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CEZ a.s.

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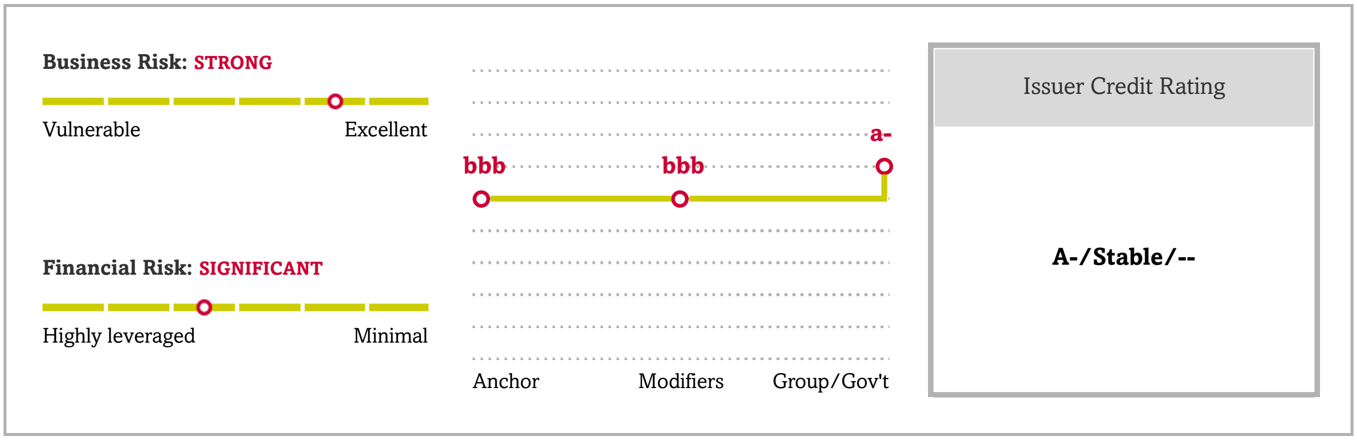


Credit Highlights

Overview

Key strengths	Key risks
Forecast EBITDA of about Czech koruna (CZK) 105 billion-CZK115 billion for 2023 gives CEZ an unrivaled position in the Czech Republic, as it is accountable for about 70% of electricity generated in the country and 65% of the electricity distributed.	Higher lignite and gas exposure leads to substantial effects from carbon prices and CO2 allowances, and also exposes the group to larger transition risk to reach net zero emissions.
Low-cost generation fleet, with about 57% from nuclear, and 37% from coal and natural gas fired generation.	Only about 6% of generation from renewables, lower than the peer group.
Strong link with the Czech government, its 70% owner; important for implementing the state's policies.	Windfall taxes and levy on revenue above price caps will limit profitability in the near to short term.
Ample headroom under core credit ratios, with funds from operations (FFO) to debt forecast at about 27% for 2023, albeit comparably lower with the extraordinarily strong 49% ratio in 2022.	Limited geographic diversification with EBITDA almost entirely generated in the Czech Republic.
Significant hedging ratio provides good earnings stability in 2023 and 2024.	

After exceptional 2022 results, we expect CEZ's credit metrics to soften over 2023-2024, due to windfall tax implementation on submarginal generation and a decrease in power prices, but to remain well above the 25% FFO to debt rating threshold. As of first-quarter 2023, CEZ sold 90% of its expected power generation in 2023 at €123 per megawatt-hour (/MWh), 53% of its 2024 generation at €123/MWh, and 29% of 2025's at €128/MWh.

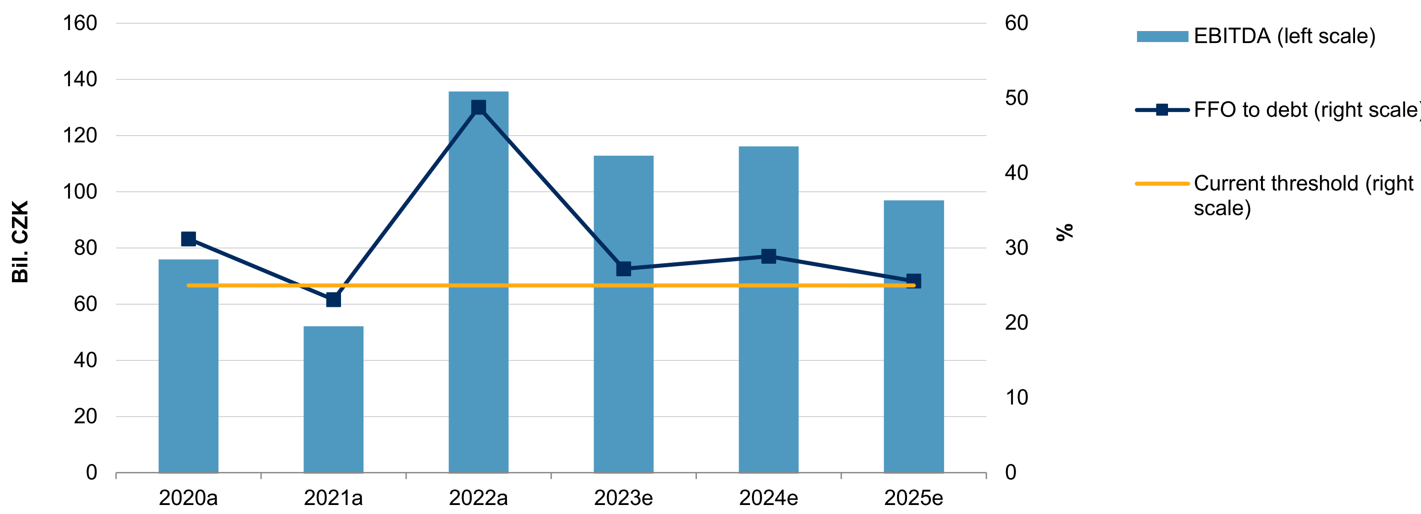
These prices are significantly above historical averages, which we estimate will result in FFO above 30%, allowing CEZ to maintain headroom under the current rating.

CEZ's S&P Global Ratings-adjusted EBITDA for 2022 materially increased by 161% year on year to CZK135.3 billion from CZK51.8 billion in 2021. Most of this improvement was led by the generation segment, where the group saw better margins due to higher realized electricity prices and higher proprietary margins in the trading division. We note realized prices in 2022--those that include the effect of hedges in place--were around € 123 per MWh compared with €83 per MWh in 2021.

This FFO increase comes despite the Czech government implementing specific measures to protect end-consumers--notably revenue caps on inframarginal rents, windfall taxes, and potential higher dividends for state-owned companies (including CEZ).

Chart 1

FFO to debt to remain above 25% threshold for the rating



a--Actual. e--Estimate. CZK--Czech koruna. FFO--Funds from operations. Source: S&P Global Ratings.

