# REPORT ON THE COMPANY'S BUSINESS OPERATIONS AND ASSETS FOR 2016

**Daniel Beneš, Chairman of the Board of Directors and Chief Executive Officer of ČEZ, a. s.**

Dear shareholders, ladies and gentlemen,

Please allow me now to inform you of ČEZ's most significant financial results of the past year and its future plans. The report is based on facts known as at March 20, 2017 and the included outlook for the 2017 financial results is based on facts known as at May 11, 2017.

**See Figure 1 "CEZ Group's 2016 Net Income Surpasses the Initial Estimate by CZK 1.6 Billion" in Annex 1 "Report on the Business Operations and Assets of ČEZ, a. s. for 2016" (hereinafter as Annex)**

I am glad that I can start the summary of the past year 2016 with positive news. CEZ Group's net income adjusted for extraordinary effects was CZK 19.6 billion in 2016, which exceeds our initial estimate by CZK 1.6 billion. We thus achieved our primary financial target of CEZ Group's adjusted net income and accomplished the key tasks resulting from our strategy focusing on operational efficiency, advanced decentralized energy, and end-use customers. In addition, in December 2016, Standard & Poor's Credit Market Services Europe Limited reaffirmed ČEZ's long-term credit rating of A– with a stable outlook.

These results are especially valuable in the context of continued uncertainty in Europe's energy sector and intensifying legal and regulatory requirements for environmentally friendly operation and safety of generating facilities. CEZ Group continued to face global trends that affect ever more strongly its opportunities and position in Europe's energy market and profoundly impact changes in electricity wholesale prices. Traditional energy is stagnating because there is a surplus of capacities in the market; conventional power plants are being displaced by subsidized renewables, while there is growing pressure by regulators and competitors on profit margins. Furthermore, fast technological advancement plays into the hands of renewables, additionally potentiated by massive state aid for construction of renewables in Germany, Denmark, and other European Union countries. The development of new technologies makes renewable generation cheaper while helping enhance efficiency of decentralized energy systems. For example, the price of battery systems dropped by 20 percent year-on-year, which brings about unprecedented levels of competition in the implementation of decentralized solutions. There is also a third reinforcing global trend, namely customers' focus on comprehensive services relating to the use of energy. End-use customers show growing interest in active control of consumption and also self-generation and corporate customers are outsourcing energy and facility management as a whole.

**See Figure 2 "Changes in Electricity Prices in 2016 Reflected Primarily Changes in Hard Coal Prices and in Expectations About the Future of the EU Emission Allowance System" in the Annex**

Let me now briefly discuss developments in the commodity markets, which are crucial for CEZ Group, in 2016. At the beginning of 2016, electricity prices in Germany slumped to a 14-year low below 21 EUR/MWh, which was primarily caused by a decrease in global coal prices and a steep fall in the prices of emission allowances. In the following months, the prices of electricity were affected, in particular, by rising hard coal prices on the world markets and, in the fall, by forced outages at France's nuclear power plants, which resulted in a gradual growth up to 35 EUR/MWh in November. The price of a 2017 forward electricity contract in Germany was 26.5 EUR/MWh in late 2015. In late 2016, the same contract was traded at 34.8 EUR/MWh, which meant a year-on-year increase in the price of electricity of 31.4%. The price of electricity in Czechia went up by 33.8%. The growth factors behind electricity prices were counteracted in 2016 by persisting low prices of emission allowances and continued growth in installed renewables capacity, especially in Germany. On March 20, 2017, electricity prices in Germany for electricity to be delivered in 2018 were traded at about 29 EUR/MWh.

The beginning of 2016 was characterized by a steep fall in the price of emission allowances, from about 8 EUR/t to 5 EUR/t in mid-February. The following months lacked a clear trend and emission allowances were traded in a range of 4–6 EUR/t, depending on the course of debate in the European Parliament over an amendment to the EU ETS directive setting rules applicable after 2020. Emission allowances closed the year 2016 at 6.6 EUR/t, which was a year-on-year price drop of 20%. On March 20, 2017, the prices of emission allowances were at about 5 EUR/t.

**See Figure 3 “ČEZ’s Strategy is Based on Three Priorities—Selected Events in 2016” in the Annex**

Global trends in the energy market persist and keep growing in importance. On the electricity generation side, there is the reinforcing trend of generation gradually shifting from conventional units to renewables and other zero-emission facilities. On the end-use customer side, comprehensive, decentralized solutions and custom-tailored products are increasingly coming to the fore. Both these trends bring about an ever-growing need for flexibility in generating facilities and transmission and distribution grids.

