MOODY'S INVESTORS SERVICE

CREDIT OPINION
1 May 2018

Update

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RATINGS

Ceske drahy, a.s.

Domicile	Czech Republic
Long Term Rating	Baa2
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Francesco Bozzano +33.1.5330.1037
Analyst
francesco.bozzano@moodys.com

Yasmina Serghini +33.1.5330.1064
Associate Managing Director
yasmina.serghini@moodys.com

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Ceske drahy, a.s.

Annual Update

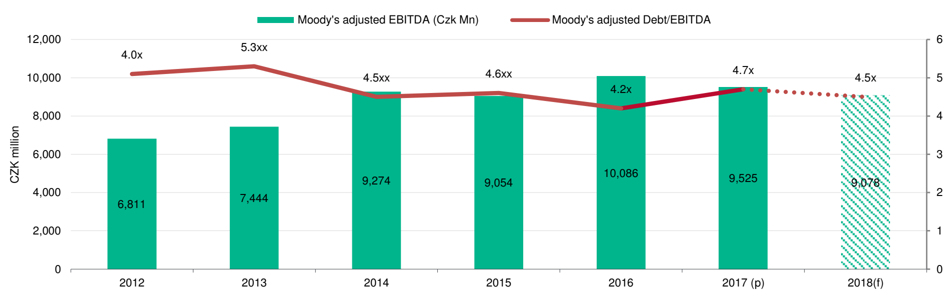
Summary Rating Rationale

Ceske drahy, a.s.'s (CD) Baa2 rating incorporates a three-notch uplift from the ba2 Baseline Credit Assessment (BCA), in accordance with our rating methodology for government-related issuers. The uplift reflects the strong relationship between the company and its sole shareholder, the Czech government (A1 positive).

CD's ba2 BCA reflects the structural improvement in the company's operating performance owing to a number of efficiency measures implemented in the last three years, especially in its cargo business. We expect CD's reported EBITDA margin to remain above 20% in 2018. We expect free cash flow to turn negative in 2018 as capital expenditure will increase in 2018 as some 2017 projects were delayed.

CD's ba2 BCA is also underpinned by the company's solid market position and high revenue visibility, owing to 10-year management contracts that it has signed with the government and 14 municipalities. We expect the majority of these contracts to be renewed when they expire in 2019.

Exhibit 1
Leverage Will Remain Solid for the Rating



All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) or Projections (proj.) are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated.
Source: Moody's Financial Metrics™.

Credit Strengths

» High probability of support from the government

» Structural improvement in operating results since 2014

» Solid position in domestic market

» Good revenue visibility, owing to long-term service contracts with central and local authorities

Credit Challenges

» High capital expenditure maintains pressure on cash generation

» The expiry of state and regional public service contracts in 2019 is a credit risk in light of ongoing liberalisation of the railways market

Rating Outlook

The stable outlook reflects our expectation that CD will be comfortably positioned at Baa2, maintaining a fairly stable operating performance and financial profile for the next 18-24 months. The stable outlook also factors in our expectation that CD will be able to renew most of its management contracts when they expire.

Factors that Could Lead to an Upgrade

» An upgrade of the sovereign rating for the Czech Republic

» 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

» EBITA margin moving towards high single digits (in percentage terms)

» Moody's-adjusted debt-to-EBITDA ratio improving to below 4.5x

» Free cash flow remaining positive on a sustained basis

Factors that Could Lead to a Downgrade

» A downgrade of the sovereign rating for the Czech Republic and/or a weakening of the close links between the company and its sole shareholder

» A downgrade of CD's BCA to ba3 from ba2 as a consequence of a weakening in the company's operational performance and/or credit metrics

