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CREDIT OPINION
20 June 2023

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.

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Ceske drahy, a.s.

Update to credit analysis

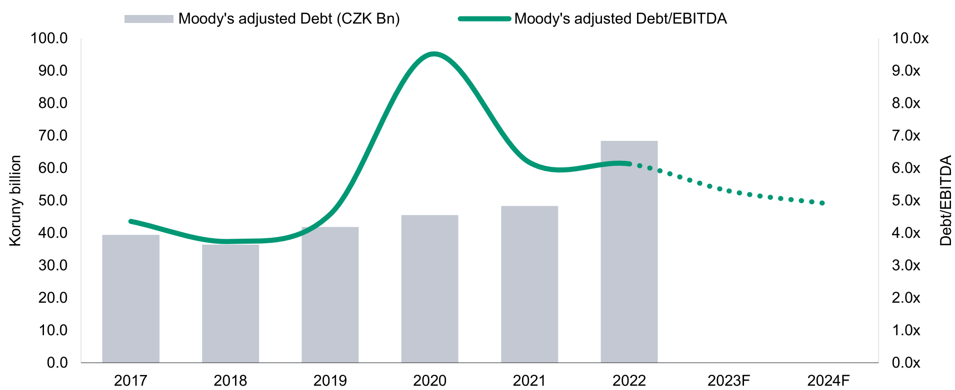
Summary

Ceske drahy, a.s.' (CD) Baa2 issuer rating incorporates a three-notch uplift from the ba2 Baseline Credit Assessment (BCA), in accordance with our Government-Related Issuers rating methodology. The uplift reflects the strong relationship between the company and its sole shareholder, the Government of Czech Republic (Aa3 negative).

CD's BCA reflects its solid operating performance in 2022 and a full recovery from the pandemic, resulting Moody's-adjusted debt/EBITDA of 6.1x, compared with 9.5x in 2020, despite the company's debt increase of around 42% to support capital spending and liquidity. We expect leverage to reduce below 5.5x in 2023 in our base case, but free cash flow (FCF) will remain negative given continuing capital expenditure needs.

CD's ba2 BCA is underpinned by the company's solid market position in the Czech Republic and high revenue visibility because of its contracts with the government and 14 municipalities for the passenger railway operations.

Exhibit 1
Leverage will moderately decrease in 2023 and 2024



All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are Financial Year-End unless indicated. Moody's forecasts (F) are Moody's opinion and do not represent the views of the issuer.
Sources: Moody's Financial Metrics™ and Moody's Investors Service

Credit strengths

» High probability of extraordinary support from the Czech government

» Solid operating performance, illustrated by growth in traffic and EBITDA

» Strong market position in the domestic passenger rail market

» Good revenue visibility because of long-term service contracts with central and local authorities

Credit challenges

» Ongoing negative free cash flow driven by high capital spending

» High leverage but we expect a reduction to around 5.5x in the next 12-18 months

» Modest reduction in market share in light of the ongoing liberalisation of the railway market

Rating outlook

The stable rating outlook reflects our expectation that CD's leverage will reduce below 6x in the next 12-18 months. The rating outlook also reflects our expectation that CD's operating performance will continue to benefit from modest revenue growth, and that it will maintain good liquidity.

Factors that could lead to an upgrade

» 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; and its EBIT margin remaining in the mid-single digits (in percentage terms), Moody's-adjusted debt-to-EBITDA ratio decreasing to around 4.5x and FCF remaining positive, all on a sustained basis.

» While we consider the company's links with the sovereign strong and an upgrade of the Czech Republic's rating would be credit positive for CD, it is unlikely to result in an upgrade of CD's rating, which is constrained by the ba2 BCA.

Factors that could lead to a downgrade

» Downgrade pressure on the rating could result if the company does not perform according to our expectations and maintains leverage above 6x in the next 12-18 months, then we could downgrade the BCA to ba3 from ba2. The BCA could also come under pressure if the company's FCF continues to remain negative for prolonged periods or if liquidity deteriorates.

