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Vier Gas Transport GmbH

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Table Of Contents

Credit Highlights

Outlook

Our Base-Case Scenario

Company Description

Business Risk

Financial Risk

Liquidity

Environmental, Social, And Governance

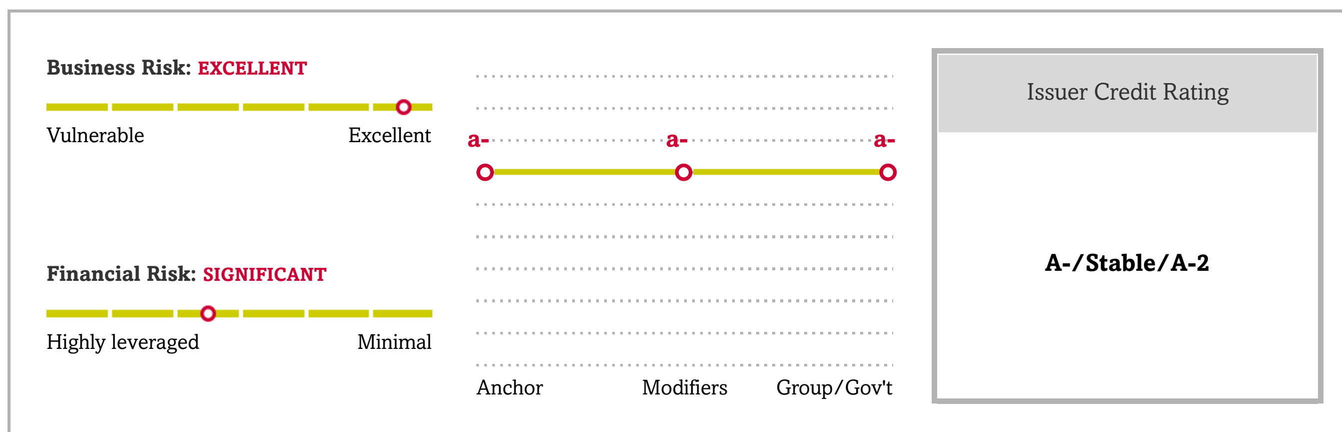
Issue Ratings - Subordination Risk Analysis

Reconciliation

Ratings Score Snapshot

Related Criteria

Vier Gas Transport GmbH



Credit Highlights

Overview

Key strengths	Key risks
Operations focused on low-risk regulated gas transmission operations in Germany, which has a supportive regulatory framework	Our expectation of weaker credit metrics, mostly toward the end of the regulatory period, due to lower operating expenditure remuneration on expansion investments
Largest gas transmission network and operator in Germany (out of 16) with a natural monopoly position in its service area	Intensive capital expenditure and dividend distributions, which will depress VGT Group's cash flows, increasing leverage over the next two years
The Network Development Plan, which supports OGE's grid expansion, an advantage compared to what we observe for other gas TSOs in Europe with more limited growth	Long-term prospects for gas infrastructure likely to moderate, leaving VGT Group in need to start looking for new sources of growth to remain relevant
Track record of prudent financial management and flexible financial policy	

Note: In this report, we refer to Vier Gas Transport GmbH (VGT Group) as the holding company owning Open Grid Europe GmbH (OGE), the group's operating subsidiary in charge of gas transmission networks in Germany. Financial metrics correspond to the VGT Group's consolidated accounts.

Lower investment measures operating expenditures lump sum allowances will hurt profitability. We estimate that the total effect on VGT Group's EBITDA will be about €140 million spread across the remaining of the regulatory period that runs until 2022. This is a change from our previous base case, and will depress credit metrics over the next two-to-three years. In the context of the Network Fee Modernization Law, the German regulator, Bundesnetzagentur (BNetzA), revised some components of the investment measures (IMA) remuneration for transmission systems operators (TSOs), including OGE. The change entails a revision of operating expenses' lump-sum remuneration during construction and hence reducing profitability starting Jan. 1, 2020. This affects the group because 55%-60% of its capital expenditure (capex) falls under such measures.

In addition, large capex needs paired with dividend distributions will consume VGT Group's cash resources and increase funding needs. The group continues to execute an intensive capex agenda, mostly related to expansion investments and adapting its grid to changes to regional gas mix availability. Capex for the rest of the regulatory period running until the end of 2022 totals €1.14 billion, out of which we expect €430 million will come in 2020 and €380 million in 2021. We believe that this, coupled with dividend distributions of €120 million in 2020 and €90 million in

