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Ratings

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Rheinbahn AG

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Table Of Contents

Rheinbahn AG

Major Rating Factors

Issuer Credit Rating
AA-/Stable/A-1+

Strengths

- Extremely high likelihood of timely and sufficient extraordinary government support due to critical role for and very strong link with the German city of Düsseldorf.
- Strong legal framework and predictable ongoing compensation payments for public service provision.
- Very high cost coverage compared to German and international peers.
- Very strong underlying economic fundamentals in the catchment area and solid ridership growth in the last year support our projection of continuously high demand for public transport.

Weaknesses

- Constrained internal liquidity position according to our metrics.
- Rising debt and slightly weaker financial results projected, coupled with new strategy to increase public transport attractiveness.

Rationale

The ratings on Rheinbahn AG reflect S&P Global Ratings' criteria for public transport providers (see "Mass Transit Enterprise Ratings: Methodology And Assumptions," published Dec. 18, 2013, on RatingsDirect). The ratings also take into account our approach for rating government-related entities (GREs) (see "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015), including our assessment that the likelihood of timely and sufficient extraordinary support for Rheinbahn from Düsseldorf under a financial stress scenario is extremely high.

In accordance with our GRE criteria, we consider that Rheinbahn plays a critical role as the provider of public transport services in the city and several neighboring communities. This assessment is underpinned by the essential--and subsidized--nature of Rheinbahn's services for the city, which we do not believe could be undertaken by a private entity. At the same time, we consider the link between Düsseldorf and Rheinbahn as very strong, due to the city's 100% ownership. We consider the chances of privatization or partial privatization of public transportation of Düsseldorf as negligible over the coming years. In May 2017, the city of Düsseldorf and Rheinbahn signed a "domination agreement" with each other, effectively limiting Rheinbahn's autonomy and bringing it formally under the managerial authority of the city. This will allow the city to directly award public contracts to Rheinbahn, in line with EU competition regulation. Overall, Rheinbahn currently has what we see as a stable legal framework for its operations, and we also take into account the appropriate supervision of strategy and operations by city representatives. The city provides annual ongoing compensation payments to Rheinbahn. Timely extraordinary support outside the contractual framework would also be available in a stress scenario, in our view.

Our assessment of Rheinbahn's stand-alone credit profile (SACP) in the 'bbb' category reflects our view of its extremely strong enterprise risk profile and strong financial risk profile. The SACP still remains constrained by our assessment of Rheinbahn's internal liquidity, as measured by cash in relation to the company's debt service under our criteria. That said, the company has increasingly diversified its external funding sources over the past years and its relation with the government owner supports its liquidity access, in our view.

We consider that Rheinbahn's enterprise risk profile has improved to extremely strong, from very strong, due to a significant increase in ridership growth, even when excluding certain statistical effects. In addition to management's ongoing efforts to increase ridership, the commissioning of a new subway line, the Wehrhahn-Linie, had very positive effects on passenger numbers. The enterprise risk profile of mass transit providers also benefits from our assessment of the public transport sector's very low industry risk. Operating revenues in the sector generally show a low volatility as susceptibility to economic cycles is very limited. At the same time, barriers of entry in the sector are high and competition generally poses low risk, which is also factored into our assessment of Rheinbahn's extremely strong market position. Likewise, Rheinbahn's quasi-monopoly position in the market, now cemented by the aforementioned domination agreement, strengthens the entity's enterprise risk profile. In addition, the economic fundamentals in the catchment area are very strong. Düsseldorf has been growing rapidly in terms of population and employment over the past years and we project that these trends will continue over our forecast horizon, leading to an increasing commuter flow.

We also take into account our view of the company's management and governance as satisfactory, as per our criteria "Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012, in the overall extremely strong enterprise risk profile. Our view of Rheinbahn's management and governance under our mass transit criteria is also satisfactory. We will continue to monitor developments in the company's strategy and its responses to increased political demands and focus on enhancing public transport attractiveness. While we take into account some of the uncertainties that are still surrounding the company's future strategy, we expect that strong standards for operating performance will be preserved, for example, regarding cost coverage.

