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Research Update:

Vier Gas Transport (Open Grid Europe Group) 'A-/A-2' Ratings Affirmed On Expected Sound Performance; Outlook Stable

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Overview

- Germany-based gas transmission system operator Open Grid Europe Group (OGE), comprising Vier Gas Transport GmbH and Open Grid Europe GmbH, has a natural monopoly in gas transmission in its service area, with low-risk, regulated earnings.
- We assess OGE's liquidity as strong.
- We are affirming our 'A-/A-2' ratings on OGE.
- The stable outlook reflects our opinion that OGE will maintain credit metrics commensurate with the ratings, owing to the group's low-risk, fully regulated operations and stable cash flows.

Rating Action

On April 30, 2015, Standard & Poor's Ratings Services affirmed its 'A-' long-term and 'A-2' short-term corporate credit ratings on Open Grid Europe Group (OGE). The outlook is stable.

Rationale

The affirmation incorporates our view that OGE will maintain its "excellent" business risk profile, supported by its natural monopoly in its service area under a regulatory framework that we assess as strong. We anticipate that the group will deliver stable operating and financial performances over the next two to three years. The group comprises the holding company Vier Gas Transport GmbH and gas transmission system operator Open Grid Europe GmbH.

We continue to regard OGE's competitive position as "strong." The group has a monopolistic market position in its service area and operates in an incentive-based regulatory framework with a revenue cap, which allows for 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. 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 or in the next regulatory period. Nevertheless, in our opinion, OGE's profitability can be more volatile than peers' over the short term.

We expect that OGE will remain exclusively focused on its core business as the leading gas transmission operator in its service area, maintain its high level of operating efficiency, and high-quality network in terms of safety and reliability.

We continue to assess OGE's financial risk profile as "significant," reflecting our base-case forecast that OGE's ratio of funds from operations (FFO) to debt will remain higher than 12% on an weighted basis for the 2013-2017 regulatory period. In our ratio calculation, we weigh each of the five years equally to capture volatility during the period, for example, triggered by the regulatory account mechanism. Because the majority of OGE's EBITDA stems from regulated activities and we assess regulatory advantage as strong, we use the "low volatility" benchmark table in our corporate methodology to assess OGE's financial risk profile.

Our assessment of OGE's liquidity as "strong" does not affect our view of OGE's stand-alone credit profile, which we assess at 'a-'.

In our base case, we assume:

- An efficiency factor of 100% for the regulatory period through to year-end 2017.
- A positive contribution from efficiency measures.
- Capital expenditures in line with the updated network development plan of €150 million-€350 million per year until 2017.
- Some volatility relating to the regulatory account mechanism.

Based on these assumptions, we arrive at the following credit measures:

- FFO to debt of more than 12% on a weighted basis for the regulatory period 2013-2017.
- Debt to EBITDA of less than 5.3x on a weighted basis for the regulatory period 2013-2017.
- Discretionary free operating cash flow turning negative in 2016 and 2017.

Liquidity

We view OGE's liquidity as "strong," as defined by our criteria, and we project that the company's ratio of liquidity sources to uses will exceed 1.5x for the 12 months started March 31, 2015, and will exceed 1.0x for the following 12 months.

We calculate the following principal liquidity sources:

- Reported access to unrestricted cash and short-term marketable securities of about €170 million on March 31, 2015.
- Positive cash flow of about €255 million in the next 12 months and about €290 million in the following 12 months.
- Access to revolving credit facilities totaling about €235 million, of which €15 million mature in June 2016, about €19 million in July 2017, and €200 million at year-end 2018.

We calculate the principal liquidity uses:

- Debt maturities in the next 12 months of €50 million and about €35 million in the following 12 months.
- Capital expenditures of about €175 million in the next 12 months and €250 million in the following 12 months.
- We expect cash dividends of up to €150 million annually over the next two years.

Outlook

The stable outlook reflects our expectation that OGE will maintain its sound operating and financial performance over the next two to three years, reflecting its very low risk and regulated earnings profile. According to our base case, we expect that OGE will maintain FFO to debt of at least 12% on a weighted-average basis, in line with a "significant" financial risk profile, applying our low volatility benchmark.

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; faced unforeseen expenses that could not be passed on to customers; 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 the current "excellent." 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 FFO-to-debt ratio reached at least 15% on a weighted-average basis and the financial risk profile improved to "intermediate." Such a development could result from lower dividend payments, leading to a reduction of adjusted debt. We do not see upside potential stemming from the business risk profile, given that we already assess the business risk profile as "excellent."

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)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed

Open Grid Europe Group	
Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	A-

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