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Reseau Ferre de France

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Table Of Contents

Reseau Ferre de France

Major Rating Factors

Issuer Credit Rating
AAA/Stable/A-1+

Strengths:

- Our view that extraordinary financial support from the French Republic is "almost certain."
- "Critical" role for the French government as owner, manager, and developer of the national rail infrastructure network and also as France's rail sector debt-defeasance entity.
- "Integral" link with the French government, given the state's close control and supervision and the company's access to emergency state funding.
- No prospect of privatization in the medium to long term.
- Continually strong financial support for the sector from the French government.

Weaknesses:

- Absence of a formal and explicit guarantee from the state for debt obligations.
- A significant capital expenditure program, only partly covered by subsidies.
- High leverage, which is expected to increase over the next two years.

Rationale

The 'AAA' rating on Reseau Ferre de France (RFF), the owner of France's rail infrastructure network, is based on an equalization with the long-term rating on the Republic of France (unsolicited rating AAA/Stable/A-1+). This reflects Standard & Poor's Ratings Services' view that there is an "almost certain" likelihood that the French sovereign would provide timely and sufficient extraordinary financial support to RFF in the event of financial distress.

We consider RFF a government-related entity (GRE). Under our GRE criteria, we base our rating approach on our view of RFF's:

- "Critical" role for the French government, given RFF's strategic mission of owning, managing, and developing the national monopoly rail infrastructure network and acting as a debt-defeasance structure for France's rail sector. We view this mandate as being of crucial social, economic, and political importance for the French economy and government; and
- "Integral" link with the French sovereign because of the government's close state supervision and control of RFF and RFF's access to emergency state funding.

The state does not explicitly guarantee RFF's debt and RFF's creditors have no direct recourse to the French government. However, owing to RFF's status as a state public agency ("Etablissement Public à Caractère Industriel et Commercial; EPIC), the French government is, by law, ultimately responsible for RFF's liabilities and would have to take over all of the company's assets and liabilities if it were dissolved.

RFF was established under the rail sector reform legislation in 1997, when it became the sole owner of France's national rail infrastructure network. Until 1996, the state was the ultimate owner of France's rail infrastructure and had delegated responsibility for the network to Societe Nationale des Chemins de Fer Francais (SNCF; AA+/Stable/A-1+). Along with the rail infrastructure, RFF also assumed responsibility for €20.5 billion of SNCF's debt as of 1997.

We assess RFF's stand-alone credit profile (SACP) at 'b+'. The SACP reflects our view of RFF's satisfactory business risk profile, which is characterized by increasing commercial revenues (96.5% of these revenues stem from passenger trains) and tempered by dependence on state subsidies. The main constraint to RFF's SACP is its highly leveraged financial risk profile.

Key business and profitability developments

In the financial year ended Dec. 31, 2010, RFF's revenues were €5.6 billion, flat on the previous year. RFF's charging and subsidy structures changed significantly during the year. Track access charges (TACs) increased by 2.2%, on average, in December 2010, although tariffs on the most established high-speed routes increased by up to 30%. Higher tariffs offset a decrease in traffic of 6.5% in 2010.

Freight activity, which represents 3.5% of RFF's commercial revenues, again slowed in 2010 (down 9%), but the decrease was much less than the 30% drop in 2009. The continued decline, at a time when the market had started to recover, was fueled by SNCF's decision to significantly reduce its single-wagon service. Passenger activity, which accounts for 96.5% of commercial revenues, was more stable, but passenger traffic decreased 3.7% in 2010, mainly owing to numerous strikes. According to RFF, this resulted in €70 million of lost revenue.

RFF's revenues are set to rise in line with an announced increase in TACs, which represent the main source of revenues. However, we anticipate that the company will continue to rely on subsidies from the state to balance its operations and ensure the coverage of network maintenance and renewal costs.

Key cash flow and capital-structure developments

RFF's reported net cash flows from operations totaled €2.11 billion in 2010, down 15% from the previous year. This was mainly because of an increase in the cost of SNCF's management and maintenance of the rail network and an adverse working capital movement.

Capital expenditure (capex) in 2010 amounted to €3.27 billion, or €1.06 billion net of investment subsidies. As a result of RFF's high level of investment, free operating cash flows were negative in 2010.

Adjusted debt stood at €27.7 billion at year-end 2010, a slight increase from the previous year. Funds from operations (FFO) to debt remained low at 3.4%. We expect RFF's debt to increase by up to €2 billion by the end of 2012 as investments continue to weigh on free cash flow generation.

