

# MOODY'S

## INVESTORS SERVICE

### ANALYSIS

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This Credit Analysis provides an in-depth discussion of credit rating(s) for CEZ, a.s. and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

## CEZ, a.s.

Prague, Czech Republic

#### *Largest electric utility group in the Central and Eastern Europe*

CEZ a.s. ("CEZ", A2 stable) is the largest electric utility group in Central and Eastern Europe (CEE). CEZ is primarily unregulated, with approximately 75% of its business represented by power generation and mining activities and around 20% derived from regulated utility activities. CEZ, which is approximately 70% owned by the Czech government, has a strong financial profile, but we anticipate the company's financials weakening over the next three years as a result of its sizeable capital investment plan and dividend obligations.

CEZ's A2 rating is underpinned by the company's dominant position in the Czech Republic energy market, leading position within the CEE energy market and solid ranking among the top 10 European electric utilities. CEZ's position within its rating category is further supported by its well-balanced vertical integration: CEZ's own coal mines cover the majority of its fuel needs and it benefits from a substantial downstream retail customer base, served by the company's own distribution and supply subsidiaries.

Although CEZ redefined its strategy, focusing on stabilisation and consolidation through efficient cost management and capital expenditure (capex) reductions, we caution that, in expectation of prolonged weak market fundamentals, the company's financial profile could weaken over the next two to three years, driven mainly by (i) a significant increase in leverage; (ii) higher debt service costs; (iii) sizeable dividend payouts; and (iv) increased costs arising from the recently approved government tax on CO2 allowances. CEZ's A2 rating also includes a one-notch uplift for potential government support, given the Czech government's controlling stake in the company.

Other key rating considerations include the following:

- » Among the largest companies in the Czech Republic, CEZ represents a significant portion of the Czech economy, and is one of the largest corporate contributors to the state budget.
- » The company's revenue and margin contribution are reasonably diversified by both business activity and by geographical region.
- » A high concentration on coal generation exposes CEZ to environmental liabilities, but a move towards renewable, and eventually, extension of the current nuclear power generation, is designed to shift the supply mix.

- » CEZ's short-term liquidity remains adequate, supported by a comfortable cash reserve, strong cash flow generation, solid headroom under committed credit facilities and the manageable maturity profile of its long-term funding. Capital investments, together with relatively sizeable dividends, represent the major constraints on CEZ's liquidity.

## Company Overview

CEZ is the majority Czech state-owned (approximately 70%), but stock-exchange-listed, holding company and main operating company for the vertically integrated CEZ Group, which is one of the largest electric utility groups in Central and Eastern Europe (CEE). As of December 2011, CEZ had a total market capitalisation of €15.6 billion and 9.3 million customers, as a result of which it ranks among the top 10 European electric utilities.

With a total installed capacity of 15,053 megawatts (MW) – 12,743 MW in the Czech Republic, 1,260 MW in Bulgaria, 730 MW in Poland and 320 MW in Romania (as of September 2011)– electricity generation is CEZ's core activity, representing more than 70% of EBITDA, followed by electricity distribution and sale. Complementing CEZ's core businesses are its other activities, such as heat generation and distribution, coal mining and processing, electrical engineering and telecommunications. These represent around 11% of the group's consolidated EBITDA.

EXHIBIT 1

### Segmental Operating Performance, CZK Million

	Revenues		EBITDA		EBITDA Margin		EBITDA Relative Contribution	
	9M 2011	9M 2010	9M 2011	9M 2010	9M 2011	9M 2010	9M 2011	9M 2010
Power production	88,023	85,720	43,097	46,553	49%	54%	69%	69%
Distribution	100,918	95,933	12,794	12,716	13%	13%	20%	19%
Mining	8,073	7,806	3,815	3,449	47%	44%	6%	5%
Other	29,723	33,888	4,340	4,254	15%	13%	7%	6%
Eliminations	-76,175	-78,959	-1,629	51	2%	0%	-3%	0%
<b>Total</b>	<b>150,562</b>	<b>144,388</b>	<b>62,417</b>	<b>67,023</b>	<b>41%</b>	<b>46%</b>	<b>100%</b>	<b>100%</b>

Source: Q1-Q3 2011 Consolidated financial results, CEZ, a.s.

