FitchRatings

RATING ACTION COMMENTARY

Fitch Publishes Hamburger Hochbahn AG's 'AAA' Rating; Outlook Stable

Mon 21 Sep, 2020 - 6:02 AM ET

Fitch Ratings - Frankfurt am Main - 21 Sep 2020: Fitch Ratings has published Hamburger Hochbahn AG (HOCHBAHN) Long-Term Foreign and Local-Currency Issuer Default Ratings (IDR) of 'AAA', The Outlooks are Stable.

Fitch rates HOCHBAHN according to its Government Related Entities (GRE) Criteria and applies a top-down approach. HOCHBAHN is viewed as a credit-linked entity to the German State of Hamburg (Hamburg, AAA/Stable/F1+) as Fitch deems HOCHBAHN's direct owner, Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH (HGV), as having a neutral role in terms of extraordinary support provision. Fitch has therefore looked-through the chain of control and the rating reflects HOCHBAHN's strong link to its ultimate government owner and the high likelihood of state extraordinary support in case of financial distress.

HOCHBAHN's rating are equalised with those of Hamburg, reflecting our view that its legal status is tantamount to a guarantee. This based on i) HOCHBAHN being excluded from competition based on the existing 10-year direct service agreement (Direktvergabe) with Hamburg (bus services) and 22.5 years (metro services); ii)there are no restrictions to receive support from its owner; iii) the profit and loss transfer agreement ensures annual deficit compensation by Hamburg; iv) the state has the same kind of control over the issuer's operations as would it of an administrative unit and v) the issuer's access to Hamburg's liquidity via cash pooling with HGV.

The assessment of the four extraordinary support factors under Fitch's GRE Criteria, resulting in a total score of 45 out of a maximum of 60, lead to the equalisation of the IDR with that of Hamburg irrespective of the Standalone Credit Profile (SCP). The SCP is assessed at 'bb', applying the Public Sector, Revenue-Supported Entities Rating Criteria and does not affect the IDRs, as they are more than four notches away from Hamburg's rating.

KEY RATING DRIVERS

Status, Ownership and Control Assessed as Very Strong

HOCHBAHN is 100% owned by Hamburg via HGV. HGV is a group holding of Hamburg, which combines a large part of Hamburg's GREs and shareholdings. We view HGV as an organisational unit but that Hamburg is finally liable for HOCHBAHN. HOCHBAHN is the largest local public transport provider in Hamburg with a market share of almost 58% in 2018. HOCHBAHN provides bus and metro services almost entirely limited to the borders of Hamburg. HOCHBAHN has a share of almost 87% and its only competitor is Verkehrsbetriebe Hamburg-Holstein (VHH, another entirely Hamburg owned GRE) with the remaining 13% (calculated by revenue distribution). HOCHBAHN is also manager of the local network infrastructure. It has a strategic role in Hamburg's local transportation and environmental planning policy.

HOCHBAHN's financial figures are consolidated in Hamburg's group accounts. Based on a directive for public passenger transport services, Hamburg is the public transport provider and has control over HOCHBAHN, similar to its administrative units. Hamburg put HOCHBAHN in charge of providing Hamburg's public transport services in 2009. This has been renewed in 27 November 2019, including metro and bus services with a tenor of 22.5 years and 10 years, respectively.

HOCHBAHN's management board consists of four members that are appointed by the supervisory board. Hamburg makes up eight members of the 16 member supervisory board, including one representative of HGV and one from Hamburg's finance department. This ensures Hamburg largely controls HOCHBAHN.

As the company operates under private/commercial law, HOCHBAHN could be subject to bankruptcy proceedings. However, based on its control and the profit and loss transfer agreement between HGV and HOCHBAHN, this is very unlikely. In case of a bankruptcy, the contract would need to be terminated and based on German equity law, HGV would need to provide security to HOCHBAHN's creditors. Consequently, we view a liquidation of HOCHBAHN as very unlikely and assume additional support prior to a default as highly likely.

