MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Deutsche Bahn Aa1 ratings, and assigns A2 to proposed hybrid issuance, outlook changed to negative

08 Oct 2019

Paris, October 08, 2019 -- Moody's Investors Service, ("Moody's") has today affirmed the Aa1 the long-term issuer rating of Deutsche Bahn AG (DB). Moody's also affirms DB's (P)Aa1 senior unsecured MTN rating, the a1 standalone baseline credit assessment (BCA) and the P-1 short-term ratings. Concurrently Moody's assigned an A2 long-term rating to the proposed issuances of the Undated Subordinated Resettable Fixed Rate Notes (junior subordinated "Hybrid") by DB, through its subsidiary Deutsche Bahn Finance B.V. The outlook was changed to negative from stable.

"The change in outlook to negative reflects that the company's leverage is expected to increase to around 7.0x in fiscal 2019 and that the company will need to sustainability grow its revenues and earnings and reduce its gross debt over the next 12 to 18 months to reduce leverage towards 5.5x, a level that is commensurate with the current a1 BCA" said Francesco Bozzano, Associate Vice President and lead analyst for DB. "The German Government's climate reforms, announced on the 20th September 2019, are also further evidence of DB's strategic importance and the German government's implied willingness to support DB", added Mr Bozzano.

The size and completion of the Hybrid remain subject to market conditions.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

DB's Aa1 issuer rating incorporates a three-notch uplift from its a1 BCA , reflecting the high support and dependence between the company and the Government of Germany (Aaa stable). In particular, Moody's highlights the increased importance of DB to achieve the government's CO2 reduction targets in the transportation sector in Germany. This is evidenced by measures being implemented by the government as part of its new climate action programme 2030, published on 20 September 2019. These measures include direct extraordinary support to DB through EUR1 billion capital injections per annum from 2020 to 2030. Government support will also come from indirect measures to stimulate the switch from air and road to rail travel through VAT reductions for passenger railways and surcharges to domestic air travel. Measures have also been implemented to prevent airlines price dumping and higher taxation for vehicles based on their CO2 emissions.

The a1 BCA remains supported by the company's size, geographical diversification and its leading global market position, as well as the predictability of the legal framework for railway companies in Germany. DB also operates in a relatively stable domestic market environment despite continued competition on its regional routes and on in the cargo business.

However, the BCA is weakly positioned due to DB's low profitability, as evidenced by Moody's Adjusted EBITA margin of 3.1% in fiscal 2018, very high financial leverage (forecast to be around 7.0x in 2019) and negative free cash flow (FCF, a deficit of around €2 billion in 2019), which reflects increasing investments and operational challenges.

The A2 rating of the Hybrid is one notch lower than DB's a1 BCA and four notches lower than the company's Aa1 long-term issuer rating. This reflects the proposed features of the security, which is perpetual, deeply subordinated and allows DB to opt for coupon deferrals on a cumulative basis. Because of these characteristics Moody's believes that, in case of need, government support may not be as strong or as timely as it would be for senior unsecured debt.

In Moody's view, the Hybrid has equity-like features that allow it to receive basket 'C' treatment (i.e 50% equity and 50% debt) for the purpose of adjusting financial statements. Please refer to Moody's Rating Methodology "Hybrid Equity Credit" (September 2018) for further details https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1125264).

Moody's expects mid-single digit revenue growth, improving operating efficiency and a gradual reduction in gross debt such that there will be a gradual strengthening in the leverage towards 5.5x over the next 12 to 18 months from the high point of 7.0x expected in 2019. This deleveraging will be driven by a combination of increased passenger and cargo traffic, a focus on the company's cost base and by regular equity injections, which will limit the need to increase the group's financial debt going forward.

Moody's also expects DB to complete the sale of its subsidiary Arriva within the next 12-18 months and expects the funds will not be distributed outside the DB group. The proceeds from this disposal will improve the company's liquidity and net debt though also lead to a reduction in absolute EBITDA (Arriva's EBITDA was EUR575 million in 2018) and partially weaken the geographical diversification of the group.