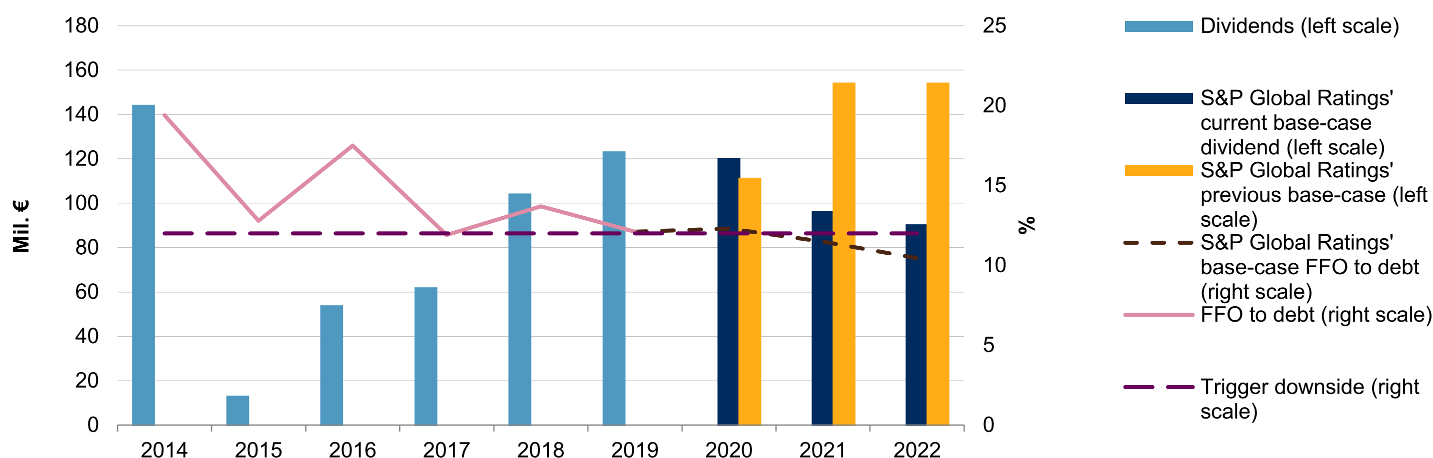
2021, will result in negative discretionary cash flow that increase the company's leverage.

Our base-case scenario forecasts for funds from operations (FFO) to debt remaining slightly above 12% in 2020. We see a risk, however, that FFO to debt, on average, could trend to below 12% over the rest of the regulatory period, as changes in the IMA opex remuneration and high capex increase leverage. We perceive management financial planning as conservative, because it often has performed above expectations and we have track record of VGT Group's prudent financial policy (see chart 1); we are now giving credit to this track record in 2020. Therefore, we expect management to introduce measures such as lower dividends that could help ratios to withstand downward pressurestarting in 2021. The company has scaled back dividends before to protect its financial position, notably in 2015-2017. In our opinion, this shows VGT Group's flexible dividend policy. Moreover, we understand the elevated capex program is mainly driven by the requirements of the German Network Development Plan (Netzentwicklungsplan) and hence should create regulated assets crucial for European energy transition. Therefore, these assets should allow for cost amortization and are less likely to become stranded resources. This is another mitigant of the downward metric trajectory. Nevertheless, we believe that additional measures might be necessary to mitigate metrics' drop toward the end of the regulatory period.

Chart 1

VGT Group--Flexible Dividend Policy

Track record of reducing dividends to protect metrics



Source: S&P Global Ratings. FFO--Funds from operations.

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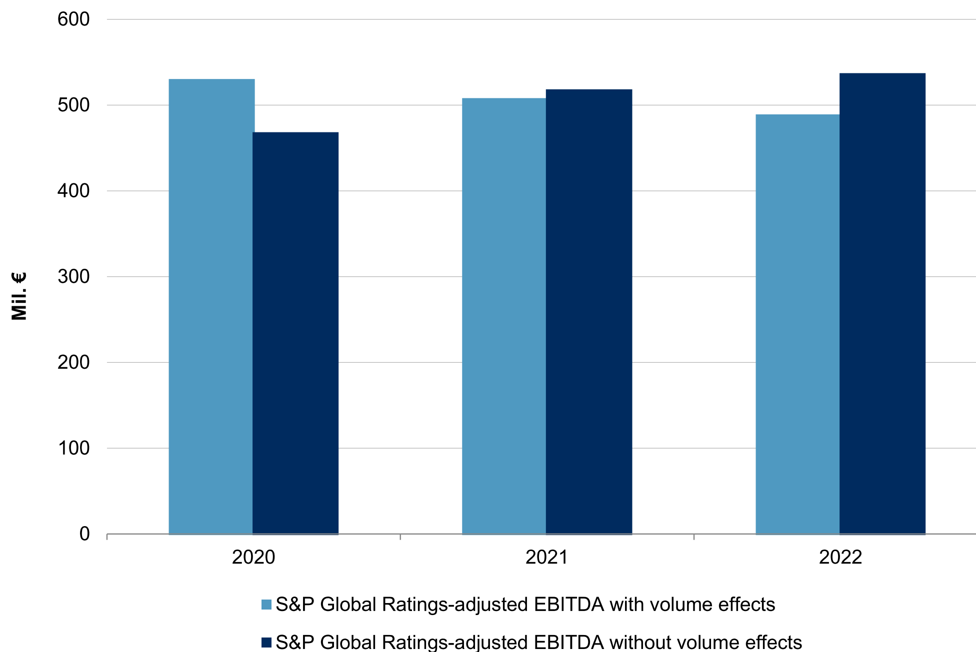
We expect resilient financial results in 2020, despite a challenging macroeconomic environment, and believe the company has room to correct the downward trend in metrics. We continue to expect financial performance in line with the rating over 2020 despite very challenging macroeconomic conditions caused by the COVID-19 pandemic. In S&P Global Ratings' opinion, this reflects the resiliency of VGT Group's excellent business risk profile, with limited exposure to economic downturns, as OGE has no volume risk and in addition are protected by what we see as a supportive German regulatory framework. We forecast FFO to debt above 12% in 2020 and slightly below 12% in 2021, still consistent with the 'A-' rating. OGE has booked the vast majority of its volumes and, from the rest, any shortfall would be compensated in future years via the regulatory account mechanism. In addition, we expect VGT Group to continue deploying its expansion investments without major delay. For now, we expect capex deferrals to be

limited to below 5% of planned.