Nonetheless, the company's moves to meet increasing demand for public transport will be reflected in slightly lower EBITDA than in previous years. Rheinbahn is currently executing an ambitious investment program, which is partially driven by political considerations, as in the case of introducing electric buses on the new "innovation lines." At the same time, Rheinbahn is also pursuing its own investment interests, primarily aimed at increasing ridership, such as through "metro bus lines" and the replacement of rolling stock at the end of its lifespan. The material expenses associated with both types of capital expenditure, mostly related to new buses, trains, and the network's infrastructure, will be significant and incur higher debt and a considerable increase in annual debt service for Rheinbahn over the next years. Debt service coverage is currently strong, as EBITDA including compensation stands well above Rheinbahn's annual debt service, but we project it will decrease sharply over the next few years. In parallel, we forecast debt levels to net revenues will increase significantly within our forecast horizon, with a decrease in momentum toward the end of the period.

However, Rheinbahn will maintain a high degree of financial flexibility over the next few years. Overall cost coverage might decrease but will stay close to 80%, which is very high by international standards. At the same time, the farebox recovery ratio (the fraction of operating expenses met by fare revenues), supported by regular tariff adjustments will remain roughly at current levels. The debt service carrying charge (debt service as a percentage of all financial obligations due in a fiscal year) will increase over the next few years due to rising debt service.

Despite an increase of own liquid funds due to the sale of some company assets unrelated to the entity's operations, liquidity will remain the primary constraining factor for Rheinbahn's SACP. Rheinbahn's available cash in relation to debt service might rise within our forecast period, but we do not consider these changes likely to be sustained beyond a few years due to new investment expenses. Despite adequate liquidity management, this leads us to cap the SACP--which results from the combination of the enterprise risk profile and the financial risk profile--in the 'bbb' category.

Liquidity

The short-term rating is 'A-1+'. We consider Rheinbahn's access to external liquidity to be satisfactory, and we understand the company could access liquidity from the city, for example, via Düsseldorf's municipal holding company, if needed. Our liquidity assessment also takes into account the increased levels of available cash at year-end 2016 compared with previous years and available liquidity facilities of €12.5 million at the beginning of 2017. At the same time, given projected maturities in 2017 and 2018, this translates into a debt service coverage (debt service measured in relation to EBIDTA plus compensation payments to Rheinbahn) of less than 2.0x of debt service in 2017, and significantly declining over the next two years. We therefore currently still view Rheinbahn's internal liquidity as weak according to our criteria, as debt service coverage with available liquidity is subdued. Rheinbahn relies on long-term borrowing and has debt maturities of €13.8 million in 2017. However, currently the largest share of outstanding financial debt will be maturing after 2018.

Outlook

The stable outlook reflects our view that Rheinbahn will continue to play a critical role for Düsseldorf and that the link between Rheinbahn and the city will remain very strong, underpinned by a stable legal framework and the domination agreement between the two parties. We consider that, in the event of financial distress, the likelihood that Rheinbahn would receive timely and sufficient extraordinary support from Düsseldorf remains extremely high. The stable outlook also reflects our view that the company will maintain its extremely strong enterprise profile and strong operating performance and cost coverage, in light of the potentially even stronger influence of the government owner in the strategy-setting process.

We could raise the ratings on Rheinbahn if our assessment of Düsseldorf's creditworthiness improved, or if Rheinbahn's SACP improved significantly toward our 'aa' category.

Similarly, we could lower the ratings if we anticipated adverse changes in the likelihood of extraordinary support from Düsseldorf, or the city's credit quality. The ratings could also come under pressure if Rheinbahn's SACP declined or if liquidity or governance practices deteriorated to very weak levels. We currently view these developments as highly unlikely.