» Moody's-adjusted debt-to-EBITDA ratio deteriorating towards 6.0x

» Free cash flow remaining negative for a prolonged period

» Deterioration in the company's liquidity profile

Key Indicators

Exhibit 2
Ceske drahy's key Indicators

KORUNY Millions	12/31/2014	12/31/2015	12/31/2016	6/30/2017(LTM)	12/31/2017 (p)	12/31/2018(f)
Revenue	33,036	33,083	33,292	33,693	33,969	33,151
EBITA Margin	6.9%	7.6%	8.9%	7.9%	6.8%	4.8%
EBITA / Avg. Assets	2.5%	2.7%	3.2%	2.9%	2.9%	1.9%
Debt / Book Capitalisation	51.8%	53.1%	52.6%	50.6%	56.0%	51.8%
Debt / EBITDA	4.5x	4.4x	4.2x	4.1x	4.7x	4.5x
FCF / Debt	0.7%	-2.6%	-1.6%	-0.4%	4.5%	-13.3%
RCF / Net Debt	19.5%	18.4%	22.5%	23.6%	21.5%	19.1%
(FFO + Interest) / Interest	6.1x	5.3x	6.3x	6.9x	7.0x	6.3x

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Source: Moody's Financial Metrics™.

Detailed Rating Considerations

Operating results have been constantly improving

The rating and the BCA reflect the improvement in CD's operating performance, which we expect to be structural. We project the company's reported EBITDA margin to remain comfortably above 20% in 2018. The improvement is the result of both (1) cost reductions and efficiency measures implemented by the company, especially in its cargo business, in the last four years; and (2) the improvement in service quality (i.e., renewal of rolling stock, better timetable) that is driving a slow but constant increase in passenger numbers. In 2017, the number of passengers reached 175 million (+4 million from 2016).

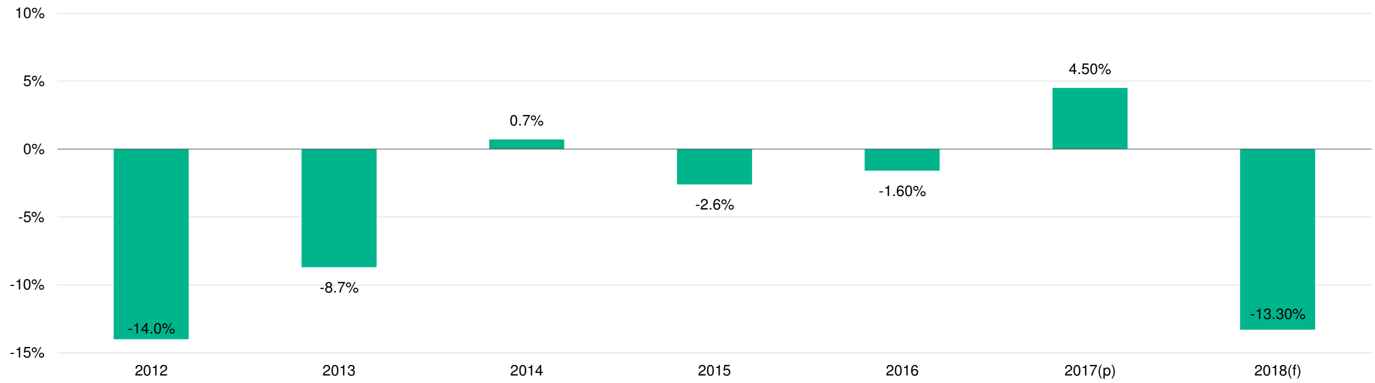
CD reported a 23% EBITDA margin in 2017 (25% in 2016). The reduction in margin was mainly due to employee cost inflation (3.2% wage growth) and higher maintenance costs. Notwithstanding this slight increase in costs in 2017, in the last four years, the EBITDA margin progression denotes a structural change compared with the weak profitability posted in 2011-13, when a poor performance in the company's freight business weighed on margins. Cargo business revenues increased by 1.3% and the division continued to generate a positive EBITDA contribution in 2017, although the increase in cost caused a 6.6% reduction against 2016.

Free cash flow will deteriorate owing to high capex needs

We expect that capex will increase to around CZK10.5 billion in 2018 from CZK5 billion in 2017, owing to delays in rolling stock investments in 2017 and the company's need to renew its train fleet. Therefore we expect free cash flow to materially deteriorate from 2018. However, CD's cash position increased to CZK7.8 as of the end of December 2017 (CZK7.6 billion as of the end of December 2016). Therefore, CD has a sufficient cash cushion to finance its capital expenditure and pay down its debt maturities of approximately CZK4 billion for 2018.