We see the company's financial performance improving excluding volume effects fluctuation. We expect VGT Group's EBITDA (see chart 2), clean of volume effects, to show a positive trend due to returns on an expanding regulatory asset base resulting from recent and ongoing expansion investments, demonstrating a fundamental improvement in the company's sustainable profitability. The regulatory account mechanism states that, irrespective of the size of revenue shortfall (or excess), the deviation, plus an interest component, must be settled over a three-year period. This mechanism is implemented with a two-year time lag. This means that the excess realized by VGT Group over 2018 (€64 million) and 2019 (€23 million) will have to be returned to the market evenly over the subsequent three years starting 2020 and 2021, respectively.

Chart 2

VGT Group--EBITDA Comparison
Clean of volume effects



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Outlook: Stable

The stable outlook on VGT reflects our expectation that, despite lower opex allowances for new investments during construction reducing profitability and hurting credit metrics, management still has room to revert the trend toward about 12% by the end of the regulatory period. The outlook also captures our assumption that the group will adhere to its flexible financial policy to protect its credit metrics, as it has done from 2015-2017.

Downside scenario

We see limited rating headroom for underperformance.

We would downgrade VGT if we believe that the decline in metrics is irreversible, with FFO to debt sustainably below 12%, notwithstanding the five-year weighted average accounting for strong performance of the past two years. This could occur, for example, if we assess remedy measures as insufficient to maintain the rating, or if more unfavorable regulatory events materialize, taking a further toll on the business profitability.

Upside scenario

Rating upside is remote because of pressure on VGT Group's metrics and uncertainties toward the regulatory period beginning 2023. However, we would consider a positive rating action in the event of a sustained improvement in credit metrics, supported by financial policy commitment to FFO to debt of at least 15%.

Our Base-Case Scenario

Assumptions

- An efficiency factor of 100% for the regulatory period of 2018-2022, or the third regulatory period
- Return on equity of 6.91% and a general productivity factor (x-gen) of 0.49%; return on excess equity of 3.03% for the third regulatory period
- Decline in operating cost allowances on investment measures during construction, to result in about €140 million EBITDA decline through 2020-2022 compared with our previous base-case scenario
- EBITDA margins declining to 47%-48% in 2020-2021 from 50.5% in 2019
- Capital expenditures at about €430 million in 2020, declining to €380 million in 2021

Key Metrics

	2019	2020E	2021E
Debt/EBITDA (x)*	5.7	6.2-6.4	6.5-6.7
FFO/debt (%)*	12.1	12.0-12.3	11.5-12
EBITDA (mil. €)*	543	520-540	520-540
(FFO) (mil. €)*	373	400-420	370-390
Capex (mil. €)*	464	420-440	370-390
Discretionary cash flow (mil. €)*	(261.8)	(200)-(220)	0-(20)

*S&P Global Ratings-adjusted. E--Estimate. FFO--Funds from operations. Capex--Capital expenditure.

- Dividend distributions of €120 million in 2020 and €90 million in 2021
- Capex intensity, coupled with sustained shareholder remuneration, to result in negative discretionary cash flows and slightly increase the company's financing needs in 2021 and 2022

Base-case projections

VGT Group's exposure to the pandemic is limited. The pandemic will take a material toll on German economic activity, most likely reducing industrial gas demand. However, we expect little impact on VGT Group's financial performance due to the regulated nature of OGE's activities, and because the vast majority of its volumes are already locked for 2020. Any deviation from the planned volumes this year or in future years would be covered by regulatory mechanisms, meaning that it would be compensated for in future years.

Operating costs in 2020 will be relevant for determining revenue cap toward the new regulatory period. Reference operating costs for grid operators according to the German legislation are based in a so-called "photo year," the middle year of the five-year regulatory period. The photo year for OGE is 2020, since it marks the middle of the 2018-2022 regulatory period, and will determine the base for revenue cap over the period starting 2023. However, the cost base can be adjusted afterward for inflation, an industry productivity factor, and a company-specific efficiency factor. The annual revenue cap also includes recovery of volatile and noncontrollable costs such as expansion investments. These parameters are usually set closer to the beginning of the next regulatory period and will be relevant for VGT Group's financial performance. Although we don't have any indication on the direction of such decisions by the BNetzA, we believe that an unfavorable decision could put even more pressure on the company's metrics.

Further revisions to precommissioning phase assets could further effect VGT Group's financial performance. Following the Incentive Regulation Ordinance (ARegV), BNetzA is also expected to revise the flat-rate operating fees for pipeline assets in precommissioning phase, other than natural gas compressors and gas pressure regulating and metering systems, revised in 2019. We expect a result that could affect gas TSOs, including OGE, by 2021.