» A downgrade of CD's rating could also be triggered by a significant deterioration in the sovereign rating or a weakening of the close links between the company and its sole shareholder, or both.

Key indicators

Exhibit 2
Ceske drahy, a.s.

	2018	2019	2020	2021	2022	2023F	2024F
Revenue (Koruny billion)	39.1	40.7	35.9	38.5	44.2	50.0	56.5
EBIT Margin %	5.4%	4.9%	-8.2%	-0.9%	4.4%	7.9%	11.6%
Debt / EBITDA	3.7x	4.6x	9.5x	6.1x	6.1x	5.3x	4.9x
FCF / Debt	-3.7%	-7.3%	-11.0%	-11.8%	-22.3%	-17.5%	-19.0%
RCF / Net Debt	24.6%	22.2%	14.4%	17.1%	13.8%	12.9%	14.2%
(FFO + Interest Expense) / Interest	7.4x	7.3x	6.3x	7.5x	5.0x	4.6x	5.3x

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are Financial Year-End unless indicated. Moody's forecasts (F) are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Investors Service forecasts

Profile

Ceske drahy, a.s. (CD) 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 has three representatives from the Czech Ministry of Transportation, and one representative each from the ministries of finance, defence, industry and trade, and regional development.

In 2022, CD recorded total revenue from principal operations of CZK44.2 billion (€1.9 billion), of which around 67% (including other income) was from passenger transportation and around 33% was from freight transportation. The company had around 21,915 employees as of 31 December 2022 and is one of the largest employers in the Czech Republic.

Detailed credit considerations

Strong revenue performance in passenger and cargo, a trend to continue in 2023-2024, despite the change in costumer habits working from home

In 2022, CD's overall revenue improved 15% from that in 2021, driven mainly by increased transportation volumes, and higher compensations received from the Ministry of Transport and regions, reflecting the regular inflation increase as CD's revenues are linked to costs through contracts with local authorities rather than to volume. Despite overall transportation volumes being 87% of that in 2019, international travel has been performing better than in 2019, reaching 117% thanks to the end of the pandemic and the affordable offers introduced by the company. Domestic travel has not yet fully recovered because business travel has decreased given the fact that a portion of customers are still working from home.

Revenues from cargo have increased by 14% compared to 2021 and by 13% compared to 2019, thanks to higher average prices per tonne due to input prices.

The company-reported EBITDA margin grew by 15% compared to 2019, reaching 26% despite inflationary pressures which increased energy and fuel costs at group level, and cargo business has faced a salary increase of 5.8%. These cost increases were partially offset by price increases but due to timing differences they were not reflected in 2022 EBITDA.

We expect Moody's adjusted EBITDA margin to continue growing in 2023 and 2024, reaching c.28% and c.30%, respectively. We expect EBITDA to be positively impacted by the recent amendments to government contracts because - going forward - inflation-related cost increases will be incorporated more quickly than in the past thereby allowing the company to pass cost increases directly on to customers. Regarding the cargo business, we expect that margins will improve due to international expansion which is more profitable and as a result of the cost efficiency programme that company has in place.

Assuming EBITDA will grow at the above levels we expect leverage of around 5.3x for 2023 and 4.9x for 2024, a level commensurate for CD's BCA of ba2.

Tenders will continue, but we expect CD to retain a market share of above 80%

The company has service contracts with the state for 21 national long-distance services and with 14 local authorities for regional services. CD remains exposed to the risk of loss of market share from the tender of contracts maturing soon. The expiry of both long-distance and regional contracts is phased out, such that less than 10% of the total passenger railway market will be up for renewal each year. We expect CD to continue to win a large portion of the contracts tendered because of its position as the incumbent operator, boosted by its ongoing efforts to improve its service and modernise its fleet. For example, in 2022, the company deployed 10 new five-wagon non-traction units on the R15 and Ex6 routes, significantly improving the quality and attractiveness of the services for passengers. CD has won 83% of contracts tendered since 2019.