CEZ's 74% share of domestic electricity generation reflects its well-entrenched position in the Czech Republic's electricity sector, which is supported by the fact that the company owns the largest distribution company in the country and supplies more than 24 terrawatt hours (TWh) of electricity to final customers. CEZ's vertical integration is further strengthened by its ownership of the largest Czech lignite mining company, Severočeské doly a.s., which covers around 60% of CEZ's lignite needs. In addition to its stable position in domestic market, the company has expanded its international presence through foreign acquisitions in certain CEE countries and Turkey:

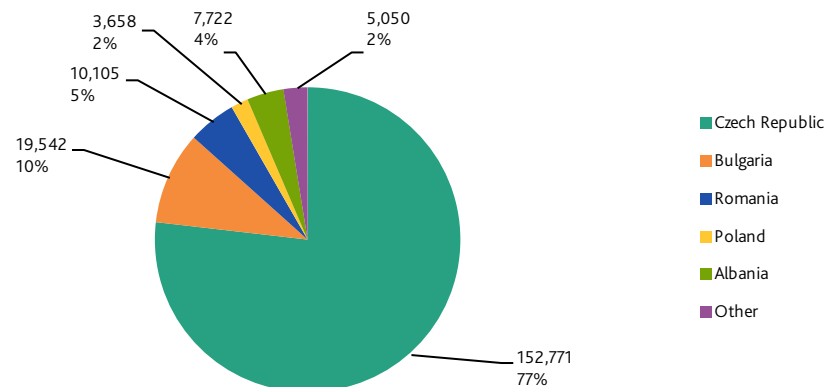
- » In Poland, CEZ owns power-generating companies Skawina and Elcho.
- » In Romania, CEZ covers approximately 18% of the distribution market through its 100%-owned distribution and supply companies. Furthermore, the company has been strengthening its presence in the Romanian electricity market through the gradual completion of a 600 MW wind park in Fantanele and Cogeaac, the largest on-shore wind farm project in Europe. Capacity of

300 MW was operational as of September 2011 and CEZ expects the remaining 300 MW to be commissioned by the end of 2012.

- » In Bulgaria, CEZ wholly owns a thermal power plant in Varna and holds a 67% stake in distribution and supply companies CEZ Razpredelenie Bulgaria and CEZ Electro Bulgaria.
- » In Albania, CEZ acquired a 76% stake in the monopoly distribution and supply company OSSH.
- » In Turkey, CEZ owns a 44.3% stake in distribution company SEDAS and a 37.36% stake in Akenerji, which generates electricity in gas-fired and hydro power plants and most recently also via a newly built wind farm.

EXHIBIT 2

### Geographic Revenue Distribution, YE 2010



Source: Annual report, CEZ, a.s.

## Recent Developments

### *Free CO2 allowances and focus on renewable generation*

While special taxes, initiated by the Czech government, are detrimental to CEZ's financial profile, we note that their impact on the company's financial performance has been rather moderate. Such taxes include the 32% gift tax on free CO2 permissions and the 26% tax on revenues from large solar power plants, which the Czech government is applying in the period 2011-13. Conversely, we view the latest government decision to move away from auctioning the free CO2 allowances, which the Czech Republic will receive as part of an EU exemption from 2013, as credit positive for CEZ's financial profile over the medium to long term.

## Management Strategy

### *Strategic focus on domestic market and cost efficiencies*

We believe that CEZ's pending acquisition of Energotrans a.s., which is active in the regulated domestic heating segment, and the related ongoing sale of its 50% share in German lignite coal mining company MIBRAG are in line with the former's "New Vision" strategic programme, implemented at the beginning of 2011. The strategy focuses on the stabilisation and consolidation of CEZ's financial profile and reinforcement of its strong domestic position. The strategy, which also involves a reduction in CEZ's capex to around CZK290 billion (€11.5 billion) during the period 2011-16, was recently

reinforced by the company's increased focus on cost efficiencies across the entire production chain. Through these efficiencies, CEZ aims to achieve additional savings of up to CZK34 billion (€1.3 billion) of free cash flow by 2015. We view such strategic objectives as being positive for CEZ, particularly when considering anticipated (i) prolonged weaknesses in electricity prices; and (ii) instability in market fundamentals. However, we note that the plan's benefits might be consumed by CEZ's newly established strategic focus on increasing the share of renewable sources in its generation mix.

CEZ has refocused its strategy towards increasing its share of the regulated Czech heating segment and expanding the proportion of its total energy production that is made up of renewable generation sources in order to (i) strengthen stable cash flow generation from regulated activities; (ii) reduce the average CO2 output of its generation portfolio; and (iii) benefit from benign subsidy schemes. CEZ expanded its presence in the Czech Republic heating market in 2009 by acquiring a controlling stake in Dalkia Usti nad Labem, a 15% stake in Dalkia CR and currently is waiting for the approval of the acquisition of Energotrans, which is supplying heat to the city of Prague.

#### *Developing renewable generation position in medium term*

In terms of renewable generation, CEZ plans to invest in acquisitions and the development of on-shore wind projects in Romania, Poland and Germany. It plans to focus mainly on projects that could be finalised and start generating cash flows by 2016, when sizeable investments in the extension of its Temelin nuclear power plant are expected to come on stream. Although these plans are supportive to CEZ's long-term strategy, we caution that the execution of such investments could burden the company's credit metrics and further weaken its financial profile in the medium term. Furthermore, the benefits from currently supportive tariff schemes for wind generation in the targeted countries could be modified by respective governments in future, potentially constraining CEZ's planned future cash flows, as evidenced by recent developments in other European countries.