Although not part of our base-case scenario, there are some upsides which would play in favor of VGT Group. A moving factor that could favor the company would be further regulatory revisions on selective adjustments to the legal framework in place to accelerate the expansion of the energy network. This entails IMA investments and capital cost balancing financing instruments. We expect result of the regulation proceedings from the Ministry of Economy and Energy (BMWi) during 2020. In addition, there is ongoing litigation regarding the x-gen factor, which we understand could translate into additional €45 million in EBITDA for the VGT Group, payable over three subsequent years after resolution. We don't consider any of these factors in our base-case scenario, but they could allow the company to build headroom for the rating.

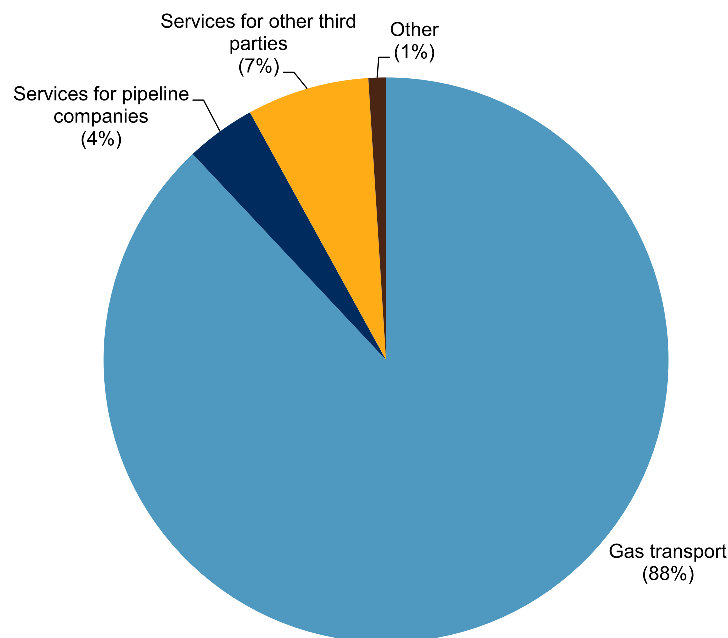
We see free cash flow after capex and dividends more negative in 2020 than in 2021 and 2022. This is as OGE completes its Zeelink project, set to be commissioned in 2021. We expect capex to moderate gradually after that, because Zeelink represented close to 33% of the total IMA expansion investments and it is unlikely that the company will engage in a project of the same magnitude (over €700 million) over our base-case horizon.

Company Description

VGT Group is the parent company of Open Grid Europe GmbH (OGE), the largest of Germany's 16 gas TSOs. Through OGE, the group designs, constructs, operates, and markets gas transmission networks. As of 2019, almost all of VGT Group's revenue (see chart 3) come from its gas transportation business, with services to pipeline companies and third parties accounting only for a small part of the remainder.

Chart 3

VGT Group--Revenue Split
As of 2019



Source: S&P Global Ratings.

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OGE transmits about 70% of Germany's annual gas volume through its 12,000-kilometer network, making it the largest supraregional pipeline network in Germany. 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 the Czech Republic.

The Vier Gas Transport Group comprises VGT (the parent company), its subsidiary OGE and its equity investments, which include a number of gas transmission assets with different levels of ownership. VGT largely performs a holding company function for OGE. Vier Gas Services GmbH & Co. KG, a long-term investment consortium including British Columbia Investment Management (32.15%), Abu Dhabi Investment Authority through Infinity Investments (24.99%), Macquarie and associated LP (24.13%), and Munich Re (18.73%), is the sole shareholder of VGT.

Business Risk: Excellent

A supportive German regulatory framework is the main pillar of VGT Group's business risk profile

We see the German regulatory framework as one of the strongest frameworks in Europe because of the regulator's solid track record of stability and five-year regulatory period with well-defined and transparent tariff-setting procedures. It also enables the group to fully recover its costs--as long as deemed efficient by the regulator--and mitigates the effects of volume and commodity risks via a regulatory account mechanism. The current regulatory period runs until 2022. This is relevant for the VGT Group because almost all of the company's earnings stem from German regulated gas transmission activities and we don't expect this to change over our base case scenario.

The regulated nature of VGT Group's earnings profile fundamentally supports the group's credit quality from S&P Global Ratings' perspective, because it makes financial performance stable and predictable. It also renders cash flows less dependent on short-term macroeconomic swings, such as the pandemic, and more so on long-term trends. Conversely, VGT Group's business is more exposed to regulatory decisions and energy policy directives.

The Network Development Plan (NDP) continues to provide an important advantage to develop OGE grid

In line with the Energy Industry Act (EnWG), TSOs operating in Germany must jointly submit a 10-year NDP in each even-numbered calendar year. Projects under this plan are necessary for the energy transition to a new energy mix, grid stability, and integration of the German network. The plan, which all TSOs will update in summer 2020, contemplates close to €6.9 billion in capex for the 2018-2028 period, out of which OGE accounts for €2.3 billion.

An important feature of these so-called IMA investments is that they are entitled to immediate cost recognition and regulatory return. This is an advantage to other jurisdictions, where investments are recognized with a time lag, increasing thereby cash flow mismatches and tacitly implying larger and longer funding needs.