Liquidity

We view RFF's liquidity as adequate over the next 12 months. We anticipate that sources of liquidity will cover uses of liquidity by 1.2x over the 12 months to June 30, 2012. RFF had more than €3.3 billion in cash and cash equivalents as of June 30, 2011, and its €1.25 billion revolving credit facility was fully undrawn.

We forecast free cash flow needs to be about €0.9 billion during the 12 months to June 30, 2012, due to RFF's significant capex. During that period, maturities from long-term debt total about €1.2 billion. RFF also had €1.5 billion of commercial paper (CP) outstanding at the end of June 2011 under its two short-term CP programs that, in total, are capped at €6 billion. Although the group expects to retain some short-term issuance, it has sufficient liquidity, in our view, to repay these facilities in the event of market disruptions.

RFF's revolving credit facility expires at the end of 2012, and we believe the company's liquidity will be less than adequate if this facility is not renewed. However, we consider that in case of need, RFF would have access to emergency funding from the French treasury ("Agence France Trésor"), which could for instance use its debt amortization fund ("Caisse de la dette publique") to buy RFF's bonds or CP issues. We consider that this allows for prompt and ample state support to RFF in the event of financial distress. In addition, we believe that tight state monitoring would allow the government to receive timely information should RFF experience financial difficulties, enabling preemptive actions and adequate, timely support if required.

Outlook

The stable outlook reflects our expectation that RFF will retain its critical role for and integral link with the French government. We therefore expect the ratings on RFF to move in line with those on France.

The ratings would come under pressure if our view of an "almost certain" likelihood of extraordinary sovereign support for RFF in the event of financial distress were to decline. This would lead us to give more weight to RFF's SACP in the overall rating and may result in a downgrade by at least one category under our GRE criteria.

However, we do not currently envisage a reduction in RFF's role for and link with the government. This is because we understand that there are no plans to privatize RFF, alter its mandate thereby reducing its crucial importance to the state, or to change its status.

Business Description

RFF is the sole owner of France's national rail infrastructure network. It was established in 1997 under the rail sector reform legislation, which also enabled France to comply with EU guidelines on the liberalization of rail activities by separating the management of rail infrastructure from that of rail operations.

RFF obtained full ownership of the national rail infrastructure assets when it was formed in 1997. Until 1996, the state was the ultimate owner of the network and had delegated responsibility to SNCF, France's incumbent rail operator. Along with the rail infrastructure assets, RFF also assumed responsibility for €20.5 billion of SNCF's debt and it continues to service this debt.

Despite the 1997 activity split, RFF and SNCF are still very much interlinked because SNCF constitutes RFF's:

- Main client, as the main user of the rail network for passenger rail services and the largest user for freight services; and
- Main supplier because the 1997 rail sector legislation delegated the management of the rail network to SNCF, including track access management. In practice, RFF's and SNCF's operations and investments are also linked as regards train stations and infrastructure works.

In 2010, TACs from rail operators, mainly from SNCF and passenger trains, represented approximately 83% of RFF's revenues. Approximately 85% of RFF's operating expenditure related to network management fees paid to SNCF.

Government Support And GRE Methodology Impact

In accordance with our criteria for rating GREs, we view the likelihood of extraordinary government support for RFF as "almost certain", reflecting our view of RFF's "critical" role for and "integral" link with the French government.

A critical role for the French Republic

We view RFF' role as "critical" for the French state given its mandate to own, manage, and develop the national rail infrastructure network and its role as a debt-defeasance structure for the sector.

As monopoly owner and operator of the national rail infrastructure, we view RFF's operations as having crucial social, economic, and political importance for the French economy and government.

RFF's key public service obligations include the:

- Construction, renewal, maintenance, and management of the national railway infrastructure;
- Allocation of railway infrastructure capacity;
- Setting, invoicing, and collection of TACs (although the state determines the evolution of TAC levels); and
- Support of France's economic development. The French government has a long tradition of developing the country through transport infrastructures.

The company's strategic mission is particularly important given the government's focus on infrastructure renewal and development. The government expects RFF to stimulate the national economy and increase the proportion of environment-friendly transportation modes. Excluding investments made through public-private partnerships, RFF's total investments in the French rail network exceeded €3.2 billion in 2010, which it anticipates sustaining over the medium term.