Moody's expects DB to maintain satisfactory liquidity over the next 12 months, supported by: (1) its cash position of EUR3.7 billion as of June 2019; (2) its EUR3 billion commercial paper programme; (3) EUR2 billion of unused committed credit lines; and (4) its sizeable cash flow from operations, which Moody's expects to be EUR3.5 billion in 2019. Major cash needs include high capital spending, which Moody's estimates will be about EUR6 billion (including EUR1 billion IFRS 16 impact) in 2019, net of grants from the German government and around EUR3 billion in debt maturities over the next 12-18 months (until December 2020).

Moody's also expects DB to maintain its excellent access to the capital markets. In addition, the liquidity assessment incorporates our assumption that, in case of need, the company would receive timely financial support from the German government.

RATING OUTLOOK

The negative outlook on DB's rating reflects Moody's expectation that the company's leverage will increase to around 7.0x in fiscal 2019 and that the company will need to sustainability grow its revenues and earnings and reduce its gross debt over the next 12 to 18 months and reduce leverage towards 5.5x, a level which is more commensurate with the current a1 BCA.

WHAT COULD CHANGE THE RATINGS UP/DOWN

An upgrade is unlikely given the company's weak positioning in the Aa1 rating category. Moreover DB's rating is one notch lower than the sovereign rating, and Moody's expects this gap to remain. Moody's expects that government support and dependence between DB and the government will remain high.

The BCA would most likely come under upward pressure if:

» there is an improvement in DB's operating performance, with its Moody's-adjusted EBITA margin exceeding 6% on a sustained basis

» DB's Moody's-adjusted debt/EBITDA remains well below 4.5x on a sustained basis

DB's Aa1 issuer rating is sensitive to any weakening in the likelihood of support from the German federal government, which Moody's expects to remain at least high, given the constitutional framework, the importance of DB to the German economy and the central role DB is expected to play in achieving the government's CO2 reduction targets for the transportation sector in Germany .

In addition, any further weakening in the BCA could result in a downgrade of the Aa1 rating. This weakening could be caused by the following factors:

» A failure to improve the company's operating performance from current levels, with its Moody's-adjusted EBITA margin remaining below 4.5%

» Moody's-adjusted debt/EBITDA failing to decrease towards 5.5x

» A weakening of the company's business profile, resulting from a change in its integrated business model, with a separation of its rail and logistics business from its infrastructure management activities

» A major decline in government infrastructure subsidies, which would increase the burden of infrastructure capital spending for the company

LIST OF AFFECTED RATINGS

..Issuer: Deutsche Bahn AG

Affirmations:

....Long-term Issuer Rating, Affirmed Aa1

....Senior Unsecured Commercial Paper, Affirmed P-1

....Senior Unsecured MTN Program, Affirmed (P)Aa1

....Other Short Term, Affirmed (P)P-1

Outlook Actions:

....Outlook, Changed To Negative From Stable

..Issuer: Deutsche Bahn Finance GmbH

Assignments:

....Backed Subordinate Regular Bond/Debenture, Assigned A2

..Issuer: Deutsche Bahn Finance GmbH

Affirmations:

....Backed Senior Unsecured Commercial Paper, Affirmed P-1

....Backed Senior Unsecured MTN Program, Affirmed (P)Aa1

....Backed Other Short Term, Affirmed (P)P-1

....Backed Senior Unsecured Regular Bond/Debenture, Affirmed Aa1

Outlook Actions:

....Outlook, Changed To Negative From Stable

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Global Passenger Railway Companies published in June 2017, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

COMPANY PROFILE

Deutsche Bahn AG (DB) is a vertically integrated rail and logistics group that owns and operates the German national rail transportation network. DB is one of the largest rails and logistics companies in the world. In 2018, DB generated EUR44 billion of revenue and EUR4.5 billion of reported EBITDA.

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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 ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Francesco Bozzano
Asst Vice President - 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

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