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CREDIT OPINION

24 April 2018

Update

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RATINGS

ČEZ, a.s.

Domicile	Czech Republic
Long Term Rating	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Positive

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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ČEZ, a.s.

Update following a change in outlook to positive

Summary

ČEZ, a.s. (ČEZ)'s credit quality is supported by (1) the company's leading position in the Czech electricity market and its well-balanced vertical integration; (2) the low-cost nature of its nuclear and lignite power generation fleet; and (3) relatively stable and predictable cash flows from its electricity distribution activities in the Czech Republic.

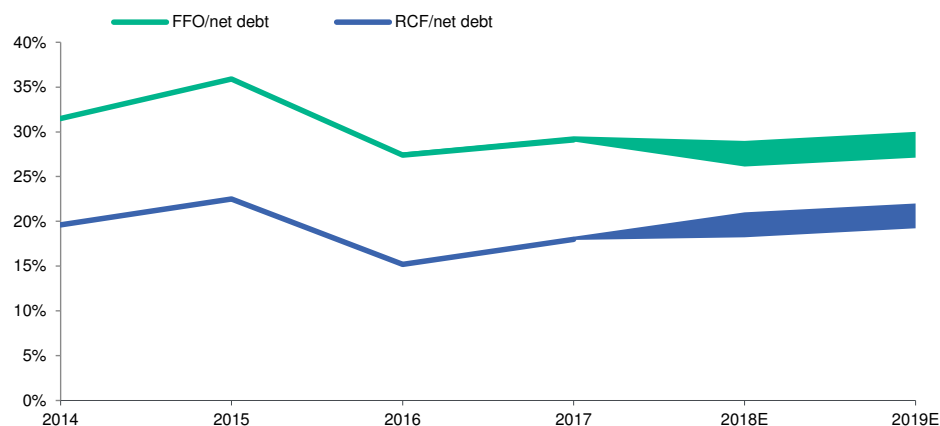
These positives are balanced by (1) relatively high exposure to merchant power generation, which together with the mining segment accounted for more than 40% of EBITDA in 2017; (2) predominantly fixed-cost power generation business exposed to low power price environment; and (3) the challenges and execution risks associated with ČEZ's strategy to expand in renewables and energy services.

We expect ČEZ's financial ratios to remain broadly stable in 2018-19 as the anticipated decline in earnings due to low hedged power prices and higher cost of carbon will be mitigated by positive free cash flows stemming from a moderate capital expenditure (capex) programme, partly offset by dividend payments.

Exhibit 1

ČEZ's financial metrics will remain broadly stable

Funds from operations (FFO) and retained cash flow (RCF)-based ratios



Note: The estimates represent Moody's forward view; not the view of the issuer.

Source: Moody's Investors Service

ČEZ's Baa1 rating incorporates one notch of rating uplift for potential support, given the 70% ownership by the Government of Czech Republic (A1 positive).

Credit strengths

- » ČEZ's generation fleet in the Czech Republic is mostly low-cost nuclear and lignite
- » Regulated network distribution activities support cash flow stability
- » Moderate capex programme results in positive free cash flows
- » Ownership by the Czech government (A1 positive)

Credit challenges

- » Large exposure to fixed-cost, merchant power generation in the Czech Republic
- » Strategy to invest, among other, in renewables creates execution risk given ČEZ's historically limited exposure to this business
- » Uncertainty surrounding the development of new nuclear plants in Czech Republic and the potential for a split of ČEZ's business

Rating outlook

The positive outlook is in line with the positive outlook on the Czech sovereign rating. It recognizes that (1) a stronger credit profile of the Government of Czech Republic, and (2) the government's continued strong support for ČEZ in the context of the potential evolution of the company's business risk profile and its strategic role in pursuing national energy policies, could result in an increase of the uplift to ČEZ's standalone credit quality to two notches versus the current one notch. It further reflects our expectation that ČEZ's key credit metrics will remain aligned with the guidance for the current rating, which includes funds from operations (FFO)/net debt around the mid twenties in percentage terms, and retained cash flow (RCF)/net debt in the high teens in percentage terms.