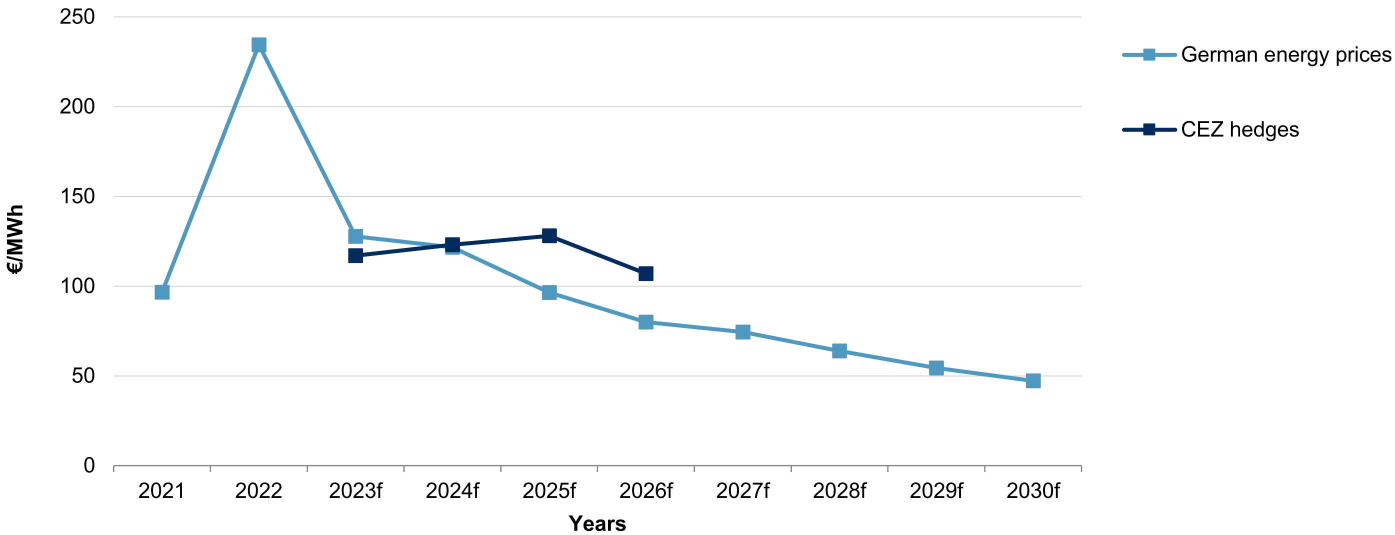
CEZ's credit metrics remain sensitive to power and carbon prices, despite its prudent hedging policy. The company has a predominantly fixed cost generation fleet, which is the largest contributor to EBITDA (78% in 2022). Overall, this exposes CEZ's consolidated EBITDA to market conditions.

Power prices in the Czech Republic remain closely linked to those in Germany, with only a small differential, given the interconnections between the two countries. We expect power prices in Germany and therefore the Czech Republic to be €120/MWh-€130/MWh in 2023 and 2024, compared with €234/MWh in 2022. This will weigh on CEZ's unhedged portion of its power generation.

That said, we expect power prices to remain well above 2021 levels, which will benefit CEZ's current hedges (see chart 2). In addition to power prices, CEZ also hedges its exposure to carbon prices. For 2023, about 13.4 million tonnes are hedged at €60 per tonne, for 2024 roughly 6.5 million tonnes are hedged at €74/tonne, and for 2025 about 2.5 million tonnes hedged at €99/tonne. Although the hedges provide some earnings protection, there is a significant burden on profitability compared with a few years ago--in 2020 the average price was below €25/tonne and below €40/tonne in 2021.

Chart 2

German energy prices compared to CEZ's average hedging price



MWh--Megawatt hour Source: S&P Global Ratings Commodity Insights

From 2023, CEZ's profitability will be temporarily affected by government measures implemented during the energy crisis. Like many other European governments, the Czechia government introduced measures to address energy affordability. This included a cap on electricity tariffs to protect households from exceptionally high power and gas prices. The government expects to fund this cap using a revenue cap on inframarginal rents, windfall taxes, and higher dividends.

CEZ's revenue in 2023 will be significantly hit by the 90% levy above price caps in its generation segment. The government set price caps for nuclear power at €70/MWh, lignite at €170/MWh for units above 140 megawatts (MW) and €230/MWh for units below 140 MW, and merchant hydro, wind, and solar power at €180/MWh, compared with standard power prices of around €120-€130/MWh in the Czech Republic for 2023.

The levy period on revenue caps is from Dec. 1, 2022, to Dec. 31, 2023. We understand there are currently no talks in place for prolonging this period. In terms of windfall taxes, the state decided to charge 60% of windfall taxes on the energy sector.

As a result, we expect CEZ to pay CZK30 billion-CZK40 billion in windfall taxes and levy of revenues above price caps, and almost CZK26 billion-CZK30 billion in advance income taxes for 2023. This will significantly impair the group's credit metrics. Windfall taxes will be levied for 2023-2025. We will monitor any potential government decisions and any effect this might have on CEZ's credit metrics.

In its first-quarter 2023 results, CEZ reiterated its policy of paying dividends equal to 60%-80% of net income. But actual dividends could be beyond 100%, which we view as fairly aggressive. In 2023, the group might pay CZK110 billion-CZK120 billion to the Czech Republic state in dividends, income taxes, and levy of revenues.

We understand that CEZ proposed to its board of directors paying CZK117 per share (translating to CZK63 billion overall), which corresponds to 80% of CEZ's net income--the upper end of its dividend policy. Although, on June 16, 2023, the Czech Republic's Ministry of Finance proposed CEZ will pay CZK145 per share (CZK78 billion overall), a 100% payout. CEZ currently has headroom in its credit metrics for the current rating, which can absorb higher dividend payments.

The 2030 strategic plan entails ambitious investments in renewables while increasing nuclear output and decreasing coal-fired generation. The group aims to achieve carbon neutrality by 2040 and expects to achieve this by adding renewable capacity while preserving nuclear. The company plans to build 1.5 gigawatts (GW) of renewables capacity by 2025 and 6 GW of capacity by 2030. CEZ has the ambition to increase the capacity of installed electricity accumulation to at least 300 MW by 2030.

CEZ also targets reducing its share of coal generated electricity to 25% by 2025 and 12.5% by 2030, significantly reducing its carbon footprint.

Although, CEZ will have to make extensive investments to achieve this. It plans make cumulative investments of CZK600 billion-CZK700 billion over 2021-2030, which includes CZK6 billion-CZK7 billion per year for 2023-2025 and CZK18 billion-CZK20 billion per year for 2026-2030 in the renewable segment. This will be partially funded by the Czech Republic's Modernization fund, which aims to support renewable projects in the country.

At the same time CEZ will also invest in switching heating plans from coal to gas, and plans to invest a further CZK10 billion roughly per year until 2030. The heavy investment cycle ahead, together with high dividend payments outside of the dividend policy range, could pressure credit metrics and lead to negative free operating cash flow. Although, we think green investments will benefit CEZ's carbon footprint in the long run.

The company's new nuclear project could impose a significant risk. Currently, the new nuclear project at Dukovany is at the first preparatory stage (preparation and supplier selection), and the group anticipates this will be complete by 2024 for an estimated total cost of about CZK2 billion. In 2022, the company launched a tender for the engineering, procurement, and construction contractor. It received three valid bids for the tender and started the evaluation process, which should complete by 2024.

The group is also in the preparatory stage for small modular nuclear reactor construction. In the new nuclear power plant at Temelin, the company received the permit for unit 2's long-term operation.