In our view, RFF also acts as a debt-defeasance structure for France's rail sector. When RFF was created in 1997, it assumed responsibility for €20.5 billion of SNCF's debt. RFF continues to service this debt and is therefore, in our view, a de facto defeasance structure for sovereign debt. Eurostat (the EU's statistical office) does not consolidate RFF's debt into its calculation of France's sovereign debt. This is because most of RFF's revenues do not stem from state subsidies but from TACs, which qualify as commercial revenues under Eurostat's criteria.

We believe that the likelihood of the European Commission impeding the French government's support of RFF is very low, and we understand that the European Commission has not questioned RFF's EPIC status. In addition, RFF's activities--unlike those of the rail operators--are not exposed to competition.

An integral link with the French sovereign

We view RFF as having an "integral" link with the French state because of the government's close supervision and control of RFF and its ultimate responsibility for RFF in an insolvency.

Strong state supervision of RFF's activities

We understand the French state maintains close control and supervision of RFF's operations:

- The state has full ownership of RFF and controls its board. Of the 18 members on RFF's board, seven represent the government (including the President, one representative of the French government shareholding agency APE, and one representative of the national court of audit), and five are appointed by the government. A change in ownership would require parliamentary approval. In our view, the government is unlikely to privatize RFF, owing to broad cross-party political support for the retention of strong state control and funding of the national rail network, given its importance to the economy and transport policy.

- RFF is subject to the oversight of a state commissioner designated by the Ministry of Transport, whose role is to ensure that the board's decisions are in line with RFF's strategic mission as defined by law. The government also approves RFF's investment program and financial plan under a multiyear contract.
- The government regulates the French rail network, sets the level of TACs, and is the sole owner of RFF's main client, SNCF. In our view, the recent creation of an independent regulator for France's rail operations, primarily to ensure equitable access to the network for all operators, does not weaken RFF's link with the state.

RFF's budget requires the approval of the supervising ministers, and its accounts are audited by the National Court of Audits ("Cour des Comptes"). RFF is also subject to checks by the state's financial controllers.

In view of this tight state monitoring, we consider that the government would be informed if RFF were to experience financial difficulties, allowing it to take preventive measures and provide adequate, timely support if required.

EPIC status provides for state support and passes ultimate responsibility for RFF's debt to the government

RFF's debt is not explicitly guaranteed by the state, so its creditors have no direct recourse to the French government. However, the state is ultimately legally responsible for RFF's debt under Law No. 80-539. This law stipulates that as the founder of a state agency (such as an EPIC), the state (or another state public agency) has to assume the EPIC's assets and liabilities if the entity were to be dissolved. As an EPIC, RFF is not subject to bankruptcy proceedings and can only be dissolved by a state decision, a prospect we view as highly unlikely. Likewise, we don't currently see a risk that RFF would be privatized.

We consider that, if necessary, RFF would have access to emergency funding from the French treasury, which could for instance use its debt amortization fund to buy RFF's bonds or CP issues. This should facilitate prompt state support for RFF if it has liquidity needs and could provide large advances in the unlikely event of financial distress.

Business Risk Profile: Satisfactory, In View Of Reliance On Subsidies And Sizable Investments

The major supports for RFF's satisfactory business risk profile are:

- RFF's monopolistic position as owner of the French rail network infrastructure. This position shields RFF from competition, but the company remains exposed to the shift of goods and passengers from rail to other modes of transport. However, new rail projects are expected to increase passenger and freight volumes in the long term.
- Relatively resilient passenger traffic, excluding one-time events, and limited exposure to freight traffic, which in our view is more cyclical than passenger traffic. Although rail freight volumes have continued to decrease, they only represent 3.5% of RFF's commercial revenues and therefore have a limited impact on its cash flows.
- Visibility over RFF's strategy and objectives, owing to a performance contract with the French government covering 2008-2012. This contract also provides greater predictability than in the past with regard to state funding and seeks to improve RFF's profitability and efficiency, although no explicit penalties apply if targets are not met.
- Our expectation that TACs will continue to increase, compensating for any reductions in subsidies, and enable full cost recovery in the medium term, fulfilling one of the objectives of RFF's performance contract. An economic

regulator for the French rail sector was set up in 2010, which is likely to increase transparency going forward.

