

Rating Action: Moody's downgrades České dráhy to Baa3; stable outlook

Global Credit Research - 28 May 2014

London, 28 May 2014 -- Moody's Investors Service has today downgraded the long-term issuer and senior unsecured ratings of České dráhy, a.s. to Baa3 from Baa2, following today's lowering to ba3 from ba2 of the company's baseline credit assessment (BCA), which is a measure of the company's standalone financial strength (without the assumed benefit of state support). The outlook on the long-term issuer and senior unsecured ratings is stable. This concludes the review for downgrade initiated on 2 April 2014.

"A weaker-than-expected 2013 operating performance, a continuing overreliance on short-term credit facilities and a slowdown of planned asset disposals prompted our decision to lower České dráhy's BCA and, subsequently, to downgrade the company's ratings," said Marie Fischer-Sabatie, a Moody's Vice President -- Senior Credit Officer and lead analyst for the issuer.

RATINGS RATIONALE

Today's downgrade of České dráhy's ratings to Baa3 from Baa2 reflects the lowering of its BCA to ba3 from ba2. The change of BCA reflects (1) the weaker-than-expected operating performance of the group during 2013 and the expectation that its credit metrics for 2014 will not improve materially and position the group more appropriately in the ba3 category; (2) a liquidity profile that remains overly reliant on short-term credit facilities and uncommitted lines; and (3) the lower-than-anticipated amount of asset disposals, due in particular to the delayed sale of stations to the Czech railway infrastructure manager, SZDC, which had been initially planned for end-2013.

However, we note positively that České dráhy has taken measures to reduce its costs, in particular at its freight subsidiary, CD Cargo. These measures have started to show positive results during 2013, with a reported EBITDA at CD Cargo improving to CZK1.7 billion, in spite of a slight decline in freight transport revenues.

As České dráhy is a 100% state-owned company, Moody's has applied its rating methodology for government-related issuers (GRIs). In accordance with this methodology, the Baa3 ratings of České dráhy reflect the combination of the following inputs: (1) BCA of ba3; (2) the A1 local-currency rating of the Czech government with a stable outlook; (3) our assessment of a high probability of government support; and (4) very high default dependence.

The ba3 BCA positively reflects (1) České dráhy'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; and (3) some recent improvements in the performance of its freight subsidiary.

The ba3 BCA also takes account of (1) the company's liquidity profile, which remains fairly weak and constrained by the group's large capex plans and its reliance on short-term credit facilities, although Moody's notes some increase in liquidity sources during the past year thanks to a CZK4 billion domestic bond issuance undertaken in July 2013 and the extension and increase of certain of the group's bank facilities; and (2) the execution risk in České dráhy's capex and asset disposal plans.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that (1) Ceske drahy will be comfortably positioned at Baa3 and (2) the group will have a fairly stable operating performance during 2014, with a financial profile which will not change materially. The comfortable positioning at Baa3 provides České dráhy with headroom for potential underperformance.

WHAT COULD CHANGE THE RATING DOWN/UP

Upward pressure on the rating would likely result from a positive change in České dráhy's BCA to ba2 from the current ba3, as a result of a sustainable improvement in the company's operating performance and credit metrics. Such an improvement would be reflected by, for example, a debt/EBITDA ratio below 6.0x and an EBITA margin around the mid single-digits in percentage terms, on a sustainable basis. In addition, in order to be upgraded, the

company would need to strengthen its liquidity position, reducing its reliance on short-term financing. An upgrade of České dráhy'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 lower České dráhy's BCA to b1 from ba3. Moody's could lower České dráhy's BCA if the company exhibited weakened credit metrics, including a debt/EBITDA ratio above 7.0x and/or an EBITA margin in the low single-digits or below in percentage terms, for a prolonged period. Furthermore, immediate downward pressure could be exerted on the rating if the company's liquidity were to weaken. A downgrade of České dráhy'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 this rating was the Global Passenger Railway Companies published in March 2013. Other methodologies used include the Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

České 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. České dráhy is 100% controlled by the Czech Republic. At the end of 2013, the company recorded total revenues of CZK32.9 billion (\$1.6 billion), and had 25,043 employees.

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