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CREDIT OPINION

7 December 2017

Update

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RATINGS

ČEZ, a.s.

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

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 to credit analysis

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) the relatively stable and predictable cash flows generated by its electricity distribution activities in Czech Republic.

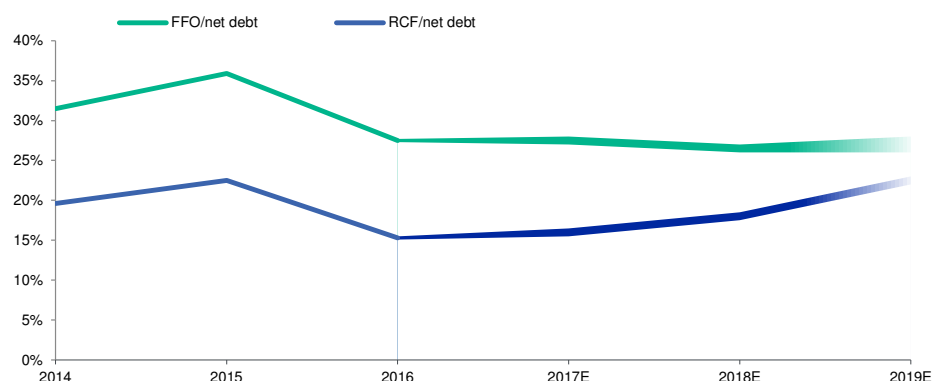
These positives are balanced by (1) the company's relatively high exposure to merchant power generation, which together with the mining segment accounted for more than 45% of EBITDA in 2016; (2) the predominantly fixed-cost power generation business exposed to low power price environment; and (3) the 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 2017-18 term as the anticipated decline in earnings due to low power prices will be mitigated by positive free cash flows stemming from a moderate capital expenditure programme, partly offset by the company's 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

The Baa1 issuer and senior unsecured ratings incorporate one notch of rating uplift for potential support, given the 70% ownership by the Government of Czech Republic (A1 stable).

Credit Strengths

- » ČEZ's generation fleet in 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 stable)

Credit Challenges

- » Large exposure to fixed-cost, merchant power generation in Czech Republic, which makes the company particularly exposed to current low power prices
- » 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 split of ČEZ's business

Rating Outlook

The stable outlook reflects our expectation that ČEZ's key credit metrics will remain aligned with the guidance for the current Baa1 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

- » 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.

Factors that Could Lead to a Downgrade

- » Financial ratios falling permanently below our guidance for the Baa1 rating;
- » The group undertakes a large debt-funded acquisition in addition to its announced potential investments;
- » ČEZ starts developing new nuclear units that weaken its business and/or financial risk profile.

Key Indicators

Exhibit 2
ČEZ, a.s.

	6/30/2017(L)	12/31/2016	12/31/2015	12/31/2014	12/31/2013
(CFO Pre-W/C + Interest) / Interest	8.0x	8.3x	8.7x	7.4x	7.3x
(CFO Pre-W/C) / Net Debt	30.6%	27.5%	35.9%	31.5%	31.9%
RCF / Net Debt	16.4%	15.3%	22.5%	19.6%	20.7%

[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

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

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.

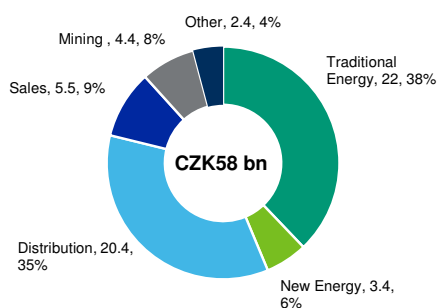
Profile

ČEZ, a.s. is one of the largest electric utility companies in Central and Eastern Europe with 15.7 gigawatts (GW) of power generation capacity and more than 8 million customers. The group operates primarily in Czech Republic (88% of EBITDA in 2016) as well as in Bulgaria (2%), Romania (8%) and Poland (1%). 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