Government Support And GRE Methodology Impact

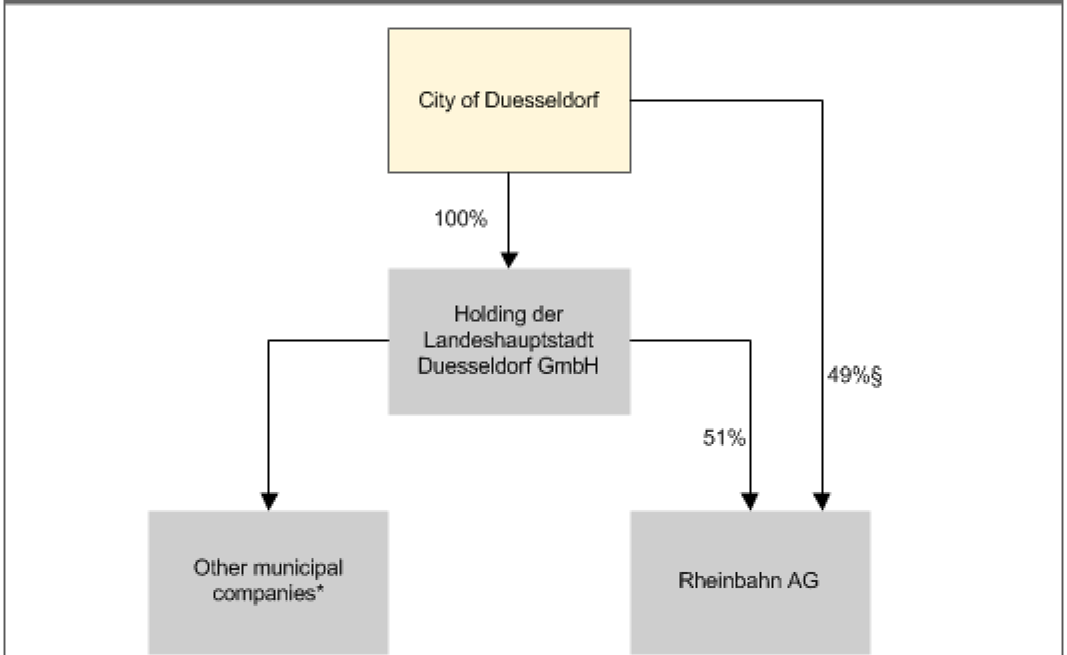
The rating on Rheinbahn reflects our opinion that there is an extremely high likelihood that Düsseldorf will provide timely and sufficient extraordinary support to Rheinbahn's debt service in a financial stress scenario. In accordance with our GRE criteria, our view is based on our assessment of Rheinbahn's:

- Critical role as quasi-monopoly provider of public transportation in the city area of Düsseldorf and some neighboring communities, and
- Very strong link with its 100% owner Düsseldorf.

We believe that Rheinbahn plays a critical role for Düsseldorf. The State of North Rhine-Westphalia (NRW) legally defines public transport as a service of general interest, underlining the special role public transportation plays. Increasing the attractiveness of public transport has also been a main focus of the current city government and Rheinbahn is instrumental to achieving this policy goal. As the main provider of public transportation in Düsseldorf, the company also assumes an important role in the implementation of the city's infrastructure development strategy. Accordingly, Rheinbahn plays a critical economic and social role for the city, and represents a large and visible local employer. As Düsseldorf's population is expected to grow over the coming years, the importance of the public transportation network is set to increase even further both for inner city transit, as well as for commuters. In our view, a default by Rheinbahn would ultimately also trigger negative repercussions for Düsseldorf's reputation in the financial markets.