CEZ Group’s strategy adopted in 2014 reacts adequately to these trends, and developments in Europe to date prove it fully correct. CEZ Group’s mission is to provide safe, reliable, and positive energy to its customers and society as a whole. Its vision is to bring innovations for resolving energy needs and help improve quality of life.

To be among the best in the operation of conventional power facilities and proactively respond to the challenges of the 21st century—that is the first priority of our strategy. We focus on operational efficiency as a prerequisite for our continued successful presence in both traditional and new energy. We made a significant step toward ensuring long-term operation of the Dukovany Nuclear Power Plant in 2016 when we obtained an unlimited operating license for Unit 1. We are now working hard to get the same license for Unit 2, the license of which expires on July 10 this year. We completed the renovation of the brown coal-fired Prunéřov Power Plant, involving a 40MW increase in the installed capacity of each of its three renovated units. We keep developing projects for new nuclear units at Temelín and Dukovany sites, and the process of environmental impact assessment (EIA) has already been started for a new unit at Dukovany.

Under our second strategic priority, we concentrate on developing a pro-customer approach, which consists in offering a broad range of quality and innovative services and products focusing on the energy needs of our end-use customers. Here the year 2016 brought further expansion of our offer of products for both residential and corporate customers, in particular through acquisitions. The acquisition of AZ KLIMA provided us with the competences of a leading company on the Czech market, with a particular focus on the design, engineering, and servicing of HVAC systems for industrial customers, and commercial and administrative buildings. In the first half of 2016, the ČEZ ESCO group incorporated juwi, since renamed to ČEZ Solární, ensuring high competence in rooftop photovoltaic solutions as well as in optimal management and operation of photovoltaic parks. At the end of the year, we established a new subsidiary, ČEZ LDS, in which we hold a 51% share. It engages in purchasing, managing, and providing services relating to the operation of local distribution systems.

Last but not least, ČEZ Prodej became the second largest gas supplier in Czechia and we acquired additional new customers by purchasing Energie2 Prodej, an alternative electricity and gas seller.

Our third strategic priority is strengthening and consolidating CEZ Group’s position in Europe. One of our target markets is Germany. After reviewing many acquisition opportunities, we successfully entered Germany’s renewable generation market by acquiring onshore wind turbines in December 2016. Our first acquisition was the Fohren-Linden wind park with a total installed capacity of 12.8 MW. It was immediately followed by another acquisition of a portfolio of wind turbines from wpd, a renowned company and a leading developer and operator of wind parks in Germany. These were 8 wind parks with an installed capacity of 85.25 MW, located in several of Germany’s federal states.

In the field of innovation, we acquired a share in a European leader in smart temperature control for households by buying into Bavarian company tado. Smart thermostats developed by the company are compatible with most boilers in Europe and can also control air-conditioning units. Another investment went to Environmental Technologies Fund 2, a renowned London fund focusing on investments in global, fast-growing companies in the field of clean technologies. We expect the investment to bring a certain return and provide us with access to unique investment opportunities and know-how, too.

We also managed to reach a strategic agreement with Sokolovská uhelná, resulting in a new contract for deliveries of Sokolov brown coal, the sale of the Tisová Power Plant to Sokolovská uhelná, as well as an agreement to settle our long-term business disputes.

Last but not least, I need to mention that CEZ Group managed in 2016 to provide shareholders with dividends for 2015 amounting to CZK 21.5 billion.

**See Figure 4 “The Operations Team and Development Team Have Been Operational Since January 1, 2016–Selected Events in 2016” in the Annex**

To accelerate the fulfillment of our strategy in 2015, we directed more capacities and resources toward development activities and established two teams, Operations and Development, within ČEZ’s Board of Directors with effect from January 1, 2016. This conceptual change in management included bolstering segment management at the expense of regional management and our newly defined segments became elementary units fully responsible for activities across countries and for attaining ambitious objectives.

