# Vier Gas Transport 'BBB+/A-2' Ratings Affirmed Despite Accelerating Investments In Hydrogen Assets; Outlook Stable

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## Rating Action Overview

- We expect Vier Gas Transport GmbH (VGT), the parent company of the Germany-based gas transmission system operator (TSO) Open Grid Europe GmbH (OGE), to continue to benefit from stable, fully regulated activities under the supportive gas transmission framework in Germany, offsetting risks associated with uncertainties associated with the longer-term economics of the hydrogen investment.
- While the amended Energy Industry Act has established a cost-plus remuneration for hydrogen with a return on equity (ROE) at 6.69%, offering clarity for hydrogen investments, we recognize that residual risks associated with hydrogen grids will persist in the long term. VGT's future business outlook is closely tied to the hydrogen economy in Germany successfully developing, which is advancing more slowly than expected.
- We expect that VGT will generate S&P Global Ratings-adjusted funds from operations (FFO) to debt of 10%-11% over 2025-2027 on a regulatory accounting basis, driven by accelerating investments in hydrogen assets, with total capital expenditures (capex) of nearly €3 billion over 2025-2027.
- We anticipate VGT will continue to benefit from stable regulated earnings from natural gas transmission operations, with the regulatory account mechanism mitigating volume and commodity risks over time.
- Therefore, we affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on VGT and our 'BBB+' issue rating on VGT's debt.
- The stable outlook indicates that we expect VGT's FFO to debt will remain at an average of 10%-11% over the next two years based on regulatory accounting, in line with the 10%-13% range we view as commensurate with the current rating.

# Rating Action Rationale

**We expect VGT's adjusted FFO to debt (adjusted for the regulatory accounting effects) will remain at 10%-11% over 2025-2027, at the low end of the 10%-13% range we view as commensurate with the rating.** This mainly stems from rising investments in natural gas and hydrogen assets, the latter of which is expected to spike to above €1 billion in 2027. We expect capex to increase to more than €650 million in 2025 and to above €1.3 billion in 2027 from about €400 million in 2023-2024, before gradually normalizing to €500 million-€650 million in 2028-2029. This is well above our previous expectations. In addition to continued high capex to integrate liquefied natural gas pipelines into the natural gas grid in the near term, capex will significantly increase and peak in 2027, reflecting the ramp-up of the hydrogen core grid, which has been approved by the national regulator (Bundesnetzagentur, or BNetzA). As prescribed in the German Energy Act, more than 9,000 kilometers (km) of hydrogen pipelines until 2032 with 101 gigawatt (GW) entry and 87 GW exit capacity and a total investment of about €19 billion should be constructed, of which OGE has already committed about €2 billion and will potentially shoulder about 25% of the total hydrogen core grid investment. We understand that as the largest gas TSO, OGE is involved in developing the most relevant import corridors to cover the German hydrogen demand in medium to long term.

**We forecast VGT's adjusted EBITDA (factoring in the regulatory accounting effects) will gradually increase from about €550 million in 2025 to €650 million-€750 million in 2026-2027.** This growth trajectory reflects the increasing regulated asset base because of investments in both natural gas and the hydrogen network. Excess revenues of €458 million in 2023 driven by much lower fuel energy costs will be returned over 2026-2028, and revenue shortfall of €155 million in 2024 due to lower transport revenue will be recovered over 2027-2029. This is related to the accounting treatment of regulatory effects under International Financial Reporting Standards (IFRS). For VGT, we focus on metrics adjusted for these regulatory accounting effects, which are much less volatile than IFRS numbers. On the regulatory accounting basis, FFO to debt increased to 14.4% in 2024. Although substantial capex, mostly in less favorably regulated hydrogen transportation activities, will constrain this metric over 2025-2027, increasing revenue from hydrogen core grid, combined with declining investments, is likely to result in improving headroom under the FFO-to-debt ratio from 2028.