In our opinion, Düsseldorf has a very strong and durable link with Rheinbahn and has a policy and a track record of providing very strong and timely financial support for the entity's operations. As a 100% municipal-owned company, Rheinbahn benefits from extensive monitoring and support from Düsseldorf and we expect that the city will maintain its 100% ownership (see chart 1) for the long term. The aforementioned domination agreement, which was signed in May 2017 between Rheinbahn and the holding company of Düsseldorf, strengthens the ties between the city and Rheinbahn with respect to supervision and management of the entity's operations. The contract allows Düsseldorf to directly authorize Rheinbahn to provide public transport services without a competitive tender. At the same time, the domination agreement explicitly obligates the city to provide financial support for the Rheinbahn's operations in the form of a loss compensation agreement, which covers the company's deficits that are incurred in the course of the provision of public services. This legal set-up makes the support mechanism of the city very predictable and we currently envisage no major challenges to the legal framework over the medium term. Annual compensation payments are calculated by Verkehrsverbund Rhein-Ruhr, a regional association of public transportation companies in NRW. Overall compensation has increased significantly over the past years to €62 million in 2016 from €55 million in 2015 and €49 million in 2014, reflecting Rheinbahn's results. We note, however, that Rheinbahn would be entitled to substantially higher compensation, based purely on the value of public services it provides, but the company generates a significant share on its own.

Chart 1
Rheinbahn AG Ownership Structure



*Public utility companies, airports, local radio stations, municipal swimming pools. §44% of total stocks from these 49% are managed by the LHD Holding GmbH.

Stand-Alone Credit Profile (SACP)

Under our revised criteria for public transport providers ("Mass Transit Enterprise Ratings: Methodology And Assumptions," Dec. 18, 2013), Rheinbahn's SACP remains in the 'bbb' range. The SACP reflects the company's extremely strong enterprise risk profile, as well as its strong financial risk profile. The SACP is constrained by our view of Rheinbahn's internal liquidity position.

Enterprise Risk Profile

Very low industry risk for the public transportation sector

We characterize Rheinbahn's industry risk as very low. Its system, and more generally, the mass transit industry as a whole, is mature and has historically demonstrated only minor susceptibility to economic cycles (including ridership trends); therefore, we view the potential effects of economic cyclicality and volatility of operating earnings as low risk. We also characterize the risk due to market competition and substitute products or services as very low. We believe barriers of entry in the mass transit industry are very high, given the system's size and large infrastructure prerequisites to operate effectively in it. As fares are usually subsidized, volatility of ridership in economic cycles is normally low.

Very strong local economy, increasing population figures, and solid ridership growth support Rheinbahn's strong market position

Düsseldorf's population has grown significantly over the past five years, particularly within the past two years, and we expect the city to continue to attract a young working-age population. Employment growth has also been strong in recent years, underpinned by the city's diversified economic structure with comparably high income levels. We expect favorable macroeconomic conditions to persist over the medium term, which will also benefit the local economy. Rheinbahn has been able to return to a path of solid ridership growth over the past year, after a short decline in passenger numbers in 2015. The number of passengers increased to 223 million from 218 million in 2015 (see table 1). We project that ridership will continue to grow steadily over the coming two to three years based on Rheinbahn's continuous efforts to increase public transportation attractiveness through enhanced services and new lines, changing attitudes toward inner-city mobility, and from increased commuter streams within its catchment area. The area numbers over 1 million inhabitants, significantly larger than Düsseldorf alone, whose population is estimated at more than 630,000.

Table 1

Rheinbahn AG Operating Performance											
	--Year ended Dec. 31--										
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Revenues (mil. €)	193.3	198	222.3	220.8	220.5	224.2	235.7	253.4	255.2	265.8	275.3
Passengers (mil.)	212.3	213.7	214.3	214.6	214.9	215.7	216.9	218.0	220.0	217.8	223.4
Staff	2,828	2,737	2,747	2,712	2,702	2,731	2,821	2,875	2,823	2,879	2,930
Length of lines (kilometers)	1617	1621	1621	1635	1620	1,630	1,632	1,632	1,636	1,633	1,385
Cost coverage (%)	75.3	79.2	84.2	82.9	80.7	80.6	81.7	82.4	84.0	83.0	81.6

