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Vier Gas Transport GmbH (Open Grid Europe Group)

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Table Of Contents

Rationale

Outlook

Standard & Poor's Base-Case Scenario

Company Description

Business Risk

Financial Risk

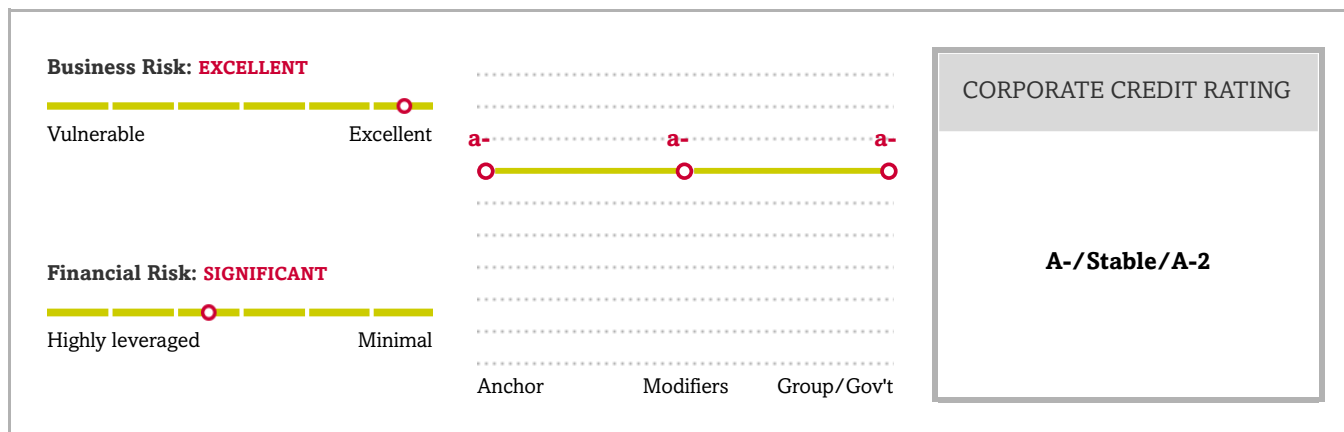
Liquidity

Ratings Score Snapshot

Reconciliation

Related Criteria And Research

Vier Gas Transport GmbH (Open Grid Europe Group)



Rationale

Business Risk: Excellent	Financial Risk: Significant
<ul style="list-style-type: none"> • Largest gas transmission network and operator in Germany with a natural monopoly position in its service area. • Very low risk and regulated earnings profile. • All earnings generated in Germany, a very low risk country. 	<ul style="list-style-type: none"> • Stable and predictable cash flow generation over the regulatory period. • Relatively high leverage and some cash flow volatility triggered by volume risk. • 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 Standard & Poor's Ratings Services' expectation that OGE will maintain sound operating and financial performance over the next two to three years, thanks to OGE's very low risk and 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 a weighted-average basis, in line with our low volatility benchmark for a "significant" financial risk profile.

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 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, leading to a reduction of 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	Key Metrics					
<ul style="list-style-type: none"> 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 OGE's revised network development plan of €150 million-€350 million per year until 2017, gradually increasing over time. Negative impact from the regulatory account mechanism in 2015 offsetting higher revenues in 2013. 	2013a	2014a	2015e	2016f	2017f	
	FFO to debt (%)*	17.3	17.3	About 11	>13	>12
	Capex (mil. €)	194	173	150-180	210-240	320-350
	Debt/EBITDA (x)*	4.9	4.4	6-7	5-5.5	5-5.5
	*Fully Standard & Poor's adjusted. Capex--Capital expenditure. a--Actual. e--Estimate. f--Forecast.					

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. Its activities comprise design and construction of pipelines from conceptual design, project management, and engineering to implementation; operation of the pipeline system, including maintenance and repair; and control and monitoring of the network and storage facilities. OGE also provides capacity management services consisting of capacity assessment and development of new gas industry standards, marketing of capacities, customer support, quantity determination, and billing services.

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. 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 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 weather, because the regulatory account mechanism compensates for shortfalls or surpluses.
- High visibility for the regulatory period ending in 2017.
- An operating efficiency factor of 100% during the regulatory period.