Factors that could lead to an upgrade

ČEZ's rating could be upgraded if (1) the sovereign rating of the Czech Republic was upgraded; (2) there was evidence of the government's continued strong support to ČEZ; (3) the company's fundamental strength remained commensurate with at least the current BCA of baa2; and (4) there was more clarity on ČEZ's potential involvement in new nuclear development and business reorganization. Positive rating pressure could also develop if ČEZ's financial profile were to strengthen such that the company's FFO/net debt were to remain in the high twenties to low thirties in percentage terms and RCF/net debt was comfortably above 20% on a sustainable basis.

Factors that could lead to a downgrade

Negative pressure on ČEZ's rating could develop if (1) the company were not able to maintain a financial profile commensurate with the current guidance, i.e. FFO/net debt around the mid twenties in percentage terms and RCF/net debt in the high teens in percentage terms; (2) the company's business risk profile were to weaken, which could be as a result of, for example, the company's involvement in new nuclear development without any support mechanism; and/or (3) the support assumption currently incorporated in our assessment were to weaken.

Key indicators

Exhibit 2
ČEZ, a.s.

	12/31/2017	12/31/2016	12/31/2015	12/31/2014
(CFO Pre-W/C + Interest) / Interest	8.6x	8.3x	8.7x	7.4x
(CFO Pre-W/C) / Net Debt	29.1%	27.4%	35.9%	31.5%
RCF / Net Debt	18.0%	15.2%	22.5%	19.6%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

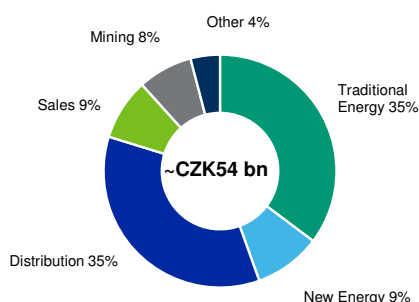
Profile

ČEZ, a.s. is one of the largest electric utility companies in Central and Eastern Europe with 14.9 gigawatts (GW) of power generation capacity and more than 8 million customers. The group operates primarily in the Czech Republic (86% of EBITDA in 2017) as well as in Romania (9%), Bulgaria (4%) and Poland (2%). It has also limited presence in Germany and France.

ČEZ's core businesses are (1) power generation, which includes traditional energy and renewables; (2) regulated distribution; (3) sales (including supply activities); and (4) mining and other activities, which complement the core business segments.

Exhibit 3

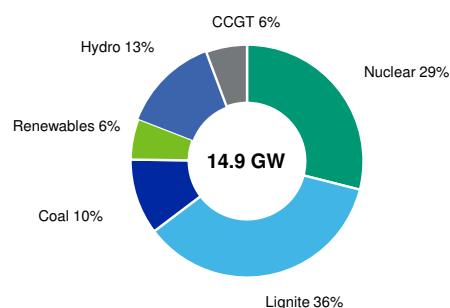
Power generation accounts for the bulk of ČEZ's EBITDA
EBITDA breakdown by segment in 2017



Source: Company's reports, Moody's Investors Service

Exhibit 4

ČEZ's installed capacity includes mainly nuclear and coal
Breakdown of installed capacity in 2017



Source: Company's reports, Moody's Investors Service

ČEZ is approximately 70% owned by the Czech government (A1 positive), whilst the remaining shares are listed on the Prague stock exchange.