**The established regulatory framework with set parameters for German natural gas TSOs ensures relatively high visibility in VGT's earnings, especially for the current regulatory period until 2027.** We understand that all key parameters for cost base and revenue cap have been determined for the fourth regulatory period (2023-2027). The German regulator BNetzA is running an initiative to modernize the regulatory framework from 2028, the start of the fifth regulatory period. Key proposed changes include the transition to a simplified weighted average cost of capital (WACC) approach from the current rate-of-return model, which is commonly used internationally and can improve the transparency to investors. The credit impact depends on the level of WACC to be determined. There will also be an option for operators to choose shortened useful lives for historical gas assets from 2026, mitigating stranded asset risk, which we view as credit positive. OGE has a proven track record regarding the acknowledgement of its cost base and efficiency score.

**We note positively that the German government has approved the amended Energy Industry Act, providing clarity on the regulatory framework for the hydrogen core grid, which is weaker than the regulation for gas transmission, in our view.** While we acknowledge the advancement of the hydrogen regulation in Germany as positive, we also note that the absence of a track record and the residual risks are relative weaknesses for the hydrogen regulation compared with gas transmission. Once hydrogen-related profits become material, we will re-assess the business positioning of VGT.

Hydrogen core network operators, including OGE, will be subject to cost-plus based regulation following an annual cost coverage principle (yearly cost application and approval by BNetzA). Pre-tax ROE for new assets is fixed at 6.69% until 2027. The financing model follows a gap funding methodology based on the so-called amortization account. As laid out in WANDA (that establishes rules to regulate tariffs for the hydrogen core network), all hydrogen core grid operators in Germany are subject to unified grid tariffs (postage stamp) with tariff cap, which will be set below annual costs in early years to attract customers and facilitate the ramp-up of hydrogen market. The gap between the ramp-up tariff cap set by BNetzA and the actual effective costs of operators will be booked in the amortization account, which will be financed by KfW, backed by a state guarantee. First offset payments occurred in March 2025. In this way, operators’ liquidity and returns are secured in the ramp-up phase.

With gradually increasing capacity bookings, operators’ revenue will also increase. As soon as revenues exceed the annual costs, hydrogen network operators will start returning the positive gap and reducing the deficit in the amortization account built up in previous years. The final settlement of the amortization account is set for 2055. In case of stranded investments caused by slower or even a failure of hydrogen ramp-up, network operators will have to cover 24% of the negative balance of the amortization accounts at the end of 2055, with the remainder covered by the state. The maximum deductible of 24% reduces by 0.5% for each year backward from 2055 in case of early cancellation through the German state, which is possible for the first time in 2039 with 16% to be borne by operators. According to the scenario analysis done by BNetzA as stated in WANDA, a balancing of the amortization account can be achieved between 2044 and 2054 with a tariff cap at the level of €15-€20 per kilowatt-hours per hour per annum (/kWh/h/a). The current proposal of €25 /kWh/h/a indicates low stranded asset risks.

**The gas transmission sector is maturing and opportunities for regulated investments are declining in the long term.** We think that the moderate and gradual decrease in demand for fossil gas from the residential and industrial sectors that we expect through 2030, followed by a sharp decline, reflect the sector’s gradual but predictable maturity. We expect that this will reduce opportunities for regulated investments in natural gas and consider gas TSOs’ business prospects to be weaker relative to those of power TSOs. As this trend accelerates, we anticipate many gas operators will need to invest to develop new business, like hydrogen, with growth potential. We note that Germany is a pioneer in Europe in setting up a regulatory framework for the hydrogen grid.

**We expect VGT’s financial policy to support the ‘BBB+’ rating**. Our rating factors in management’s strong commitment to the current rating. We expect dividend policy and financial risk management to remain prudent. The shareholder consortium includes long-term infrastructure and strategic investors with the proven flexibility in the past to adjust dividends in case support is needed for the company’s operations and investment activities.

# Outlook

The stable outlook reflects our view that VGT will continue to benefit from stable, fully regulated activities under the supportive gas transmission framework in Germany, offsetting risks associated with uncertainties associated with the longer-term economics of the hydrogen investment. As the regulatory returns over 2024-2027 are set, we expect the company to sustain FFO to debt of 10%-11% over the next two years despite increasing investments.