Support Track Record and Expectations Assessed as Very Strong

HOCHBAHN is not subject to EU competition rules and there are no restrictions on government support.

Hamburg prompted HOCHBAHN and VHH to create the requirements for a direct award of a service contract (Direktvergabe) in line with the EU provision No. 1370/2007 in 2014. HOCHBAHN and VHH are both in compliance with this provision and the agreement was signed with HOCHBAHN on 27 November 2019. The respective passenger transport act further ensures that HOCHBAHN is protected from competition for the entire lifetime of this contract. This means that local public transport in Hamburg is provided by consolidated GREs based on exclusive special provisions for services for the public and is in line with the law for granting aid and EU competition law.

HOCHBAHN is the most important transport provider in Hamburg, ensuring mobility even in remote areas and provides essential services for the public (Daseinsvorsorge). To ensure mobility in Hamburg and its metropolitan area, HOCHBAHN needs to operate lines that are not profitable. Due to this, HOCHBAHN and Hamburg agreed on a profit and loss transfer agreement, which ensures annual deficit compensation (Fehlbetragsausgleich) by Hamburg. Under this agreement, HOCHBAHN is eligible for and receives consistent support from its owner covering its losses.

HOCHBAHN further receives funding for Hamburg-promoted investments. According to HOCHBAHN's business plan, these will be EUR297 million in 2020-2023, covering almost 20% of scheduled gross investments (EUR1,525 million). The reminder will largely be debt funded.

Finally, HOCHBAHN has a cash pooling agreement with its owner. This means HOCHBAHN is not reliant on credit lines with financial institutions but can access liquidity from HGV, preventing HOCHBAHN from lacking liquidity in case of need.

Socio-Political Implications of Default Assessed as Moderate

We believe it would be difficult for HOCHBAHN difficult to be substituted by a private player as the services provided include nonprofitable services and HOCHBAHN reports ongoing deficits that are covered by the profit and loss agreement with HGV.

As the main local public transport provider for one of the largest cities in Germany, a disruption of its services would lead to significant political or economic repercussions for Hamburg. However, we view this factor as driven by the financial implications of default and a financial default of HOCHBAHN would not materially affect the provision of its essential public services and endanger the GRE's mission. We view this factor as having moderate implications overall.

Financial Implications of Default Assessed as Very Strong

HOCHBAHN provides essential public services. As the largest transport company in Hamburg and the metropole region, HOCHBAHN is core for a key project of the city, called "Hamburg-Takt", ensuring it moves to supply driven public transport from demand-driven. With this project Hamburg aims to ensure that its citizens should be able to reach transport within five minutes and to reduce private transport. Hamburg aims to increase public transport's share of total transport in Hamburg by 8% to 30% in 2030 from 22% in 2017. According to HOCHBAHN, this would mean a 50% increase in its annual customers.

HOCHBAHN is core to Hamburg achieving its climate goals including the conversion of its transport fleet to emission-free driving. HOCHBAHN is leading a central government-supported project to test digital mobility solutions. HOCHBAHN receives subsidies for Hamburg-promoted investments and Hamburg is aware that this requires HOCHBAHN to increase its debt. Given the essentiality of the investments provided for Hamburg, we assume Hamburg is very likely to support HOCHBAH.

Hamburg reports by group accounting and all its GREs are grouped under HGV. If a GRE defaulted on its obligations, the borrowing capacity of Hamburg and its other GREs would be significantly impaired. Hamburg is one of the 16 German states, the largest subnational borrowing group with frequent needs to tap the capital market. Any doubts about Hamburg's capacity to service its own debt as well as that of its GREs would lead to severe negative repercussions of its creditworthiness and borrowing capacity.

SCP

Based on Fitch's Public Sector, Revenue-Supported Entities Rating Criteria, HOCHBAHN's SCP is 'bb', which reflects a Stronger assessment for Revenue Defensibility and Midrange assessment for Operating Risk, and leverage (Fitch net adjusted debt to EBITDA) approaching 16.7x in our rating case scenario.