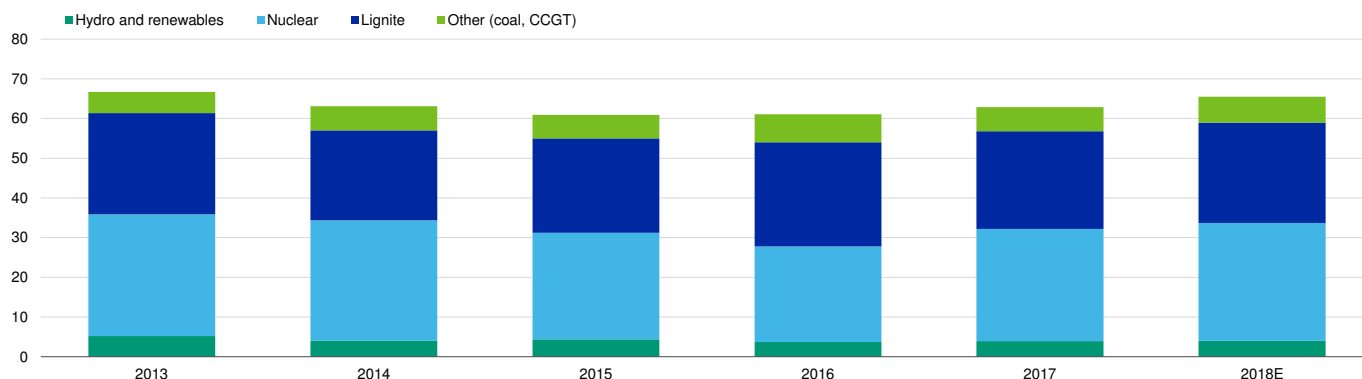
Detailed credit considerations

Fixed-cost generation fleet impacted by low power prices

ČEZ is the largest generator in the Czech Republic, where it has 13 GW installed capacity and a market share of around 67%. This position is further supported by its vertical integration as the company (1) own mines covering 71% of its lignite needs; and (2) has a 29% market share in supply. Offsetting these positives, however, is that ČEZ's generation fleet is predominantly fixed-cost in nature, with over 85% of generation output represented by lignite, nuclear and hydro.

Exhibit 5

ČEZ's generation is predominantly fixed cost
Output in TWh



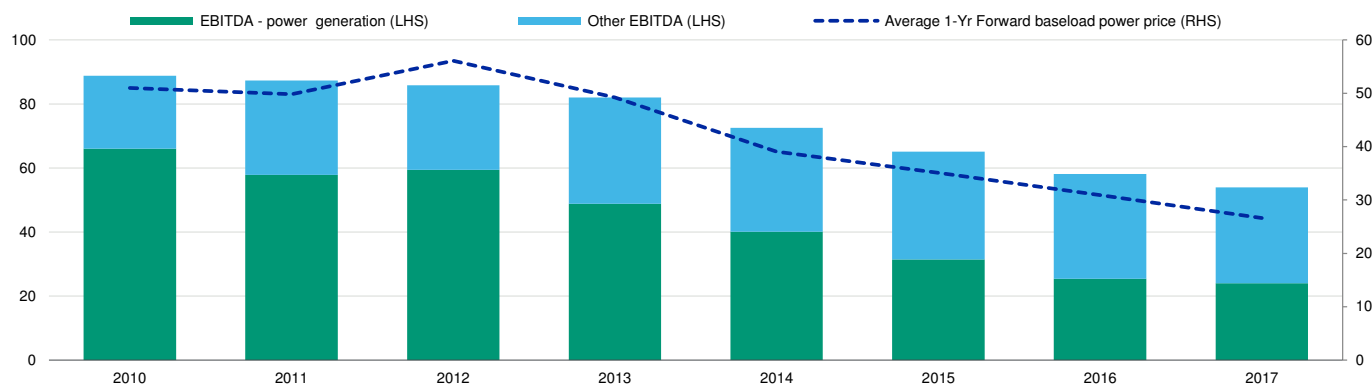
Note: Total generation expected at 65.5 TWh in 2018.

Source: Company, Moody's Investors Service

This makes the company particularly exposed to prevailing wholesale power prices as evidenced over the recent years when ČEZ's EBITDA declined as power price environment became challenging for merchant generators.

Exhibit 6

ČEZ's EBITDA has declined along power prices
EBITDA in CZK billion, power price - €/MWh



Source: Moody's Investors Service

Czech power prices are closely linked to those in Germany given the interconnections between the two countries. Forward baseload power prices in Germany have rebounded from their 2016 lows, with the recent increase in wholesale prices mainly driven by higher commodity and carbon prices. Current 1-year forwards are around €38/MWh. We expect power prices in Germany to remain volatile and low by historical levels over the period to 2022. This reflects our view that (1) current high coal prices will moderate and carbon prices will only moderately rise, and (2) reserve margins will remain high as renewables output grows to meet government targets. (See [Europe's electricity markets: In Germany, renewables growth pressures prices, mitigated by plant closures](#), November 2017).