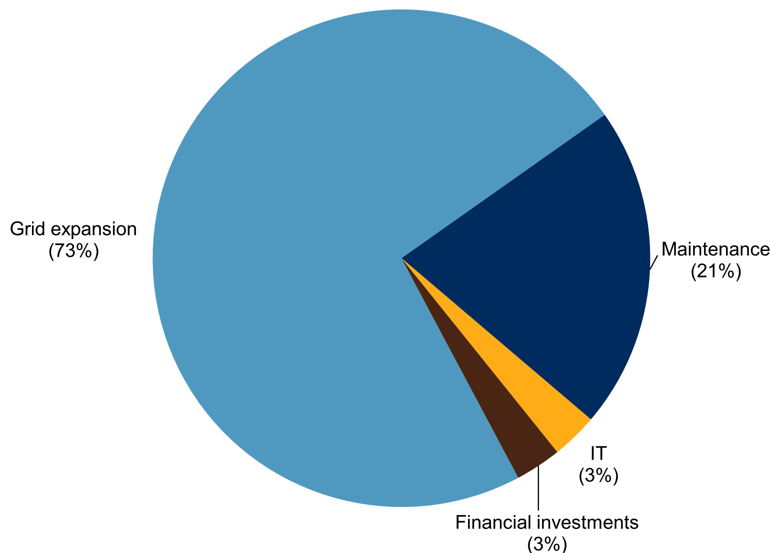
OGE's largest project currently falling under these measures is Zeelink, in which OGE owns 75% and Thyssengas GmbH, another German TSO, 25%. The project includes a 216-kilometer pipeline running through the Belgian-German border, two compressor stations at Würselen and Ledgen, four gas pressure regulating and metering stations, and an additional gas pressure regulating station.

The pipeline will transport high-calorific gas (H-gas) from the Zeebrugge LNG terminal in Belgium from the German-Belgian border via St. Hubert to Legden. As low-calorific gas (L-gas) availability declines in the region due to production closure at Dutch field Groningen and general production decline in Northwest Europe, gas infrastructure is being gradually converted to H-gas from L-gas. Because L-gas and H-gas are transported in separate systems due to technical reasons, OGE's project is relevant to guarantee the long-term security of gas supply in the North Western part of Germany, and particularly in the State of North Rhine-Westphalia. The expected commissioning date is 2021.

Close to three-quarters out of the company's capex are destined for grid expansion (see chart 4). Although we expect this ratio to moderate beyond 2022, it shows that OGE has room to add to its regulatory asset base, which we see as favorable for the Group's business risk profile.

Chart 4

VGT Group--Capex Split
By category, as of 2019



Source: S&P Global Ratings.

However, long-term prospects are moderating for gas infrastructure

We believe that investments in gas infrastructure need to be done more and more selectively across Europe, to avoid overinvesting and stranded investments on the continent's road to decarbonization (carbon-neutrality no later than 2050). For example, OGE's share of total NDP capex will decline upon completion of Zeelink in 2021, and we don't envision any major project that supersedes it in the near term in the company's project pipeline. For the time being, we believe that gas will play a crucial role in the energy transition, particularly in Germany, where coal and nuclear phase-outs will likely increase gas demand. However, for now, we foresee little need for aggressive investments even under such a scenario, because the German gas grid is on track towards absorbing potential incremental gas consumption in the next decade. Although we continue to see the role of gas as crucial over the next decades, this trend raises questions about the long-term relevance of gas grids.

Although in early stages, hydrogen could be the path beyond the bridge of the energy transition

We understand that the group, through its subsidiary OGE, is under different stages of green hydrogen projects that aim to prove the viability of sector coupling. For example, the GetH2 Nukleus project, together with additional stakeholders, creates the first publicly accessible green hydrogen infrastructure in Germany. Another project, Westküste100, is a practical application of green hydrogen in the entire value chain while at the same time coupling energy, fuel, and cement industries. Although OGE is not undertaking these projects on its own, we believe it could

provide an expertise advantage if or when hydrogen gains industry-wide traction.

We see gas operators across Europe lobbying, together with other stakeholders, for proving the viability of sector coupling with green hydrogen in an effort to remain relevant beyond the bridge role of gas amid the energy transition and spark the discussion of including hydrogen assets into the regulatory asset base (at least until commercial market participants would take over). Currently, this infrastructure is not part of regulated remuneration.

We see hydrogen as having certain advantages over batteries because it can be used across the full spectrum of the energy demand, contrary to electricity, which represents about 20% of it. This could be particularly relevant for industry segments with high thermal needs, such as the chemical, steel, and paper industries, accounting for over 40% of the German gas demand each year, and in light of the country's ambition to decarbonize the economy by 2050. Another advantage, particularly relevant for OGE, is that gas infrastructure can be adapted to transport hydrogen at relatively low costs. On the other hand, one key element that weighs on green hydrogen prospects is that production remains uneconomical at this stage, with estimated production costs at €160-€170 per megawatt-hour, markedly above the current levelized cost of electricity for a wind parks in Germany at €50-€55 per megawatt-hour. A further disadvantage is that a lot of energy is lost while it is produced, which translates in many inefficiencies at the current technological stage.

In general, we believe that hydrogen infrastructure development will require a substantial degree of political will and cooperation among many stakeholders, mainly including network operators, industrial consumers, and regulators. In our opinion, the development of big scale hydrogen solutions is at early stages in Europe, but projects such as these are positive signals, which could benefit gas network operators, including OGE, over the long term.