We will monitor how this evolves, as it could be a key negative consideration if the company finances the new plant on its own, without full or close to full cost cover from the state.

However, this would be contrary to our current expectations as CEZ has contracted parameters with the Czech government on electricity purchase prices from the new facility and conditions for the state to partially fund the project. This removes regulatory, offtake, and financial risk for CEZ.

Potential extraordinary backing from the Czech government continues to support the rating. In our view, CEZ benefits from potential extraordinary support from the Czech government given the company's importance in the implementation of the state's policies and strong link to the government. We expect the Czech government will continue to own about 70% of the company. Our view is further underpinned by CEZ's position as the dominant Czech power generator and the power distributor.

Outlook: Stable

The stable outlook indicates that, although we forecast CEZ will post strong credit metrics from 2023-2024 because of strong power price momentum, we expect its credit metrics to return to close to historical levels eventually as power prices decline. We consider FFO to debt of well above 25% to be commensurate with CEZ's 'bbb' stand-alone credit profile.

We have not changed our view that there is a moderately high likelihood the Czech Republic would offer CEZ extraordinary support, in case of need. At this stage, our base case does not factor in the government's upcoming decision regarding the financing of a potential nuclear project. Once this decision has been announced, we could place the rating on CreditWatch while we assess the implications for CEZ's future business perimeter and balance-sheet quality.

Downside scenario

We could lower the rating on CEZ if its SACP falls by one notch or more. This could stem from:

- Unplanned outages causing a fall in generated output that would eventually lead to adjusted FFO to debt falling below 25% for a prolonged period.
- Increased political risk depressing CEZ's financial metrics and leading, for example, to a largely negative discretionary cash flow (DCF) to debt ratio. This could occur if the Czech Republic extracts more cash from power utilities than we anticipate in our base case, through increased dividends or imposing windfall taxes.

Upside scenario

We see limited upside potential for the rating. An upgrade would require either a substantial, two-notch upward revision of CEZ's SACP, a higher assessment of the likelihood of extraordinary government support, or an upgrade of the Czech Republic.

That said, we could raise the SACP by one notch once the scale of potential government intervention becomes clearer and if we have confidence FFO to debt will remain above 35% and DCF to debt will be at least neutral. A one-notch upward revision of the SACP would not trigger an upgrade, all else being equal.

Our Base-Case Scenario

Under our 2023-2025 base-case scenario, we assume

- Real GDP growth in the Czech Republic of 0.2% in 2023, 2.3% in 2023, and 2.3% in 2024.

Generation

- Volume produced for sale in Czech Republic over 2023-2025 stable at around 46 terawatt hours (TWh)-48 TWh.
- In 2023, CEZ will continue to offtake 5 TWh of electricity from the Pocerady coal power plant, which it disposed of in 2020.
- Prices hedged: 53% at €123/MWh in 2024, 29% at €128/MWh in 2025, and 7% at €107/MWh in 2026.
- Assumed power prices of about €124/MWh for 2023, €114/MWh for 2024, €99/MWh for 2025, and €86/MWh for 2026 for the unhedged volume.
- Carbon dioxide costs averaging around €82/tonne for 2023, €86/tonne for 2024, and €90/tonne for 2025.
- Open position amounting to 17%–23% of electricity delivery from generation in the Czech Republic.

Networks

- Pre-tax weighted-average cost of capital fixed at 6.54% for the whole regulatory period until 2025.
- We expect investments into the Czech distribution network to grow and stay at an increased level of about CZK15 billion (compared with CZK11 billion in 2019 and CZK8 billion in 2016).
- EBITDA affected by higher regulatory asset base, depreciation, and amortization.

Sales and energy service companies

- EBITDA from electricity and gas sales (less than 1% of the consolidated figure) to decline to zero by 2022 due to increasing procurement costs, but to recover thereafter.

Mining

- EBITDA to rise in the short term because of higher coal sales at higher realized prices, despite the increase in fixed operating expenses, especially energy.

Other and financial policy:

- Adjusted EBITDA of CZK105 billion-CZK115 billion in 2023, increasing to about CZK110 billion-CZK120 billion in 2024.
- EBITDA margins of about 33%-38%.
- Annual capital expenditure (capex) to grow to about CZK52 billion-CZK69 billion, largely driven by investments in new solar and gas capacity in the Czech Republic.
- Minimum 100% dividend payout in 2023 as the Czech Ministry of Finance indicated on June 16, 2023, dividends thereafter to be paid in line with CEZ's dividend policy of 60%-80% payout.
- From 2023, a 19% tax rate and cash taxes assumed to be in line with profitability.
- No large, debt-financed acquisitions.
- Margin collateral posted gradually flowing back to CEZ as power price delta declines for new contracts.

Key metrics

CEZ--Key metrics*					
	--Fiscal year ended Dec. 31--				
(Bil. CZK)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
EBITDA	51.8	135.3	105-115	110-120	125-135
Debt	188.3	257.1	230-240	230-240	250-260
Dividends	27.9	25.6	75-80	26-29	20-25
Capex	31.9	33.6	48-53	60-65	65-70
FFO to debt (%)	23.1	48.8	26-28	28-30	25-27
Debt to EBITDA (x)	3.6	1.9	1.9-2.3	1.8-2.2	2.4-2.8

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

We expect the credit metrics to be strong and well above the threshold level as the group will continue to benefit from high energy prices, however the levy on revenue above the price cap and windfall tax will somewhat limit upside potential. In 2022, CEZ saw strong growth in its credit metrics due to higher profitability, mainly benefited by high market prices. The group's FFO to debt increased to 48.8% in 2022 from 23.1% in 2021.

In 2023, we expect FFO to debt to be above the threshold level--within the range of 27%-30% and above our 25% downside trigger for the rating. This is because the company will continue to benefit from high energy market prices.

Also, on Dec. 30, 2022, the company had large margin deposits amounting to CZK76 billion due to the unprecedented power price increase last year, which have already largely returned in 2023. This is considering the substantial inflow of working capital expected in 2023, which will lead to lower net debt as well as better FFO to debt and debt to EBITDA in the coming period.

From 2023, we expect power prices will be substantially lower than in 2022. This will potentially lead to more volatile credit metrics that notably impact CEZ's unhedged generation. The forecast metrics will also be subject to the evolution of investments and dividend policy.

Company Description

CEZ a.s. is an integrated energy company with presence in a wide range of electricity-related businesses: generation, distribution, supply, mining, and energy trading. It benefits from an unrivaled position in the Czech electricity market.

CEZ's strategy is predominantly focused on development and optimal utilization of its existing generation portfolio. It also aims to achieve a significant position in stable markets near the Czech Republic, such as Germany, Italy, and Poland. This strategy led management to exit markets like Romania, and Bulgaria. CEZ also plans to exit the generation market in Poland, by disposing of hard coal power plants CEZ Chorzow and CEZ Skawina, as well as in Turkey.