We therefore expect CD's reported gross debt to only marginally increase in 2018 and the company's leverage (measured as the ratio of Moody's-adjusted debt to EBITDA) to remain below 5.0x through 2018 (4.7x in 2017), a level that places the rating comfortably at the current level.

Exhibit 3
FCF/Debt Will Deteriorate Owing to Capital Expenditure Increase



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Source: Moody's Financial Metrics™.

Expiry of public service contracts is a credit risk

The opening up of both the national long-distance and the regional transportation segments to competition could weaken CD's current solid market position, and as such represents a material long-term credit risk. However, we believe that the liberalisation process will be very gradual and manageable by CD. Currently, the company has service contracts with the state for national long-distance services, and with 14 local authorities for regional services. Most of the service contracts will expire in 2019. Services regulated by these contracts account for the majority of CD's passenger services revenue.

The government is considering putting five single lines out to tender, with the new service contracts entering into effect in between 2020 and 2021. We estimate these lines to account for less than 10% of CD's passenger service revenue and 5% of total revenue. The service contracts for the remaining lines should be directly awarded to CD without tender. As far as regional transportation is concerned, only four regions so far have expressed their intention to tender the new contracts. Because a tender process can normally take up to two years, regions that are not yet preparing for bids are unlikely to be ready to tender new contracts before the expiry of the existing contracts. Therefore, we believe that most of the regional contracts are likely to be directly awarded to CD. Also, CD could win at least part of the contracts to be tendered. This is because of its position as the incumbent operator, compounded by its recent efforts to improve its service and modernise its fleet, preserving its market position.

High probability of support and very high default dependence

As the national railway operator in the Czech Republic, CD is 100%-owned by the Czech government and as such we have applied our rating methodology for government-related issuers. In accordance with this methodology, the Baa2 rating of CD reflects the combination of the following inputs:

» the BCA of ba2

» the A1 positve local-currency rating of the Czech government

» our assessment of a high probability of government support

» a very high default dependence between the company and the government

The high probability of support reflects the company's 100% state ownership and tight control by the Czech government. The Czech government does not explicitly guarantee CD's obligations, but we assume that it would be likely provide extraordinary support to the company in case of financial stress.

The very high default dependence currently assigned to CD reflects (1) the high level of operational and financial links between CD and its sole shareholder, as more than 41% of the company's revenue are generated with the state and the regions (CZK14 billion in 2017);

and (2) the very high degree of overlap between the revenue bases of CD and its sole shareholder, as both entities generate most of their income in the Czech Republic.

CD's business profile is underpinned by its solid market position and revenue visibility

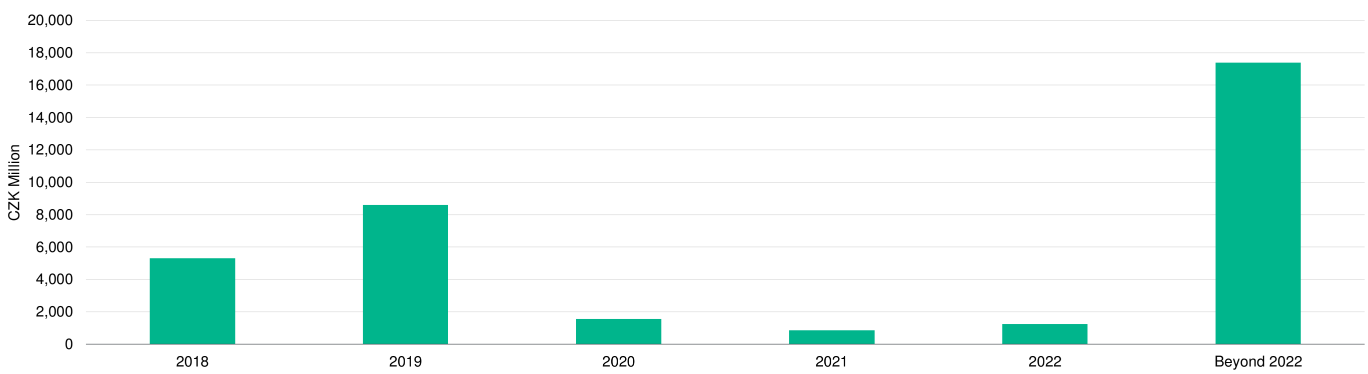
CD's BCA reflects its limited size, with annual revenue of roughly €1.4 billion, which is smaller than that of its major European peers. However, the ba2 BCA also positively reflects (1) CD's role as the dominant provider of rail transportation in the Czech Republic; and (2) the high visibility of the revenue the company derives from its passenger transportation activities, in light of the 10-year management contracts that it has signed with the government and the country's 14 municipalities.