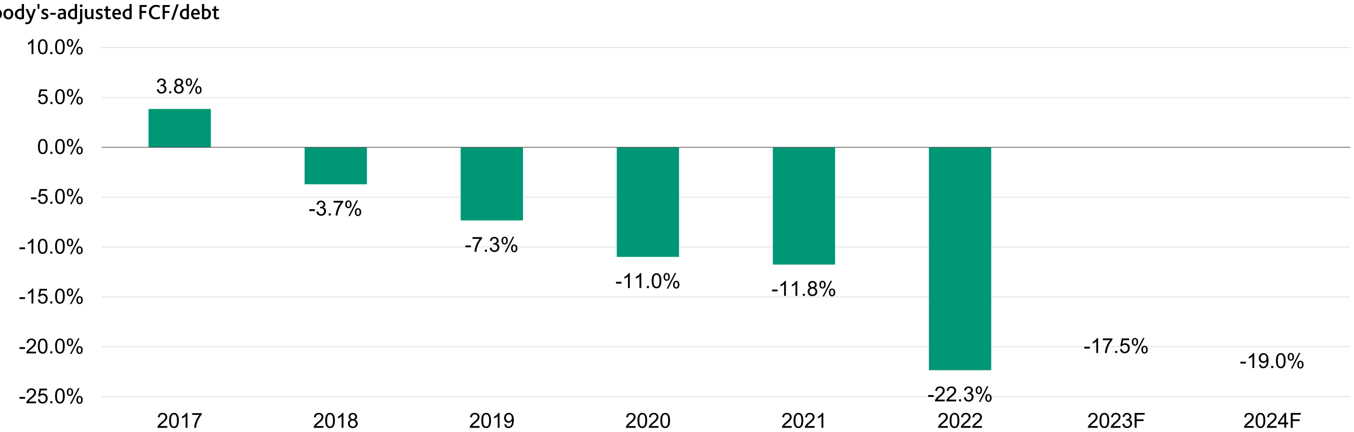
As a result of the tenders in 2019 and 2020, CD lost about a 7% market share in the regional market and 11% in the long-distance market. This corresponds to a revenue reduction of around 5% and an impact on EBITDA of CZK200 million in 2020. CD's market share remained stable in 2022, with 79.5% of the long-distance passenger market, 88.6% of the regional passenger market and 58% of the cargo market. In 2022, the company was selected for 10-year contracts on several routes in the Ústí nad Labem Region, and won the tender for a new route in the Moravian-Silesian Region. We expect CD's market share to remain stable at well above 80% for at least the next 18-24 months.

Higher debt levels and negative FCF because of capital spending and lower earnings

We expect capital spending to continue to increase mainly because of CD's need to renew its train fleet, which will be key in ensuring that the company remains competitive. Capital spending needs are likely to increase until 2026, reaching around CZK24 billion on average annually. We expect the company to generate around CZK10 billion from land disposals to the Czech railway infrastructure owner, which will boost cash flow from operations. Even with the disposals, the increase in capital spending will strain FCF, which will remain negative at least until 2023 because internal cash flow generation will not be sufficient to fund future capital spending needs.

Exhibit 3

Negative FCF driven by capital spending requirements
Moody's-adjusted FCF/debt



All figures and ratios are calculated using our estimates and standard adjustments. The Forecasts (f) are our opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Investors Service forecasts

We expect the company will continue to borrow to fund capital spending needs, however the pressure on financial metrics, particularly leverage, will be somewhat offset by growth in EBITDA and cash from asset sales.

High probability of government support during the post-pandemic period

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

» the BCA of ba2

» the Aa3 local-currency rating of the Czech government with a negative outlook

» 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 significant control by the Czech government. The Czech government does not explicitly guarantee CD's obligations, but we assume that it would likely provide extraordinary support to the company in case of financial stress.

In addition to the regular support the company receives from the government, CD received pandemic-related support of CZK290 million from the government in 2020, and CZK737 million in 2021. Around CZK558 million of this amount was to compensate for coronavirus-related losses and to partly cover infrastructure usage costs.

In 2022, the government provided extraordinary support in the form of a subsidy of around CZK380 million to partly compensate CD for the renewable energy surcharge it pays because of its internal combustion engine vehicles.