Peer comparison

Table 1

Vier Gas Transport GmbH -- Peer Comparison

Industry sector: Gas					
	Vier Gas Transport GmbH	N.V. Nederlandse Gasunie	National Grid PLC	Enagas S.A.	SNAM SpA
Ratings as of April 24, 2020	A-/Stable/A-2	AA-/Stable/A-1+	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Negative/A-2
	--Fiscal year ended Dec. 31, 2019--				--Fiscal year ended Dec. 31, 2018--
(Mil. €)					
Revenue	1,073.9	1,360.9	17,326.8	1,182.7	2,860.8
EBITDA	542.8	970.6	5,574.7	986.8	2,343.2
Funds from operations (FFO)	373.4	783.1	4,226.4	765.8	1,762.5
Interest expense	77.7	115.0	1,298.3	127.2	238.6
Cash interest paid	80.9	107.8	1,023.4	119.3	196.1
Cash flow from operations	325.2	649.7	4,291.4	761.6	1,880.0
Capital expenditure	464.1	395.7	4,572.7	44.6	916.4
Free operating cash flow (FOCF)	(138.9)	254.0	(281.3)	717.0	963.6

Table 1

Vier Gas Transport GmbH -- Peer Comparison (cont.)					
Industry sector: Gas					
	Vier Gas Transport GmbH	**N.V. Nederlandse Gasunie**	**National Grid PLC**	**Enagas S.A.**	**SNAM SpA**
Discretionary cash flow (DCF)	(261.8)	26.0	(1,688.4)	337.3	(193.4)
Cash and short-term investments	1,060.4	72.2	1,384.2	1,099.0	1,889.8
Debt	3,078.2	3,921.2	32,405.7	4,391.7	12,913.9
Equity	1,193.4	6,033.3	23,692.2	3,168.8	5,985.0
Adjusted ratios					
EBITDA margin (%)	50.5	71.3	32.2	83.4	81.9
Return on capital (%)	8.8	6.5	6.3	8.6	9.0
EBITDA interest coverage (x)	7.0	8.4	4.3	7.8	9.8
FFO cash interest coverage (x)	5.6	8.3	5.1	7.4	10.0
Debt/EBITDA (x)	5.7	4.0	5.8	4.5	5.5
FFO/debt (%)	12.1	20.0	13.0	17.4	13.6
Cash flow from operations/debt (%)	10.6	16.6	13.2	17.3	14.6
FOCF/debt (%)	(4.5)	6.5	(0.9)	16.3	7.5
DCF/debt (%)	(8.5)	0.7	(5.2)	7.7	(1.5)
Capex/sales (%)	43.22	29.08	26.39	3.77	32.03

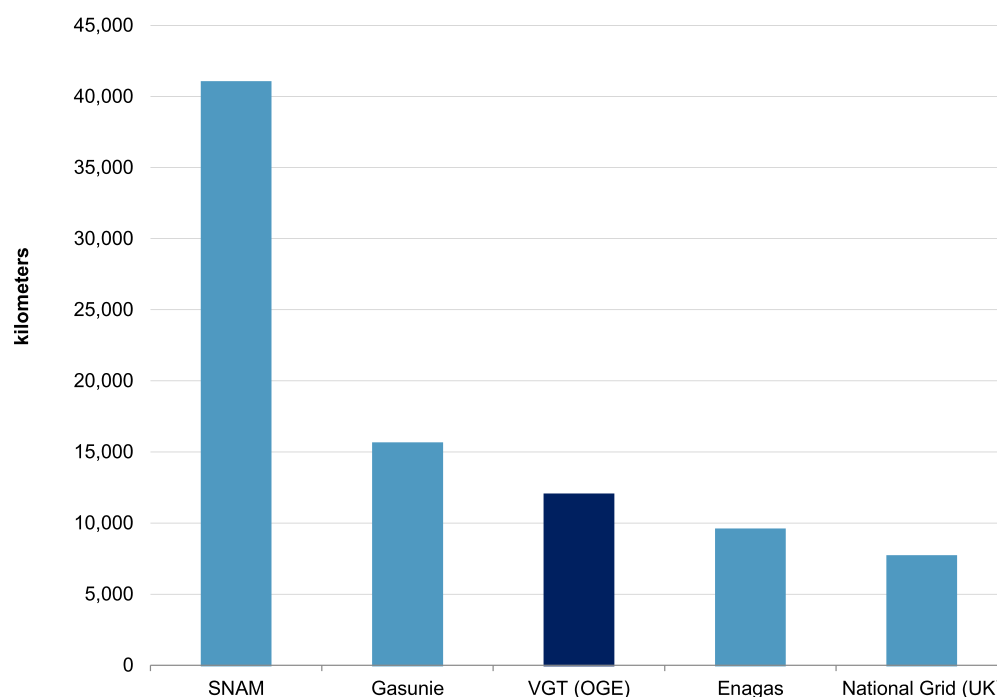
OGE's operations are concentrated in Germany, a country which we see as characterized by one of the strongest regulatory frameworks in Europe, in line with the Netherlands, the U.K. and Italy, and more favorable than Spain. This is an advantage compared with, for example, Enagas, and partially explains why we rate VGT higher despite weaker metrics, the remaining component being Enagas' larger share of unregulated activities.

OGE's closest peer is Gasunie, because they both have operations in Germany and are exposed to the same regulatory environment; however, Gasunie's operations are more diversified, being also the Dutch gas TSO, and has healthier credit metrics. More importantly, the company benefits from the Dutch government's support, which translates into a higher rating.