The Operations team focuses on efficient use of CEZ Group's conventional energy assets, mining, and all support and centralized services, striving to make optimal use of existing assets and leveraging synergies across CEZ Group. The Development team is an umbrella unit for renewables, decentralized energy, and distribution, sales, and trading activities. The Operations team is led by Martin Novák, Vice-Chairman of the Board of Directors and Chief Financial Officer, and the Development team is led by Tomáš Pleskač, member of the Board of Directors and Chief Renewable Energy and Distribution Officer. Both teams has successfully taken steps toward fulfilling our medium-term financial objective, namely CEZ Group's additional EBITDA exceeding CZK 9 billion in 2020.

In the Operations team, they concerned with increasing efficiency, especially by cutting the fixed costs of the Headquarters and support activities. Another contribution is the optimization of generating facility deployment and operation, including the interface between coal mining and generation, and increase in direct sales of electricity, heat, and certified power by-products. As for financing, an agreement was successfully made between EBRD and CEZ Razpredelenie Bulgaria under which the company can take out a loan of up to CZK 3.1 billion without any guarantee by ČEZ, thus further reducing our financial exposure abroad.

The Development team has successfully continued with activities to increase efficiency of the distribution segment in Czechia and abroad. As for existing assets in renewables, the process of accreditation of support for generation in wind parks in Romania through green certificates was successfully completed, including the allocation of certificates, which was previously suspended until accreditation completion.

Besides the major acquisitions of renewables in Germany mentioned above, we managed to make a number of acquisitions as well as achieve organic growth in the segment of Sales. The field of ESCO services has been growing in importance and is one of a few areas offering profit opportunities in the energy sector. It responds to customers' interest in comprehensive services relating to the use of energy. The member of CEZ Group that consolidates expert and sales capacities for solutions providing energy savings, decentralized sources, lighting, and other energy products is ČEZ ESCO. It concentrates on creating integrated offers for corporate clients, small and medium-sized businesses, and the public sector. During 2016, the portfolio of existing subsidiaries was supplemented by other companies expanding the offer of energy products and services. The ESCO group's 2016 revenue exceeded CZK 3 billion, growing by 57% year-on-year.

We also made big advances in the construction of infrastructure for the development of electric mobility in 2016. We managed to add new locations to our network of fast-charging stations; we got a grant under the EU's CEF program, which will allow us to build 42 fast-charging stations on major roads across Czechia this and next year.

Dear shareholders, let us now deal with specific figures and results showing CEZ Group's performance in 2016, consolidated for ČEZ, a. s. and its subsidiaries and other affiliates. You can now take a look at a table summarizing the most significant financial indicators for 2016 and comparing them to 2015.

**See Figure 5 "CEZ Group Financial Results" in the Annex**

Operating revenues decreased by CZK 6.4 billion year-on-year, which was mainly due to a decrease in revenue from the sales of electricity and related services of CZK 7.2 billion, resulting primarily from lower realization prices of generated electricity. The year-on-year decrease in other operating revenues of CZK 1.8 billion reflects a nonrecurrent 2015 revenue arising from the repayment of debts of the Railway Infrastructure Administration from 2010. By contrast, there was an increase of CZK 2.5 billion in revenues from the sales of gas, coal, heat, and other sales due to higher revenue from the sales of services and an increased amount of gas and heat sold.

EBITDA decreased by CZK 7.0 billion year-on-year to CZK 58.1 billion. Net income, that is to say income after tax, decreased by CZK 6.0 billion year-on-year to CZK 14.6 billion. Adjusted net income decreased by CZK 8.0 billion to CZK 19.6 billion, while the amount of adjustment for extraordinary effects generally unrelated to ordinary financial performance in a given year was CZK 2.1 billion lower in 2016 than in 2015. Primary causes for the year-on-year decrease in net income included a decrease in electricity realization prices. Other negative effects on the year-on-year comparison were produced by nonrecurrent 2015 revenue from the refund of a portion of gift tax on emission allowances for 2011 and 2012, the 2015 revenue arising from the repayment of debts of the Railway Infrastructure Administration to ČEZ Prodej from 2010, and partial goodwill amortization and additions to allowances on the profit or loss of joint ventures in Turkey in 2016. A positive year-on-year effect was produced by the renewal of green certificate allocation in Romania, contributing CZK 0.8 billion.

CEZ Group's assets as at December 31, 2016 were CZK 630.8 billion. Its return on assets in 2016 was 2.3% and its return on equity amounted to 5.4%.

Now I would like to inform you about financial results in the business segments into which CEZ Group was divided in 2016. A significant change from previous years is separate reporting of results for the traditional energy and new energy segments.

