

Summary:

CEZ a.s.

Primary Credit Analyst:

Monica Mariani, Milan (39) 02 72111-207; monica_mariani@standardandpoors.com

Secondary Credit Analyst:

Mark Schindele, Stockholm (46) 8-440-5918; mark_schindele@standardandpoors.com

Table Of Contents

Rationale

Outlook

Summary:

CEZ a.s.

Credit Rating: A-/Stable/--

Rationale

The 'A-' rating on Czech electric utility CEZ a.s. is based on the company's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'A-', as well as on our opinion that there is a "moderately high" likelihood that the Czech Republic (foreign currency A/Stable/A-1, local currency A+/Stable/A-1) would provide timely and sufficient extraordinary support to CEZ in the event of financial distress.

In accordance with our criteria for government-related entities, our view of a "moderately high" likelihood of extraordinary government support is based on our assessment of 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. CEZ controls more than 70% of the domestic generation capacity and 60% of the entire power distribution grid; and
- "Strong" link with the Czech government, given the latter's approximate 70% stake in CEZ.

CEZ's SACP reflects our view of the company's dominance in the Czech power generation market (over 70% share) and its strong position in the country's distribution and supply markets (60% and 45% shares, respectively). CEZ also benefits from competitive, low-cost power generation, and strong cash flow generation.

These strengths are offset by: the large contribution to CEZ's earnings from power generation and wholesale markets; the company's strong appetite for growth, leading to debt-funded acquisitions in both domestic and higher-risk Eastern European markets; and the high proportion of nuclear generation in CEZ's portfolio. CEZ is also likely to face somewhat tighter environmental regulations from 2013, when the current completely free allocation system for carbon allowances expires.

Key business and profitability developments

In the first nine months of 2009, CEZ reported a 1.5% year-on-year increase in EBITDA, to Czech koruna (CZK) 71 billion. EBITDA benefited from price hedging before the economic downturn, accounting changes in network operations, and increased mining activity. The company has confirmed its revised guidance for EBITDA of CZK90.3 billion in 2009. Over 70% of CEZ's EBITDA comes from unregulated generation and trading activities, which we view as volatile, and more vulnerable than other utility operations to fluctuations in electricity prices and demand. That said, CEZ implements what we consider to be a satisfactory hedging policy to limit the impact of the volatility in wholesale prices, and has hedged virtually its entire output in 2010. Overall, we regard CEZ's business risk profile as "strong".

Key cash flow and capital-structure developments

We view CEZ's financial risk profile as "intermediate", although we believe that its flexibility will diminish considerably in 2009 and beyond due to the company's ambitious expansion program alongside weakening earnings. Major acquisitions either completed or announced in 2009 include stakes in Turkish power generation and distribution companies, the Albanian incumbent power distributor, a German coal mine, Czech heating producers,

and the buyout of Romanian power distributors. On the other hand, CEZ has put new share buybacks on hold.

As of September 2009, CEZ's net reported debt increased to CZK106 billion from CZK89 billion at the end of 2008, primarily reflecting capital expenditures (capex) of CZK37 billion, acquisitions of CZK18 billion, and dividends of CZK26 billion, all of which were only partially offset by internal cash flow generation. We believe that CEZ's debt is likely to increase further in full-year 2009 and beyond due to ongoing capex and acquisition activity, coupled with lower cash flow generation than the company anticipated due to weak macroeconomic conditions. CEZ expects the latter to result in weaker demand and lower prices over the near term. In our view, this is likely to lead to a weakening of CEZ's credit metrics from their historically high levels, although we deem the group capable of maintaining a ratio of funds from operations (FFO) to debt of above 35%.

Liquidity

In the first half of 2009, CEZ improved its liquidity profile with several bond issues. However, in the third quarter, liquidity was weakened again, mainly by acquisition activity. In the fourth quarter, the company proactively issued medium- and long-term debt, but in our view, it will need to continue refinancing in the coming months to maintain adequate liquidity. At the end of September 2009, CEZ reported cash and securities of CZK25.5 billion, and committed bank lines maturing in over 12 months' time of CZK 11.1 billion, compared with short-term debt of CZK47 billion. In the fourth quarter of 2009, however, CEZ raised medium- or long-term debt of close to CZK38 billion.

CEZ had CZK22.7 billion in committed, short-term bank lines available as of September 2009. Although we consider the short-term nature of these bank lines to be a weakness, CEZ has renewed them every year to date. We understand that CEZ's high dependence on short-term bank lines derives from constraints posed by Czech public procurement law.

We anticipate that CEZ's discretionary cash flow will be negative in 2010, partly due to acquisitions (some of which are still subject to regulatory authorizations). At the same time, we consider there to be some flexibility in the discretionary nature of part of CEZ's planned capex.

Some of CEZ's funding includes covenants relating to financial performance, which should be manageable in our view, as well as to majority government ownership, and to material adverse change clauses.

Outlook

The stable outlook reflects our view that CEZ's business and financial risk profiles remain commensurate with the current SACP, as well as our assessment of government support. At the same time, we believe that the group's investment activity over the last year, combined with lower cash flow generation than CEZ anticipated, have largely used up all the headroom within the SACP.

We could consider taking a negative rating action if CEZ's SACP were to deteriorate, or if government support were to weaken. In our view, weak market conditions or an aggressive growth strategy could have an adverse effect on CEZ's SACP, particularly if acquisitions or investments were to result in higher business or financial risk. Higher business risk could lead us to increase the credit metrics that we consider appropriate for a SACP at the 'A-' level (currently FFO to debt of above 35%). Inadequate liquidity, on our assessment, could also have negative implications for the SACP. We do not see any rating upside at present.

Additional Contact:

Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com

Additional Contact:

Infrastructure Finance Ratings Europe; InfrastructureEurope@standardandpoors.com

Copyright © 2010 by Standard & Poors Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved. No part of this information may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P. S&P, its affiliates, and/or their third-party providers have exclusive proprietary rights in the information, including ratings, credit-related analyses and data, provided herein. This information shall not be used for any unlawful or unauthorized purposes. Neither S&P, nor its affiliates, nor their third-party providers guarantee the accuracy, completeness, timeliness or availability of any information. S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents are not responsible for any errors or omissions, regardless of the cause, or for the results obtained from the use of such information. S&P, ITS AFFILIATES AND THEIR THIRD-PARTY PROVIDERS DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained herein even if advised of the possibility of such damages.

The ratings and credit-related analyses of S&P and its affiliates and the observations contained herein are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or make any investment decisions. S&P assumes no obligation to update any information following publication. Users of the information contained herein should not rely on any of it in making any investment decision. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of each of these activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P's Ratings Services business may receive compensation for its ratings and credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge) and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.7280 or by e-mail to: research_request@standardandpoors.com.

Copyright © 1994-2010 by Standard & Poors Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc. All Rights Reserved.