České Dráhy

The story behind the deal

As the Czech Republic has taken its place at the heart of Europe as a dynamic and innovative economy, its transport infrastructure – including České Dráhy (ČD), the state-owned passenger and freight incumbent rail provider – has required a sustained effort to overcome decades of underinvestment. This transformation has included not only ČD’s rail fleet – recent upgrades have included Siemens Railjet high-speed trains – but also its business and financial models.

The Czech Republic is different from neighbouring countries such as Germany and Austria as rail infrastructure has been unbundled, allowing ČD to focus on rail operation. The government has a proactive rail market liberalisation strategy and ČD has agreed to open-up to 75% of the long-haul market to competition by 2019. As a result, it is undergoing a transformation from a relatively inefficient local operator to a slimmer, more efficient regionally-focused company.

ČD operates three businesses: regional lines, which are based on long-term contracts with Czech regions, long-haul lines, based on long-term contracts with the Ministry of Transport, and a cargo business. The passenger businesses, which are regulated, represent around 95% of ČD’s revenues. The decision in 2009 by the Ministry of Transport to include a market-opening clause when it signed a 10-year contract with ČD was therefore a pivotal moment in the company’s history.

“Immediately, the most important issue became how we would prepare for competition,” explains Petr Vohralík, CFO of ČD. “Crucially, we saw the change not as a threat but as an opportunity. It has led to a transformation of the company’s business model, how it serves customers, and how it approaches financing.”

ČD’s new CEO and management team are making the company more efficient, less bureaucratic and more consumer-orientated. From a financial perspective, ČD is streamlining processes and reducing headcount: the number of employees fell 20% from 2009 to 2011 without any impact on customer services or revenue generation.

ČD’s goal is to become competitive on a European scale. “To that end, investment in modernisation of our stock is critical,” says Vohralík. “In the past 20 years, little money was spent on rolling stock and service quality and company image suffered. Five years ago when the new management team came on board, they set out a long-term vision that included an increase in transportation volumes and revenue growth – all underpinned by sizeable investment.”

The company has almost finalised a modernisation programme for its regional business with the majority of the required rolling stock ordered. Now the focus is switching to long-haul rail. ČD’s key investment has been in 15 Siemens Railjet coaches (originally developed for Austria’s Österreichische Bundesbahnen). The introduction of Railjet will significantly change the quality and speed of rail travel in the Czech Republic.

To date, orders have been signed for seven units, which will connect Prague with Vienna, Graz and other cities. Should orders for the remaining eight units be signed, the intention is to connect the Czech capital with Bratislava, the capital of Slovakia, and Budapest, the capital of Hungary. “Railjet will cement our position as a domestic and international player,” says Vohralík.
An evolving financial strategy
ČD’s investment in Railjet and its ongoing upgrading of existing rolling stock has significantly increased the company’s capital expenditure, which has totalled €250 million in two years. While 40% of ČD’s project costs have come from EU funds, it has needed to raise the remainder (largely from the bond market).

ČD’s ability to access the bond market is testament to its remarkable transformation. “Five years ago, the company was loss making from an ebitda perspective and had no positive cashflow,” recalls Vohralík. At the time, ČD’s capex was financed by state-guaranteed EUROFIMA (European Company for the Financing of Railroad Rolling Stock) loans, bank loans or leasing facilities from ING. ČD’s overdraft facility was the only short-term credit facility the company could get without a government guarantee.

ČD’s new management worked to convince its banks that it could develop a sustainable business on its own without requiring support from the government. Ultimately, this strategy culminated in the company establishing long-term contracts with the central and regional governments. Having transformed corporate governance, ČD approached a rating agency and in 2011 Moody’s awarded the company an investment grade rating.

In June 2011, ČD made its Eurobond debut with a €300 million five-year issue. “It was a milestone in the company’s history, not just in its financing; it showed we were credible,” says Vohralík. The bond issue brought ČD’s financing strategy into line with its Western European peers by giving it the flexibility of being able to access both the bond market and banking facilities. It also made the company the first CEE railway firm to obtain an external credit rating and tap the bond market.

After its debut issue performed solidly, ČD returned with a second €300 million Eurobond in July 2012 that offered a fixed coupon of 4.125%. “Based on the advice of our joint lead managers, including ING, we tested the appetite of investors for a longer tenor and successfully sold a seven-year bond. The bond closed nine times oversubscribed and offered a yield in line with our debut bond despite the longer maturity. The pricing enabled us to reduce our overall cost of funds and was an extraordinarily positive outcome,” notes Vohralík.

The warm reception afforded to ČD can be explained not only by the company’s renaissance in recent years but also to the dearth of high quality issues from CEE. “The market likes high quality regional issues but there are only a handful of such credits,” says Vohralík. “During the roadshow, we received extensive feedback that investors wanted to diversify their risk and that CEE was seen as a safe region. We were able to utilise that positive feeling and build momentum.”

A longstanding relationship
ING’s relationship with ČD dates back seven years when the bank provided leasing facilities for new wagons and rolling stock. “ING was there for the company even when we were not performing well – it has always shown commitment to the relationship,” says Vohralík. Since then, the relationship has expanded to include more complex products and services, including provision of an overdraft facility and a role as manager for ČD’s first commercial paper issue in the local market. ING’s role as a house bank to ČD was an important factor in its selection as a joint lead manager for its second eurobond. “Commitment brings rewards and ING convinced us that it could achieve attractive terms in the capital markets – that proved to be the case,” says Vohralík.

ING’s approach is different to some global banks that ČD works with, according to Vohralík. “It has a tailor-made approach rather than a suitcase banker strategy,” he says. “You feel you are a priority and communication reflects that. You can just pick up a phone and someone
who understands the relationship will provide assistance. For us, it is the right strategy and it has meant that ING has won episodic business as it has arisen. ČD makes a point of being fair to its banks: if they offer their balance sheet to us then they are the first institution we call if we have other needs – it is a mutually beneficial approach.” Robert Chudoba, head of corporate clients, ING Commercial Banking, Czech Republic agrees: “At ING we focus on understanding our clients’ business and challenges, which helps us to design relevant value-adding solutions. The business relationship with ČD is strong and we appreciate the professionalism of the company and the pleasant nature of our communication with them. We are proud to be a valuable partner for ČD”.