**See Figure 6 "Contribution to 2016 EBITDA by Segment" in the Annex**

The biggest segment, Generation—Traditional Energy, saw its EBITDA decrease by CZK 7.0 billion, of which a CZK 6.5 billion decrease was seen in Czechia. The main cause of the decrease was lower realization prices of generated electricity, including positive impacts of hedges, which had a negative year-on-year effect amounting to CZK 6.1 billion. Another factor behind the year-on-year change was higher expenses on weld inspections at nuclear power plants and the costs of related measures, totaling CZK 0.5 billion. The negative effect of change in generation volume and structure also amounted to CZK 0.5 billion, when lower generation at nuclear power plants was significantly offset by higher generation at other facilities. By contrast, a positive effect was produced by increased income from commodity trading and increased heat deliveries. A decrease of CZK 0.5 billion in EBITDA in Poland was caused primarily by lower utilization of green certificates due to a decrease in their market price.

EBITDA of the Generation—New Energy segment increased by CZK 1.0 billion year-on-year, primarily due to an increase of CZK 2.0 billion in Romania. This reflects not only the renewed allocation of green certificates for our Fântânele Vest and Cogealac wind farms but also the receipt of certificates for past periods during which allocation was suspended. By contrast, a negative effect was produced by a decrease of CZK 0.7 billion in EBITDA in Poland due to additions to impairments of Eco-Wind projects in connection with unfavorable changes in renewables legislation in the country. A decrease of CZK 0.3 billion in EBITDA in Czechia results from additions to provisions relating to a legal resolution of the situation concerning purchase prices of electricity generated at the Vranovská Ves photovoltaic power plant.

The Distribution segment achieved a year-on-year increase of CZK 0.3 billion in EBITDA. An increase in Czechia, resulting primarily from increased electricity consumption, and an increase in Bulgaria, achieved through overhead reduction and higher connection revenues, were partially offset by a decrease in EBITDA in Romania, which was mostly due to lower regulated tariffs.

The Sales segment registered a year-on-year decrease of CZK 1.4 billion in EBITDA. However, it was largely attributable to the 2015 one-time revenue of CZK 1.1 billion from the repayment of the Railway Infrastructure Administration's debt to ČEZ Prodej; another significant portion of it was due to an increase in fixed operating costs resulting from the segment's development activities. In contrast, a positive effect was produced by higher deliveries of gas to new customers and another positive effect on EBITDA was brought about by the development and acquisition growth of ESCO activities in Czechia. An increase in sales was also registered in Slovakia, due to higher deliveries of gas to new customers.

The Mining segment increased its EBITDA by CZK 0.1 billion year-on-year, primarily due to higher sales outside CEZ Group and a higher margin on nonenergy activities.

Let us now take a look at developments in CEZ Group's cash flows.

**See Figure 7 "CEZ Group Cash Flows" in the Annex**

Cash flows from operating activities decreased by CZK 23.6 billion year-on-year. Main causes included changes in assets and liabilities; lower income before income taxes with adjustments to reconcile income before income taxes to net cash provided by operating activities; and higher income tax paid.

Cash used in investing activities increased by CZK 3.0 billion year-on-year, primarily due to purchases of bank bonds; the opposite effect was produced by a year-on-year decrease in investments in property, plant, and equipment and intangible assets, that is, CAPEX and higher proceeds from sales of noncurrent assets.

Cash used in financing activities, including the net effect of currency translation in cash, decreased by CZK 31.1 billion year-on-year. The main cause was a year-on-year decrease in the repayment of borrowings and increase in proceeds from borrowings, accounting for CZK 31.5 billion.

**See Figure 8 "CEZ Group Assets, Equity, and Liabilities" in the Annex**

The value of CEZ Group's consolidated assets increased by CZK 28.2 billion year-on-year to CZK 630.8 billion. Noncurrent assets decreased by CZK 3.8 billion to CZK 489.3 billion. This includes a CZK 5.5 billion increase in the value of total property, plant and equipment—primarily due to completed investment projects. The decrease in noncurrent assets is largely due to reclassification of MOL shares to current available-for-sale securities with an effect of CZK 9.4 billion. There was a decrease in the value of investment in associates and joint ventures, which reflected low profits of joint ventures in Turkey. By contrast, noncurrent assets were increased by purchased bonds and green certificates allocated to Romanian power plants for 2013 to 2015. Current assets increased by CZK 32.0 billion in 2016.