## Rating Rationale

#### *Application of Unregulated Utilities and Power Companies Methodology*

When assessing CEZ's BCA, we apply our Rating Methodology for Unregulated Utilities and Power Companies, published in August 2009, which identifies key areas of focus for assessing the relative fundamental credit quality of unregulated utility companies and explains how key quantitative and qualitative risk factors map to specific rating outcomes. The methodology focuses on the assessment of the market and the company's competitive position, cash flow predictability of business model, financial policy and key credit metrics.

Based on CEZ's historical financial performance, the methodology grid indicates a BCA of 6 (equivalent to an A2 rating). We would expect the difference between the grid outcome and the actual BCA to narrow in the future, as CEZ's financial flexibility may be further eroded by the increase in the company's debt as a result of its still large capital investment plan and its demanding dividend policy.

## Rating Drivers

EXHIBIT 4

### Rating Factors

**CEZ, a.s.**

Unregulated Utilities	Aaa	Aa	A	Baa	Ba	B	Caa
<b>Factor 1: Market Assessment, Scale and Competitive Position (25%)</b>							
a) Size and scale (15%)			x				
b) Competitive position and market structure (10%)			x				
<b>Factor 2: Cash Flow Predictability of Business Model (25%)</b>							
a) Fuel strategy and mix (5%)				x			
b) Degree of integration and hedging strategy (5%)			x				
c) Capital requirements and operational performance (5%)					x		
d) Contribution from low-/high-risk businesses (10%)			x				
<b>Factor 3: Financial Policy (10%)</b>							
				x			
<b>Factor 4: Financial Strength Metrics (40%)</b>							
a) CFO pre-WC + Interest/Interest (10%)		x					
b) CFO pre-WC/Debt (12.5%)		x					
c) RCF/Debt (12.5%)		x					
d) FCF/Debt (5%)					x		
<b>Rating:</b>							
a) Methodology implied BCA							<b>6 (A2)</b>
b) Actual BCA assigned							<b>7 (A3)</b>

Sources: Moody's Regulated Electric and Gas Utilities Methodology, Moody's Financial Metrics

### (1) Market Assessment, Scale and Competitive Position

#### *Size and Scale*

With assets of US\$31.3 billion as of third quarter 2011, total generation capacity of 15 GW and 9.3 million customers, CEZ is the largest electric utility in CEE and ranks among the top 10 European electric utilities. Indeed, we expect that CEZ will retain its well-entrenched position within the Czech Republic's electricity market, despite continuing market liberalisation. As a result of these factors, we score the company a solid A for this sub-factor.

#### *Competitive Position and Market Structure*

Although fully liberalised, the Czech electricity market is significantly concentrated and dominated by the vertically integrated CEZ, which has a market share of around 74% based on installed capacity and a 61% share in terms of distribution. The remaining generation capacity is spread among small independent power producers without major concentration. Among the major competitors in the distribution segment are E.ON, established in the southern regions of the Czech Republic, and PRE, which distributes electricity in the capital city of Prague.

Notwithstanding CEZ's well-entrenched position in the Czech market, we do not regard a higher score than A for this sub-factor as appropriate, given the relatively small size of CEZ's domestic market and the company's weaker position compared with that of its peers in the wider European market.

## (2) Cash Flow Predictability of Business Model

### *Fuel Strategy and Mix*

CEZ's exposure to CO<sub>2</sub>-heavy, coal-based generation is balanced by its nuclear generation capacities. However, its Baa score for this sub-factor reflects the currently low proportion of the company's total electricity production that is generated by renewable sources. Around 50% of CEZ's electricity generation is coal-based (mainly brown coal-fired, but fitted with de-sulphurisation equipment), 41% is produced at its two nuclear power plants, Temelin and Dukovany, and the remainder comes from renewable energy sources (mainly from 40 hydropower facilities and increasingly from the on-shore wind park the company is building in Romania). Therefore, CEZ has a diversified generation fleet covering different parts of the electricity dispatch curve. CEZ's fuel mix is in line with the overall fuel mix of electric utilities in the Central European region, where (with the exception of Poland) CO<sub>2</sub>-heavy, coal-based generation is balanced by nuclear generation capacities.

EXHIBIT 5

CEZ Group (September, 2011)	Installed Capacity (MW)		Generation (TWh)	
Lignite coal (base load and mid merit)	5,895	39%	20.7	42%
Nuclear (baseload)	3,900	26%	20.6	41%
Hard coal (base load and mid merit)	2,867	19%	3.3	7%
Hydro and others	2,391	16%	5.3	10%

Source: Company

CEZ's renewable generation capacity has been expanding as a result of the gradual commissioning of its 600 MW on-shore wind park in Romania and the company increasing its solar capacity by 125 MW over 2009 and 2010. However, we do not expect that the company will significantly modify its production mix, given the generally lower utilisation of those types of generation assets.