CEZ has a market share of about 65% of the generation segment in the Czech Republic. In 2022, its total capacity was 11.8 GW, and its total production was 54.3 TWh. Most of its generation mix comprises nuclear, hard coal, and lignite (89% of generation in 2022). Lignite generation is supported by CEZ's ownership of the largest mining company in the

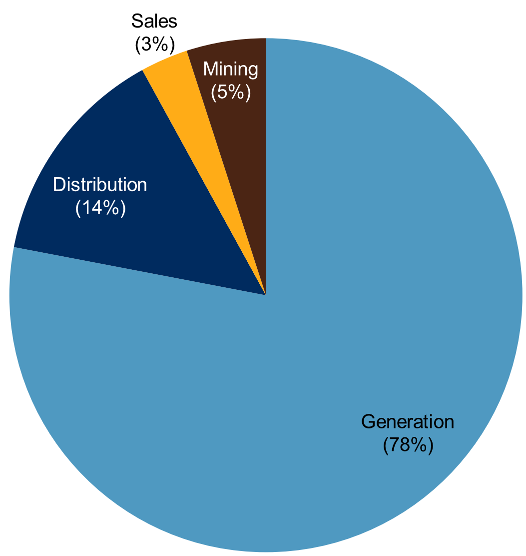
Czech Republic, which almost entirely covers CEZ's needs.

CEZ sold about 28% of the coal extracted to external parties. Coal- and lignite-fired power plants represented 37% of capacity and 32% of generation volume in 2022. It aims to decrease its coal-fired capacity to 3.0GW in 2025.

CEZ owns the largest distribution company in the Czech Republic and controls about 65% of the country's electricity distribution. The Czech Republic is CEZ's largest shareholder and holds a 70% stake in the share capital and voting rights. The remaining 30% is publicly listed.

Chart 4

2022 EBITDA split



Source: Company Data

Peer Comparison

Table 1

CEZ a.s.--Peer comparison					
Industry sector: Energy					
	CEZ a.s.	**Vattenfall AB**	**Fortum Oyj**	**Statkraft AS**	**Verbund AG**
Ratings as of June 4, 2021	A-/Stable/A-2	BBB+/Positive/A-2; Nordic regional scale --/--/K-1	BBB/Stable/A-2	A/Stable/A-1	A/Positive/A-1

Table 1

CEZ a.s.--Peer comparison (cont.)

	--Fiscal year ended Dec. 31--				
(Mil. €)	2,022.0	2,022.0	2,022.0	2,022.0	2,022.0
Revenue	11,634.2	21,511.2	8,804.0	15,102.2	10,319.6
EBITDA	5,601.0	4,318.2	2,249.0	5,409.3	2,240.9
Funds from operations (FFO)	5,191.0	3,616.8	1,881.0	3,932.6	1,855.0
Interest expense	269.3	469.4	295.9	73.7	78.9
Cash flow from operations	196.8	122.2	2,104.0	3,818.3	1,870.3
Capital expenditure	1,391.3	2,223.0	534.0	763.4	1,224.6
Free operating cash flow (FOCF)	(1,194.5)	(2,100.8)	1,570.0	3,054.9	645.6
Discretionary cash flow (DCF)	(2,256.2)	(4,409.2)	538.0	2,084.9	167.8
Cash and short-term investments	1,515.4	9,563.4	3,772.0	5,594.2	409.3
Debt	10,644.7	2,222.9	4,128.2	0.0	3,727.8
Equity	10,773.5	12,370.9	7,737.0	12,507.2	8,323.0
Adjusted ratios					
EBITDA margin (%)	48.1	20.1	25.5	35.8	21.7
Return on capital (%)	23.9	15.9	6.1	41.8	17.0
EBITDA interest coverage (x)	20.8	9.2	7.6	73.4	28.4
FFO cash interest coverage (x)	28.9	12.7	10.4	41.2	44.3
Debt/EBITDA (x)	1.9	0.5	1.8	0.0	1.7
FFO/debt (%)	48.8	162.7	45.6	0.0	49.8
Cash flow from operations/debt (%)	1.8	5.5	51.0	0.0	50.2
FOCF/debt (%)	(11.2)	(94.5)	38.0	0.0	17.3
DCF/debt (%)	(21.2)	(198.4)	13.0	0.0	4.5

CEZ is the largest generator, distributor, and supplier of electricity in the Czech Republic, and has a higher market share in its home market than peers Vattenfall and Verbund. Notably, CEZ generates about 65% of all power in the country. The peer companies are relatively similar in size, but CEZ has less renewable power generation, especially compared with Vattenfall, Verbund, and Statkraft that all have inherently strong positions in the hydroelectric segment.

Business Risk: Strong

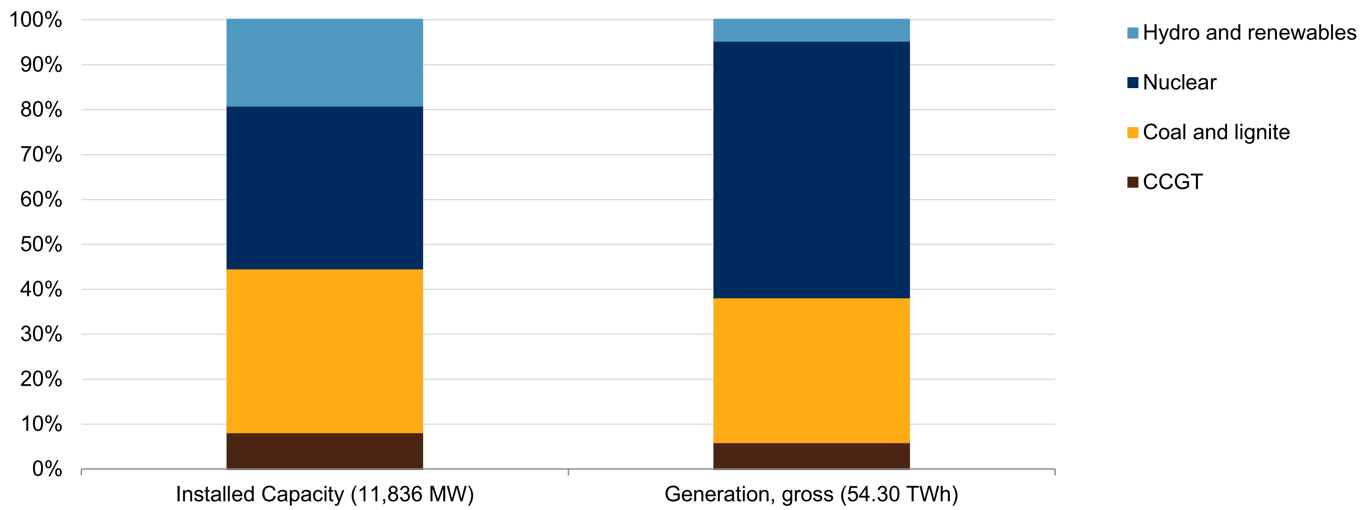
We assess CEZ's business risk profile as strong. Our assessment is underpinned by:

- CEZ's unrivaled position in the Czech power market;
- A diversified and low-cost electricity generation fleet despite its unregulated activities being significantly exposed to volatile power prices; and
- A large contribution of stable cash flows from regulated activities, typically about 25% of earnings.

CEZ's diversified and low-cost electricity generation fleet is exposed to power prices. In our view, CEZ benefits from its diverse generation fleet along the load curve. Its first focus is on nuclear assets, and on lignite and hard coal, together about 72% of generation assets, and the second is power, hydro, renewables, and combined cycle gas turbines assets.

