for shortfalls or surpluses.
- High visibility for the regulatory period ending in 2017.
- For the third regulatory period starting 2018, we do not expect any material changes to the regulatory framework that could change our assessment of a strong regulatory advantage.
- The remuneration rates for excess equity, new assets, and old assets are likely to be significantly lower than in the current regulatory period.
- An operating efficiency factor of 100% during the second and third regulatory periods.

## Peer comparison

**Table 1**

**Open Grid Europe Group -- Peer Comparison***

| | Open Grid Europe Group | TenneT Holding B.V. | N.V. Nederlandse Gasunie | National Grid PLC | Thyssengas |
|---|---|---|---|---|---|
| Rating as of June 3, 2016 | A-/Stable/A-2 | A-/Stable/A-2 | AA-/Stable/A-1+ | A-/Stable/A-2 | A/Stable/-- |
| **(Mil. €)** | **--Fiscal year ended--** | | | | |
| | **Dec. 31, 2015** | | | **March 31, 2015** | **Dec. 31, 2014** |
| Revenues | 885.7 | 2,844.0 | 1,631.0 | 21,012.3 | 233.1 |
| EBITDA | 392.9 | 1,045.0 | 1,141.0 | 7,695.6 | 125.8 |
| Funds from operations (FFO) | 292.0 | 751.7 | 885.2 | 5,582.8 | 83.9 |
| Net income from cont. oper. | 101.7 | 28.0 | 552.9 | 2,790.9 | 30.5 |
| Cash flow from operations | 300.3 | 1,245.7 | 847.4 | 6,332.0 | 41.0 |
| Capital expenditures | 199.7 | 2,489.0 | 349.7 | 4,538.1 | 48.4 |
| Free operating cash flow | 100.6 | (1,243.3) | 497.7 | 1,793.9 | (7.3) |
| Discretionary cash flow | 87.8 | (1,388.8) | 135.6 | (33.1) | (7.3) |
| Cash and short-term investments | 149.7 | 3.0 | 64.7 | 1,528.8 | 26.4 |
| Debt | 2,540.5 | 5,549.4 | 4,069.2 | 37,069.6 | 381.3 |
| Equity | 859.5 | 3,918.0 | 5,717.5 | 18,003.1 | (52.5) |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 44.4 | 36.7 | 70.0 | 36.7 | 53.9 |
| Return on capital (%) | 5.4 | 3.2 | 8.5 | 9.4 | 17.7 |
| EBITDA interest coverage (x) | 5.6 | 6.7 | 7.9 | 4.7 | 6.3 |
| FFO cash int. cov. (X) | 5.6 | 5.9 | 7.0 | 6.7 | 8.2 |
| Debt/EBITDA (x) | 6.5 | 5.3 | 3.6 | 4.8 | 3.0 |
| FFO/debt (%) | 11.5 | 13.5 | 21.8 | 15.1 | 22.0 |
| Cash flow from operations/debt (%) | 11.8 | 22.4 | 20.8 | 17.1 | 10.8 |

**Table 1**

| Open Grid Europe Group -- Peer Comparison* (cont.) | | | | | |
|---|---|---|---|---|---|
| Free operating cash flow/debt (%) | 4.0 | (22.4) | 12.2 | 4.9 | (1.9) |
| Discretionary cash flow/debt (%) | 3.5 | (25.0) | 3.3 | (0.1) | (1.9) |

*Figures are consolidated group figures at the Vier Gas Transport GmbH level.

## Financial Risk: Significant

OGE generates low-risk, stable, and predictable cash flows over the regulatory period, and has relatively high debt, so we regard its financial risk profile as significant. In line with OGE's revised network development plan, we expect a notable increase of capex from 2016 onward. That said, in our base case we forecast an increase in adjusted debt over the next two to three years compared with the past two years, and adjusted FFO to debt of more than 12% on a weighted basis for the 2014-2018 period.

In our ratio calculation, we apply the same weights to the figures in each of the five years to capture volatility during the regulatory period, for example, due to the regulatory account mechanism. We use the low volatility table in our corporate methodology to assess OGE's financial risk profile because the majority of OGE's EBITDA stems from regulated activities, which we consider to have a strong regulatory advantage.

### S&P Global Ratings' Base-Case Cash Flow And Capital Structure Scenario

- Negative discretionary free operating cash flow in 2017 and 2018, reflecting higher capex from 2016.
- Adjusted weighted-average FFO to debt remaining higher than 12% over 2014-2018, with some volatility triggered by swings within the regulatory account.
- Debt to EBITDA ranging between 5x and 5.6x through 2017.
- In case of notable lower remuneration for the third regulatory period, an equity measure by its shareholders in order to maintain an FFO-to-debt ratio of at least 12% on an equal weighted basis, either via reduction in dividend payments or equity injection.

### Financial summary

**Table 2**

| Open Grid Europe Group -- Financial Summary* | | | |
|---|---|---|---|
| | --Fiscal year ended Dec. 31-- | | |
| | **2015§** | **2014** | **2013** |
| **Rating history** | A-/Stable/A-2 | A-/Stable/A-2 | A-/Stable/A-2 |
| **(Mil. €)** | | | |
| Revenues | 885.7 | 1,017.3 | 1,033.4 |
| EBITDA | 392.9 | 539.3 | 502.1 |
| Funds from operations (FFO) | 292.0 | 413.6 | 428.5 |
| Net income from continuing operations | 101.7 | 225.2 | 86.5 |
| Cash flow from operations | 300.3 | 380.3 | 456.5 |
| Capital expenditures (capex) | 199.7 | 172.6 | 193.9 |
| Free operating cash flow (FOCF) | 100.6 | 207.7 | 262.6 |