Liquidity Analysis

As of the end of December 2017, CD had cash of CZK7.8 billion on its balance sheet and can count on CZK7.5 billion available under committed facilities, with maturities exceeding 12 months. Together with operating cash flow that we forecast at approximately CZK5.5 billion-CZK6.0 billion in 2018, the available liquidity will comfortably cover the expected cash uses, including (1) capital expenditure of close to CZK10.5 billion; and (2) debt repayments of CZK4 billion bond due in 2018, which will be fully repaid with available cash.

Exhibit 4

Ceske Drahy's Debt Maturity Profile Shows Moderate Refinancing Risk in 2019
CZK million



Source: Ceske drahy

Corporate Profile

Ceske drahy, a.s. is the national railway operator in the Czech Republic. The company is mainly engaged in passenger and freight transportation and associated activities.

CD was formed in 2002 when the state-owned company Czech Railways split into two separate companies: Ceske drahy, a joint stock company, and the Railway Infrastructure Administration (Sprava zeleznicni dopravni cesty, or SZDC), a state-owned company. CD is 100%-controlled by the Czech Republic, which exercises its shareholding rights through a steering committee. This committee is composed of three representatives from the Czech Ministry of Transportation, and one representative from the ministries of finance, defence, industry and trade, and regional development.

In 2017, CD recorded total revenue from principal operations of CZK34 billion (€1.4 billion, in line with 2016), of which around 65% was from passenger transportation and around 35% from freight transportation. The company has around 23,500 employees and is one of the largest employers in the Czech Republic.

Rating Methodology and Scorecard Factors

To provide an overall indication of CD's credit quality on a standalone basis (i.e., the BCA), we have applied our Global Passenger Railway Companies rating methodology, published in March 2013. The BCA is three notches lower than the grid-indicated rating of baa2, and reflects the company's exposure to market liberalization and the company's high capital expenditure requirements.

Exhibit 5

Rating Factors

Ceske drahy, a.s.

Passenger Railway Industry Grid [1][2]	Current LTM 6/30/2017		Moody's 12-18 Month Forward View As of 4/23/2018 [3]	
Factor 1 : SIZE (15%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue ($ Billion)	$1.4	B	$1.3 - $1.4	B
b) Number of Passenger Transported (PKM billion)	Ba	Ba	Ba	Ba
Factor 2 : MARKET POSITION (40%)				
a) Stability of Operating Environment	Baa	Baa	Baa	Baa
b) Market Characteristics	Baa	Baa	Baa	Baa
c) Competitive Environment	Aa	Aa	Aa	Aa
Factor 3 : COST POSITION AND PROFITABILITY (15%)				
a) EBITA Margin	7.9%	Baa	5% - 5.5%	Ba
b) EBITA / Avg. Assets	2.9%	B	1.8% - 2%	B
Factor 4 : CAPITAL STRUCTURE (15%)				
a) Debt / Book Capitalisation	50.6%	A	51% - 52%	A
b) Debt / EBITDA	4.1x	Baa	4.3x - 4.6x	Baa
Factor 5 : CASH FLOW AND INTEREST COVERAGE (15%)				
a) FCF / Debt	-0.4%	Ba	-10% - 0%	Ba
b) RCF / Net Debt	23.6%	Baa	18% - 19%	Baa
c) (FFO + Interest) / Interest	6.9x	A	6x - 6.5x	A
Rating:				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned				Baa2
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	ba2			
b) Government Local Currency Rating	A1/Positive			
c) Default Dependence	Very High			
d) Support	High			
e) Final Rating Outcome	Baa2/Stable			