Chart 5

Installed capacity and generation in 2022



CCGT--Combined cycle gas turbines. MW--Megawatts. TWh--Terawatt hours. Source: Company data.

In addition, CEZ's predominantly low-cost nuclear power generation fleet provides a competitive advantage because it allows the company to benefit from increased power prices as seen in 2022.

CEZ's generation fleet operates with a low fuel cost base. Nuclear fuel costs (including an approximate €2/MWh contribution to the state's nuclear account) amount to approximately €8/MWh, while lignite costs are approximately €104/MWh, assuming a CO_2 price of €93 per metric ton. This is still better placed on the cost curve than combined cycle gas turbines and coal plants.

The relatively low variable cost is partly the result of the internal sourcing of 65% of the company's lignite needs, along with the geographic proximity of the mines from which the company sources lignite. This compares with our expectation of an average price of generated electricity of around €120/MWh-€130/MWh in 2023.

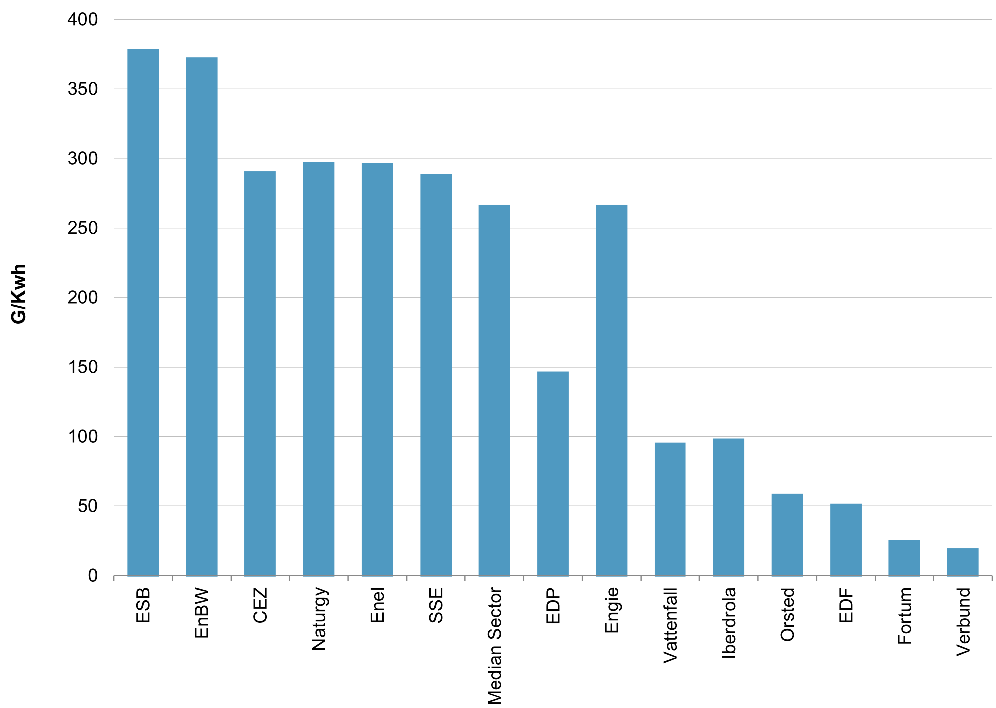
Continuous increases in CO2 prices toward and even above €90/mt will likely have only a temporary negative effect on the cost position in 2023. This is because CEZ sells electricity on a forward-looking basis and buys CO2 emission allowances for the same periods. We will monitor CO2 prices and what impact, if any, this might have on CEZ's cash flow.

Unlike other EU countries, the Czech Republic has an energy policy that is relatively supportive of nuclear power and coal, owing to the moderately limited natural potential for wind in the country. Within its strategy, CEZ aims to become a fully integrated renewables player, and although we expect the continued closure of old low and marginal coal units, this will likely take time, which implies CEZ will be carbon neutral later than many international peers. We expect the generation strategy to focus predominantly on nuclear and renewables. By 2025, the company expects installed capacity of renewable energy of about 3.7 GW, up from 2.25 GW in 2022. However, this will depend on regulatory developments. CEZ is also expanding its renewable capacity outside of the Czech Republic, as it acquired and is now developing wind onshore assets in Western Europe. 142 MW are in operation and the developing pipeline is 419 MW, predominantly in Germany.

Decarbonization and reduction of carbon emission intensity are key risks for group as, when it comes to pollution, CEZ is weaker positioned than many peers due to its coal plants. CEZ announced a new target relating to its plan to decrease its share of coal-fired electricity generation to 25% by 2025 and to 12.5% by 2030, from 36% in 2022. The strategy also includes lowering emission intensity to 0.26 tonnes of CO2/MWh in 2025 from 0.38 tonnes of CO2/MWh in 2019, and 0.16 tonnes of CO2/MWh in 2030, i.e., a 57% reduction, as well as building 1.5 GW of renewable energy sources (RES) by 2025 and 6 GW of RES by 2030.

Chart 6

CEZ's carbon intensity is among the highest of rated peers…



g/kwh: grams per kilowatt hour Source: S&P Global Ratings.

The temporary decline in contributions from the regulated business in 2022 is mainly due to disproportionate growth in the generation segment. Regulated activities, especially electricity distribution operations, represented around 30% of EBITDA in 2021, and represented only one-half of that in 2022. Despite this, we do not expect CEZ to stop operating as an integrated utility, and expect the ratio of earnings from regulated operations to gradually improve.

Its strategy brings in meaningful contributions from the stable electricity distribution operations in the Czech Republic, which has a strong regulatory framework. This will continue to support cash flow and provide stability, thus bolstering the company's business risk profile.

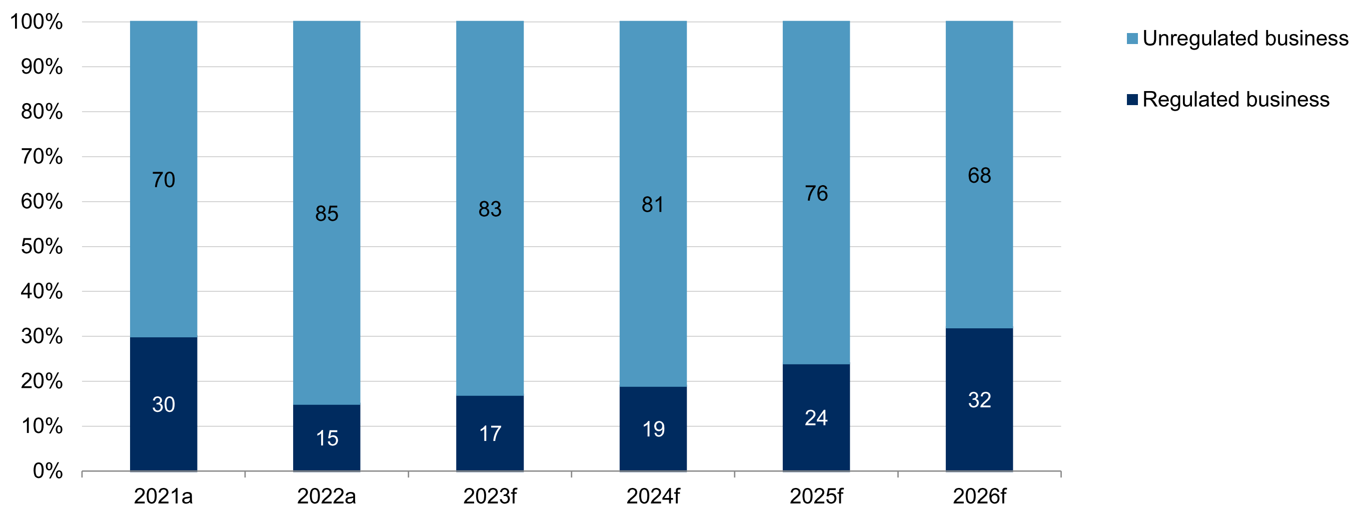
The group's overall regulatory asset base (RAB) has improved by 10% in 2022 to CZK134 billion from CZK122 billion in 2021. We expect it will grow by 8% compound annual growth rate in 2020-2025 and reach roughly CZK160 billion by 2025 and CZK200 billion by 2030 thanks to revaluation and investments.