**Table 2**

**Open Grid Europe Group -- Financial Summary* (cont.)**

| | --Fiscal year ended Dec. 31-- | | |
|---|---|---|---|
| | **2015§** | **2014** | **2013** |
| **Rating history** | A-/Stable/A-2 | A-/Stable/A-2 | A-/Stable/A-2 |
| **(Mil. €)** | | | |
| Dividends paid | 12.8 | 143.9 | 324.5 |
| Discretionary cash flow (DCF) | 87.8 | 63.8 | (61.9) |
| Debt | 2,540.5 | 2,396.3 | 2,479.0 |
| Preferred stock | 0.0 | 0.0 | 0.0 |
| Equity | 859.5 | 897.2 | 772.0 |
| Debt and equity | 3,400.0 | 3,293.5 | 3,251.0 |
| **Adjusted ratios** | | | |
| EBITDA margin (%) | 44.4 | 53.0 | 48.6 |
| EBITDA interest coverage (x) | 5.6 | 7.5 | 7.5 |
| FFO cash int. cov. (x) | 5.6 | 7.0 | 17.3 |
| Debt/EBITDA (x) | 6.5 | 4.4 | 4.9 |
| FFO/debt (%) | 11.5 | 17.3 | 17.3 |
| Cash flow from operations/debt (%) | 11.8 | 15.9 | 18.4 |
| FOCF/debt (%) | 4.0 | 8.7 | 10.6 |
| DCF/debt (%) | 3.5 | 2.7 | (2.5) |
| Net cash flow/capex (%) | 139.8 | 156.3 | 53.6 |
| Return on capital (%) | 5.4 | 9.7 | 9.5 |

*Figures are consolidated group figures at the Vier Gas Transport GmbH level. §Change in accounting method relating to consolidation of sales and cost of materials.

## Liquidity: Strong

We assess OGE's consolidated liquidity position as strong, supported by our view that its liquidity resources will exceed its funding needs bymore than 1.5x in the next 12 months and by more than 1.0x in the following 12 months. OGE's liquidity profile is further supported by its well-established relationships with its core banks and generally high standing in the credit markets.

| Principal Liquidity Sources | Principal Liquidity Uses |
|---|---|
| • Reported access to unrestricted cash and short-term marketable securities of about €210 million on March 31,2016<br>• Positive cash flow generation of around €300 million annually for the next 24 months.<br>• Access to revolving credit facilities totaling about €219 million, of which about €19 million mature in July 2017 and €200 million mature in December 2018. | • Debt maturities of about €46 million in the next 12 months and about €48 million the following 12 months.<br>• Capex of about €320 million in the next 12 months and about €440 million in the following 12 months.<br>• Cash dividend payments of about €44 million in 2016 and about €57 million in 2017. |

### Debt maturities

- 2016: €46 million
- 2017: €48 million
- 2018: €0 million
- 2019: €105 million
- Thereafter 2019: €2.301 billion

## Ratings Score Snapshot

### Corporate Credit Rating

A-/Stable/A-2

### Business risk: Excellent

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Strong

### Financial risk: Significant

- **Cash flow/Leverage:** Significant

### Anchor: a-

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

# Reconciliation

**Table 3**

**Reconciliation Of Open Grid Europe Group Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)***

| | --Fiscal year ended Dec. 31, 2015-- | | | | | |
|---|---|---|---|---|---|---|
| **Open Grid Europe Group reported amounts** | | | | | | |
| | **Debt** | **EBITDA** | **Operating income** | **Interest expense** | **EBITDA** | **Cash flow from operations** |
| Reported | 2,524 | 351 | 197 | 64 | 351 | 322 |
| **S&P Global Ratings' adjustments** | | | | | | |
| Interest expense (reported) | -- | -- | -- | -- | (64) | -- |
| Interest income (reported) | -- | -- | -- | -- | 1 | -- |
| Current tax expense (reported) | -- | -- | -- | -- | (32) | -- |
| Operating leases | 38 | 19 | 3 | 3 | 16 | 16 |
| Postretirement benefit obligations/deferred compensation | 69 | 2 | 2 | 3 | (1) | 25 |
| Surplus cash | (150) | -- | -- | -- | -- | -- |
| Dividends received from equity investments | -- | 21 | -- | -- | 21 | -- |
| Asset retirement obligations | 60 | -- | -- | -- | -- | 2 |
| Non-operating income (expense) | -- | -- | 7 | -- | -- | -- |
| Reclassification of interest and dividend cash flows | -- | -- | -- | -- | -- | (65) |
| Total adjustments | 17 | 42 | 11 | 6 | (59) | (21) |
| **S&P Global Ratings' adjusted amounts** | | | | | | |
| | **Debt** | **EBITDA** | **EBIT** | **Interest expense** | **Funds from operations** | **Cash flow from operations** |
| Adjusted | 2,541 | 393 | 208 | 70 | 292 | 300 |

*Figures are consolidated group figures at the Vier Gas Transport GmbH level.

# Related Criteria And Research

## Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Business And Financial Risk Matrix

| | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| **Business Risk Profile** | Minimal | Modest | Intermediate | **Significant** | Aggressive | Highly leveraged |
| **Excellent** | aaa/aa+ | aa | a+/a | **a-** | bbb | bbb-/bb+ |
| Strong | aa/aa- | a+/a | a-/bbb+ | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| Fair | bbb/bbb- | bbb- | bb+ | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |

## Ratings Detail (As Of June 3, 2016)

| | |
|---|---|
| **Open Grid Europe Group** | |
| Corporate Credit Rating | A-/Stable/A-2 |
| Senior Unsecured | A- |
| Short-Term Debt | A-2 |
| **Corporate Credit Ratings History** | |
| 15-Feb-2013 | A-/Stable/A-2 |

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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