These supports are partly offset by:

- RFF's exposure to variations in volumes and one-time events such as strikes. Whereas in 2009, traffic on the network increased by 2.2%, despite a decline in passenger numbers, in 2010, the number of train-kilometers declined by 6.5%. This is partly because of numerous strikes that RFF says resulted in lost revenue of €70 million. Unlike most of its peers, RFF continued to experience a decline in freight traffic in 2010 as SNCF withdrew its single-wagon services in an attempt to reduce losses at its rail freight business.
- Reliance on subsidies. State subsidies under the multiyear contract under which RFF operates are declining as commercial charges increase, unlike those for other European rail infrastructure managers. Subsidies are set yearly in the State Finance Law, which exposes RFF to the budgetary pressures of the French government. This led to a 5% reduction in subsidies in 2010 and may result in further reductions in the future.
- Limited efficiency and low flexibility of operating expenditures. RFF's cost base is largely fixed, and the cost of SNCF managing and maintaining the rail network represented 90% of operating spending in 2010. The operating efficiency of SNCF's infrastructure division is low, given its very large and unionized workforce. In addition, costs related to the reform of SNCF's postretirement benefits have been partly passed on to RFF.
- Significant capex over the medium term, which will weigh on free cash flow generation. Investments are determined in RFF's performance contract, which earmarked €13 million of spending by 2015 to modernize the network. RFF will also contribute to new projects under concession or public-private partnership schemes. RFF's capex totaled €1.1 billion net of subsidies in 2010, and we forecast net spending on the main network in 2011 and 2012 to be €1.5 billion annually, plus €500 million for new projects over the two years. In our view, RFF's ability to reduce investment levels is limited.

Financial Risk Profile: Highly Leveraged, Reflecting High Debt And Weak Cash Flow Generation

The main weaknesses of RFF's highly leveraged financial risk profile are:

- High debt, which translates into weak credit metrics. RFF assumed responsibility for €20.5 billion of SNCF's debt in 1997. It has since increased its total debt burden to help finance network maintenance and renewal. Adjusted debt was €27.7 billion on Dec. 31, 2010, the debt-to-EBITDA ratio exceeded 25x, and FFO to debt was about 3%.
- Our anticipation that free cash flow will remain negative in the medium term because of RFF's large capex program and commitments for new projects. Consequently, we expect RFF to refinance upcoming debt maturities through new issuance and total debt to increase by more than €2 billion by the end of 2012.
- RFF's weak capital structure. RFF continues to have a negative equity position (€1.19 billion in 2010), which reflects its low start-up equity and net losses in the first 10 years of operation, which were only partly offset by capital injections.

These weaknesses are mitigated by:

- Ongoing financial support from the state. RFF has received a significant amount of subsidies to finance its sizable capex program, which contribute to adequate liquidity.
- A staggered debt-maturity profile, with limited peaks and typically no more than €2.5 billion of repayments in

any given year. In addition, the average tenor of RFF's debt was 12.5 years as of March 31, 2011, exceeding that of many corporate issuers.

- Limited exposure to interest rate and foreign currency risks. RFF aims to have no more than 20% of debt at floating rates and uses swaps to ensure that foreign currency risk is fully hedged.

Table 1

Reconciliation Of Reseau Ferre de France Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2010--									
Reseau Ferre de France reported amounts										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	31,847.6	(1,193.1)	5,657.9	2,154.6	1,490.6	1,208.4	2,106.4	2,106.4	--	1,061.5
Standard & Poor's adjustments										
Postretirement benefit obligations	4.4	--	--	1.2	1.2	0.3	(1.2)	(1.2)	--	--
Surplus cash and near cash investments	(4,089.8)	--	--	--	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	16.2	--	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	(1,179.8)	(1,179.8)	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	28.5	--	--
Total adjustments	(4,085.4)	0.0	0.0	1.2	17.4	0.3	(1,181.0)	(1,152.5)	0.0	0.0
Standard & Poor's adjusted amounts										
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Cash flow from operations**	**Funds from operations**	**Dividends paid**	**Capital expenditures**
Adjusted	27,762.2	(1,193.1)	5,657.9	2,155.8	1,508.0	1,208.7	925.4	953.9	0.0	1,061.5

Table 2

Reseau Ferre de France--Peer Comparison

Industry Sector: Railroads					
	Reseau Ferre de France	**Deutsche Bahn AG**	**Porterbrook Rail Finance Ltd.**	**Rede Ferroviaria Nacional REFER, E.P.E.**	**Infrabel**
Issuer credit rating as of Aug. 4, 2011	AAA/Stable/A-1+	AA/Stable/A-1+	BBB/Stable/--	B+/Watch Neg/--	AA+/Negative/A-1+
Stand-alone credit profile assessment	b+	a-	N/A	ccc	bbb+
Likelihood of support	Almost certain	Very high	N/A	Very high	Almost certain

Table 2

Reseau Ferre de France--Peer Comparison (cont.)