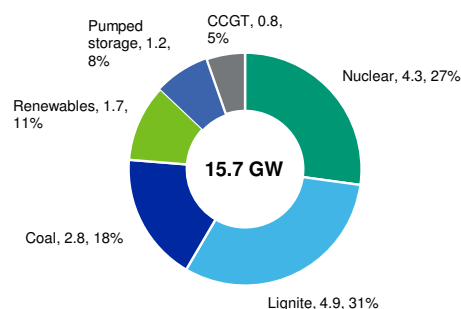
Power generation accounts for the bulk of ČEZ's EBITDA
EBITDA breakdown by segment in 2016, in CZK billion



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

Exhibit 4

ČEZ's installed capacity includes mainly nuclear and coal
Breakdown of installed capacity in 2016, in GW



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

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

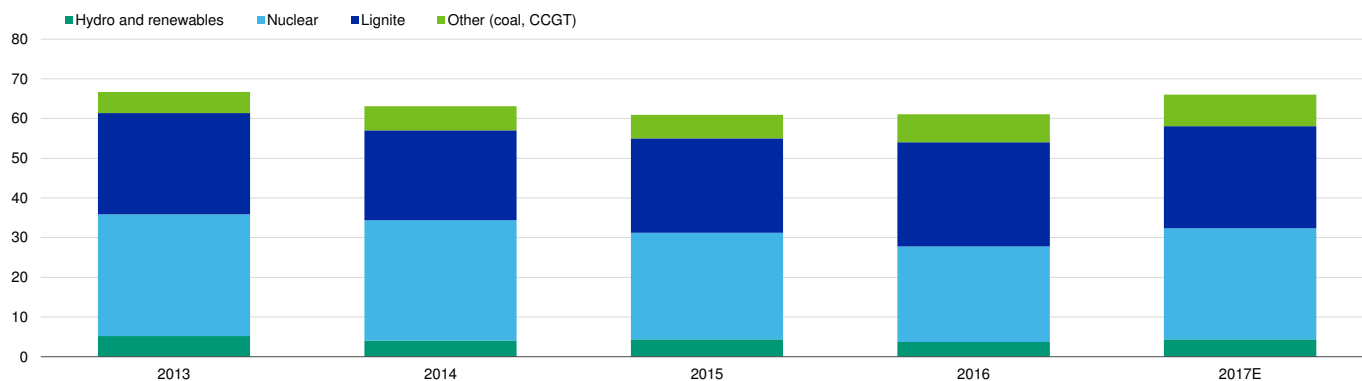
Detailed Credit Considerations

Fixed-cost generation fleet impacted by low power prices

With around 13 GW of installed capacity, ČEZ is the largest generator in Czech Republic - having a market share of around 68%. This position is further supported by its vertical integration as (1) ČEZ's own coal mines cover 68% of its lignite needs; and (2) it has a 32% market share in supply. Offsetting these positives, however, is the fact that ČEZ's generation fleet is predominantly fixed-cost in nature, with 88% of generation output represented by lignite, nuclear and hydro.

Exhibit 5

ČEZ's generation is predominantly fixed-cost
Output in TWh



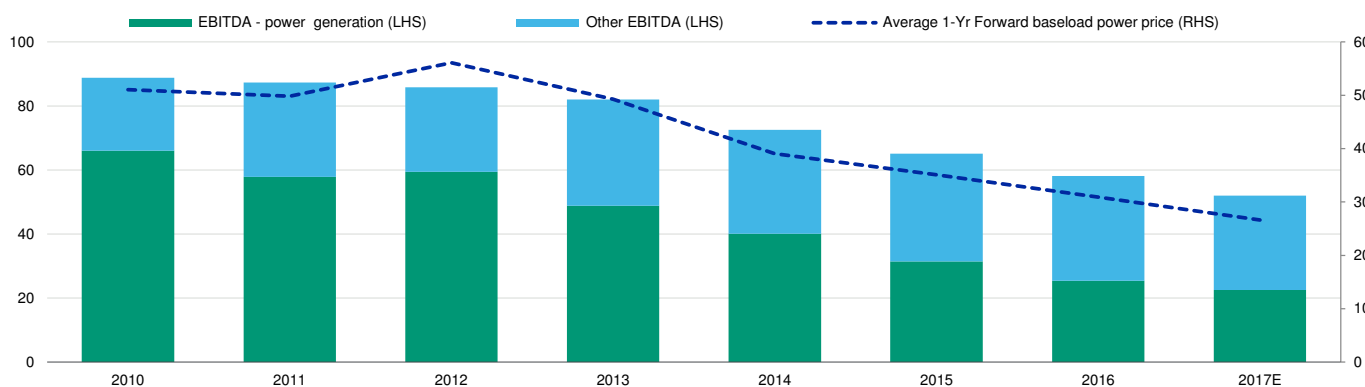
Source: Company, Moody's Investors Service

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. While forward baseload power prices in Germany have rebounded from their lows in 2016, the current prices of €36/MWh are below historical levels and spreads on coal remain tight.