The impact of changes in wholesale power prices on ČEZ will be limited in the near term, given that the company has hedged 95% of its 2018 output at €31.5/MWh. For 2019, ČEZ has a 68% hedge ratio at €31/MWh. The hedge ratio decreases to 36% in 2020, with a locked-in price of €34/MWh. More positively, we note that ČEZ benefits from a fairly low fuel cost estimated at €7/MWh for nuclear and €17-18/MWh for lignite plants (assuming current CO₂ prices), which is supportive of the company's profitability. The low variable cost of ČEZ's lignite plants is partly driven by the proximity of the mines.

Overall, we expect ČEZ's EBITDA from power generation to stabilize from this year on the back of a modest power price recovery and higher output. The positive impact of higher realised prices will be partly offset by higher costs of emission allowances, to the extent these have not been hedged or are not received for free (carbon prices of around €12-13 per tonne are significantly above last year levels of around €7-8 per tonne).

Regulated distribution activities support cash flow stability

Around 35% of ČEZ's EBITDA is derived from regulated electricity distribution network activities. Some 84% of this segment's earnings come from the Czech Republic, where the company owns five of the eight distribution grids, representing an aggregate regulated asset base (RAB) of CZK97.1 billion and accounting for around 65% of electricity distributed. The group's distribution activities in Romania (Baa3 stable) and Bulgaria (Baa2 stable) are much smaller in scale.

Exhibit 7

Summary of ČEZ's electricity distribution network activities

	Czech Republic	Bulgaria	Romania
Regulator / Price Control	ERO / 4th regulatory period	EWRC / 4th regulatory period	ANRE / 3rd regulatory period
Regulatory period	2016-20	2015-18	2014-18
Pre-tax allowed return	7.951% (nominal)	7.04% (nominal)	7.7% (real)
Regulated Asset Base	€3,803 million	€279 million	€506 million

Source: Company, Moody's Investors Service

We view the regulatory framework for electricity distribution networks in the Czech Republic as well-defined, providing adequate and fair remuneration for operating expenditure and investments and generally supportive of ČEZ's credit quality.

Czech distribution activities are in their fourth regulatory period. We note that in January 2018 the Czech Energy Regulatory Office (ERO) decided to extend the current period by two years. Therefore, existing regulatory parameters including the 7.95% allowed return underpinning tariff decisions will be maintained until 2020, which will support earnings of the Czech distribution networks. (See also [Proposed two-year extension of current regulatory period credit positive for Czech networks](#), September 2017).

ČEZ's distribution activities in Bulgaria and Romania, contributing around CZK3 billion to the group's 2017 EBITDA, provide less earnings predictability due to less stable regulatory regimes. The lack of transparency and stability of the regulatory environment coupled with adverse political intervention has prompted ČEZ to review its presence in the Bulgarian market. The company agreed the sale of its Bulgarian assets in February 2018 but the transaction has yet to be concluded. (See also [Sale of Bulgarian assets is credit neutral](#), February 2018).

Sales segment provides platform for development of new energy solutions but competition pressures volumes and margins

With sales of 17.8 TWh, ČEZ is a large supplier of electricity in the Czech Republic, accounting for 29% of the market. Outside of its domestic market, the company's electricity retail sales amounted to 19.2 TWh, of which 10.1 TWh in Bulgaria and 3.3 TWh in Romania in 2017. The foreign activities contributed, however, a small proportion (around 11%) to this segment's EBITDA of CZK4.6 billion.

We note that the company's 2017 earnings in the Czech Republic fell by CZK0.9 billion in comparison with the previous year. A drop in market share from 32% in 2016 reflected strong competition, which pressured volumes (-9%) and margins. Whilst the business is an important platform for growth of the company's operations in new energy solutions, a key pillar of ČEZ's strategy, we expect the environment to continue to be challenging, with further pressure on earnings this year.

