

Rating Action: Moody's upgrades Ceske drahy to Baa2

Global Credit Research - 09 May 2016

Assigns (P)Baa2 provisional rating to new bonds

Milan, May 09, 2016 -- Moody's Investors Service has upgraded the long-term issuer and senior unsecured ratings of Czech national railway operator Ceske drahy, a.s. to Baa2 from Baa3, and upgraded the company's baseline credit assessment (BCA), which is a measure of the company's standalone financial strength, to ba2 from ba3. Concurrently Moody's has assigned a provisional (P)Baa2 rating to the perspective Eurobond to be issued by Ceske drahy. The outlook on the long-term issuer and senior unsecured ratings is stable.

"The upgrade of Ceske drahy's ratings and BCA reflects structural improvements to the company's operational performance and leverage (measured as Moody's adjusted debt/EBITDA), which we expect to remain between 4.5x and 5.0x over the next 18-24 months" said Lorenzo Re, a Moody's Vice President -- Senior Analyst and lead analyst for the issuer.

"The upgrade also reflects Ceske drahy's improving liquidity, deterioration of which presented a major constraint to a rating upgrade, which will be further enhanced by the announced bond issue" adds Mr. Re.

RATINGS RATIONALE

The upgrade of Ceske drahy's ratings to Baa2 from Baa3 follows the upgrade of its BCA to ba2 from ba3. The change in the BCA reflects the structural improvement in the company's operating performance and financial metrics. Although operating results showed some volatility in 2014-15, owing to non-recurring items, Moody's believes that the efficiency measures implemented by the company, especially in its cargo business, will allow it to maintain stable profitability in the next 18-24 months with an EBITDA margin (as adjusted by Moody's) remaining at a healthy 25%-26%.

Leverage has also materially improved and the rating agency expects that Ceske drahy's debt/EBITDA ratio will remain at 4.5x-5.0x through 2018, a level that comfortably places the rating at the current level. This is also underpinned by Ceske drahy's reviewed investment policy: while Moody's expects that capex will remain relatively high at some CZK5 billion - CZK6 billion per annum over the next three years, this is materially lower than the peak reached in 2011-2013 and should allow investments to be now fully funded with internal cash flows. Moody's forecasts do not factor in the potential disposal of railway stations to the Czech railway infrastructure manager, SZDC, which, if completed, would represent an additional credit positive.

The upgrade of BCA also reflects the improvement in the company's liquidity profile, as in the past two years Ceske drahy materially reduced its overreliance on short-term debt and uncommitted credit facilities by issuing long-term private placements (EUR115 million in 2015) and increasing the amount of its committed back-up line (CZK10.6 billion, or almost EUR400 million as of March 2016). The announced issue of a euro denominated bond will further improve the liquidity and the average duration of the company's debt. The failure to issue the announced bond and refinance the EUR300 million bond maturity in June 2016 would put negative pressure on the rating.

As Ceske drahy is a 100% state-owned company, Moody's has applied its rating methodology for government-related issuers (GRIs). In accordance with this methodology, the Baa2 ratings of Ceske drahy reflect the combination of the following inputs: (1) BCA of ba2; (2) the A1 local-currency rating of the Government of Czech Republic with a stable outlook; (3) Moody's assessment of a high probability of government support; and (4) very high default dependence.

The ba2 BCA positively reflects (1) Ceske drahy's role as quasi-monopoly provider of rail transportation in the Czech Republic; (2) the high visibility of the revenues the company derives from its passenger transportation activities in light of the 10-year management contracts that it signed with the government and the country's 14 municipalities. In Moody's view, the risk that these contracts will not be renewed upon expiration in 2019 is quite limited; and (3) some recent improvements in the performance of its freight subsidiary (CD Cargo).

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Ceske drahy will be comfortably positioned at Baa2, owing to the expected fairly stable operating performance and financial profile for the next 18-24 months. The stable outlook also assumes that Ceske drahy will be able to renew most of its management contracts upon expiration.

WHAT COULD CHANGE THE RATING DOWN/UP

Upward pressure on the rating would likely result from a positive change in Ceske drahy's BCA to ba1 from the current ba2, as a result of a sustainable improvement in the company's operating performance with (1) EBITA margin moving towards high-single digits, (2) debt/EBITDA improving to below 4.5x and (3) free cash flow remaining positive on a sustained basis. An upgrade of Ceske drahy's rating could also be triggered by an upgrade of the rating of the Czech Republic.

Downward pressure on the rating could arise if Moody's were to downgrade Ceske drahy's BCA to ba3 from ba2 as consequence of a weakening in the company's credit metrics, with its debt/EBITDA ratio deteriorating towards 6.0x, and free cash flow remaining negative for a prolonged period. Downward pressure could be exerted on the ratings if the company's liquidity were to weaken. A downgrade of Ceske drahy's rating could also be triggered by a downgrade of the rating of the Czech Republic and/or a weakening of the close links between the company and its sole shareholder.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Passenger Railway Companies published in March 2013. Other methodologies used include the Government-Related Issuers methodology published in October 2014. Please see the Ratings Methodologies page on www.moody.com for a copy of these methodologies.

Ceske drahy, a.s. is the national railway operator in the Czech Republic. The company is mainly engaged in the passenger and freight transportation industries and has almost 24,000 employees. Ceské dráhy is 100% controlled by the Czech Republic. In 2015, the company reported total revenues of CZK33.1 billion (EUR1.2 billion) and an EBITDA of CZK6.4 billion (EUR237 million).

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moody.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moody.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moody.com for additional regulatory disclosures for each credit rating.

Lorenzo Re

Vice President - Senior Analyst
Corporate Finance Group
Moody's Italia S.r.l
Corso di Porta Romana 68
Milan 20122
Italy
Telephone:+39-02-9148-1100

Marina Albo
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Italia S.r.l
Corso di Porta Romana 68
Milan 20122
Italy
Telephone:+39-02-9148-1100



© 2016 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE. MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and

reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.