According to EU regulation No. 1370/2007, municipalities can directly mandate a company to provide public transportation service without a public tendering process under certain preconditions, which are met by the signing of the domination agreement. Effective 2013, the German law ruling mass transit has been adapted to this EU directive, thereby providing a legally secure national framework for directly mandated public transport companies. Düsseldorf and its neighboring communities had decided in 2009 to extend the existing contractual assignment of public transportation services to Rheinbahn until 2019, which represented the maximum possible transition period. This step already demonstrated Düsseldorf's strong commitment to the company, in our view.

Ahead of the expiration of this contractual assignment for public transportation services in 2019, the holding company of the city of Düsseldorf signed the domination agreement with Rheinbahn. The contract allows Düsseldorf to directly mandate Rheinbahn under the new EU regulation. The so-called "fourth railway package" in its current form, as adopted by the EU parliament, does not contain any challenges to this option, in our understanding and hence we don't expect it to affect Rheinbahn's creditworthiness. Overall, we view Rheinbahn's very stable ownership structure and contractually defined excellent market position as central credit strengths.

Satisfactory management and governance in line with international standards, with high benchmarks for operating performance

Rheinbahn's management has a strong track record of continuously improving the company's operating results through business restructuring, efficiency gains, expanding its customer base, and increasing fare prices, thereby achieving high cost-coverage for a mass transit enterprise. We therefore see the management's ability to set high goals for operating performance and execute its strategy as positive. Oversight by and coordination with the government owner is ensured. But the potential involvement of the municipal administration in the company's operations as well as external regulations constrain Rheinbahn's management's strategic flexibility at times. The current municipal government has even strengthened involvement in the strategy-setting process, which is legally covered by the domination agreement. While this further underlines the company's key importance for the city, any adverse effects on the strong standards for operating performance should be carefully weighed. Rheinbahn reports according to German Generally Accepted Accounting Principles and we view the company's financial planning as prudent and realistic in general.

Financial Risk Profile

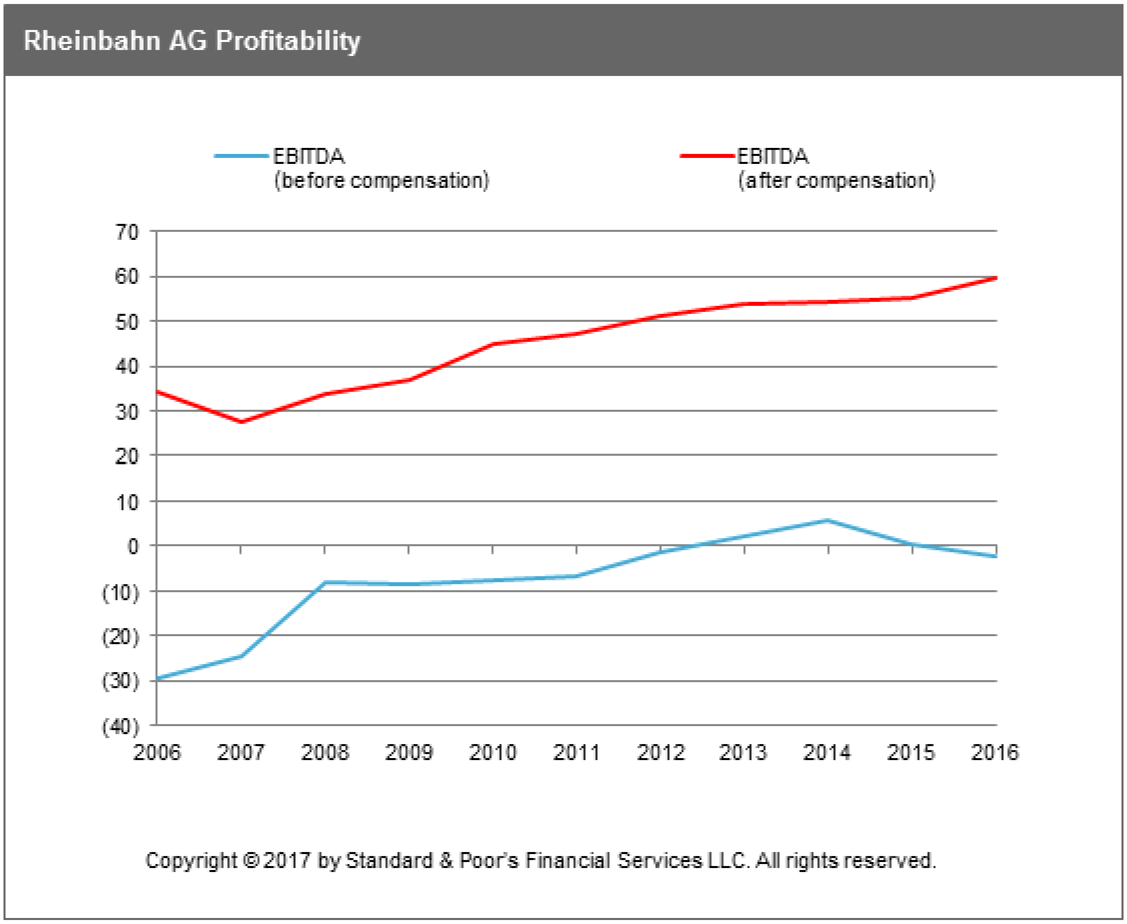
Strong financial policies reflect the nature of Rheinbahn's business