The fifth regulatory period from January 2021 to December 2025 will support RAB growth. In the current plan, the weighted average cost of capital is 6.54% and is fixed for the full regulatory period. The investment in the distribution segment is directed to digital transformation and preparation for decentralized generation. CEZ continues to invest in grids; of the CZK180 billion total capex it expects to invest over 2023-2025, about CZK45 billion will go to distribution (about one-third of the capex budget).

After CEZ sold its Bulgarian and Romanian regulated assets in 2021, it saw regulated activities make a smaller contribution to EBITDA. We estimate this will continue over the next two to three years because the unregulated segment will make a disproportionate contribution. We see this as negative, but not sufficient to weigh on the rating. Once power prices have normalized, we expect contributions from regulated earnings to revert to historical levels.

Chart 7

We expect the share of EBITDA from regulated utilities to gradually improve



Source: Company data.

Despite CEZ's supply segment contributing to around 3% of 2022 EBITDA, CEZ is the largest electricity supplier in the Czech Republic. In 2022, the retail segment's contribution to EBITDA declined substantially from 8% in 2021 to 3% in 2022. This is mainly due to a disproportionate contribution by the generation segment, led by high energy prices during the period.

We believe the same will continue for the next two to three years but eventually it will increase to the previous level. CEZ is the largest electricity supplier in the Czech Republic and is also a supplier of last resort with around 45% market share as of December 2022, compared with about 41% in 2021.

CEZ also increased its customers by 4% to 3.29 million in 2022 from 3.16 million in 2021. The increase was mainly due to the transition of hundreds of thousands of customers to new suppliers as a result of the collapse of major suppliers in fourth-quarter 2021 and lower acquisition activity by alternative suppliers during 2022 because of extreme price volatility. We view this increase as positive because it allows CEZ to achieve economies of scale despite the low margin business.

CEZ has material exposure to carbon price risk through its lignite and hard coal generation, which comprised 36% of its installed capacity in 2022. As of March 31, 2023, CEZ hedged around 6.5 million tonnes of its emission allowance needs at €74.4/t for 2024 and around 2.5 million tonne at €99/t for 2025. As current hedges are finishing, the structurally higher emission allowances will have a somewhat negative effect on earnings in 2024 and 2025. We will monitor CO2 prices and what impact, if any, hedging might have on CEZ's cash flows.

Financial Risk: Significant

Our assessment of CEZ's financial risk profile is underpinned by our expectation that FFO to debt will remain above 25% over 2023-2024, with debt reduction in 2023 as margins flow back. We consider 2022 an extraordinary year due to the ongoing rise in energy prices caused by the Russia-Ukraine conflict. The company hugely benefitted from extremely high power prices, which led to 161% growth in the group's EBITDA to CZK135.3 billion and FFO to debt to increase up to 48.8% in 2022 from 23.1% in 2021. For 2023, we expect profitability to decline mainly due to the anticipated decline in energy prices as well as the Czech government's measures to levy on generation revenue above price caps, windfall taxes, and higher than expected dividends.

This will lead EBITDA to be in the range of CZK105 billion-CZK115 billion for 2023-2024. However, in 2023, we expect large working capital inflows of about CZK40 billion-CZK50 billion mostly driven by margin call inflows thereby reducing net debt. We forecast net debt to remain around CZK200 billion-CZK210 billion over 2023-2024, down from CZK257 billion in 2022.

This assumes CEZ will continue to pay dividends in line with its financial policy of 60%-80% of the year's adjusted profit after tax with exception of 2023. We expect dividends of about CZK78 billion in 2023 and around CZK26 billion-CZK29 billion in 2024. We also expect investments to remain high, see Base-Case Scenario above, and that they will largely consume cash flow generated over the coming years. The company has guided CZK110 billion in total over 2023-2024.

Hence, we expect FFO to debt to be within the range of 25%-30% and debt to EBITDA to be remain well below the threshold limit i.e., not more than 3x.

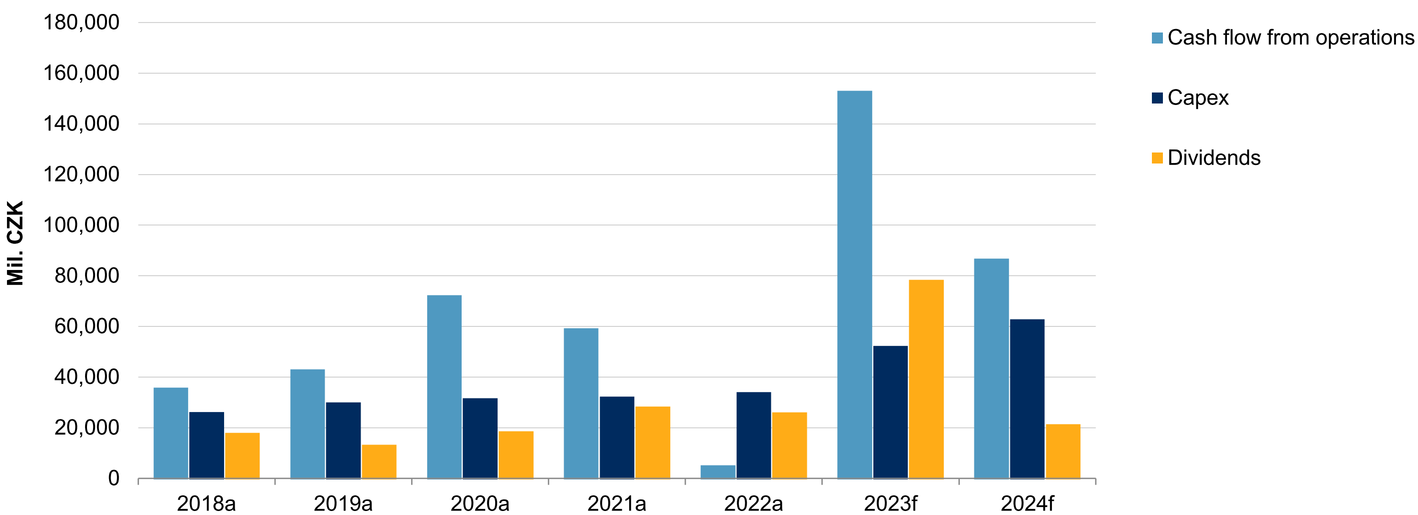
We forecast capex will ramp up to CZK52 billion-CZK62 billion annually in 2023-2024, from around CZK33 billion-CZK35 billion in 2021-2022. CEZ plans to invest significantly in renewables and its regulated distribution networks. We believe the company is in a good position to slowly transition its generation mix to fossil-free, because it already has a high share of low carbon dioxide-emitting nuclear in the portfolio (around 56% of total generation output) and has credible path to net zero as announced in its VISION 2030 strategic update.