### Downside scenario

We could downgrade VGT if the company's FFO to debt on a regulatory accounting basis decreased below 10% without a clear prospect of a swift recovery. Downside rating pressure could emerge from a change in VGT's financial policy as reflected in increased dividend payments, which we do not anticipate at this stage, as the company has a track record of committing to its financial policy. Pressure could also emerge from the risks related to hydrogen investments. For example, if hydrogen-related earnings were to represent a material share of the company's earnings or should there be a significant setback or even a failure in ramping up the hydrogen economy in Germany.

### Upside scenario

We see an upgrade of VGT as unlikely as it would require excellent predictability of future business prospects, including those related to hydrogen infrastructure, and FFO to debt adjusted from regulatory accounting effects sustainably above 13%. We see this scenario as unlikely over the next two years given high growth capex dedicated to hydrogen core grid in Germany. In the long term, upside potential could stem from supportive investment stimulus and a successful and timely ramp-up of the hydrogen economy. This effectively removes the residual risks in the German regulatory framework for hydrogen infrastructure, therefore we view it as equivalent in strength to current fossil gas regulation.

## Company Description

VGT is the parent company of OGE, the largest of Germany's 15 gas TSOs. Through OGE, the company designs, constructs, operates, and markets gas transmission networks. On average, over 85% of VGT's revenues came from its gas transportation business, with services to pipeline companies and third parties accounting only for less than 15%.

OGE transmits gas through its 12,000-km network, making it the largest supra-regional pipeline network in Germany. Its pipeline systems connect the border-crossing points to cities, municipalities, and industrial users in Germany and to pipeline systems of neighboring countries, such as the Netherlands, Belgium, France, Switzerland, Austria, and the Czech Republic.

The Vier Gas Transport Group comprises VGT (the parent), its subsidiary OGE, and its equity investments, which include several gas transmission assets with different levels of ownership. VGT largely performs a holding company function for OGE. Vier Gas Services GmbH & Co. KG is the sole shareholder of VGT. It is a long-term investment consortium that includes British Columbia Investment Management Corp. (32.15%), Abu Dhabi Investment Authority (ADIA, 24.99%), Fluxys Belgium S.A. (24.13%), and Munich Reinsurance Co. (18.73%). Snam International B.V. has agreed to acquire ADIA's stake in VGT, which is still subject to regulatory approval and the fulfilment of customary contractual conditions. Snam and Fluxys have also entered into an agreement, which will result in both parties holding an equal share (approximately 24.5%) after the completion of Snam's share acquisition.

# Our Base-Case Scenario

## Assumptions

- ROE of 5.07% on new gas assets and of 3.51% on old assets over the 2023-2027 regulatory period. We assume a general productivity factor of 0.87% and factor in an individual efficiency score of 100%.
- Pre-tax ROE of 6.69% for hydrogen assets.
- Annual capital cost allocation adjustment under the 2023-2027 regulatory period.
- EBITDA margins declining to 33%-34% over 2024-2026, including a temporary improvement to about 40% in 2025, mostly due to regulatory accounting effects and the new regulatory period.
- Capex of €412 million in 2024, increasing to above €650 million in 2025, and up to about €900 million in 2026 and over €1.3 billion in 2027, leading to negative free operating cash flow over 2025-2027.
- Net dividend distribution (after shareholder contribution) of €149 million in 2024, down to about €100 million annually over 2025-2027.

