MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns (P)Baa1 rating to Ceské dráhy; negative outlook (Czech Republic)

Global Credit Research - 05 May 2011

First-time assignment

Milan, May 05, 2011 -- Moody's Investors Service has today assigned a provisional (P)Baa1 issuer rating to Ceské dráhy, a.s. ("CD"). The outlook on the rating is negative. This is the first time that Moody's has assigned ratings to CD.

The assigned rating is provisional because it is contingent on the successful conclusion of CD's plan to strengthen its capital structure by securing long term financing of a minimum amount of CZK 7.5 billion.

Upon the finalization of the long term financing in accordance with the plan, Moody's will endeavor to assign a definitive rating. A definitive rating may differ from a provisional rating.

As CD is a 100% state-owned company, Moody's has applied its rating methodology for government-related issuers (GRIs), last updated in July 2010 (Government-Related Issuers: Methodology Update). In accordance with Moody's GRI rating methodology, the Baa1 rating of CP 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

RATINGS RATIONALE

"The BCA of 11, equivalent to a Ba1 corporate family rating, is two notches lower than the indication provided by Moody's methodology grid outcome (Baa2), as the structurally weak liquidity management has weighed on the credit assessment," says Marco Vetulli, a Moody's Vice President-Senior Credit Officer and lead analyst for CD.

The BCA factors in: (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 ten-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 CD's 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 program," concludes Mr. Vetulli.

Nonetheless, 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 impact the credit metrics, and therefore 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) a structural weak liquidity position, with the company being over-reliant on short term debt and the negative free cash-flow contemplated for 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 high probability of support currently assigned to CD reflects its 100% state ownership and that it is tightly controlled by the Czech government, with government-nominated representatives dominating its steering committee. Although the Czech government does not explicitly guarantee CD's obligations, it currently provides significant support to the company via loan guarantees (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 group were to be in financial stress in the future to ensure 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, evidenced by the fact that around 33% of its revenues is provided by government, in the form of operating subsidies and capital grants, and regional financial compensation for the public services provided by the company; and (ii) the very high degree of overlap of the revenue bases of CD and its sole shareholder, as both entities generate most of their income in the Czech Republic.

The negative outlook is based on the execution risk related to the full completion of CD's plan to strengthen its liquidity profile currently underway. This plan includes not only the securing of additional CZK 10.5 billion of long term financing, but also asset sale activities for about CZK 1.6 billion during the next few quarters.

Moody's could stabilise the outlook, when the company timely concludes its financing plan as anticipated throughout the 2011 year.

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

CD's (P)Baa1 issuer rating is somewhat 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 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.

PRINCIPAL METHODOLOGIES

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

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 July 2011 these operations will be transferred to the Czech network manager, Správa €eleznicní 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 billion) and employed 38,046 people.

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Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information, and confidential and proprietary Moody's Investors Service information.

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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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