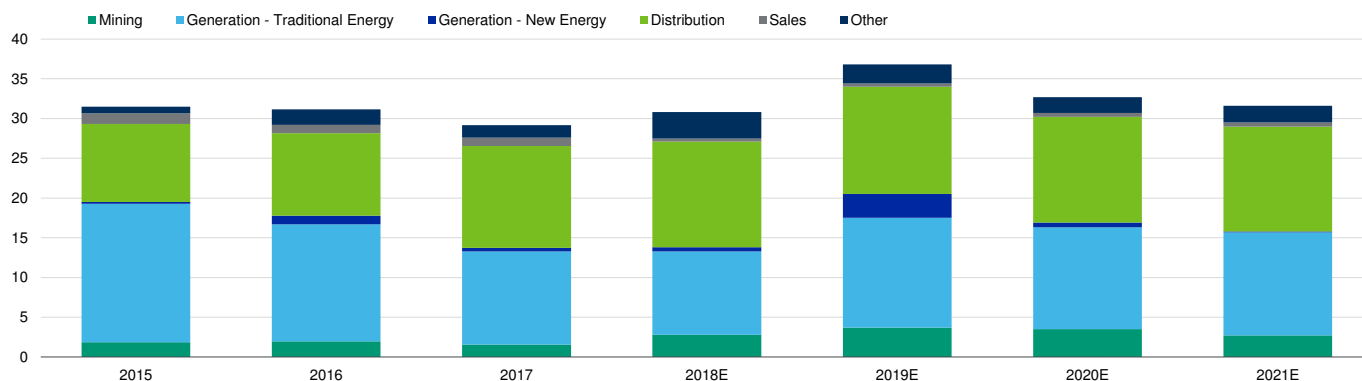
Strategy to build on the company's core competences coupled with modest growth in new ventures

ČEZ's strategy aims to maximise cash flows from its traditional business and strengthen the company's position in central Europe by investing into renewables, decentralized solutions, the heat sector and distribution.

The company's total investment plans amount to around CZK160 billion over the 2018-22 period, with the majority of spending split between traditional energy segment (CZK61 billion) and distribution (CZK66 billion). Planned annual investments of CZK30-35 billion are broadly in line with the historical average, although with some shift in spending towards renewables and distribution networks, following the completion of investments designed to refurbish and upgrade the generation fleet over the last few years.

Exhibit 8

Majority of ČEZ's investments is planned in the power generation and distribution segments in CZK billion



Source: Company, Moody's Investors Service

While ČEZ's strategy is comparable with most of its European peers, which seek to expand operations in renewable energy and services, we see potentially greater execution risk for ČEZ as it may expose the company to new businesses and geographies (e.g. onshore wind in Germany and France). Nevertheless, the currently planned investments are fairly small in the context of ČEZ's activities, with a

very modest increase in renewable capacity by 2020. Given ČEZ's ambitions of further growth in renewables, the actual investments and increase in installed capacity may be higher, although we currently expect the company to remain cautious in pursuing growth opportunities in this area.

Credit metrics to be well positioned against our guidance absent increased investments

ČEZ targets a financial profile with leverage of 2.5-3x on a net debt/EBITDA basis. The company's dividend policy assumes a pay-out of 60-100% of consolidated adjusted net income from 2016 and 2017 profits. This range is expected to be narrowed for the following years subject to the strategic update.

We expect ČEZ to demonstrate FFO/net debt in the mid to high twenties in percentage terms in the medium term in the absence of additional investments that have not been yet identified. In this regard we note that ČEZ could face additional demands on its cash flows once the company's development strategy has been refined, which is expected in 2018.

More details on new nuclear expected in 2018

ČEZ's generation fleet includes two nuclear power plants - Dukovany, which consists of four units (2 GW in total) commissioned in 1985-87, and Temelin, which has two units (around 2.3 GW in total) commissioned in 2002-03. Whilst the plants' availability was affected over the past few years by the unplanned nuclear outages due to prolonged weld checks and license renewals, ČEZ expects production to increase to around 30 TWh in 2019.

The government's energy policy is to preserve full independence of the Czech Republic in power generation after the country runs out of domestic coal and nuclear plants reach the end of their operational life. In this regard, nuclear is to remain a key component of the country's fuel mix in the future. This will require development of new nuclear units once Dukovany nuclear power plant reaches end of its operations, currently expected in 2035.

