MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa2 rating to Ceske drahy's proposed new notes; outlook stable

21 Jun 2022

Paris, June 21, 2022 -- Moody's Investors Service ("Moody's") has assigned a Baa2 rating to Czech national railway operator Ceske drahy, a.s.'s ("CD", "Ceske drahy", or the company) proposed new €500 million senior unsecured notes. Concurrently, Moody's has affirmed the Baa2 long-term issuer rating, the Baa2 senior unsecured ratings and the ba2 company's Baseline Credit Assessment (BCA) which reflects the company's standalone financial strength. The outlook is stable.

The proposed new notes will be used to fund its increasing capital expenditure needs in the next 18-24 months, repay maturing debt and to support liquidity.

RATINGS RATIONALE

The affirmation of Ceske drahy's ratings and BCA reflects a solid operating performance in 2021 despite the continued severe impact of the pandemic, resulting in lower Moody's adjusted Debt/EBITDA of 6.2x compared with 9.5x in 2020. However, the decision to increase balance sheet debt by around 45% to support capex and liquidity rather than through equity will push leverage back up to around 6.6x in 2022, putting pressure on the BCA as well as the overall Baa2 rating. Although Moody's expects leverage to reduce to around 6x in 2023 in the base case, this leaves no cushion for underperformance.

Ceske drahy's Baa2 issuer rating incorporates a three-notch uplift from the ba2 BCA, in accordance with Moody's Government-Related Issuers Methodology. The uplift reflects the continued strong relationship between the company and its sole shareholder, the Czech Republic (Czech Republic, Government of, Aa3 stable).

CD's ba2 BCA is underpinned by the company's solid market position in the Czech Republic and high revenue visibility, owing to contracts that it has signed with the government and 14 municipalities for the passenger railway operations.

The BCA also reflects CD's operational improvements as it recovers from the challenges posed by the pandemic. Despite the modest recovery in revenues to CZK38.5 billion from CZK36.4 billion in 2020, the company's reported EBITDA margin improved to 20.7% from 14% in 2020. This was achieved mainly through increased productivity and lower personnel costs. CD's reported EBITDA margin should increase to above 25% in the next 12 to 18 months despite some inflationary pressures.

In addition to the company's higher debt burden and consequently continued high leverage, which is likely to be in excess of 6.0x in 2022, the BCA is constrained by the negative free cash flow that Moody's expects in the next 18 to 24 months driven by capital expenditure needs. Capital expenditure will be mainly allocated to the continued modernization of the passenger and freight rolling stock, which is key to remaining competitive.

Following the loss of several tenders in 2019 and 2020, the company continues to face the risk of tender losses going forward. However, supported by recent contract wins, Moody's expects the company to maintain a strong market share of well above 80% in the Czech passenger railway market.

LIQUIDITY

CD has good liquidity. The company has access to at least CZK34 billion of liquidity, including CZK1.8billion unrestricted cash on its balance sheet as of the end of March 2022, CZK10.4 billion available under committed facilities, CZK7.2 billion undrawn bank loans, (with maturities exceeding 12 months as of the end of May 2022), Eurofima loan of CZK7.2 billion, subsidies of CZK1.2 billion and operating cash flow which Moody's estimates at CZK6.6 billion. This available liquidity will comfortably cover the expected capital spending of close to CZK25 billion (post-IFRS 16) and debt repayments of CZK3.9 billion in 2022. The proposed new notes as well as increased cash from operations will further enhance liquidity, enabling the repayment of CD's maturing EUR400 million Eurobond in May 2023.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that CD's leverage will reduce to or below 6x in the next 18-24 months despite the proposed additional debt as a result of capital expenditure needs. The outlook also reflects Moody's expectation that CD's operating performance will continue to recover from the pandemic and the company will continue to maintain good liquidity.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward pressure on the rating would likely result from an upgrade of CD's BCA to ba1 from the current ba2, as a result of a sustainable improvement in the company's operating performance; EBIT margin remaining in the mid-single digits (in percentage terms), Moody's-adjusted debt-to-EBITDA ratio decreasing to around 4.5x on a sustained basis, and free cash flow remaining positive on a sustained basis.

While linkages with the sovereign are deemed strong and an upgrade of the rating of the Czech Republic would be positive for CD's credit quality, it will unlikely result in an upgrade of CD's rating which is currently constrained by the ba2 BCA.

The issuer rating could come under pressure if there is a further deterioration and downgrade of the BCA, and if this is not adequately compensated by stronger sovereign support or increasing strategic importance to the Czech Republic.

The BCA is weakly positioned as a result of the increased level of debt on balance sheet and consequently still high leverage despite an improvement in the company's earnings. If the company does not perform as Moody's expects and it fails to reduce leverage below 6x in the next 12-18months, the BCA could be downgraded to ba3 from ba2 as a consequence. The BCA could also come under pressure if free cash flow remains negative for a prolonged period or if there is a deterioration in the company's liquidity profile.

A downgrade of Ceske drahy's rating could also be triggered by a significant deterioration in the sovereign rating for the Czech Republic and/or a weakening of the close links between the company and its sole shareholder.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Passenger Railways and Bus Companies published in December 2021 and available at https://ratings.moodys.com/api/rmc-documents/360649, and Government-Related Issuers Methodology published in February 2020 and available at https://ratings.moodys.com/api/rmc-documents/64864. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

COMPANY PROFILE

In 2021, CD recorded total revenue from principal operations of CZK38.5 billion (€1.6 billion), of which around 67% (including other income) was from passenger transportation and around 33% was from freight transportation. The company has around 22,186 employees as of 31 December 2021 and is one of the largest employers in the Czech Republic.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security 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 issuer/deal page for the respective issuer on https://ratings.moodys.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.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com.

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

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on https://ratings.moodys.com.

Please see https://ratings.moodys.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 issuer/deal page on https://ratings.moodys.com for additional regulatory disclosures for each credit rating.

Kristin Yeatman
Vice President - Senior Analyst
Corporate Finance Group
Moody's France SAS
96 Boulevard Haussmann
Paris, 75008
France
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Jeanine Arnold
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's France SAS
96 Boulevard Haussmann
Paris, 75008
France
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

MOODY'S
INVESTORS SERVICE