### *Degree of Integration and Hedging Strategy*

CEZ's A score for this sub-factor is supported by the company's solid vertical integration, which is demonstrated by its high share of own upstream coal reserves and solid share of its downstream segments through its own distribution companies and retail sales to households. Electricity distribution and sales represent more than 62% of CEZ's revenues and contributed 19% of its EBITDA. CEZ serves 9.3 million customers (3.5 million in the Czech Republic, 2.0 million in Bulgaria, 1.4 million in Romania, 1.3 million in Turkey and 1.1 million in Albania).

CEZ fully owns the largest brown coal mining company in the Czech Republic, Severoceske Doly, which provides 60% of CEZ's annual lignite requirements. The reserves of Severoceske Doly are sufficient to secure a supply for the lifetime of CEZ's existing and renewed lignite power plants. The remaining lignite comes from local, independent coal mines, particularly in North Bohemia, for which CEZ is often the only significant customer. However, CEZ's contract with Mostecka Uhelna (MUS), an important external lignite coal supplier, lasts only until 2012. The long-term agreement that CEZ concluded with MUS in 2005 regarding the supply of lignite until 2055 is subject to an ongoing

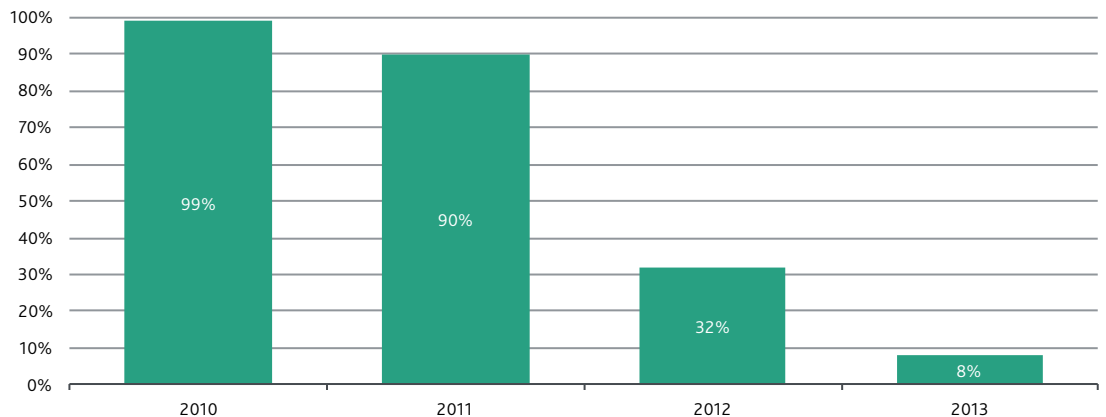
dispute. Any plans to build a new coal thermo-power plant would require the removal of current mining limits on lignite coal mines in the Czech Republic.

In addition to benefiting from a vertically integrated business model, CEZ seeks to stabilise its future cash flow through its trading operations on the Prague Energy Exchange. The Prague Energy Exchange, established in 2007, enables CEZ to implement a multi-year forward sales strategy. The company hedges its open position in electricity generation against price risk by selling electricity on a forward basis for one to three years. However, CEZ has a long position in generation, which increases its exposure to volatility in electricity prices and volumes. In this context, we note that the company sells the majority of its electricity under short-term contracts, most of which have duration of one year. A partially mitigating factor is that CEZ sells approximately 50% of its generated electricity through its distribution and supply companies.

EXHIBIT 6

### Share of Hedged Generation from CEZ Power Plants

(as of 31 Oct 2011)



Source: Company

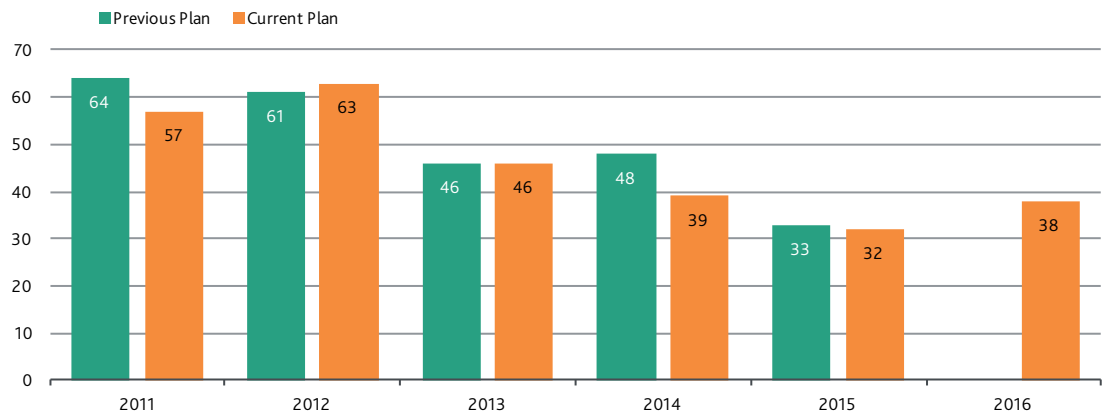
### *Capital Requirements and Operational Performance*

Although reduced, CEZ's investment programme, targeting the replacement and upgrade of its asset base, is still ambitious – we expect it to reach CZK287 billion (€11 billion) over the period 2011-16. As a result, the company's score for this sub-factor is constrained to Ba.