The Czech government is currently investigating three options for the development of new nuclear. These include (1) development by ČEZ; (2) development by the state; and (3) a transformation of ČEZ, including a breakup of the conventional generation, including nuclear power, from that of regulated distribution, sales and renewable activities. Whilst there is currently no clarity regarding ČEZ's role in building new nuclear power plants or the business split, we understand that the analysis includes a potential for the support mechanism, such as, for example, state guarantees, which would evidence a strong support to ČEZ from the Czech government.

We understand that more clarity regarding ČEZ's role in development of new nuclear and the potential for the group's split is expected in the first half of 2018, although delays to the currently envisaged schedule are possible. Final investment decision will not be, however, made before 2028.

ČEZ's current rating does not factor in possible new nuclear investment as there remains significant uncertainty regarding both the timing and potential government support for such a project. We caution that development of new nuclear carries significant risk given the long lead time and high costs.

Government ownership provides a rating uplift

Given the 70% ownership by the Czech government (A1 positive), ČEZ is considered a Government-Related Issuer (GRI) under Moody's methodology.

ČEZ's Baa1 rating factors in one notch of uplift from the company's baseline credit assessment (BCA) of baa2 based on our estimate of strong support from the Czech government. This in turn reflects ČEZ's critical role within the Czech energy sector and its high strategic importance to the overall Czech economy, given that it represents one of the largest employers and contributors to the state budget.

We consider that the default dependence is moderate given that whilst ČEZ generates the majority of its earnings in the Czech Republic, the group is exposed to developments in the German power market which influence heavily Czech power prices.

Relatively high risk from decarbonisation of the power sector

The EU has committed to reduce greenhouse gas emissions by 40% from 1990 levels and to increase the contribution of renewables to energy demand to 27% by 2030. These targets, agreed in 2014, formed the basis of the EU's Nationally Determined Contributions incorporated into the Paris Agreement, and are designed to significantly decarbonise the region's economies. We believe that

unregulated utilities, which account for 40% of EU carbon emissions, will need to deliver a significant share of the reductions, and that this will create a variety of risks and opportunities for individual utilities.

We believe that ČEZ has a relatively high exposure to carbon transition risks compared to peers, given its material exposure to centralized and carbon-intensive (lignite) power generation. The company's carbon intensity of its generation fleet amounts to 440 g/kWh. Despite ČEZ's ambition to become a major European player in renewables, and small investments in consumer technology, ČEZ currently has limited exposure to renewables and services.

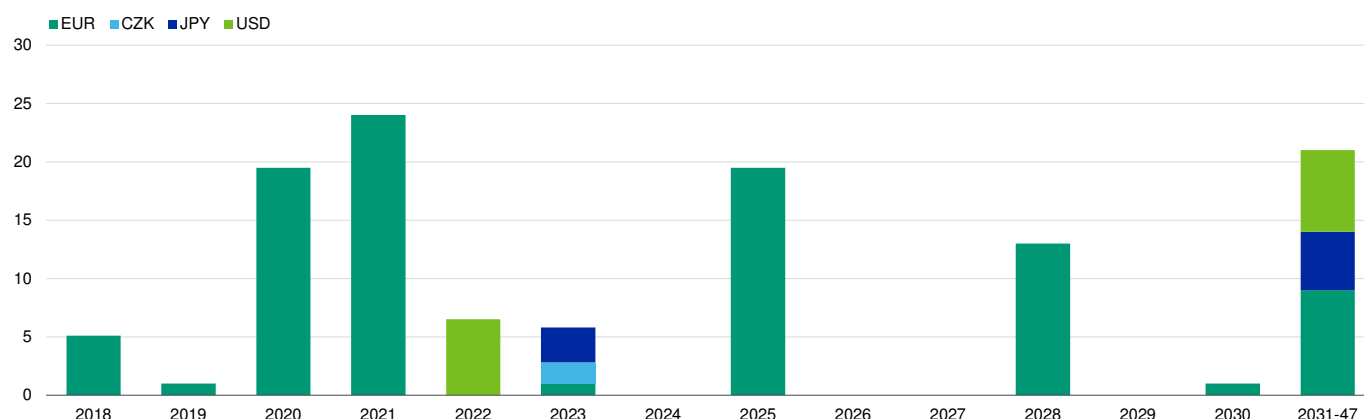
Liquidity analysis

As of end-December 2017, ČEZ's liquidity was supported by CZK12.6 billion of cash and CZK18.7 billion of undrawn committed facilities.