Equity, including noncontrolling interests, decreased by CZK 10.8 billion to CZK 261.4 billion. This was due to a decrease in dividends declared, excluding dividends on treasury shares, amounting to CZK 21.4 billion, and a decrease of CZK 4.1 billion in other comprehensive income. By contrast, net income generated in 2016 increased equity by CZK 14.6 billion.

I would also like to briefly mention treasury shares held by ČEZ, a. s. At the beginning of 2016, there were 3,755,021 treasury shares, representing 0.7% of the registered capital, held on the asset account of ČEZ, a. s. with the Central Securities Depository to cover claims arising out of the Company's stock option plan. No stock option plan beneficiary claimed the grant of any ČEZ stock options during 2016, so the balance did not change by December 31, 2016, and there were 3,755,021 treasury shares, that is, 0.7% of the registered capital, held on the asset account.

Noncurrent liabilities increased by CZK 3.2 billion to CZK 240.0 billion, primarily due to an increase of CZK 5.5 billion in nuclear provisions. An increase of CZK 35.7 billion in current liabilities, to CZK 129.4 billion, was primarily due to an increase of CZK 21.5 billion in payables from short-term derivative trading, including options, and an increase of CZK 13.6 billion in short-term loans, including the current portion of long-term debt. The total value of bonds issued was CZK 132.0 billion as at December 31, 2016, which was a year-on-year decrease of CZK 2.7 billion.

Let us now have a closer look at changes in electricity generation.

**See Figure 9 "CEZ Group Electricity Generation" in the Annex**

CEZ Group generated 61.1 TWh of electricity in 2016, 0.2 TWh up year-on-year. Generation in Czechia, amounting to 56.9 TWh, was 0.3 TWh, i.e., 0.6% higher than in 2015. The biggest decrease in generation, by 2.7 TWh, was reported by nuclear power plants due to extended scheduled and unscheduled outages. By contrast, electricity generation from coal increased by 1.6 TWh, and there was also an increase of more than 35% in generation from biomass. The Počerady 4 CCGT plant proved to be of importance in 2016. Thanks to its flexibility, it managed to partially cover for electricity generation outages at nuclear power plants. The facility's generation was ten times as high as originally planned, increasing by 1.3 TWh year-on-year.

Abroad, CEZ Group registered a decrease of 6.3% in generation in Romania, which was primarily due to generation restrictions imposed by the transmission system operator in order to regulate the transmission grid. The amount generated in Bulgaria and Poland remained virtually unchanged year-on-year.

We expect that CEZ Group will generate 66 TWh in 2017; this includes 28 TWh of expected generation at nuclear power plants, i.e., 4 TWh more year-on-year, and 33 TWh at coal-fired and CCGT facilities, i.e., at a level similar to that of 2016.

In the next section, I would like to inform you about selected capital projects in Czechia in 2016.

**See Figure 10 "CEZ Group CAPEX" in the Annex**

A total of CZK 6.8 billion was invested in nuclear power plants in 2016. Both nuclear power plants continued implementing projects to fulfill requirements from the National Action Plan for Nuclear Safety Enhancement. At the Temelín Nuclear Power Plant, a renovation of the venting system of steam generators took place and technical issues with steam paths at both turbine generators were dealt with. At the Dukovany Nuclear Power Plant, capital expenditure projects related to the planned extension of operation beyond 2016 took place, particularly the renovation of management control systems for non-nuclear equipment and enhancement of seismic resistance of load-bearing structures of Units 3 and 4.

The General Meeting held in June 2016 decided to spin off the parts of enterprises related to projects for new nuclear power plants, that is, their assets and liabilities, as new subsidiary project companies. The actual spin-off took place on October 1, 2016. Updated business plans for new nuclear power plants were approved for both sites, Dukovany and Temelín, in December 2016, defining, in particular, specific activities for 2017 aimed at preserving the value of both projects while minimizing expenditure incurred in this period.

A total of CZK 7.9 billion was invested in conventional generating facilities in Czechia. The comprehensive renovation of the Prunéřov II Power Plant was completed; the installed capacity of the renovated units was increased by 3 x 40 MW and the units are currently under trial operation. Other investments were made in a new 660MW unit at the Ledvice Power Plant. The power plant is operating in a plant verification regime.