Peer comparison

Table 1

Open Grid Europe Group--Peer Comparison*

Industry Sector: Utility Company						
	Open Grid Europe Group	TenneT Holding B.V.	N.V. Nederlandse Gasunie	National Grid PLC	Thyssengas	
Rating as of June 5, 2015	A-/Stable/A-2	A-/Stable/A-2	A+/Positive/A-1	A-/Stable/A-2	A/Stable/--	
(Mil. €)	--Fiscal year ended Dec. 31, 2014--			Fiscal year ended March 31, 2014	Fiscal year ended Dec. 31, 2013	
Revenues	1,017	2,597	1,720	17,913	239	
EBITDA	539	1,353	1,275	6,021	116	
Funds from operations (FFO)	414	1,012	948	4,048	74	
Net income from continuing operations	225	541	604	2,995	(40)	
Cash flow from operations	380	1,593	991	4,173	30	
Capital expenditures	173	2,131	500	3,778	11	
Free operating cash flow	208	(538)	491	395	19	
Discretionary cash flow	64	(689)	149	(886)	19	
Debt	2,396	3,983	4,609	28,921	402	
Equity	897	3,928	5,532	15,757	(119)	
Adjusted ratios						
EBITDA margin (%)	53.0	52.1	74.1	33.6	48.7	
Return on capital (%)	9.7	12.6	9.7	8.7	15.9	
EBITDA interest coverage (x)	7.5	8.4	7.9	3.9	6.0	
FFO cash interest cov. (x)	7.0	8.7	7.5	5.1	N.M.	
Debt/EBITDA (x)	4.4	2.9	3.6	4.8	3.5	
FFO/debt (%)	17.3	25.4	20.6	14.0	18.5	
Cash flow from operations/debt (%)	15.9	40.0	21.5	14.4	7.5	
Free operating cash flow/debt (%)	8.7	(13.5)	10.7	1.4	4.9	
Discretionary cash flow/debt (%)	2.7	(17.3)	3.2	(3.1)	4.9	

Table 1**Open Grid Europe Group--Peer Comparison* (cont.)**

*Consolidated group figures at the Vier Gas Transport GmbH level. N.M.--Not meaningful.

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 gradual increase of capital expenditure (capex) from 2016 onward. That said, in our base case we forecast only a moderate increase of leverage (debt to EBITDA) until 2017 compared with the past two years, and adjusted FFO to debt of more than 12% on a 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 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 Base-Case Cash Flow And Capital Structure Scenario

- Negative discretionary free operating cash flow in 2016 and 2017, reflecting higher capex from 2016.
- Adjusted weighted-average FFO to debt remaining higher than 12% over the regulatory period 2013-2017, with some volatility triggered by swings within the regulatory account.
- Debt to EBITDA ranging between 5x and 5.5x through to year-end 2017, except for 2015 when we project it at 6x-7x.

Financial summary**Table 2****Open Grid Europe Group--Financial Summary***

(Mil. €)	--Fiscal year ended Dec. 31--	
	2014	2013
Revenues	1,017	1,033
EBITDA	539	502
Funds from operations (FFO)	414	428
Net income from continuing operations	225	87
Cash flow from operations	380	456
Capital expenditures (capex)	173	194
Free operating cash flow	208	263
Dividends paid	144	325
Discretionary cash flow	64	(62)
Debt	2,396	2,479
Equity	897	772
Debt and equity	3,294	3,251

Table 2**Open Grid Europe Group--Financial Summary* (cont.)**

Adjusted ratios		
EBITDA margin (%)	53.0	48.6
EBITDA interest coverage (x)	7.5	7.5
FFO cash interest coverage (x)	7.0	17.3
Debt/EBITDA (x)	4.4	4.9
FFO/debt (%)	17.3	17.3
Cash flow from operations/debt (%)	15.9	18.4
Free operating cash flow/debt (%)	8.7	10.6
Discretionary cash flow/debt (%)	2.7	(2.5)
Net cash flow/capex (%)	156.3	53.6
Return on capital (%)	9.7	9.5

*Consolidated group figures at the Vier Gas Transport GmbH level.

Liquidity: Strong

We assess OGE's consolidated liquidity position as "strong" as defined in our criteria, supported by our view that its liquidity resources will exceed its funding needs by well over 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
<ul style="list-style-type: none"> Reported access to unrestricted cash and short-term marketable securities of about €170 million as of 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. 	<ul style="list-style-type: none"> Debt maturities in the next 12 months of €50 million and about €35 million in the following 12 months. Capex of about €175 million in the next 12 months and €250 million in the following 12 months. Cash dividends that we estimate at up to €150 million annually over the next two years.

Debt maturities

- 2015: €50 mil.
- 2016-2019: €178 mil.
- 2020 and thereafter: €2.25 bil.

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 Standard & Poor's Adjusted Amounts (Mil. €)						
--Fiscal year ended Dec. 31, 2014--						
Open Grid Europe Group reported amounts						
	Debt	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations
Reported	2,534	500	354	67	500	429
Standard & Poor's adjustments						
Interest expense (reported)	--	--	--	--	(67)	--
Interest income (reported)	--	--	--	--	2	--
Current tax expense (reported)	--	--	--	--	(56)	--
Operating leases	38	20	4	4	15	15
Postretirement benefit obligations/deferred compensation	73	0	0	2	(1)	6
Surplus cash	(248)	--	--	--	--	--
Dividends received from equity investments	--	19	--	--	19	--

Table 3

Reconciliation Of Open Grid Europe Group* Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €) (cont.)						
Non-operating income (expense)	--	--	8	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(69)
Total adjustments	(137)	39	13	6	(87)	(48)
Standard & Poor's adjusted amounts						
	Debt	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
Adjusted	2,396	539	367	72	414	380

*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: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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 June 5, 2015)	
Open Grid Europe Group	
Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Short-Term Debt	A-2

Ratings Detail (As Of June 5, 2015) (cont.)

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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