Note: [1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations; [2] As of 6/30/2017(L); Source: Moody's Financial Metrics™; [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Investors Service

Appendix

Exhibit 6

Peer Comparison Table

(in US millions)	SNCF Mobilites Aa3 Stable			Deutsche Bahn AG (P)Aa1 Stable			Ceske drahy, a.s. Baa2 Stable		
	FYE Dec-16	FYE Dec-17	LTM Dec-17	FYE Dec-15	FYE Dec-16	LTM Jun-17	FYE Dec-15	FYE Dec-16	LTM Jun-17
Revenue	$33,766	$35,965	$35,965	$45,506	$45,535	$46,000	$1,346	$1,363	$1,365
EBITDA	$3,374	$4,125	$4,125	$5,396	$5,614	$5,597	$389	$413	$398
EBITA Margin	4.0%	5.4%	5.4%	1.7%	2.6%	2.9%	7.6%	8.9%	7.9%
EBITA / Avg. Assets	3.1%	4.2%	4.2%	1.2%	1.8%	2.0%	2.7%	3.2%	2.9%
FFO + Int Exp / Int Exp	6.2x	8.0x	8.0x	7.5x	7.7x	8.4x	5.3x	6.3x	6.9x
Total Debt/Capital	69.0%	69.7%	69.7%	68.9%	71.0%	69.7%	53.1%	52.6%	50.6%
Debt / EBITDA	5.9x	5.4x	5.4x	6.2x	6.2x	6.1x	4.4x	4.2x	4.1x
FCF / Debt	-5.9%	-1.0%	-1.0%	-4.8%	-0.6%	-2.8%	-2.6%	-1.6%	-0.4%
RCF / Net Debt	13.9%	19.8%	19.8%	20.9%	19.4%	20.6%	18.4%	22.5%	23.6%

All figures and ratios calculated using Moody's estimates and standard adjustments. FYE = Financial Year-End. LTM = Last 12 Months.
Source: Moody's Financial Metrics

Exhibit 7

Moody's-adjusted debt breakdown
Ceske drahy

(in KORUNY Millions)	FYE Dec-12	FYE Dec-13	FYE Dec-14	FYE Dec-15	FYE Dec-16	LTM Ending Jun-17
As Reported Debt	**30,268**	**34,585**	**36,782**	**37,191**	**37,805**	**35,824**
Operating Leases	4,447	4,425	4,562	4,245	4,248	4,248
Non-Standard Adjustments	0	260	425	467	313	0
Moody's-Adjusted Debt	**34,716**	**39,270**	**41,769**	**41,903**	**42,366**	**40,072**

All figures are calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Exhibit 8

Moody's-adjusted EBITDA breakdown
Ceske drahy

(in KORUNY Thousands)	FYE Dec-12	FYE Dec-13	FYE Dec-14	FYE Dec-15	FYE Dec-16	LTM Ending Jun-17
As Reported EBITDA	**5,440.7**	**5,502.7**	**7,660.4**	**7,512.0**	**8,655.0**	**8,608.0**
Operating Leases	1,482.5	1,475.1	1,520.5	1,415.0	1,416.0	1,416.0
Unusual	-97.4	478.1	105.6	653.0	39.0	-188.0
Non-Standard Adjustments	-15.0	-12.3	-13.9	-11.0	-24.0	0.0
Moody's-Adjusted EBITDA	**6,810.8**	**7,443.6**	**9,272.7**	**9,569.0**	**10,086.0**	**9,812.0**

All figures are calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Ratings

Exhibit 9

Category	Moody's Rating
CESKE DRAHY, A.S.	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

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