OGE ranks among the largest European TSOs, following SNAM and Gasunie in terms of network length (see chart 5), and ahead of Enagas and National Grid (when only accounting for the U.K. grid). We see OGE as still able to capture growth in the German market over the next two-to-three years. This represents an advantage compared with other jurisdictions, where we see new projects slowing. This is why we see the group's metrics exhibiting has the highest capex to sales ratio among its European peers, with 43% as of 2019, higher than the 26% average, and notably than Enagas, which has a ratio of 4% due to very limited room for growth in Spain.

Chart 5

Selected Gas TSOs' Network Length



Source: S&P Global Ratings.

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Financial Risk: Significant

We expect VGT Group's financial performance to align with the rating over the next two years, but that metrics will require remedy measures from management beyond that point. We believe there is still room for management to correct the trend. We base our opinion on the company's historical evidence of supportive and proactive liability management.

However, we see VGT Group's metrics with minimal room for underperformance following the unfavorable regulatory determination of reducing lump-sum opex allowance for certain assets under construction under IMA investments, We see this trend as a fundamental change on the company's profitability. This adds to significant investments and sustained dividend distributions that will increase the company's funding needs. We see the FFO-to-debt trajectory declining toward the end of the current regulatory period markedly below our 12% rating trigger.

The other factor influencing VGT Group's metrics over the rest of the regulatory period are volume effects, which are temporary and do not influence the company's long-term financial stability. VGT Group's metrics exhibit some artificial volatility due to volume effects that are neutralized through the regularly account mechanism, although with a time lag running two-to-five years after the over- or under-shooting of allowed revenues. Therefore, when assessing

the company's financial risk profile, we weight its metrics equally over a five-year span. We benchmark VGT Group's metrics against the low volatility table.

Financial summary

Table 2

Vier Gas Transport GmbH -- Financial Summary					
Industry sector: Gas					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. €)					
Revenue	1,073.9	1,008.2	923.0	947.9	885.7
EBITDA	542.8	551.3	467.8	516.8	392.9
Funds from operations (FFO)	373.4	387.0	325.8	449.5	325.1
Interest expense	77.7	58.7	61.1	65.9	69.8
Cash interest paid	80.9	65.8	67.7	67.3	67.8
Cash flow from operations	325.2	406.4	332.5	412.0	273.1
Capital expenditure	464.1	436.2	469.6	261.0	199.7
Free operating cash flow (FOCF)	(138.9)	(29.8)	(137.1)	151.0	73.4
Discretionary cash flow (DCF)	(261.8)	(133.8)	(198.8)	97.4	60.6
Cash and short-term investments	1,060.4	409.2	106.4	189.4	149.7
Gross available cash	1,060.4	409.2	106.4	189.4	149.7
Debt	3,078.2	2,821.2	2,735.8	2,571.0	2,540.5
Equity	1,193.4	1,178.9	1,063.6	949.5	859.5
Adjusted ratios					
EBITDA margin (%)	50.5	54.7	50.7	54.5	44.4
Return on capital (%)	8.8	9.7	8.2	9.4	6.2
EBITDA interest coverage (x)	7.0	9.4	7.7	7.8	5.6
FFO cash interest coverage (x)	5.6	6.9	5.8	7.7	5.8
Debt/EBITDA (x)	5.7	5.1	5.8	5.0	6.5
FFO/debt (%)	12.1	13.7	11.9	17.5	12.8
Cash flow from operations/debt (%)	10.6	14.4	12.2	16.0	10.8
FOCF/debt (%)	(4.5)	(1.1)	(5.0)	5.9	2.9
DCF/debt (%)	(8.5)	(4.7)	(7.3)	3.8	2.4

Metrics may differ from previous published reports since we updated our Ratios and Adjustments methodology on April 1, 2019, which affects the calculation of VGT'S ratios.

Liquidity: Adequate

We assess VGT Group's liquidity as adequate because its sources of liquidity will exceed its uses by 1.4x over the next 12 months, in our opinion.

Our assessment also includes qualitative factors, such as proven access to debt capital markets and sound relationships with banks, reflected in the company's diverse sources of funding. For example, in 2019, VGT issued two