We expect power prices in Germany to remain in a range of €30-35/MWh over the period 2017-22. 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 81% of its 2018 output at €30/MWh. For 2019, ČEZ has a 57% hedge ratio at €29.5/MWh. The hedge ratio decreases to 26% in 2020, with a locked-in price of €33/MWh.

Overall, we expect ČEZ's EBITDA from power generation to decline by some 10% this year before stabilizing from 2018 onwards on the back of a modest power price recovery. We note that ČEZ benefits from a fairly low fuel cost estimated at €7/MWh for nuclear and €14-15/MWh for lignite plants, 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.

Regulated distribution activities support cash flow stability

Around 35% of ČEZ's EBITDA is derived from regulated electricity distribution network activities. Some 85% of this segment's earnings are derived from the activities in Czech Republic, where the company owns five of the eight distribution grids, representing an aggregate regulated asset base (RAB) of CZK93 billion and covering around 65% of total customers. 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	ERU / 4th regulatory period	EWRC / 4th regulatory period	ANRE / 3rd regulatory period
Regulatory period	2016-18*	2015-18	2014-18
Pre-tax allowed return	7.951% (nominal)	7.04% (nominal)	7.7% (real)
Regulated Asset Base (year-end 2016)	€3,280 million	€278 million	€525 million

* Subject to final decision, to be extended until 2020.

Source: Company, Moody's Investors Service

We view the regulatory framework for electricity distribution networks in 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, which covers 2016 to 2018. We note, however, that in August 2017 the Czech Energy Regulatory Office (ERO) published a proposal to extend the current period by two years. Under the proposal, existing regulatory parameters including the 7.95% allowed return underpinning tariff decisions will be maintained until 2020, which would be credit positive for ČEZ. (See [Proposed two-year extension of current regulatory period credit positive for Czech networks](#), September 2017). The ERO's decision regarding extension of the current regulatory period is expected in January 2018.

ČEZ's distribution activities in Bulgaria and Romania, contributing around CZK3.1 billion to the group's EBITDA in 2016, 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 the Varna power plant in October and opened the divestment process for the Bulgarian distribution assets. We consider these divestments to be credit neutral given the small size of the business in the context of ČEZ's finances.

Sales segment provides a platform for development of new energy solutions

With sales of 19.6 TWh, ČEZ is a large supplier of electricity in Czech Republic, accounting for 32% of the market. Outside of the domestic market, the company's electricity retail sales amounted to 15.1 TWh, of which 9.7 TWh in Bulgaria and 3.4 TWh in Romania in 2016. The foreign activities contributed, however, a small proportion (around 9%) to this segment's EBITDA of CZK5.5 billion.

We consider retail earnings of lower quality than ČEZ's other segments and the company is exposed to competition and the risk of declining margins. Nonetheless, the business is an important platform for growth of the company's operations in new energy solutions, which are one of the key pillars of ČEZ's strategy.

