

Rating Action: Moody's affirms Deutsche Bahn's Aa1 ratings and downgrades BCA to a3; changes outlook to stable

04 Jul 2022

Paris, July 04, 2022 -- Moody's Investors Service ("Moody's") has today affirmed the Aa1 long-term issuer rating of Deutsche Bahn AG (DB or the company). Moody's also affirms DB's (P)Aa1 senior unsecured MTN program rating, and the P-1 commercial paper rating.

Concurrently Moody's downgraded to a3 from a2 the standalone Baseline Credit Assessment (BCA) and downgraded to Baa1 from A3 the long-term rating of the backed Undated Subordinated Resettable Fixed Rate Notes (junior subordinated "Hybrid") issued by DB, through its subsidiary Deutsche Bahn Finance GmbH. The outlook has been changed to stable from negative.

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

RATINGS RATIONALE

The affirmation of DB's Aa1 long-term issuer rating with a five notch uplift from the a3 BCA reflects Moody's view that the high level of government support expected for the company is sufficient to justify a Aa1 rating with a stable outlook despite the weaker BCA. The previous negative outlook had captured the significant stress arising from the pandemic. While recent months have seen clear signs of recovery, the ongoing capital expenditure needs and the still constrained profitability are likely to result in elevated leverage for a more extended period, at a level no longer consistent with an a2 BCA, despite significant capital contributions from the government. The downgrade of DB's BCA to a3 reflects Moody's expectations that the company's leverage will remain above 7.0x and its free cash flows will be materially negative in the next 18-24 months, higher than levels seen prior to 2019, as a result of high capital expenditure and increased levels of debt. The change of the outlook to stable from negative reflects Moody's expectations that post-pandemic recovery will continue and that the company will be able to offset increased inflationary pressures through among others its cost savings programme.

DB's Aa1 long-term issuer rating combines: (1) its a3 BCA; and (2) Moody's assessment of a high likelihood that the company will receive extraordinary support from the German Government (Aaa stable) in times of need. This assessment is based on the German government's willingness, and very strong ability to provide support to DB, given the sovereign's ample financial reserves, as reflected in its Aaa rating. Such an assessment results in a five-notch uplift to the company's BCA for a final rating of Aa1.

DB's BCA remains supported by the company's size, geographical diversification and leading global market position, as well as the stability and predictability of the legal framework for railway companies in Germany.

The increase in the uplift in DB's final rating to five notches from four notches above the BCA is consistent with Moody's assessment of the continuing strategic importance of DB beyond the government's guarantee to provide a public rail service across Germany. This also reflects DB's key contribution to the government's Climate Action Program and the achievement of the government's CO2 reduction target (CO2 reduction targets were set based on CO2 emissions in 1990) for the German transport sector, which in 2021 was raised to -48% by 2030 (from -42%, the previous target set in 2019); its increasingly important role as the European hub for rail transport; and its vital importance to the German government's energy replacement strategy which is necessary to compensate for energy deliveries from Russia. DB is also vital to fulfilling new transport requirements triggered by the military conflict in Ukraine. The government has established a strong track record of ongoing and extraordinary support for DB when needed. For example, to compensate for losses related to COVID-19, the government provided EUR3.8 billion in 2021 and a further EUR2.2 billion is expected in 2022. This is in addition to the more than EUR9 billion expected annual capex contributions and EUR1 billion annual capital injection (equity and investment grants) the government will continue to make through to 2030 for the Climate Action Program and other indirect measures such as VAT reductions and surcharges to domestic air travel aimed at promoting the increased utilisation of rail transport in Germany.

Despite government support, DB's gross debt increased to around EUR41 billion in 2020 from around EUR 36 billion in 2019 as a result of the pandemic, however it has remained stable in 2021. Moody's expects a broadly

stable debt position in 2022 before reducing to around EUR 38 billion in 2024. DB's revenues recovered ahead of pre-pandemic levels already in 2021, however EBITDA did not fully recover because revenues from the lower margin freight segments were proportionately higher than they were before the pandemic. Moody's expects EBITDA and operating cash flow to recover close to pre-pandemic levels in 2022 based on recent trading. Recovery will be bolstered by the ongoing volume growth and the execution of the company's cost saving program, which aims to reduce costs by more than EUR5 billion from 2020 to 2024. Moody's expects the company's leverage to remain high at around 7x in the next 18-24 months and to improve to 6.5x thereafter if the cost savings plan is successful.