## EXHIBIT 7

**Investments 2011-16**

CZK billion



Source: Company

The domestic generation sector represents around 50% of CEZ's total planned capex. In addition, the company will make investments in (i) the distribution segment (27% of total capex); (ii) foreign subsidiaries (12% of total capex); and (iii) the mining segment (7% of total capex).

The majority of the CZK32 billion capex CEZ has planned for foreign subsidiaries will be directed towards investments in Romania: wind projects Fantanele and Cogealac (installed capacity of 600 MW) are the company's main foreign investment projects, accounting for more than half of its investments in the country, and are expected to culminate in 2012.

#### *Contribution from Low-risk/high-risk Businesses*

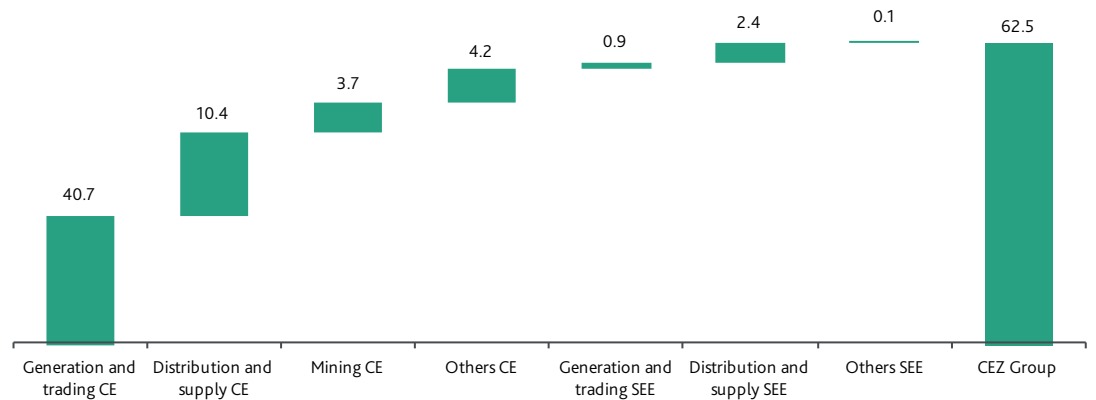
CEZ's A score for this sub-factor reflects the increased lower-risk regulated activities undertaken by the company. This follows (i) CEZ's expansion into the regulated Czech heating sector through the acquisition of heating assets from Dalkia; and (ii) its strategic refocus on its domestic electricity market, away from higher-risk developing regions of south-east Europe, stipulated in its New Vision strategy.

CEZ's expansion into the regulated heating segment will focus particularly on areas of the Czech heating market where the company could leverage its current generation facilities.

We consider CEZ's domestic electricity market to be relatively well established and have a solid track record compared with that of other isolated or still developing CEE electricity markets. This reflects the coupling of Czech and Slovak electricity markets, the strong interconnection between the Czech and German electricity markets, and the stable regulatory environment in distribution and heating segments in the Czech Republic.

EXHIBIT 8

## Contribution to EBITDA for Q1-Q3/2011



Source: Company

Despite its latest strategic shift towards domestic operations, CEZ remains significantly exposed to less stable, higher-risk countries in south-east Europe with regulatory regimes that are still developing. We regard the regulatory systems in those countries, especially in Bulgaria, as relatively high risk, reflecting (i) a degree of unpredictability and a lack of track record; and (ii) insufficient insulation from political influences.

### (3) Financial Policy

We score CEZ Baa for this rating factor. As more than 30% of CEZ's shares are listed on the Prague stock exchange, the company needs to balance the interests of both stockholders and creditors. CEZ's historically solid financial performance enabled the company to gradually increase dividend payouts, reaching its target payout ratio of 50%-60% in recent years. Furthermore, the company's historically strong cash flow generation and relatively low level of indebtedness enabled it to finalise a sizeable share buy-back, aimed at optimising its capital structure. We believe that CEZ will be able to successfully execute the capex reduction and cost-cutting measures set out in its New Vision strategy. However, we caution that the company will be challenged to sustain its historically robust financial profile in the current environment of stagnant electricity prices, considering its growing leverage levels, increasing interest expenses and additional costs arising from the tax on free CO2 allowances.

### (4) Financial Strength Metrics

Historically, CEZ has enjoyed significant financial flexibility as a result of successful restructuring, strong operating performances, positive market developments and relatively low leverage compared with its European peers. However, CEZ's debt increased to CZK185 billion (€7.5 billion) in third quarter 2011, from CZK106 billion (€4.2 billion) at the end of 2008, as the company had to finance ambitious foreign acquisitions, cover demanding upgrades and the reconstruction of its domestic asset base and fund sizeable dividend payouts. Although CEZ's debt increased at a slower rate in 2011, we caution that persistently weak market fundamentals will challenge the strong financial profile of the company, as evidenced by its weakened results for the first three quarters of 2011. Despite the capex reductions and cost-saving efficiency measures announced in CEZ's new strategy and implemented by the company from 2011, we expect that, over the medium term, its debt protection metrics will weaken. The main drivers of the expected weakening are stagnant electricity prices and lower volumes of generated electricity, as power production and trade generates the vast majority of CEZ's EBITDA (66.5% for first three quarters of 2011).

