MOODY'S
INVESTORS SERVICE

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.moodys.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. České 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).

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