However, over the coming year, the company needs to address that above 30% of its total electricity generation still stems from fossil fuels, notably lignite. For example, CEZ is accelerating the construction of renewables (in the retail sector over 4 thousand PV power plants with a capacity of 27 MW have been installed); in the construction of new PV plants CEZ has already received support for 173 MW and CEZ projects with a capacity of over 1,012 MW have been submitted to the second round.

CEZ's announced capex program for the coming period is large, with CZK110 billion (€5.7 billion) total guided for 2023-2024, a significant increase from the previous 2021-2022 total of CZK33 billion-CZK35 billion annually. Given the rating headroom, we believe this could increase further in coming years.

Chart 8

Operating cash flow will not cover investment and dividends in 2023 and we expect credit ratios to soften



Capex--Capital expenditure. a--Actual. e-- Estimate. f--Forecast. CZK--Czech koruna. Source: S&P Global Ratinxgs.

We view CEZ's dividend policy as less aggressive, with 60%-80% of adjusted net income distributed to shareholders as compared to the earlier policy of 80%-100%, but actual dividend payments can vary. In the event of 100% payout, CEZ's ability to reduce its debt will be hindered by continuous, sizable dividend distributions at the request of its majority shareholder, the Czech government.

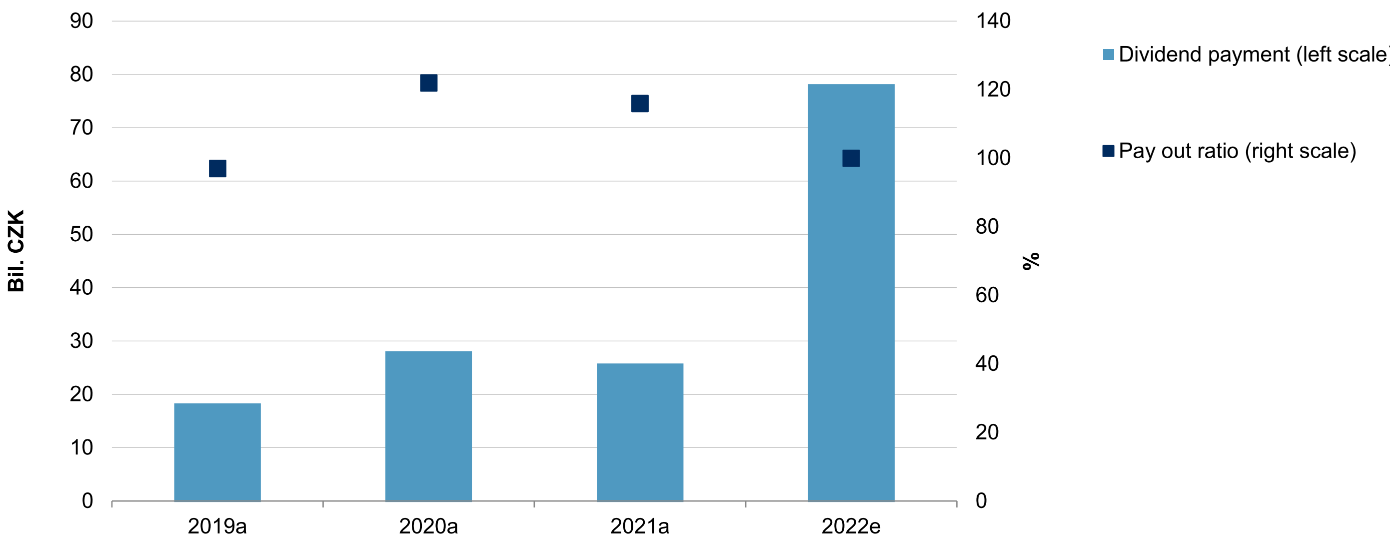
The company paid dividends of CZK52 per share in 2020 (122% payout ratio) and CZK48 per share in 2021 (116% payout ratio). In 2022, the group paid a total dividend of CZK26 billion based on 2021 net income.

Dividends for 2020 and 2021 were set in two ways: the regular component corresponded to a payout ratio of 100% of CEZ Group's adjusted net income, while the extraordinary component (beyond the 100% payout ratio) reflected the contribution of the sale of Romanian (2020) and Bulgarian (2021) assets to CEZ Group's debt capacity.

In 2023, due to CEZ's high profitability, the Ministry of Finance proposed that CEZ would pay CZK145 per share (100% payout ratio). We forecast that based on 2022 net income, CEZ might pay around CZK78 billion dividends in total.

Chart 9

Actual dividend payment and dividend payout ratio



a--Actual. e--Estimate. Note--The actual payment of dividend is done in the next financial year. CZK--Czech koruna. Source: S&P Global Ratings.

Financial summary

Table 2

CEZ a.s.--Financial summary

Industry sector: Energy					
	--Fiscal year ended Dec. 31--				
	2022	**2021**	**2020**	**2019**	**2018**
(Mil. CZK)					
Revenue	281,053.0	224,822.0	209,522.0	201,781.0	175,717.0
EBITDA	135,306.0	51,791.0	75,482.0	55,831.0	48,624.0
Funds from operations (FFO)	125,401.0	43,537.0	65,808.0	46,008.0	39,657.9
Interest expense	6,503.0	4,751.0	5,942.2	6,316.3	6,612.6
Cash interest paid	4,158.0	4,415.0	5,926.0	5,687.0	5,639.1
Cash flow from operations	4,754.0	58,867.0	71,880.0	42,670.0	35,427.9
Capital expenditure	33,610.0	31,937.0	31,281.0	29,541.0	25,758.0
Free operating cash flow (FOCF)	(28,856.0)	26,930.0	40,599.0	13,129.0	9,669.9
Discretionary cash flow (DCF)	(54,505.0)	(1,033.0)	22,460.0	253.0	(7,943.1)
Cash and short-term investments	46,461.0	27,139.0	8,819.0	9,758.0	7,278.0
Gross available cash	46,461.0	27,139.0	8,819.0	11,002.0	9,434.0
Debt	257,150.0	118,328.0	210,890.5	216,559.1	202,631.5
Equity	260,261.0	162,840.0	238,563.0	255,364.0	239,281.0

Table 2

CEZ a.s.--Financial summary (cont.)

Industry sector: Energy					
	--Fiscal year ended Dec. 31--				
	2022	2021	2020	2019	2018
Adjusted ratios					
EBITDA margin (%)	48.1	23.0	36.0	27.7	27.7
Return on capital (%)	23.9	4.0	9.5	5.1	3.9
EBITDA interest coverage (x)	20.8	10.9	12.7	8.8	7.4
FFO cash interest coverage (x)	28.9	10.3	12.1	9.1	8.0
Debt/EBITDA (x)	1.9	3.6	2.8	3.9	4.2
FFO/debt (%)	48.8	23.1	31.2	21.2	19.6
Cash flow from operations/debt (%)	1.8	31.3	34.1	19.7	17.5
FOCF/debt (%)	(11.2)	14.3	19.3	6.1	4.8
DCF/debt (%)	(21.2)	(0.5)	10.7	0.1	(3.9)

CZK--Czech koruna.