We view positively CEZ's efforts to increase its regulated activities (networks, heating, renewable), which we consider to be lower risk and to have been supportive to the company's performance recently. However, the positive impact of increased generation from renewable generation (an increase in EBITDA of CZK1.5 billion (€61 million) for first three quarters of 2011) have not been sufficient to offset the adverse impact on CEZ of lower electricity prices and volumes (a decrease in EBITDA of CZK4.6 billion (€0.2 billion) for the first three quarters of 2011). These lower prices and volumes caused CEZ's EBITDA to decrease by 7% overall, falling to CZK62.4 billion from CZK67 billion in first three months of 2011.

To remain safely positioned within the current rating category, CEZ would need to maintain its debt protection metrics such that its funds from operations (FFO)/net debt ratio remains at least in the low thirties in percentage terms and its retained cash flow (RCF)/net debt ratio at least in the low twenties. These minimum ratio guidelines take into account CEZ's change in strategic focus towards core markets and efficiency programmes.

## EXHIBIT 9

**Operating Performance**

	2007	2008	2009	2010
Revenues	174,563	183,958	196,352	198,848
EBITDA	76,823	87,766	92,697	90,474
Interest Expense	3,681	5,503	6,489	7,476
FFO	60,512	68,196	79,379	73,993
RCF	48,840	46,974	52,818	45,210
FCF	13,481	3,175	-9,998	-14,636

Source: Moody's Financial Metrics

## EXHIBIT 10

**Leverage and Debt Coverage Ratios**

	2007	2008	2009	2010
Total Debt	92,470	125,409	181,536	185,769
Net Debt	77,625	106,320	153,196	162,612
FFO Interest Coverage	17.4x	13.4x	13.2x	10.9x
FFO/Net Debt	78.0%	64.1%	51.8%	45.5%
RCF/Net Debt	62.9%	44.2%	34.5%	27.8%
FCF/Net Debt	17.4%	3.0%	-6.5%	-9.0%
Debt/EBITDA	1.2x	1.4x	2.0x	2.1x

Source: Moody's Financial Metrics

## Structural Considerations

We note that structural subordination is not an issue, as the majority of the company's debt is either at CEZ or at its fully guaranteed subsidiaries, although there is a limited level of debt at the recently acquired companies. When acquiring new companies, CEZ will look for the most attractively structured and priced funding, either at the CEZ a. s. level or at the subsidiary level. We also note that from CEZ's perspective the company's existing debt has, in relative terms, been favourably structured and priced. All things being equal, we would expect this structure to remain in place.

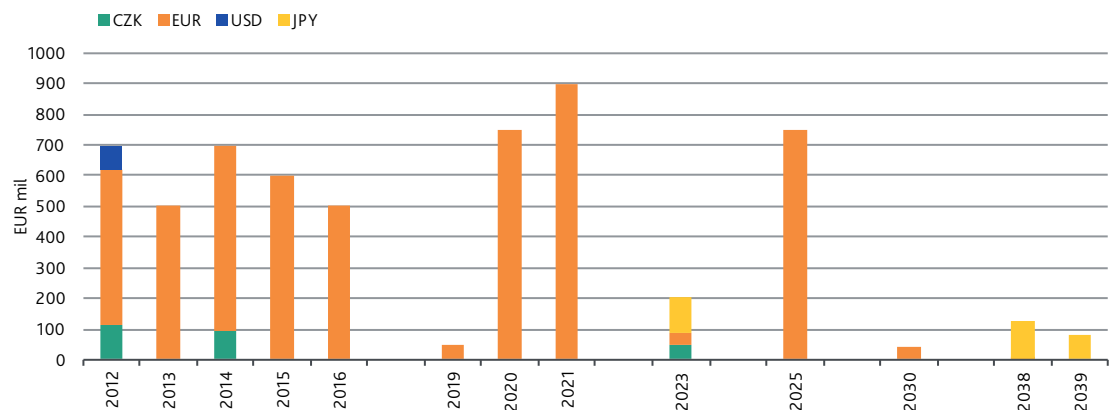
In accordance with the Czech Electricity Law, CEZ has created two companies: CEZ Distribuce, which owns and operates the group's distribution assets, and CEZ Prodej, which sells electricity to end-customers of the CEZ Group. This structure is in compliance with the requirement for legal unbundling between regulated activities (distribution) and unregulated activities (supply and generation).