The Stronger revenue defensibility assessment reflects the assessments of Demand as Stronger and Pricing as Midrange. HOCHBAHN had a total passenger volume (metro and bus services) of over 466 million passengers in 2019, and this level is usually not subject to fluctuation. In light of the COVID-19 pandemic and corresponding lockdown measures, passenger volume declined sharply in 1H20. It has already recovered to over 70% to date and HOCHBAHN expects passenger volume to reach about 95% of 2019 volumes from in 2021.

Even in times of economic downturns we assume the reliance on HOCHBAHN as main local transport mean to be unchanged and considering the economic prospects of Hamburg, the population and thus passengers are likely to increase further. This also considers the city's political goal to increase the importance of HOCHBAHN for local transport and reduce individual traffic.

The Moderate operating risk assessment reflects operating costs assessed at Midrange and resource management assessed at Stronger.

Based on the public services provided, HOCHBAHN is loss-making in general and receives annual compensation for its losses from its owner. Driven by expansion of the infrastructure and the modernisation of its fleet towards emission free busses and metro trains, HOCHBAHN significantly increased its debt to EUR1,065 million in 2019 from EUR458 million in 2015, corresponding to an increase in leverage to 15.1x from 6.0x.

For 2020-2024 HOCHBAHN further faces high annual net investments needs of between EUR245 million and EUR350 million. Therefore, debt is likely to increase to close to EUR2 billion in 2024. Based on the annual profit and loss-making transfer agreement, HOCHBAHN is likely to receive full annual compensation for the losses envisaged in its medium-term plan, limiting the increase of the company's leverage. According to our rating case, HOCHBAHN's leverage is likely to increase to 16.7x in 2024 from 15.1x in 2019.

DERIVATION SUMMARY

Under its GRE Criteria, Fitch equalises HOCHBAHN's rating with those of Hamburg as Fitch views the legal status of the former as tantamount to a government guarantee. Fitch also classifies HOCHBAHN as an entity linked to Hamburg and applies a top-down approach based on its assessment of the strength of linkage with and incentive to support by Hamburg. HOCHBAHN's GRE support score is assessed at 45, reflecting a combination of three factors assessed at Very Strong (Status, Ownership & Control, Support Track Record & Expectations and Financial Implications of a Default) and Socio-Political Implications of a Default assessed at Moderate.

KEY ASSUMPTIONS

While German GREs' most recently available data may not have indicated performance impairment, material changes in revenue and cost profiles are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and some form of government restrictions are maintained or broadened. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for their severity and duration, and incorporate revised qualitative and quantitative inputs based on performance expectations and assessment of key risks, including extraordinary support.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The rating is the highest level on Fitch's scale and cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Weaker features of the legal status, weakening confidence on the ultimate nature of the government guarantee and loosening links between HOCHBAHN and Hamburg, including a perceived dilution of support could lead to a notch down from Hamburg's ratings.

Negative rating action on Hamburg would be reflected in HOCHBAHN's ratings, assuming that the links between Hamburg and HOCHBAHN remain unchanged.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

DATE OF RELEVANT COMMITTEE

27 August 2020

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT	RATING		
Hamburger Hochbahn AG	LT IDR	AAA Rating Outlook Stable	Publish
•	ST IDR	F1+	Publish
•	LC LT IDR	AAA Rating Outlook Stable	Publish
• senior unsecured	LT	AAA	Publish

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Guido Bach
Senior Director
Primary Rating Analyst
+49 69 768076 111
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Nazim Dadashov
Analyst

Secondary Rating Analyst
+49 69 768076 149

Raffaele Carnevale
Senior Director
Committee Chairperson
+39 02 879087 203

MEDIA CONTACTS

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Hamburger Hochbahn AG	-

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE

AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

 In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other

information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

International Public Finance Supranationals, Subnationals, and Agencies Europe

Germany