The Baa1 rating of the Hybrid is one notch lower than DB's a3 BCA and six notches lower than the company's Aa1 long-term issuer rating. This reflects certain 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.

LIQUIDITY

Moody's expects DB to have excellent liquidity over the next 12 months, supported by its cash position of EUR4 billion as of 31 March 2022; its fully available commercial paper programme of EUR3 billion as of 31 March 2022; its undrawn EUR2.5 billion committed credit lines as of 31 March 2022; its recovering cash flow from operations, which Moody's expects to be around EUR3.7 billion in 2022; and the planned government support.

The major cash needs for DB are capital expenditure (net of grants from the German government), which Moody's estimates at around EUR6.5 billion (including IFRS 16) in 2022, and around EUR1 billion in debt maturities by December 2022.

Moody's expects DB to maintain its excellent access to the capital markets.

RATING OUTLOOK

The stable outlook reflects the company's ongoing recovery in earnings and cash flow and Moody's expectations that leverage will stabilize at around 7x in the next 18-24 months, a level commensurate with its a3 BCA. The stable outlook also assumes that DB will not engage in any meaningful corporate transactions over the medium term other than the divestment of Arriva.

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

An upgrade is unlikely given that DB's rating is one notch lower than the sovereign rating and Moody's expects this gap to remain.

The BCA could be upgraded if DB's leverage, measured by Moody's-adjusted debt/EBITDA, decreases below 6.0x on a sustained basis, DB successfully executes its plan to materially improve operational efficiencies, operating performance improves as evidenced by a substantial and sustained increase in Moody's-adjusted EBIT margin to mid-single digits and the company achieves a sustainable, positive free cash flow.

A downgrade of Germany's sovereign rating could result in a downgrade of DB's ratings. In addition, Moody's could downgrade the DB's ratings if the likelihood of extraordinary support from the government decreases or if the BCA deteriorates further and this is not adequately compensated by evidence of stronger government support.

DB's BCA could be downgraded if the company fails to execute its cost-saving plan and its Moody's-adjusted debt/EBITDA remains above 7x on a sustained basis, or DB's EBIT margin fails to improve to at least 3%. Negative rating action could also occur if the company's business profile weakens, for example as the result of a change in its integrated business model, with a separation of its rail and logistics business from its infrastructure management activities

LIST OF AFFECTED RATINGS

Downgrades:

..Issuer: Deutsche Bahn AG

... Baseline Credit Assessment, Downgraded to a3 from a2

..Issuer: Deutsche Bahn Finance GmbH

...BACKED Subordinate Regular Bond/Debenture, Downgraded to Baa1 from A3

Affirmations:

..Issuer: Deutsche Bahn AG

... LT Issuer Rating, Affirmed Aa1

...Commercial Paper, Affirmed P-1

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

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

..Issuer: Deutsche Bahn Finance GmbH

...BACKED Commercial Paper, Affirmed P-1

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

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

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

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

Outlook Actions:

..Issuer: Deutsche Bahn AG

...Outlook, Changed To Stable From Negative

..Issuer: Deutsche Bahn Finance GmbH

...Outlook, Changed To Stable From Negative

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Government-Related Issuers Methodology published in February 2020 and available at <https://ratings.moody.com/api/rmc-documents/64864> , and Passenger Railways and Bus Companies published in December 2021 and available at <https://ratings.moody.com/api/rmc-documents/360649> . Alternatively, please see the Rating Methodologies page on <https://ratings.moody.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 2021, DB generated EUR47 billion of revenue and EUR3.2 billion of reported EBITDA.

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.moody.com/rating-definitions> .

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