## Liquidity

CEZ's short-term liquidity is satisfactory, supported by strong cash flow generation, solid headroom under committed facilities of CZK30 billion (€1.2 billion) and a comfortable cash reserve of CZK24.3 billion (€982 million) as of September 2011. Despite constrained financial markets, CEZ successfully renewed its committed short-term facilities and managed to extend the maturities for a third of its short-term portfolio to three years. Although recently reduced as part of its new strategy, CEZ's planned capital investments, together with its relatively sizeable dividend payout ratio of 50%-60%, represent major constraints on the company's liquidity and we expect that they will result in negative free cash flow in the medium term.

Despite the maturity profile of CEZ's bond portfolio, which represents the main part of the company's long-term funding, having been extended to slightly over seven years, we caution that CEZ will need to refinance approximately €500 million of maturing bonds every year over the period 2012-16.

EXHIBIT 11  
CEZ Bond Maturity Profile  
(in EUR million)



Source: Company

## Rating Positioning & Peer Comparison

A long-term strategic focus on the consistent upgrade and modernisation of its asset base has positioned CEZ closer to the leading Western European utilities in terms of competitive position, business risk profile and financial performance, with DONG Energy (Baa1 stable), Vattenfall (A2 stable) or Fortum (A2 stable) being its closest peers. However, despite a clear leading position in the CEE region and dominance in its domestic Czech market, CEZ still lags behind the largest European utilities in terms of size, scale and diversification. Although CEZ historically aimed to increase its geographic diversification, its foreign acquisitions were mainly focused on the higher risk, Southern and Eastern European countries, increasing its business risk profile. CEZ benefits from the fact that it generates a relatively high proportion of its electricity from nuclear sources, which partially offsets its relatively high exposure to high CO<sub>2</sub> lignite-based generation, compared with its Western European peers.

EXHIBIT 12

### Rating Factors - Peer Companies

	CEZ	PGE	Vattenfall	Fortum	DONG
<b>Factor 1: Market Assessment, Scale &amp; Competitive Position (25%)</b>					
a) Size and Scale	A	Baa	Aa	A	Baa
b) Competitive Position and Market Structure	A	A	A	Baa	Baa
<b>Factor 2: Cash Flow Predictability of Business Model (25%)</b>					
a) Fuel Strategy and Mix	Baa	Baa	A	Aa	Ba
b) Degree of Integration and Hedging Strategy	A	A	Baa	Baa	Baa
c) Capital Requirements and Operational Performance	Ba	B	Ba	Baa	B
d) Contribution from Low/High Risk Businesses	A	Baa	Aa	Aa	A
<b>Factor 3: Financial Policy (10%)</b>					
a) Financial Policy	Baa	Baa	Baa	Baa	Baa
<b>Factor 4: Financial Strength Metrics (40%)</b>					
a) (CFO Pre-W/C + Interest) / Interest Expense (3 year Avg)	Aa	Aaa	A	A	A
b) (CFO Pre-W/C) / Net Debt (3 year Avg)	Aa	Aaa	A	A	A
c) RCF / Net Debt (3 year Avg)	Aa	Aaa	A	Ba	A
d) FCF / Net Debt (3 year Avg)	Ba	Aa	Baa	Ba	Ba
<b>Rating:</b>					
a) Indicated Rating from Grid	6 (A2)	6 (A2)	6 (A2)	8 (Baa1)	8 (Baa1)
b) Actual BCA Assigned	7 (A3)	8 (Baa1)	7 (A3)	7 (A3)	8-10

Sources: Moody's Regulated Electric and Gas Utilities Methodology, Moody's Financial Metrics

In our view, PGE, the leading vertically integrated power group in Poland, is CEZ's only meaningful comparable peer in the CEE region. However, PGE is still at a relatively early stage of its modernisation process and, given its lack of connections with other European markets, relies more strongly on its domestic market. PGE's almost purely coal-based (95%) generation portfolio not only requires substantial investments into upgrade and reconstruction, but also will need significant investments in renewable and nuclear capacities if the company is to overcome the current competitive disadvantage of high CO<sub>2</sub> intensity. Furthermore, the Czech electricity market has a stronger track record as a transparent and fully liberalised market, whereas in Poland, disputes over compensations

for the abolishment of long-term power purchase agreements still hinder electricity market transparency and predictability.

EXHIBIT 13

**Peer Group - Financial Ratios (USD million)**

(as of December 2010)

Company Name	Revenue	Total Assets	EBIT Margin %	(FFO + Interest Expense) / Interest Expense	FFO / Net Debt	RCF / Net Debt	FCF / Net Debt
CEZ, a.s.	104,386	284,899	33.4%	1,089.7%	45.5%	27.8%	-9.0%
Fortum Oyj	83,553	303,825	26.3%	895.0%	24.8%	13.6%	-0.6%
Vattenfall AB	297,056	806,703	18.4%	620.3%	25.9%	22.6%	-2.8%
PGE Polska Grupa Energetyczna S.	68,077	174,075	20.7%	2,572.1%	1,400.9%	1,039.8%	110.2%
DONG Energy A/S	97,293	252,956	16.0%	515.2%	26.3%	24.6%	-3.7%