The very high default dependence currently assigned to CD reflects the high level of operational and financial links between CD and its sole shareholder, because around 38% of the company's 2022 revenue was received directly by the state and the regions. It also reflects the very high degree of overlap between the revenue bases of CD and its sole shareholder because 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 an annual revenue of roughly €1.9 billion, which is smaller than that of its major European peers. However, the ba2 BCA also positively reflects CD's role as the dominant provider of rail transportation in the Czech Republic and the high visibility of its revenue from its passenger transportation activities, in light of the company's contracts with the government and the country's 14 municipalities. We expect to see a gradual increase in the proportion of revenue from public entities as regions gradually switch to availability-based contracts (Brutto contracts) from contracts with revenue risk from the sale of tickets for CD (Netto contracts). We also expect to see higher pricing in contracts to compensate for increasing energy costs.

ESG considerations

Ceske drahy, a.s.'s ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 4
ESG Credit Impact Score

CIS-3

Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

Ceske Drahy's ESG Credit Impact Score (**CIS-3**) reflects CD's government ownership and high level of government support which partially offsets the ESG risks identified for CD in the IPS scores. As a standalone entity without government support CD's credit rating would be more impacted by ESG risks.

Exhibit 5
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

CD's Environmental Issuer Profile Score (IPS) reflects the company's moderate exposure to natural capital, in light of the company's rail freight segment which represents around one third of revenues in and relies on the transport of natural resources such as coal and metals. The company aims to reach carbon neutrality by 2050 at the latest.

Social

CD's exposure to social risks (**CIS-4**) is mainly driven by the company's very high fixed cost base related to employees which is difficult to reduce or restructure in line with revenue trends due to the government ownership. Human Capital risk also includes the risk of industrial action, strikes and pressure to increase salaries. CD is moderately exposed to Health and Safety, and well as customer relations because managing sensitive consumer information creates data privacy risks.

Governance

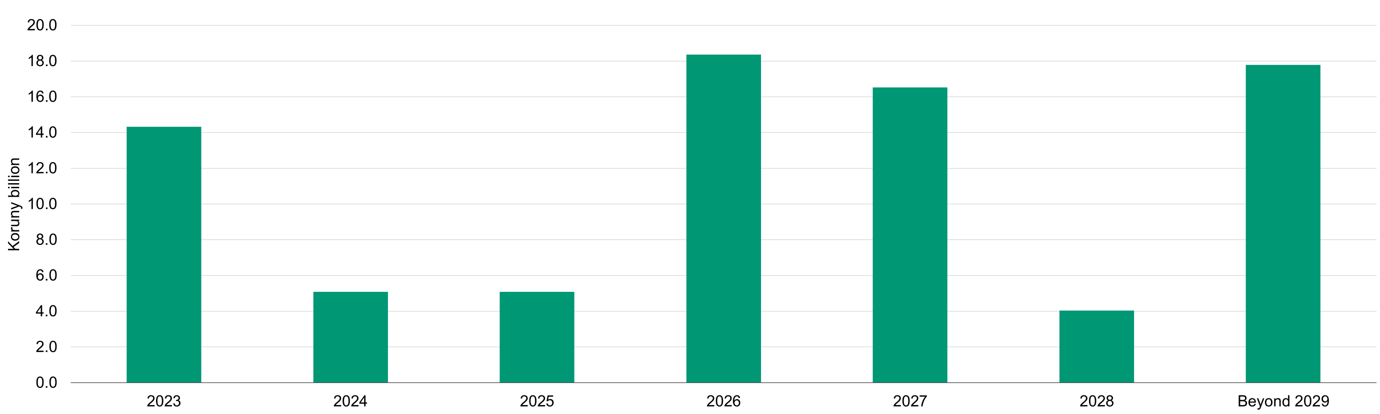
CD's governance risk (**G-3**) is linked primarily to high levels of senior management turnover and concentrated ownership. The company's governance risks are supported by the sovereign governance score; for the Czech Republic this is positive (G-1).