Rheinbahn's financial policies are strong, underpinned by prudent long-term planning with clear visibility of investment projects and their funding. Rheinbahn's reporting ensures appropriate transparency. Reserve and liquidity policies are less formalized but rely on adequate planning, in our view. Debt management is in line with the nature of Rheinbahn's investment needs, and derivatives are used for hedging interest rate risk and fuel price exposure only.

Good debt service coverage due to sound EBITDA performance

Following three years of positive EBIDTA (excluding compensation), Rheinbahn has started to post slightly negative results again when adjusting for real estate transactions (see chart 2). We project that Rheinbahn's EBITDA will decrease further in the near future and not return to positive results over our forecast horizon. Including compensation payments, EBITDA coverage is currently still very strong at over 200% of debt service in 2016, but is projected to decline significantly to below 100% due to higher loan volumes maturing maturities after 2017, which will ultimately become a constraining factor for Rheinbahn's SACP.

Chart 2



Internal liquidity remains a constraining factor, but is set to improve over the next years; access to external liquidity sources is satisfactory

The liquidity position of the entity usually is and still remains the constraining factor to Rheinbahn's SACP. But this assessment is set to change in our base-case scenario over the course of the next year. Ahead of significant investment expenditures and backed by the sale of some real estate properties, Rheinbahn has increased its cash position to €70 million as of year-end 2016 and will retain much of this cash at least over the next two years. Available liquidity facilities total €12.5 million as of January 2017. We estimate that this cover about 2.8x Rheinbahn's debt service in 2017, including drawn amounts under the liquidity facilities, compared to about 1.5x in 2016. Rheinbahn's cash position as of year-end 2016 translates into about 105 days of available cash under our criteria in 2017, as opposed to around 60 days in 2016.

We consider Rheinbahn's access to external liquidity as satisfactory, and we understand the company could access liquidity from various external sources such as commercial and promotional banks and from the city's holding company if liquidity there is strengthened again. The relation with Rheinbahn's government owner hence also mitigates the internal liquidity situation, in our view.