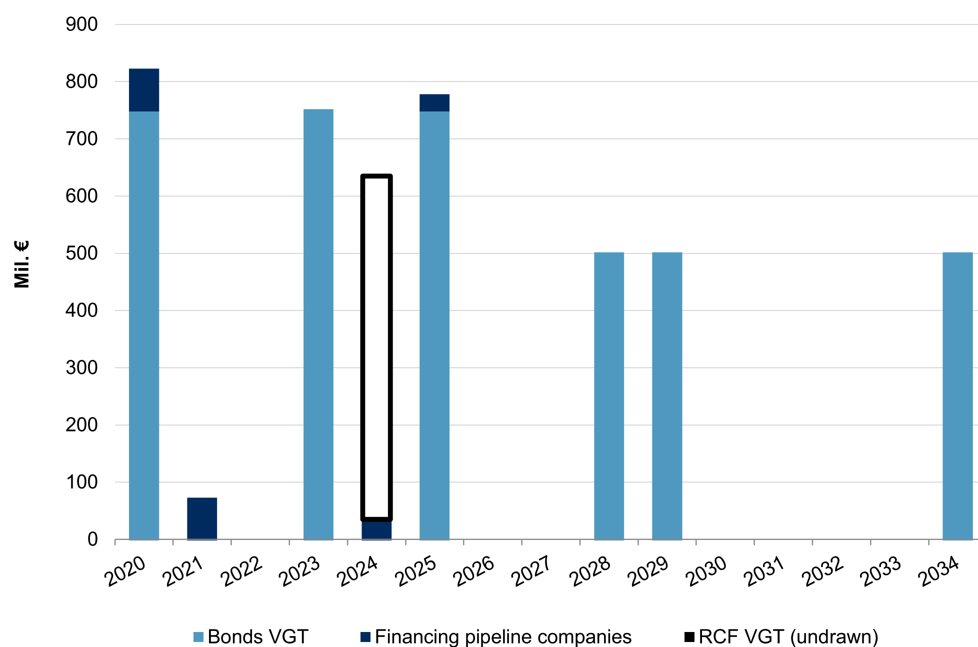
€500 million bonds at 10 and 15 years with 0.125% and 0.5%, respectively. We also believe that the company displays prudent risk management that underpins its liquidity position.

Principal Liquidity Sources	Principal Liquidity Uses
Over the next 12 months, we expect liquidity sources to include: • Cash and liquid investments of €1.03 billion as of Dec. 31, 2019 • Undrawn committed credit line of €600 million, maturing in August 2024 • Cash FFO of €390 million	For 2020, we expect liquidity uses to include: • Debt maturities of €821 million • Working capital outflows of about €10 million • Capex of €415 million • Dividend distributions of €120 million

Debt maturities

Chart 6

VGT Group--Maturity Schedule
As of Dec. 31, 2019



Source: S&P Global Ratings.

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Environmental, Social, And Governance

Environmental and social aspects are relevant to VGT Group's business. Although not yet a relevant component of the company's earnings, we see the efforts in green hydrogen pioneering as relevant. On one hand, it contributes to sparking the discussion on the adoption of clean energies toward decarbonizing the German economy in hand with the need of a framework that supports it. On the other hand, these are the first steps toward ensuring the long-term sustainability of VGT Group's business, because gas infrastructure relevance will decline as the energy mix moves towards zero carbon emissions.

Notwithstanding this, for now, the German energy transition creates opportunities for gas infrastructure companies, such as OGE. In our opinion, gas will remain a crucial component for the transition process to the medium and long-term energy mix, particularly in light of plans to shut down coal generation by 2038 and the nuclear shutdown in Germany scheduled for 2022.

Close to 55%-60% of VGT Group's capex in the 2020-2022 strategic plan will fall under investment measures, which represents gas infrastructure that will be key for the energy transition in Germany and is fully aligned with country's long-term climate policy.

We believe that the company's technical and operational standards will continue to ensure a high degree of network security and reliability, thereby mitigating environmental risks over the coming years, which is key to managing regulatory risk and public opinion.

In our view, VGT Group's management and governance framework meets industry standards and is particularly driven to align stakeholder interests toward long-term sustainability goals.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2019, the company's capital structure consists of:

- €3.75 billion bonds issued at the VGT level, €1 billion of which were partially issued to refinance the €750 million bond due 2020; and
- €219 million at the pipeline company level, which are reported at pro-rata share (51%).

Analytical conclusions

We rate VGT's debt at the level of the issuer credit rating, because we believe debt sitting at pipeline companies does not represent a material disadvantage to bondholders.

Reconciliation

Table 3

Vier Gas Transport GmbH -- Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Fiscal year ended Dec. 31, 2019--						
Vier Gas Transport GmbH's reported amounts (mil. €)							
	Debt	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
	3,995.2	539.2	365.4	67.2	542.8	406.1	472.4
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	(88.5)	--	--
Cash interest paid	--	--	--	--	(72.6)	--	--
Reported lease liabilities	20.4	--	--	--	--	--	--
Postemployment benefit obligations/deferred compensation	55.4	0.5	0.5	2.2	--	--	--
Accessible cash and liquid investments	(1,060.4)	--	--	--	--	--	--
Capitalized interest	--	--	--	8.3	(8.3)	(8.3)	(8.3)
Dividends received from equity investments	--	12.0	--	--	--	--	--
Asset-retirement obligations	58.6	--	--	--	--	--	--
Nonoperating income (expense)	--	--	7.2	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(72.6)	--
Debt: guarantees	1.3	--	--	--	--	--	--
Debt: earnouts and deferred consideration for business acquisitions	7.7	--	--	--	--	--	--
EBITDA: valuation gains (losses)	--	(8.9)	(8.9)	--	--	--	--
Total adjustments	(917.0)	3.6	(1.2)	10.5	(169.4)	(80.9)	(8.3)
S&P Global Ratings' adjusted amounts							
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
Adjusted	3,078.2	542.8	364.2	77.7	373.4	325.2	464.1

Ratings Score Snapshot

Issuer 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:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- 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
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial 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 May 7, 2020)*

Vier Gas Transport GmbH	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Issuer Credit Ratings History	
30-Apr-2018	A-/Stable/A-2
27-Apr-2017	A-/Negative/A-2
15-Feb-2013	A-/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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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