Liquidity: Adequate

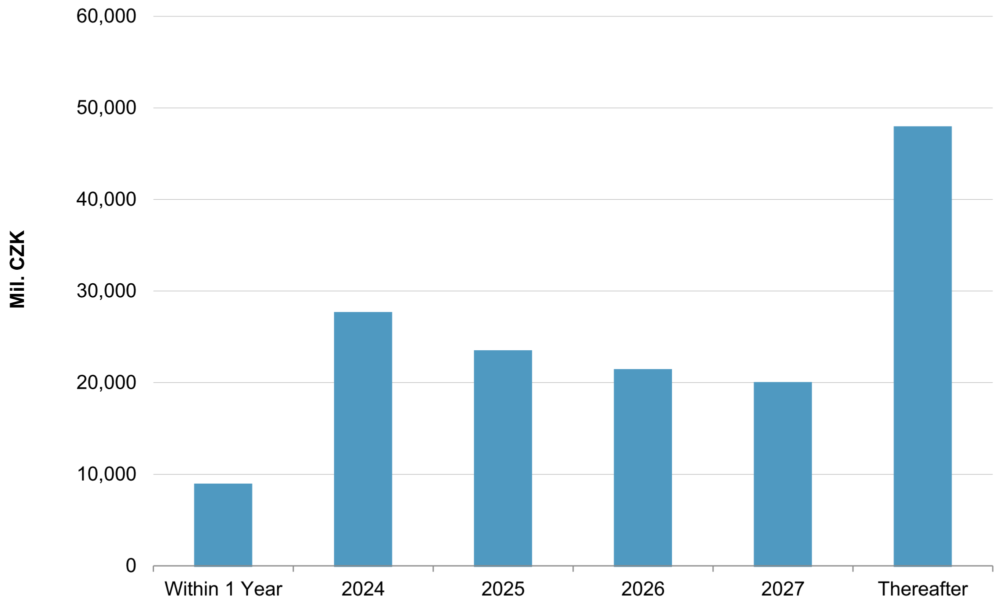
We view CEZ's liquidity position as adequate under our criteria, based on our expectation that available liquidity resources will cover expected cash outflows by close to 1.9x in the next 12 months, including all refinancing needs. Supportive qualitative factors include strong bank support, the company's high standing in credit markets, and ongoing benefits of its state ownership.

Principal liquidity sources	Principal liquidity uses
We expect principal liquidity sources over the next 12 months from March 31, 2023, will include: • Unrestricted cash and securities of about CZK99.28 billion, according to management data. • Available headroom of about CZK66.48 billion under various committed back-up facilities maturing after 12 months. • Cash FFO of about CZK60 billion-CZK65 billion. • Working capital inflow of about CZK37 billion.	We expect principal liquidity uses over the next 12 months from March 31, 2023, will include: • Debt maturities of about CZK37.5 billion. • Annual capex of about CZK54 billion as per the company's guidance. • Dividends of about CZK78 billion (excluding any extraordinary dividends).

Debt maturities

Chart 10

Debt maturity profile



CZK--Czech koruna. Source: S&P Global Ratings.

Environmental, Social, And Governance

ESG Credit Indicators

E-1 E-2 E-3 **E-4** E-5	S-1 **S-2** S-3 S-4 S-5	G-1 **G-2** G-3 G-4 G-5
- Climate transition risks - Waste and pollution	- N/A	- Risk management, culture, and oversight

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Over the past decade CEZ has committed to generate carbon-neutral electricity by 2050 and has implemented several measures to reduce its CO2 emissions intensity (0.29 metric tonnes of CO2/MWh in 2022 versus 0.57 metric tonnes of CO2/MWh in 2010) by upgrading its lignite fleet and planning to close some of its least efficient lignite and hard coal plants.

Emission intensity of electricity and heat generation in the Czech Republic decreased year on year by 1% to 0.29 tonnes of CO2/MWh, despite the energy crisis and the maximum deployment of all emission sources. Sulphur dioxide emissions decreased by 19% year on year and nitrogen oxide emissions decreased by 9%.

We think CEZ remains significantly exposed to challenges from carbon price developments and EU decarbonization objectives in light of its carbon-intensive fleet (electricity generation from coal was approximately 32% of total output, or 17.5 TWh, in 2022). Additional risks lie in its sizable nuclear fleet (57% of output in 2022).

In 2015 and 2016, the group mismanaged the surveillance of its reactors, causing significant outages and additional costs. Its end-of-cycle liabilities (of both decommissioning and nuclear waste storage) are also significant, and captured in our asset retirement obligations debt adjustment (approximately CZK66 billion in 2020).

From a social perspective, the Czech Republic's main political parties support both nuclear and coal, acknowledging nuclear generation's central role in preserving national energy independence.

In recent years, renewable ambitions have increased, and the country's climate and energy plan envisage a significant increase in the targeted share of production from renewables to 22% in 2030 from 13.0% in 2020, or approximately 1 GW of solar capacity.

We expect CEZ will be a significant operator in the Czech Republic, but that it will require significant investments. CEZ's nuclear activities also pose several governance risks, as we believe uncertainty surrounding the government's decision on future nuclear reactor construction will continue to limit the long-term visibility of the group's overall structure and strategic directions.

Government Influence

We consider CEZ to be a government-related entity and believe there is a moderately high likelihood that the Czech government would provide extraordinary support to CEZ in the event of financial distress.

Our assessment is based on CEZ's:

- Important role for the Czech government as both a provider of an essential service and a key player in the implementation of state energy policies. The company produces about 70% of the domestic power output--sufficient to cover domestic consumption requirements--and distributes more than 65% of electricity in the Czech Republic; and
- Strong link with the Czech government, as the latter is involved in key strategic decisions through its representation on CEZ's supervisory board. The finance ministry owns about 70% of CEZ, and the remaining shares are publicly held. We anticipate that the state will retain its strategic control over CEZ and remain a supportive shareholder by avoiding any further negative interventions.

Issue Ratings - Subordination Risk Analysis

Capital structure

CEZ's debt structure comprises senior unsecured debt in the form of bonds and loans issued at the parent level. All of the company's financial debt is at the CEZ a.s. level.

Analytical conclusions

We rate the debt issued by CEZ at 'A-', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating

A-/Stable/--

Business risk: Strong

- **Country risk:** Intermediate
- **Industry risk:** Intermediate
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Related government rating:** AA-
- **Likelihood of government support:** Moderately high (+2 notches from SACP)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments , April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings , March 28, 2018
- 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 | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers , Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry , March 28, 2014
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry , Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities , Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 23, 2023)*

CEZ a.s.	
Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-
Issuer Credit Ratings History	
26-Nov-2020	A-/Stable/--
31-Mar-2020	A-/Negative/--
02-Oct-2006	A-/Stable/--

*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.