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## Research Update:

# Germany-Based Gas Transmission System Operator OGE Group Assigned 'A-/A-2' Ratings; Outlook Stable

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## Overview

- Germany-based utility Vier Gas Transport GmbH is the holding company of the gas transmission system operator Open Grid Europe GmbH (OGE).
- We are assigning our 'A-' long-term and 'A-2' short-term corporate credit ratings to the OGE Group, comprising Vier Gas Transport and OGE.
- The stable outlook reflects our opinion that OGE Group will maintain credit metrics commensurate with the ratings, in view of the group's low-risk and fully regulated generation of earnings and cash flows.

## Rating Action

On Feb. 15, 2013, Standard & Poor's Ratings Services assigned its 'A-' long-term and 'A-2' short-term corporate credit ratings to Germany-based OGE Group, comprising the holding company Vier Gas Transport GmbH and the gas transmission system operator (TSO) Open Grid Europe GmbH (OGE). The outlook is stable.

At the same time, we assigned our 'A-' long-term issue rating to Vier Gas Transport's €2,750 million credit facility.

## Rationale

The ratings on OGE Group reflect our assessment of the group's business risk profile as "excellent" and its financial risk profile as "significant." The "excellent" business risk profile is underpinned by OGE Group's leading market position as the largest gas TSO in Germany; its natural monopoly position in its service area; and its low-risk and regulated earnings profile.

OGE Group ships about 70% of the total annual gas volumes in Germany, or approximately 62.5 billion cubic meters per year, and its transportation grids extend close to 11,000 kilometers. The group's revenues are regulated by the German energy regulator the Federal Network Agency (BNetzA), with a revenue cap methodology that in our view allows for relatively stable and predictable revenues and EBITDA over a five-year period. The incentive-based regulation was introduced from Jan. 1, 2010, and has, in our opinion, become more credit-supportive over the past two years. In our view, the framework's credit-supportive changes include, for example, the elimination of a time lag for the recovery of investments. We also view positively a TSO's ability to

recover, in the short term, any deviation in incurred fuel and commodity costs compared to the amount assumed in the cost base.

These strengths are mitigated by regulatory reset risks, which in our view are limited at present because the current regulatory period started on Jan. 1, 2013. That said, we understand that some uncertainties remain, such as the regulator's final decision on the efficiency factor, which influences the calculation of the cost base. We understand that revenues in the first year of a regulatory period are based on a defined historical cost base (2010 is the base year for the current regulatory period). Revenues are then adjusted for an efficiency factor, and subsequently adjusted for inflation and a preset productivity factor throughout the regulatory period. In our view, this represents a relative weakness compared with allowed revenues based on the recovery of projected costs. We further understand that the regulator could reset the productivity factor, a risk that also applies to the efficiency factor. In our view, an increase of the industrywide productivity factor--set at 1.25% from 2010, and 1.5% from 2013--or a reassessment of OGE Group's efficiency factor to less than 100%, would reduce its earnings. That said, we understand that OGE Group and its owners are committed to maintaining the current ratings and would consider amending the group's dividend policy to provide further financial flexibility if necessary.

OGE Group's "significant" financial risk profile reflects its large and partially debt-financed capital expenditure (capex) program, which we believe will gradually increase leverage throughout the forecast period. That said, in our view, OGE Group will be able to maintain Standard & Poor's-adjusted funds from operations (FFO) to debt of more than 12% in the near-to-medium term, which we consider commensurate with the rating in view of the group's low-risk, stable, and predictable cash flow generation.

### **Liquidity**

The short-term rating on OGE Group is 'A-2'. We assess OGE Group's consolidated liquidity position as "strong" as our criteria define the term. Our assessment is supported by our view that OGE Group's liquidity resources will exceed its funding needs by much more than 1.5x in the next 12 months. OGE Group's well-established and solid relationships with banks, generally high standing in the credit markets, and typically prudent risk management further support our opinion of liquidity as "strong."

OGE Group has access to an undrawn €500 million credit facility, divided into a five-year €100 million revolving credit facility (RCF) and a five-year €400 million capex facility. We believe that OGE Group will retain comfortable headroom under the covenants for its committed credit facility.

For the 12 months from Dec. 31, 2012, we estimate that OGE Group's consolidated liquidity sources will exceed €900 million under our base-case scenario. These sources include:

- A cash balance exceeding €100 million;
- Access to €500 million under an undrawn committed credit facility

expiring in May 2017; and

- Annual consolidated FFO exceeding €300 million.

We estimate that OGE Group's consolidated liquidity needs over the 12 months from Dec. 31, 2012, will be close to €400 million under our base-case scenario. These liquidity needs comprise mainly:

- Consolidated capex of about €250 million; and
- Dividends of about €150 million.

## Outlook

The stable outlook reflects our view that OGE Group's stable cash flows and sound profitability under our base-case scenario will support the group's "excellent" business risk profile. In addition, we anticipate that OGE Group's adjusted FFO-to-debt ratio will remain more than 12% on a consolidated basis in the near-to-medium term, which is in line with our assessment of the group's "significant" financial risk profile.

Downward rating pressure could arise if OGE Group's operating and financial performance were to weaken unexpectedly to undermine its business and financial risk profiles. Such weakening could result from the German regulator BNetzA setting a lower-than-expected efficiency factor; other changes to the regulatory framework in Germany with detrimental effects on OGE Group; or other factors that could cause the group's revenues and EBITDA to be more volatile than we currently anticipate. That said, we understand that OGE Group and its owners are committed to maintaining the current ratings and would consider amending the group's dividend policy to provide further financial flexibility if necessary. Weakening could also result from OGE Group having higher investment levels and increased funding needs than we assume in our base case; or from the group undertaking acquisitions, for instance of further stakes in the pipeline companies in which it holds shares at present. Pressure on the ratings could arise from a sustained decline in OGE Group's FFO-to-debt ratio to less than 12%.

We consider an upgrade to be unlikely over the medium term, due to OGE Group's substantial capital investment plans in the coming years, and our opinion that there is limited rating headroom in terms of debt capacity under our base-case assumptions. However, we would consider taking a positive rating action if OGE Group's financial risk profile were to strengthen substantially, especially if the group were to maintain its consolidated adjusted FFO-to-debt ratio at more than 15% and generate neutral-to-positive discretionary cash flows on a sustainable basis, all else remaining equal.

## Ratings List

New Rating; CreditWatch/Outlook Action

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

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