(Mil. €)	--Fiscal year ended Dec. 31, 2010--			--Fiscal year ended Dec. 31, 2009--	
Revenues	5,657.9	34,410.0	381.7	74.4	962.0
EBITDA	2,155.8	4,902.4	316.6	(144.9)	107.0
EBIT	1,508.0	2,323.4	130.8	(147.7)	195.2
Interest expense	1,208.7	1,090.4	154.9	185.3	1.4
Net income from continuing operations	197.4	1,039.0	(1.0)	(120.5)	194.9
Funds from operations (FFO)	953.9	4,640.3	171.7	(325.7)	39.8
Working capital	(28.5)	(479.0)	9.2	(45.6)	162.2
Cash flow from operations	925.4	4,161.3	180.8	(371.3)	202.0
Capital expenditures	1,061.5	3,537.9	83.2	264.7	1,182.4
Free operating cash flow	(136.1)	623.4	97.7	(636.0)	(980.4)
Discretionary cash flow	(136.1)	609.4	(68.8)	(636.0)	(12.7)
Cash and short-term investments	13.0	0.0	124.7	0.6	559.5
Debt	27,763.1	21,755.1	1,913.0	5,539.2	0.0
Equity	(1,193.1)	13,852.0	(86.9)	2,409.8	13,084.4
Adjusted ratios					
Annual revenue growth (%)	(0.8)	17.3	1.4	(2.6)	(26.9)
EBITDA margin (%)	38.1	14.2	82.9	(194.6)	11.1
EBITDA interest coverage (x)	1.8	4.5	2.0	(0.8)	76.1
EBIT interest coverage (x)	1.2	2.1	0.8	(0.8)	138.9
Return on capital (%)	5.7	6.9	5.6	(1.9)	1.5
FFO/debt (%)	3.4	21.3	9.0	(5.9)	N.M.
Free operating cash flow/debt (%)	(0.5)	2.9	5.1	(11.5)	N.M.
Debt/EBITDA (x)	12.9	4.4	6.0	(38.2)	0.0
Total debt/debt plus equity (%)	104.5	61.1	104.8	69.7	0.0

N.M.--Not meaningful.

Table 3

Reseau Ferre de France--Financial Summary

Industry Sector: Railroads

	--Fiscal year ended Dec. 31--			
(Mil. €)	**2010**	**2009**	**2008**	**2007**
Revenues	5,657.9	5,702.3	3,815.1	3,778.9
EBITDA	2,155.8	2,274.2	190.6	417.2
Net income from continuing operations	197.4	304.0	11,849.0	(771.0)

Table 3

Reseau Ferre de France--Financial Summary (cont.)				
Funds from operations (FFO)	953.9	1,070.8	(178.2)	(173.7)
Working capital	(28.5)	220.4	20.2	22.2
Cash flow from operations	925.4	1,291.2	(158.0)	(151.5)
Capital expenditures	1,061.5	1,061.2	669.9	397.7
Free operating cash flow	(136.1)	230.0	(827.9)	(549.2)
Discretionary cash flow	(136.1)	230.0	(827.9)	(549.2)
Cash and short-term investments	12.1	0.0	0.0	0.0
Debt	27,762.2	27,284.3	27,402.6	27,161.6
Equity	(1,193.1)	(1,372.9)	(1,532.7)	(13,191.5)
Debt and equity	26,569.1	25,911.4	25,869.9	13,970.1
Adjusted ratios				
Annual revenue growth (%)	(0.8)	49.5	1.0	1.8
EBITDA margin (%)	38.1	39.9	5.0	11.0
EBITDA interest coverage (x)	1.8	1.9	0.3	0.6
EBIT interest coverage (x)	1.2	1.3	(0.5)	0.0
Return on capital (%)	5.7	6.2	(1.7)	0.1
FFO/debt (%)	3.4	3.9	(0.7)	(0.6)
Free operating cash flow/debt (%)	(0.5)	0.8	(3.0)	(2.0)
Debt/EBITDA (x)	12.9	12.0	143.8	65.1
Debt/debt and equity (%)	104.5	105.3	105.9	194.4

Related Criteria And Research

- Societe Nationale des Chemins de Fer Francais, April 28, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Ratings Detail (As Of August 4, 2011)*	
Reseau Ferre de France	
Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	A-1+
Senior Unsecured (42 Issues)	AAA
Senior Unsecured (1 Issue)	AAA/A-1+
Issuer Credit Ratings History	
30-Sep-1997	AAA/Stable/A-1+
Default History	
None	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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