Extremely strong financial flexibility due to high cost coverage

Rheinbahn has retained its high farebox recovery ratio of 78% in 2016, as ticket sale revenues increased by almost 5% compared with the previous year. This increase also incorporates a rise in fares in 2016, but primarily reflects the strong ridership growth of the past year also related to the commission of a new subway line ("Wehrhahn-Linie"). The subway line has been operational since February 2016 and offers the potential to keep up demand for public transportation over the coming years. Around 70% of ticket sale revenues stem from long-term subscriptions (excluding social ticket) as subscriber numbers have stabilized in 2016 following a slight decrease in 2015. We expect subscriptions to slightly increase over the next years. Rheinbahn has a strong track record of increasing farebox revenues over the past decade, which supports our assessment of Rheinbahn's high flexibility compared with peers. Tariff increases have been supportive of this trend. The expenditure side of Rheinbahn's operations also shows some flexibility, as the company currently has a debt service carrying charge of below 10% in 2016. However, the ratio is projected to increase to above 20% over the next few years on the back of higher maturing loan volume after 2017.

Debt is rising over the next years, due to Rheinbahn's high investments

We project, in line with Rheinbahn's management, that its financial debt will increase to €496 million by the end of 2019, from €440 million in 2016. This is based on large planned investments as the transportation fleet and infrastructure acquired in the 1960s and 1970s reach the end of their lifespan. Investments by the city, for example, the development of new neighborhoods, as well as efforts to improve accessibility, regularly triggers investment requirements for Rheinbahn as well. Debt to revenues was 1.3x in 2016 and will slightly decrease to 1.1x in 2017, before picking up to 1.3x in 2018. At the same time, debt to net revenues was around 7.4x in 2016 and we expect it to increase slightly over 8.9x until 2018.

Rheinbahn's high and increasing debt burden reflects substantial investments in the asset base. Rheinbahn plans total investments of €619 million from 2017 to 2021, primarily to enlarge and renew the transportation fleet and to upgrade transportation infrastructure. We expect that Rheinbahn will receive public sector investment grants from Düsseldorf and NRW of approximately €111 million, about 18% of the planned investment spending. We expect Rheinbahn to finance the remaining €507 million from its own internal liquidity and by new borrowing.

Table 2

Rheinbahn AG Financial Summary

	--Fiscal year ended Dec. 31--						
(Mil. €)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Rating history	AA-/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+	AA-/Stable/A-1+
Revenues	220.5	224.2	235.7	253.4	255.0	265.6	283.1
Farebox revenues	163	167.9	175.7	187.6	199.1	205.9	215.6
Operating expenses before D&A	228.3	231.2	237.1	240.7	249.3	265.1	277.6
EBITDA including compensation	44.8	47	51.2	53.7	54.2	55.2	59.5
Cash and short-term investments	28.9	50.8	38.9	55.8	28.5	32.3	70.4

Table 2

Rheinbahn AG Financial Summary (cont.)							
	--Fiscal year ended Dec. 31--						
(Mil. €)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Financial debt	240.9	280.1	307.7	322.4	307.3	373.9	439.9
Equity	268.3	270.4	272.5	283.2	283.2	195.3	203.2
Adjusted ratios							
EBITDA (DSC) coverage	1.6	1.6	0.8	1.7	1.8	1.8	2.1
Debt service carrying charge (%)	11%	11%	23%	13%	14%	13%	10%
Farebox recovery ratio (%)	71%	73%	74%	78%	80%	78%	78%
Financial debt to revenues incl. compensation	0.9	1.0	1.1	1.1	1.0	1.2	1.3
Financial debt to net revenues	5.4	6.0	6.0	6.0	5.7	6.8	7.4

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Governments - General: Mass Transit Enterprise Ratings: Methodology And Assumptions, Dec. 18, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Duesseldorf Public Transport Company Rheinbahn AG Ratings Affirmed At 'AA-/A-1+'; Outlook Stable, June 19, 2017

Ratings Detail (As Of August 21, 2017)	
Rheinbahn AG	
Issuer Credit Rating	AA-/Stable/A-1+
Issuer Credit Ratings History	
16-Jun-2008	AA-/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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