MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades CEZ's rating to Baa1; outlook stable

Global Credit Research - 06 Apr 2016

London, 06 April 2016 -- Moody's Investors Service (Moody's) has today downgraded to Baa1 from A3 the senior unsecured ratings of CEZ, a.s. (CEZ) and the rating on the notes issued by CEZ MH B.V. which are guaranteed by CEZ. Concurrently, Moody's has downgraded to (P)Baa1 from (P)A3 the long-term provisional rating on CEZ's euro medium-term note (EMTN) programme. The outlook on all ratings is stable.

RATINGS RATIONALE

Today's rating action concludes the review initiated on 12 February 2016. The rating downgrade reflects CEZ's exposure to an ongoing weak power price environment and Moody's expectation that the company's credit metrics will deteriorate from current levels in the next two to three years.

CEZ's generation fleet in the Czech Republic is predominantly fixed-cost in nature, with around 90% of output represented by lignite, nuclear and hydro, thus making it particularly exposed to movements in wholesale power prices. After a sharp decline in recent months reflecting notably lower coal and carbon prices, current forward power prices in the Czech Republic, which are linked to prices in Germany due to interconnections between both countries, have stabilised around EUR22/MWh.

As hedges roll off, lower power prices will result in a further reduction in CEZ's operating cash flow in the next two to three years because market-exposed generation activities represent around 45% of its 2015 EBITDA. This pressure on the company's financial profile could be further exacerbated by its recent announcement that it may invest an additional CZK50 to 60 billion by 2020 into renewables, decentralized solutions, heat sector and distribution, notably. The rating downgrade therefore also takes into account that CEZ has amended its leverage target, to 2.5x -- 3.0x net debt/EBITDA from 2.0x -- 2.5x previously, to accommodate such potential additional investments.

At the same time, the Baa1 rating continues to reflect the low-cost nature of CEZ's generation fleet, the stabilizing contribution of its regulated domestic distribution activities, which accounted for close to 25% of EBITDA in 2015, and Moody's expectation that the company should be able to continue to generate positive free cash flows even in the currently low power price environment as it has completed a major capex programme to refurbish existing power plants.

Moody's expects that CEZ will demonstrate funds from operations (FFO)/net debt in the high twenties in percentage terms and retained cash flow (RCF)/net debt in the low twenties in percentage terms in the medium term, in the absence of additional investments that have not been identified yet. These compare with actual ratios of FFO/net debt of 33% and RCF/net debt of 20% at year-end 2015. Moody's guidance for CEZ's revised Baa1 rating, including FFO/net debt around the mid twenties in percentage terms and RCF/net debt in the high teens in percentage terms, takes into account the agency's expectation that these ratios could weaken further should appropriate additional investment opportunities arise.

Moody's notes that uncertainties surrounding potential M&A activity have abated in recent months as CEZ announced in March 2016 that it did not submit a binding bid for Vattenfall's lignite and hydro assets in Germany. CEZ's ratings do not factor in the potential impact of any of significant M&A transaction or investment in new nuclear given the very significant uncertainties surrounding their likelihood.

Given its 70% ownership by the Government of Czech Republic (A1 stable), CEZ's Baa1 rating incorporates one notch of uplift under Moody's methodology for Government-Related Issuers from its standalone credit quality or baseline credit assessment (BCA) of baa2 based on the agency's estimate of a strong degree of government support.

RATING OUTLOOK

The outlook is stable, reflecting Moody's expectation that CEZ's key credit metrics will remain aligned with the agency's guidance for the current Baa1 rating, which includes FFO/net debt around the mid twenties in percentage terms and RCF/net debt in the high teens in percentage terms.

WHAT COULD CHANGE THE RATING UP/DOWN

Higher than expected power prices or a moderate dividend policy resulting in FFO/net debt sustainably in the high twenties to low thirties in percentage terms and RCF/net debt comfortably above 20% on a sustainable basis, could exert upward pressure on ratings.

Negative pressure on CEZ's rating would develop if (1) financial ratios fall permanently below Moody's guidance for the Baa1 rating; (2) the group undertakes a large debt-funded acquisition in addition to its announced potential investments; or (3) it starts developing new nuclear units that weaken its business and/or financial risk profile.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in October 2014, and Government-Related Issuers published in October 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

Headquartered in Prague, Czech Republic, CEZ a.s. is one of the largest electric utility companies in Central and Eastern Europe with 15.9 gigawatts of generation capacity. It reported revenues of CZK210 billion (EUR 7.7 billion) in 2015.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Paul Marty
Vice President - Senior Analyst
Infrastructure Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Neil Griffiths-Lambeth
Associate Managing Director
Infrastructure Finance Group

JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454