The majority of ČEZ's upcoming debt maturities is related to bank debt with limited bond maturities until 2020, when the €750 million 4.5% notes come due.

Exhibit 9

Bond maturity profile as of end-December 2017 in CZK billion



Note: In addition to bonds, ČEZ had CZK36 billion in bank debt outstanding as of end-December 2017.

Source: Company, Moody's Investors Service

Structural considerations

ČEZ is the principal borrower for the ČEZ group and the issuer under the €8 billion euro medium-term note (EMTN) programme.

Following the early redemption of convertible bonds in the amount of CZK12.6 billion with the proceeds from the sale of a 7.5% stake in MOL in April 2017, ČEZ's capital structure includes a mix of senior unsecured bonds and bank debt. As of end-December 2017, some 8% of debt was raised at the subsidiary level.

Rating methodology and scorecard factors

ČEZ is rated in accordance with the rating methodology for [Unregulated Utilities and Unregulated Power Companies](#), published in May 2017, and [Government-Related Issuers](#), published in August 2017.

Exhibit 10

Rating Factors

ČEZ, as.

Unregulated Utilities and Unregulated Power Companies Industry Grid [1][2]			Moody's 12-18 Month Forward View As of April 2018 [3]	
	Current FY 12/31/2017			
Factor 1 : Scale (10%)	Measure	Score	Measure	Score
a) Scale (USD Billion)	A	A	A	A
Factor 2 : Business Profile (40%)				
a) Market Diversification	Ba	Ba	Ba	Ba
b) Hedging and Integration Impact on Cash Flow Predictability	Baa	Baa	Baa	Baa
c) Market Framework & Positioning	Ba	Ba	Ba	Ba
d) Capital Requirements and Operational Performance	A	A	A	A
e) Business Mix Impact on Cash Flow Predictability	Aa	Aa	Aa	Aa
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 4 : Leverage and Coverage (40%)				
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	8.5x	A	7x - 8.5x	Baa
b) (CFO Pre-W/C) / Net Debt (3 Year Avg)	30.7%	Baa	25% - 30%	Baa
c) RCF / Net Debt (3 Year Avg)	18.5%	Baa	18% - 22%	Baa
Rating:				
a) Indicated Rating from Grid		Baa1		Baa2
b) Actual Baseline Credit Assessment Assigned		baa2		
Government-Related Issuer	Factor			
a) Baseline Credit Assessment	baa2			
b) Government Local Currency Rating	A1			
c) Default Dependence	Moderate			
d) Support	Strong			
e) Final Rating Outcome	Baa1			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of 12/31/2017; Source: Moody's Financial Metrics™.