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

CD has excellent liquidity. The company has access to at least CZK33 billion of liquidity, including CZK14.7 billion of unrestricted cash on its balance sheet as of the end of March 2023; CZK10.9 billion available under committed facilities; CZK7.5 billion of undrawn bank loans (with maturities exceeding 12 months); and estimated Moody's operating cash flow of CZK9.3 billion. This available liquidity will comfortably cover the expected capital spending of close to CZK24 billion (post-IFRS 16) and debt repayments of CZK14.3 billion in the next 12 months.

Exhibit 6
CD has upcoming refinancing needs in 2023



Source: Company data

Methodology and scorecard

To provide an overall indication of CD's credit quality on a standalone basis (that is, the BCA), we have applied our Passenger Railways and Bus Companies Methodology, published in December 2021. The BCA is one notch lower than the 2022 scorecard-indicated outcome of Ba1, and two notches below the forward-looking grid outcome of Baa3, reflecting the negative free cash flow and the expectation of increased capital spending going forward.

Exhibit 7
Rating factors
Ceske Drahy a.s.

Passenger Railways and Bus Companies Industry Scorecard [1][2]	Current FY 12/31/2022		Moody's 12-18 Month Forward View As of 6/9/2023 [3]	
Factor 1 : Scale (15%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$1.9	B	$2.3 - $2.6	B
Factor 2 : Business Profile (25%)				
a) Stability of Operating Environment	Baa	Baa	Baa	Baa
b) Market Characteristics	Baa	Baa	Baa	Baa
c) Competitive Environment	A	A	A	A
Factor 3 : Profitability and Efficiency (10%)				
a) EBIT Margin	4.4%	B	7.9% - 11.6%	Baa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	6.1x	B	4.9x - 5.3x	Ba
b) RCF / Net Debt	13.8%	Ba	12.9% - 14.2%	Ba
c) (FFO + Interest) / Interest	5.0x	A	4.6x - 5.3x	A
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Rating:				
a) Scorecard-Indicated Outcome		Ba1		Baa3
b) Actual Rating Assigned				Baa2
Government-Related Issuer	**Factor**			
a) Baseline Credit Assessment	ba2			
b) Government Local Currency Rating	Aa3/Negative			
c) Default Dependence	Very High			
d) Support	High			
e) Actual Rating Assigned	Baa2/Stable			

1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations; [2] As of 12/31/2022; [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 Financial Metrics™

Appendix

Exhibit 8
Peer comparison

(in $ million)	Ceske drahy, a.s. Baa2 Stable			Deutsche Bahn AG Aa1 Stable			SNCF S.A. Aa3 Stable		
	FY Dec-20	FY Dec-21	FY Dec-22	FY Dec-20	FY Dec-21	FY Dec-22	FY Dec-20	FY Dec-21	FY Dec-22
Revenue	1,550	1,778	1,898	45,541	55,697	59,332	34,212	41,117	43,684
EBITDA	207	364	479	481	3,947	5,181	3,289	6,585	7,984
EBITA Margin %	-7.4%	-0.2%	5.2%	-8.0%	-0.7%	2.0%	-2.5%	6.0%	9.4%
EBITA / Average Assets	-2.8%	-0.1%	2.0%	-4.9%	-0.5%	1.5%	-0.7%	1.7%	3.0%
(FFO + Interest Expense) / Interest Expense	6.3x	7.5x	5.0x	3.9x	9.4x	9.3x	1.4x	2.4x	4.5x
Total Debt / Capital	53.9%	55.8%	65.1%	86.5%	80.8%	74.1%	86.7%	84.8%	73.5%
Debt / EBITDA	9.5x	6.1x	6.1x	98.1x	12.3x	8.1x	28.7x	14.6x	10.1x
FCF / Debt	-11.0%	-11.8%	-22.3%	-12.1%	-6.3%	-3.1%	-5.9%	-1.7%	0.6%
RCF / Net Debt	14.4%	17.1%	13.8%	4.2%	15.3%	16.9%	0.1%	6.6%	17.7%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Exhibit 9
Moody's-adjusted debt breakdown
Ceske drahy, a.s

