

**Rating Action: Moody's assigns definitive Baa1 ratings to České dráhy; negative outlook (Czech Republic)**

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Global Credit Research - 19 Jul 2011

**Approximately EUR 300 million in debt affected**

Milan, July 19, 2011 -- Moody's Investors Service has today assigned a definitive Baa1 issuer rating to České dráhy, a.s. ("CD" or "the company"). At the same time, the rating agency has assigned a definitive Baa1 senior unsecured bond rating to the Company's EUR300 million notes which were issued on 24 June and will mature in 2016. The outlook on all ratings is negative.

Moody's definitive ratings for CD are in line with the previously assigned provisional rating and follow the successful placement of CD's inaugural bond issuance of EUR300 million as well as Moody's review of the final documentation of the issued euro notes.

**RATINGS RATIONALE**

As CD is a 100% state-owned company, Moody's has applied its rating methodology for government-related issuers (GRIs), according to which the Baa1 rating of CD reflects the combination of the following inputs:

- A baseline credit assessment (BCA) of 11 (on a scale of 1 to 21, where 1 represents the lowest level of credit risk and 11 equates to Ba1)
- The A1/stable local currency rating of the Czech government
- The high probability of government support
- Very high dependence

The high probability of support currently assigned to CD reflects its 100% state ownership and its tight control by the Czech government, with government-nominated representatives dominating its steering committee. Although the Czech government does not explicitly guarantee all of CD's obligations, it currently provides significant support to the company via loan guarantees (indeed, a large portion of CD's debt is supported by government guarantee). Therefore, Moody's believes it is likely that the Czech Republic would provide extraordinary support to CD if the company were to experience financial stress to ensure the timely payment of debt coming due.

The very high default dependence currently assigned to CD reflects: (i) the high level of operational and financial linkages between CD and its sole shareholder, as evidenced by the provision of around 33% of its revenues by the government in the form of operating subsidies and capital grants, as well as by regional financial compensation for the public services provided by the company; and (ii) the very high degree of overlap between the revenue bases of CD and that of its sole shareholder given that both entities generate most of their income in the Czech Republic.

The BCA takes account of the following factors: (i) CD's role as quasi monopoly provider of rail transportation in the Czech Republic; (ii) the good 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 14 municipalities; (iii) the good performance of its freight franchise; and (iv) its strong asset base and plan to sell its non-core assets.

Furthermore, the rating assumes not only that CD will be largely successful in implementing its "non-core assets" divestment plan over the next few years, but also that it will utilise these proceeds to partially fund its capital investment programme.

However, despite these positive factors, the BCA is constrained by: (i) the execution risk related to CD's capital investment programme and the associated expected negative free cash flow, which could affect the credit metrics and therefore also the credit profile of the company, if it were unable to achieve the anticipated level of improvement in terms of both its efficiency and market penetration; (ii) CD's structurally weak liquidity position, given its still relatively high dependence on short-term debt and Moody's expectation that the company will generate negative free cash flow over the next few years; (iii) the risk that CD could see its market position eroded following the opening up of the market to competition; and (iv) the limited size of the company compared with certain other European railways companies, which may become CD's competitors in the future.

The negative outlook is based on the execution risk related to the full completion of CD's plan to strengthen its liquidity profile, currently under way. This plan includes not only securing CZK10.5 billion of long-term financing, (of which CZK8.5 billion has already been secured), but also selling assets totalling approximately CZK1.7 billion by the end of 2011. Moody's would consider stabilising the rating outlook upon CD's timely conclusion of its financing plan during the course of 2011, as currently anticipated.

Moody's notes that upward pressure on the ratings could be limited in the short term. However, the ratings could come under upward pressure from a sustained improvement in both the company's operational performance, reflected by an EBITA margin that is sustainably in the high single digits, and in its financial performance, with a debt/EBITDA ratio approaching 3.5x.

CD's Baa1 issuer rating is sensitive to any reduction in the expected high level of support from the government. However, given the framework in which CD operates and its strong economic importance to the Czech Republic, Moody's considers it likely that support levels will remain high. However, the rating could come under downward pressure if the company's debt/EBITDA ratio were to increase to above 5.5x by 2011 and/or its EBITA margin were to remain below 5% after 2012. Furthermore, immediate downward pressure on the ratings could result from concerns regarding liquidity.

**RATING METHODOLOGIES**

The principal methodology used in rating, České dráhy a.s. was the Global Passenger Railway Companies Industry Methodology, published in December 2008. Other methodologies used include the Government-Related Issuers methodology published in July 2010. Please see the

Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

Ceské dráhy, a.s. is the national railway operator in the Czech Republic. The company is mainly engaged in the passenger and freight transportation industries and associated activities. CD also manages the traffic control activities for the railway network, but from September 2011 these operations will be transferred to the Czech network manager, Správa Železniční dopravní cesty ("SZDC"). CD is 100% controlled by the Czech Republic. As of 31 December 2010, the company recorded total revenues of CZK37.8 billion (USD2.0 billion) and employed approximately 38,000 people.

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Milan  
Marco Vetulli  
VP - Senior Credit Officer  
Corporate Finance Group  
Moody's Italia S.r.l  
Telephone: +39-02-9148-1100

Paris  
Eric de Bodard  
MD - Corporate Finance  
Corporate Finance Group  
Moody's France SAS  
JOURNALISTS: 44 20 7772 5456  
SUBSCRIBERS: 44 20 7772 5454

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



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