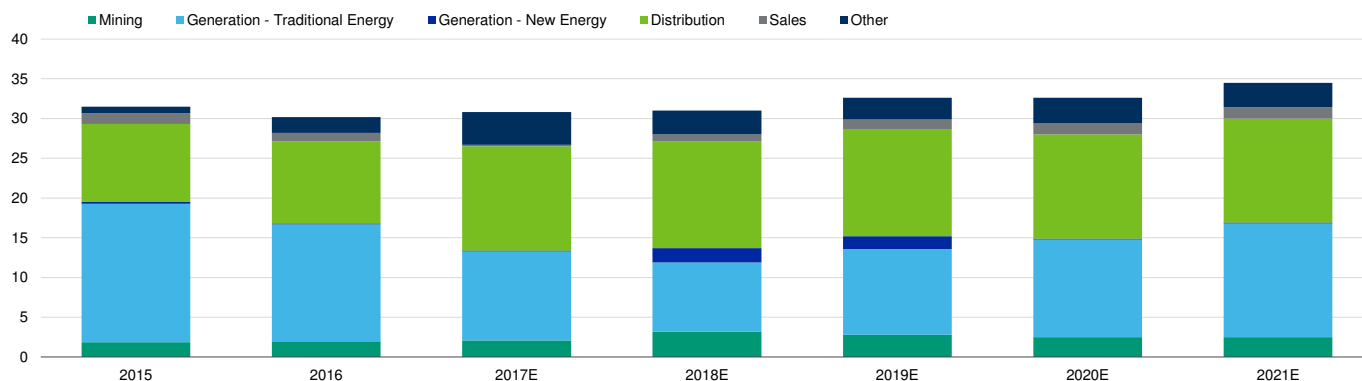
Strategy to build on the company's core competences coupled with modest growth in new ventures

ČEZ's strategy for 2017-21 period 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 2017-21 period, with the majority of spending split between traditional energy segment (CZK57 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

According to ČEZ's strategy, investments coupled with cost reduction and efficiency gains will drive an improvement in the group's EBITDA by CZK9 billion in total by 2020 in terms of comparison with the business plan from 2015.

While ČEZ's strategy is comparable with that of most of its European peers, which seek to expand operations in renewable energy and services, the execution risk is higher 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 finances, with an increase in renewable capacity to 1.8 GW by 2020 from 1.7 GW in 2016.

We expect credit metrics to be well positioned against our guidance absent increase in 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 based on 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 Q1 2018.

More details regarding development of new nuclear expected in Q1 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 (2.1 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 until 2019.

The government's energy policy is to preserve full independence of Czech Republic in power generation after the country runs out of domestic coal. 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 new nuclear development, which assume either that (1) ČEZ will develop the project, (2) the state will develop the project, or (3) ČEZ's business will be split, with the state acquiring a bigger part of the company and developing the project. According to the company, any of the above would require a support mechanism, including potential state guarantees. We expect more clarity regarding ČEZ's role in development of new nuclear and the potential for the group's split in Q1 2018. 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 stable), 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 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 500 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.

Moody's framework for assessing the risk associated with decarbonisation in this industry is set out in [Carbon Transition Brings Risks and Opportunities for Unregulated Utilities](#) published in October 2016.

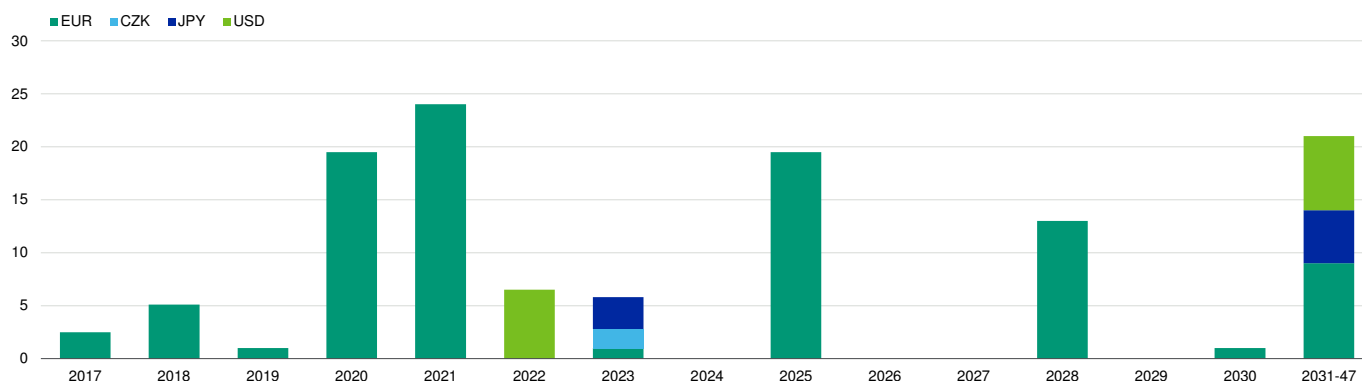
Liquidity Analysis

As of end-September 2017, ČEZ's liquidity was supported by CZK13.8 billion of cash and CZK18.6 billion of undrawn committed facilities.

