

Rating Action: Moody's affirms CEZ's A2 rating and maintains negative outlook

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London, 27 March 2014 -- Moody's Investors Service ("Moody's") has today affirmed the A2 senior unsecured ratings of CEZ, a.s. (CEZ) and the A2 rating assigned to approximately EUR470 million of exchangeable bond securities issued by CEZ MH B.V., a 100% subsidiary of CEZ, and maintained the negative outlook. Concurrently, Moody's has also affirmed the (P)A2 long-term provisional rating of CEZ's euro medium-term note (EMTN) programme.

RATINGS RATIONALE

"The affirmation of CEZ's rating reflects Moody's expectation that a further decline in Central European electricity prices is unlikely and that the company has flexibility to mitigate a reduction in operating cash flow as existing hedges roll off" says Scott Phillips, a Moody's Vice President -- Senior Analyst in Moody's Infrastructure Finance group and lead analyst for CEZ. "However, recent comments from the Czech Government have increased uncertainty regarding the group's future financial policy," adds Mr. Phillips.

Since 2011, forward power prices in the Czech Republic have decreased from around EUR55/MWh to around EUR35/MWh driven by a number of factors including: (1) falls in the price of coal and carbon, which have reduced the cost of generation of price-setting plants in the region, (2) significant additions of renewable based generation sources on to the grid; and (3) weak demand for electricity. However, since mid-2013 power prices in the region have stabilised reflecting: (1) a modest increase in the price of carbon to around EUR6/tonne reflecting in part a plan by the European Commission to reform the market and boost prices; and (2) an improving outlook for the European macro economy.

CEZ's generation fleet in the Czech Republic is predominantly fixed-cost in nature -- with around 80% of total capacity represented by lignite, nuclear and hydro making it particularly exposed to movements in wholesale power prices. However, the group is somewhat protected in the near-to-medium term via its forward-selling strategy with around 86% of its power pre-sold for 2014 and around 73% pre-sold for 2015 -- at prices materially higher than available in the market. While lower prices will likely lead to a reduction in operating cash flow from 2015 onwards, Moody's believes that CEZ has some capacity to absorb this through further cuts to expenditure, if required. However, its ability to manage this environment may be constrained by a new and more aggressive dividend policy. On 24 March 2014, the new Finance Minister -- Mr. Andrej Babis -- suggested that CEZ should payout 100% of its net income for 2013. If such a policy were sustained going forwards, the resulting increase in leverage would significantly, and negatively affect CEZ's financial profile.

Moody's expects that CEZ's key credit metrics could fall below its guidance for the current A2 rating (funds from operations (FFO) / net debt above 30%; and retained cash flow (RCF) / net debt above 20%) in 2014 and 2015 although metrics should improve again in 2016 and 2017, assuming the existing payout ratio (of 50-60%) is maintained.

While CEZ's strategy to invest in one or more nuclear units at its Temelin site would likely lead to a significant reduction in key credit metrics, to levels incommensurate with the existing rating, Moody's does not currently factor in this risk as there remains significant uncertainty regarding both the timing and support level for such a project.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Given the negative outlook on the ratings, Moody's does not expect upwards rating pressure. Confirmation of the existing dividend policy would be a catalyst for Moody's to consider stabilising the outlook.

Negative pressure on CEZ's rating would develop if (1) Moody's considers that the maintenance of financial metrics at levels comfortably above guidance over the medium term is unlikely; (2) the group were to materially increase its payout policy; or (3) the group develops new nuclear units that further weakens its financial profile.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Unregulated Utilities and Power Companies published in August 2009, and the Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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