

Rating Action: Moody's confirms NET4GAS' ratings; changes outlook to negative

27 Jun 2022

Frankfurt am Main, June 27, 2022 -- Moody's Investors Service ("Moody's") has today confirmed the long-term Ba2 Corporate Family Rating (CFR), the Ba2-PD probability of default rating and the Ba2 senior unsecured debt ratings of NET4GAS, s.r.o. (N4G), the owner and operator of the gas transmission system in the Czech Republic (Aa3 stable). The outlook is negative. This rating action concludes the review for downgrade initiated on 3 March 2022.

RATINGS RATIONALE

The confirmation of N4G's ratings at Ba2 reflects the continued payment of ship-or-pay tariffs by N4G's key customer, the major Russian shipper, and the continued significant cash flow generation and consequent build-up of cash balances since the multi-notch rating downgrade from Baa2 on 23 March 2022.

In taking this rating action, Moody's has balanced N4G's continued good financial performance against the significant downside risks associated with the current geopolitical environment and the multiple scenarios in which Russian gas flows and/or non-payment of ship-or-pay tariffs may arise.

N4G generates around 75% of its revenues from transporting gas that is primarily sourced from Russia to Western and Southern Europe under long-term gas transit contracts. The Russian company Gazprom Export LLC, a 100% subsidiary of Gazprom, PJSC, has the monopoly on pipeline gas exports from Russia. N4G's transit contracts are largely on a ship-or-pay basis, meaning that the company receives most income from capacity payments and independent of actual gas flows. The transit contracts are primarily with the major Russian gas shipper.

While Russia, through Gazprom Export LLC, has in recent months stopped gas flows to certain European buyers, including Polskie Gornictwo Naftowe i Gazownictwo SA (Baa2 stable) in Poland, Bulgargaz EAD, a subsidiary of Bulgarian Energy Holding EAD (Ba1 stable), and Danish utility Orsted A/S (Baa1 stable), gas has generally continued to flow into Europe and N4G's pipeline is utilized.

Since N4G's gas transportation network is located centrally in Europe, Moody's expects that in case of a cessation of gas flows from Russia or a disruption of capacity payments by the Russian shipper, or both, the company could replace part but not all of the business with the Russian shipper. The extent to which alternative bookings would be obtained would depend on the volumes of gas in Europe, where this was received and how it was allocated across countries.

Moody's notes that N4G has accumulated unrestricted cash of around CZK5.5 billion as of 15 June 2022 supported by the shareholders' decision to suspend dividend pay-outs which has strengthened its financial profile. While the committed bank facilities of EUR100 million (around CZK2.6 billion) expired in May and have not been replaced to date, Moody's expects N4G to continue to preserve cash in order to mitigate its debt repayment risk, the next significant debt maturity being a bank term loan in May 2025.

OUTLOOK RATIONALE

As N4G remains highly exposed to a cessation of capacity payments, whether resulting from the cessation of gas deliveries from Russia to Europe or otherwise, the negative outlook reflects this material risk. Any further developments that would suggest a high probability of the cessation of such payments would likely result in a ratings downgrade.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Given the negative outlook, an upgrade of N4G's ratings in the near term is unlikely and would require high visibility as to the continued receipt of capacity payments from the Russian shipper into the medium term, or its replacement with revenues from alternative shippers with a solid credit profile; or tangible external credit support; or a combination of these.

The outlook could be changed to stable if N4G continues to receive capacity payments under the long-term transit contracts and uses them to strengthen its financial profile to significantly reduce refinancing risk ahead of the next debt maturities in 2025; or if the company obtains adequate support from its owners or other stakeholders to offset any further deterioration of its credit profile.

N4G's ratings could be downgraded if capacity payments to the company were, or were expected to be, discontinued or materially delayed, resulting in material pressure on its liquidity and financial profile, without clear and adequate replacement through new bookings or external credit support; or if the company ceased to use free cash flows to strengthen its financial profile, for example by resuming dividend pay-outs.

The principal methodology used in these ratings was Natural Gas Pipelines published in July 2018 and available at <https://ratings.moodys.com/api/rmc-documents/64961>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

NET4GAS, s.r.o. is the owner and operator of the Czech gas transmission system. N4G is ultimately 50% owned by Allianz Infrastructure Czech Holdco II S.a r.l., part of the wider Allianz group and 50% by Borealis Novus Parent B.V., a subsidiary of OMERS Administration Corporation. The company's core business consists of transporting gas, primarily sourced from Russia, towards Western and Southern Europe under long-term contracts. It is also the regulated domestic gas transmission network operator under an unlimited licence. In 2021, N4G reported revenues of CZK10,373 million and EBITDA amounting to CZK8,955 million.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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