(in Koruny million)	2018	2019	2020	2021	2022
As Reported Debt	**31,469**	**41,837**	**45,548**	**48,299**	**68,405**
Operating Leases	4,950	0	0	0	0
Non-Standard Adjustments	44	2	0	0	0
Moody's-Adjusted Debt	**36,463**	**41,839**	**45,548**	**48,299**	**68,405**

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Exhibit 10
Moody's-adjusted EBITDA breakdown
Ceske drahy, a.s

(in Koruny million)	2018	2019	2020	2021	2022
As Reported EBITDA	**8,649**	**9,991**	**4,533**	**8,587**	**11,469**
Operating Leases	1,650	0	0	0	0
Unusual	-527	-813	260	-705	-309
Moody's-Adjusted EBITDA	**9,772**	**9,178**	**4,793**	**7,882**	**11,160**

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Exhibit 11

Select historical and projected Moody's-adjusted financial data

(in Koruny million)	2018	2019	2020	2021	2022	2023F	2024F
INCOME STATEMENT							
Revenue	39,097	40,656	35,915	38,534	44,222	49,971	56,467
EBITDA	9,772	9,178	4,793	7,882	11,160	13,938	17,653
EBIT	2,123	1,987	(2,955)	(359)	1,966	3,930	6,543
Interest Expense	1,275	1,186	1,091	1,191	2,041	2,584	2,847
BALANCE SHEET							
Cash & Cash Equivalents	3,438	8,436	5,751	3,434	8,761	1,146	897
Total Debt	36,463	41,839	45,548	48,299	68,405	73,801	86,481
Net Debt	33,025	33,403	39,797	44,865	59,644	72,655	85,584
CASH FLOW							
Funds from Operations (FFO)	8,136	7,441	5,731	7,687	8,253	9,344	12,172
Cash Flow From Operations (CFO)	7,475	7,682	3,736	6,421	6,457	7,491	14,191
Capital Expenditures	(8,817)	(10,742)	(8,725)	(12,101)	(21,740)	(20,402)	(30,617)
Dividends	(12)	(12)	(12)	-	-	-	-
Retained Cash Flow (RCF)	8,124	7,429	5,719	7,687	8,253	10,652	12,321
RCF / Debt	22.3%	17.8%	12.6%	15.9%	12.1%	14.4%	14.4%
RCF / Net Debt	24.6%	22.2%	14.4%	17.1%	13.8%	14.9%	14.6%
Free Cash Flow (FCF)	(1,354)	(3,072)	(5,001)	(5,680)	(15,283)	(11,603)	(16,277)
FCF / Debt	-3.7%	-7.3%	-11.0%	-11.8%	-22.3%	-15.7%	-19.0%
PROFITABILITY							
% Change in Sales (YoY)	15.1%	4.0%	-11.7%	7.3%	14.8%	14.9%	12.8%
EBIT margin %	5.4%	4.9%	-8.2%	-0.9%	4.4%	10.3%	11.7%
EBITDA margin %	25.0%	22.6%	13.3%	20.5%	25.2%	30.0%	31.1%
INTEREST COVERAGE							
(FFO + Interest Expense) / Interest Expense	7.4x	7.3x	6.3x	7.5x	5.0x	5.1x	5.3x
(EBITDA - CAPEX) / Interest Expense	0.7x	-1.3x	-3.6x	-3.5x	-5.2x	-2.0x	-4.5x
EBIT / Interest Expense	1.7x	1.7x	-2.7x	-0.3x	1.0x	2.0x	2.4x
EBITDA / Interest Expense	7.7x	7.7x	4.4x	6.6x	5.5x	5.9x	6.3x
LEVERAGE							
Debt / EBITDA	3.7x	4.6x	9.5x	6.1x	6.1x	4.8x	4.8x
Net Debt / EBITDA	3.4x	3.7x	8.3x	5.7x	5.3x	4.7x	4.7x

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Source: Moody's Financial Metrics™

Ratings

Exhibit 12

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

Source: Moody's Investors Service

REPORT NUMBER 1368710

CLIENT SERVICES

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