The company's debt maturities include CZK21.4 billion of debt repayments over the next 12 months. The majority of upcoming debt maturities is related to bank debt. ČEZ's refinancing needs will increase in 2020, when its €750 million 4.5% notes come due.

Exhibit 9

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



Note: In addition to bonds, ČEZ had CZK38.3 billion in bank debt outstanding as of end-September 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-September 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]

	Current LTM 6/30/2017	
	Measure	Score
Factor 1 : Scale (10%)		
a) Scale (USD Billion)	A	A
Factor 2 : Business Profile (40%)		
a) Market Diversification	Ba	Ba
b) Hedging and Integration Impact on Cash Flow Predictability	Baa	Baa
c) Market Framework & Positioning	Ba	Ba
d) Capital Requirements and Operational Performance	A	A
e) Business Mix Impact on Cash Flow Predictability	Aa	Aa
Factor 3 : Financial Policy (10%)		
a) Financial Policy	Baa	Baa
Factor 4 : Leverage and Coverage (40%)		
a) (CFO Pre-W/C + Interest) / Interest (3 Year Avg)	8.2x	A
b) (CFO Pre-W/C) / Net Debt (3 Year Avg)	33.9%	Baa
c) RCF / Net Debt (3 Year Avg)	19.9%	Baa
Rating:		
a) Indicated Rating from Grid		Baa1
b) Actual Baseline Credit Assessment Assigned		baa2

Moody's 12-18 Month Forward View As of December 2017 [3]

	Measure	Score
	A	A
	Ba	Ba
	Baa	Baa
	Ba	Ba
	A	A
	Aa	Aa
	Baa	Baa
	6x - 8x	Baa
	25% - 30%	Baa
	13% - 18%	Baa
		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 06/30/2017; 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

ČEZ, a.s.

Selected Moody's adjusted financial data

CZK Millions	2012	2013	2014	2015	2016	LTM Jun 2017
INCOME STATEMENT						
Revenue	215,095	216,988	198,306	206,134	201,641	202,125
EBITDA	85,053	88,352	69,296	67,970	57,385	58,964
EBIT	57,069	54,504	41,591	39,351	28,407	29,165
Interest Expense	9,153	9,737	8,806	7,414	6,574	6,566
Net Income	39,503	35,574	24,783	23,484	14,096	15,282
BALANCE SHEET						
Total Debt	220,105	232,599	216,885	184,174	190,885	174,079
Cash & Cash Equivalents	30,148	41,957	36,879	25,595	16,218	23,661
Net Debt	189,957	190,642	180,006	158,579	174,667	150,418
CASH FLOW						
Funds from Operations (FFO)	66,461	60,864	56,786	56,928	47,999	45,964
Cash Flow from Operations (CFO)	58,209	65,446	63,263	65,540	42,806	40,580
Cash Dividends - Common	-23,995	-21,336	-21,320	-21,309	-21,325	-21,333
Retained Cash Flow (RCF)	42,462	39,524	35,237	35,615	26,666	24,621
Capital Expenditures	-47,115	-38,870	-28,386	-24,870	-29,406	-23,766
Free Cash Flow (FCF)	-12,905	5,236	13,328	19,357	-7,933	-4,529
RATIOS						
FFO Interest Coverage	8.3x	7.3x	7.4x	8.7x	8.3x	8.0x
FFO / Net Debt	35.0%	31.9%	31.5%	35.9%	27.5%	30.6%
RCF / Net Debt	22.4%	20.7%	19.6%	22.5%	15.3%	16.4%
FCF / Net Debt	-6.8%	2.7%	7.4%	12.2%	-4.5%	-3.0%
PROFITABILITY						
EBIT Margin %	27%	25%	21%	19%	14%	14%
EBITDA Margin %	40%	41%	35%	33%	28%	29%
LEVERAGE						
Debt / EBITDA	2.6x	2.6x	3.1x	2.7x	3.3x	3.0x
Net Debt / EBITDA	2.2x	2.2x	2.6x	2.3x	3.0x	2.6x

Source: Moody's Financial Metrics

Ratings

Exhibit 12

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

Source: Moody's Investors Service

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