Sources: Moody's Financial Metrics

## Appendix 1: Application of Moody's Joint Default Analysis for Government-Related Issuers

Given its substantial ownership by the government of the Czech Republic, CEZ falls within the scope of our rating methodology for government-related issuers (GRIs).<sup>1</sup> In accordance with this methodology, CEZ's A2 senior unsecured rating is determined by the application of joint default analysis and reflects the combination of the following components:

### EXHIBIT 14

#### Government-Related Issuer Rating Inputs

a) Baseline Credit Assessment (BCA)	7
b) Government Local Currency Rating	A1
c) Default Dependence	Moderate
d) Support	Strong

Source: Moody's

- » A baseline credit assessment (BCA) of 7 (on a scale of 1 to 21, where 1 represents the lowest risk and 7 is equivalent to A3), which reflects CEZ's standalone credit quality before taking into account any support. The main drivers of the BCA are described in the Rating Drivers section, below.
- » The A1 local currency rating of the Czech government, CEZ's main shareholder.
- » The strong level of government support available to CEZ, reflecting its strategic importance to the Czech economy and the country's moderately interventionist government. Any impact of a potential reduction in state ownership on our support assumption will depend on the government's rationale for disposing of its shares and the targeted final ownership. Our strong support assumption will not be affected by any reduction in state ownership, as long as CEZ remains at least 51% owned by the Czech Ministry of Finance and the owner supports the group's newly established strategy of stabilisation and consolidation.
- » Moderate default dependence, which reflects the fact that CEZ generates the majority of its earnings in the Czech Republic, notwithstanding its electricity export business and acquisitions in Eastern Europe. In addition, CEZ is among the largest companies in the Czech Republic, representing a significant portion of the Czech economy, and is the largest corporate contributor to the state budget.

<sup>1</sup> ["The Application of Joint Default Analysis to Government-Related Issuers"](#), updated on 22 July 2010.

## Appendix 2: Adjustment Summary

We make a number of standard analytical adjustments to the accounts of non-financial corporate debt issuers. Our objective is to better reflect – for analytical purposes – the underlying economics of transactions and events, and to improve the comparability of a company's accounts with those of its peers. We do not perform forensic or audit procedures and these adjustments do not imply that the accounts fail to comply with accounting standards. Indeed, many of our adjustments are inconsistent with IFRS. Our goal is to enhance the analytical value of financial data rather than to assess compliance with laws or regulations governing financial reporting.

The following table shows how the adjustments we made have affected certain key credit metrics for CEZ. The adjustments detailed below are already incorporated in our rating analysis for the company.

EXHIBIT 15	
Calculation of FFO	
CZK MM	2010
<b>Reported CFO</b>	<b>77,165</b>
- (Inc)/Dec in accounts trade receivable	-561
- (Inc)/Dec in inventory	-649
- (Inc)/Dec in accts payable and accrued/other liabilities	15,455
- (Inc)/Dec in working capital accounts	-11,995
<b>Reported FFO*</b>	<b>79,415</b>
+ IFRS operating cash flow adjusted to align FFO and CFO (Note 1)	1,317
+ Capitalised interest adjustment	-3,034
+ Treatment of nuclear fuel as an operating cost, not capex	-3,705
<b>Adjusted FFO</b>	<b>73,993</b>

Source: Moody's Financial Metrics

EXHIBIT 16	
Calculation of Adjusted Interest Expense	
CZK MM	2010
<b>Reported interest expense</b>	<b>5,498</b>
+ Nuclear adjustment	958
+ Capitalised interest	3,034
- Unpaid accrued interest	-2,014
<b>Adjusted interest expense</b>	<b>7,476</b>

Source: Moody's Financial Metrics

EXHIBIT 17	
Calculation of Adjusted Net Debt	
CZK MM	2010
<b>Reported debt</b>	<b>164,444</b>
+ Nuclear adjustment	21,325
<b>Total adjusted debt</b>	<b>185,769</b>
- Reported cash and equivalents	-22,163
- Short-term cash deposits less than 1 year	-994
<b>Net adjusted debt</b>	<b>162,612</b>

Source: Moody's Financial Metrics

## Moody's Related Research

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- » [PGE Polska Grupa Energetyczna S.A.](#)
- » [DONG Energy A/S](#)
- » [Fortum Oyj](#)
- » [Vattenfall AB](#)
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### Industry Outlooks:

- » [EMEA Electric and Gas Utilities, November 2011 \(137305\)](#)

### Special Comments:

- » [Large European Utility Borrowers: Will They Defend a Single-A Rating?, November 2011 \(137140\)](#)
- » [European Power Company Bondholders Are Worse Off than in 2008, September 2011 \(136184\)](#)
- » [Euro-Area Government-Related Utility Issuers Stressed by Weak Sovereigns, September 2011 \(136185\)](#)

### Rating Methodology:

- » [Unregulated Utilities and Power Companies, August 2009 \(118508\)](#)

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