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Investors Service

Appendix

Exhibit 11

Peer Comparison Table

	CEZ, a.s. Baa1 Positive			Fortum Oyj Baa2 Negative			Orsted A/S Baa1 Stable			Edison S.p.A. Baa3 Stable			Vattenfall AB A3 Stable		
	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-15	FYE Dec-16	FYE Dec-17
(in US millions)															
Revenue	\$8,388	\$8,253	\$8,570	\$3,840	\$4,019	\$5,107	\$9,742	\$8,506	\$8,580	\$12,561	\$12,209	\$11,231	\$17,034	\$16,282	\$15,859
EBITDA	\$2,766	\$2,349	\$2,301	\$1,256	\$1,056	\$1,464	\$781	\$2,027	\$1,525	\$1,766	\$634	\$899	\$3,976	\$3,103	\$4,197
TOTAL ASSETS	\$23,586	\$24,001	\$28,780	\$25,751	\$24,329	\$27,499	\$22,093	\$19,915	\$24,632	\$15,637	\$13,738	\$13,708	\$55,416	\$45,472	\$50,542
Total Debt	\$7,404	\$7,451	\$8,356	\$7,663	\$6,645	\$7,387	\$6,948	\$5,006	\$6,663	\$3,431	\$2,774	\$1,936	\$20,093	\$18,699	\$18,706
Net Debt	\$6,375	\$6,818	\$7,606	-\$1,247	\$1,209	\$2,707	\$3,391	\$2,239	\$2,023	\$3,127	\$2,557	\$1,623	\$15,161	\$14,214	\$15,757
FFO / Net Debt	35.9%	27.4%	29.1%	-90.8%	70.7%	40.9%	51.8%	88.3%	93.5%	37.3%	22.8%	57.6%	22.6%	19.1%	20.9%
RCF / Net Debt	22.5%	15.2%	18.0%	9.8%	-14.6%	-2.5%	47.7%	83.7%	67.9%	34.1%	19.6%	54.2%	22.0%	18.1%	20.0%
FFO Interest Coverage	8.7x	8.3x	8.6x	5.1x	5.3x	5.9x	6.6x	7.3x	6.3x	8.8x	6.1x	13.5x	5.7x	5.1x	4.6x
Net Debt / EBITDA	2.3x	3.0x	3.0x	-1.0x	1.2x	1.7x	4.4x	1.2x	1.2x	1.8x	4.2x	1.7x	3.8x	4.9x	3.6x

All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.

Source: Moody's Financial Metrics™.

Exhibit 12

ČEZ, a.s.

Selected Moody's adjusted financial data

CZK million	2013	2014	2015	2016	2017
INCOME STATEMENT					
Revenue	216,988	198,306	206,134	201,641	199,435
EBITDA	88,352	69,296	67,970	57,385	53,550
EBIT	54,504	41,591	39,351	28,407	24,247
Interest Expense	9,737	8,806	7,414	6,574	6,205
Net Income	35,574	24,783	23,484	14,096	13,016
BALANCE SHEET					
Net PP&E	421,971	422,486	417,741	423,906	426,411
Total Assets	626,459	612,149	586,707	614,864	611,860
Total Debt	232,599	216,885	184,174	190,885	177,643
Cash & Cash Equivalents	41,957	36,879	25,595	16,218	15,930
Net Debt	190,642	180,006	158,579	174,667	161,713
Total Liabilities	371,373	351,240	310,664	341,027	339,741
CASH FLOW					
Funds from Operations (FFO)	60,864	56,786	56,928	47,923	47,025
Cash Flow from Operations (CFO)	65,446	63,263	65,540	42,806	40,479
Dividends	-21,336	-21,320	-21,313	-21,333	-17,859
Retained Cash Flow (RCF)	39,524	35,237	35,615	26,590	29,166
Capital Expenditures	-38,870	-28,386	-24,870	-29,406	-25,355
Free Cash Flow (FCF)	5,236	13,328	19,357	-7,933	-2,735
FFO / Net Debt	31.9%	31.5%	35.9%	27.4%	29.1%
RCF / Net Debt	20.7%	19.6%	22.5%	15.2%	18.0%
FCF / Net Debt	2.7%	7.4%	12.2%	-4.5%	-1.7%
FFO / Debt	26.2%	26.2%	30.9%	25.1%	26.5%
RCF / Debt	17.0%	16.2%	19.3%	13.9%	16.4%
PROFITABILITY					
EBIT Margin %	25.1%	21.0%	19.1%	14.1%	12.2%
EBITDA Margin %	40.7%	34.9%	33.0%	28.5%	26.9%
INTEREST COVERAGE					
FFO Interest Coverage	7.3x	7.4x	8.7x	8.3x	8.6x
LEVERAGE					
Debt / EBITDA	2.6x	3.1x	2.7x	3.3x	3.3x
Net Debt / EBITDA	2.2x	2.6x	2.3x	3.0x	3.0x
Debt / Book Capitalization	46%	43%	38%	39%	37%

All figures and ratios are calculated using Moody's estimates and standard adjustments.

Source: Moody's Financial Metrics

Ratings

Exhibit 13

Category	Moody's Rating
CEZ, A.S.	
Outlook	Positive
Senior Unsecured	Baa1

Source: Moody's Investors Service

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