## Key metrics

**Vier Gas Transport GmbH--Forecast summary**

| Period ending | Dec-31-2023 | Dec-31-2024 | Dec-31-2025 | Dec-31-2026 | Dec-31-2027 |
|---|---|---|---|---|---|
| (Mil. EUR) | 2023a | 2024a | 2025e | 2026f | 2027f |
| Revenue | 1,648 | 1,133 | 1,300-1,400 | 1,250-1,350 | 1,450-1,550 |
| EBITDA | 944 | 434 | 500-600 | 450-550 | 600-700 |
| Funds from operations (FFO) | 787 | 266 | 350-450 | 250-350 | 400-500 |
| Capital expenditure (capex) | 387 | 413 | 650-750 | 850-950 | 1,300-1,400 |
| Free operating cash flow (FOCF) | 437 | (131) | (300)-(200) | (450)-(550) | (950)-(850) |
| Debt | 3,090 | 3,390 | 3,500-4,000 | 4,000-4,500 | 5,000-5,500 |
| **Adjusted ratios** | | | | | |
| Debt/EBITDA (x) | 3.3 | 7.8 | 6.0-6.5 | 8.0-8.5 | 7.5-8.5 |
| FFO/debt (%)§ | 10.3 | 14.4 | 10-11 | 10-11 | 10-11 |
| FFO cash interest coverage (x) | 8.5 | 4.1 | 4.5-5.0 | 3.5-4-0 | 4.0-4.5 |
| FOCF/debt (%) | 14.1 | (3.9) | (10)-(5) | (15)-(10) | (20)-(15) |

All figures are adjusted by S&P Global Ratings, unless stated as reported. §Excluding the regulatory accounting effects, meaning without the temporary effect on earnings stemming from volume, price, or changes in operating costs that lead to over- or under-shooting under IFRS accounting. a--Actual. e--Estimate. f--Forecast. EUR--euro. FOCF--Free operating cash flow.

# Liquidity

We now assess VGT’s liquidity as adequate as we forecast liquidity sources will cover uses by about 1.2x over the next 12 months from April 1, 2025. VGT successfully issued a €500 million seven-year bond in November 2024 to prefund its €750 million bond maturity in June 2025.

VGT's syndicated revolving credit facility (RCF) of €600 million remains undrawn, which the company extended to 2029 with another one-year extension option. In addition, the company has a €500 million commercial paper program in place. Beside the €750 million bond due in 2025, there is no major debt maturity until 2027 when a €500 million bond becomes due.

### Principal liquidity sources

- Unrestricted cash and short-term marketable securities of about €532 million as of the end of March 2025, in addition to a €250 million term deposits maturing in May 2025;
- Availability under RCFs totaling about €658 million; and
- Cash FFO of about €400 million-€450 million.

### Principal liquidity uses

- About €775 million short-term maturity, mainly composed of the €750 million bond due in June;
- Capex of €650 million-€900 million;
- Net cash dividend payments of about €100 million; and
- Minor working capital outflow.

## Issue Ratings--Subordination Risk Analysis

### Capital structure

As of Dec. 31, 2024, VGT's capital structure mainly consists of:

- €3.7 billion in bonds issued at the VGT level; and
- €439 million bank loans at the pipeline company level, which is reported at pro rata share (51%).

### Analytical conclusions

We rate VGT's debt at 'BBB+', in line with the issuer credit rating, as we think that the debt sitting at pipeline companies does not represent a material disadvantage to VGT bondholders.

## Rating Component Scores

**Rating Component Scores**

| Component | |
|---|---|
| Foreign currency issuer credit rating | BBB+/Stable/A-2 |
| Local currency issuer credit rating | BBB+/Stable/A-2 |
| Business risk | Excellent |
| Country risk | Very low |
| Industry risk | Very low |
| Competitive position | Strong |
| Financial risk | Significant |
| Cash flow/leverage | Significant (low volatility table) |
| Anchor | a- |
| Diversification/portfolio effect | Neutral/Undiversified |
| Capital structure | Neutral |
| Financial policy | Neutral |
| Liquidity | Adequate |
| Management and governance | Neutral |
| Comparable rating analysis | Negative |
| Stand-alone credit profile | bbb+ |

# Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

# Related Research

- German Electricity And Gas Preliminary Regulatory Advantage Assessment: Strong, May 19, 2025
- Snam Ratings Raised To ‘A-’ On Sovereign Upgrade; Outlook Negative On Reduced Financial Headroom, April 15, 2025
- Industry Credit Outlook 2025: EMEA Utilities, Jan. 14, 2025
- Tear Sheet: Vier Gas Transport GmbH, Oct. 24, 2024

# Ratings List

| **Ratings list** | |
|---|---|
| **Ratings Affirmed** | |
| **Vier Gas Transport GmbH** | |
| Issuer Credit Rating | BBB+/Stable/A-2 |
| Senior Unsecured | BBB+ |