A total of CZK 10.3 billion was invested in distribution grids, of which CZK 8.7 billion was invested in Czechia where the investments went primarily into distribution grid renovation and development.

Let us now turn our attention to selected events in regulation, which affects CEZ Group in all countries where it operates.

**See Figure 11 "Energy Sector Regulation Significantly Affects CEZ Group in All Countries Where It Operates" in the Annex**

The whole energy environment remains highly regulated, although some regulatory measures and medium-term ambitions can be hardly regarded as benefiting the energy sector or the national economy as a whole. Renewable generation support, market regulation measures, and energy efficiency ambitions with the deadlines announced by the European Commission can only be achieved at huge expenses, which are very difficult to quantify and, consequently, discuss with the citizens and governments of individual European countries today.

At European Union level, there was continued discussion about a reform of the EU ETS, that is, the greenhouse gas emission allowance trading system. However, there was no significant progress. Then in November the European Commission published its proposal for an extensive "winter" legislative package named "Clean Energy for All Europeans." The package includes several legislative proposals covering a new electricity market design, renewable energy, security of electricity supply, energy efficiency, and governance rules for an energy union. Renewables covered more than 25% of European energy consumption in 2016 and their share will keep increasing. It should be 47% by 2030. This will mean less space for conventional energy. Unstable, weather-dependent supply will require large flexible capacity at power plants or higher flexibility on the side of consumption, and will contribute to further advancement in electricity storage technologies.

Let us look in more detail at selected events in regulation in selected countries where CEZ Group operates.

For Czechia, 2016 can be described as the first full year in which national strategy documents approved for the energy sector in 2015 were being fulfilled. The Czech government evaluated the fulfillment of the State Energy Policy at the end of 2016, concluding that 14 tasks had been fully accomplished, 7 tasks were accomplished partially, and 13 tasks were in progress. Practically all tasks with deadlines in 2014 and about a half of tasks with deadlines by the end of 2015 or at the end of 2016 have been accomplished. As far as National Action Plan for Nuclear Energy is concerned, work on its fulfillment was delayed at the very beginning, until a government representative for nuclear energy was appointed, so no major milestone in its fulfillment has been achieved yet.

An important process for CEZ Group was the licensing procedure conducted by the State Office for Nuclear Safety of the Czech Republic, concerning extension to the operation of the Dukovany Nuclear Power Plant. On March 30, 2016, ČEZ received a renewed operating license for Unit 1 for an indefinite period of time, conditional on meeting a number of requirements. Utmost attention is paid to acting on the conditions. As for Unit 2, the State Office for Nuclear Safety decided to extend the existing license until July 10, 2017 on the basis of ČEZ's application. In January 2017, we filed an application for a renewed operating license for Unit 2 of the Dukovany Nuclear Power Plant after that date, that is, after July 10, 2017.

Radiographs and welded joints were inspected at both nuclear power plants by means of radiological and ultrasound testing in 2016, based on a decision to carry out special inspections of all plant welded joints. The total number of welds inspected in 2016 was 15,000 at the Dukovany Nuclear Power Plant and 10,500 at the Temelín Nuclear Power Plant.

In line with conclusions made by internal committee of inquiry, ČEZ adopted a number of personnel, systemic, and organizational measures in order to maximize prevention in the future. These included, in particular, removing several employees from their offices or reducing their salaries, increasing ČEZ's staff capacity, and utilizing subsidiaries instead of contracted services as much as possible. A "third generation" of contracts with contractors was also introduced to guarantee, for example, restrictions on contractor chains.

In Romania, a state of uncertainty was ended after many years in 2016 concerning the allocation of green certificates for the Fântânele Vest and Cogealac wind parks. After the European Commission's successful completion of the formal notification process in June 2016, the Romanian regulator issued the final accreditation for both parks on September 27, 2016. The wind farms are entitled to be part of the renewable generation support program in accordance with applicable legislation and obtain green certificates for the electricity they generate. For 2016, this means support amounting to two green certificates—one allocated and one deferred.

Poland passed legislative amendments introducing a number of significant changes in the system of support for renewable electricity generation, with an overall negative impact on the rate of return on developed wind farm projects in the country. Under a new auction mechanism, the largest support will be provided for technologies described as "stable" and "predictable." On the contrary, the lowest support will be provided to the producers of wind power. A wind turbine will be newly deemed a structure within the meaning of the building act, which may result in a significant increase in property tax paid by wind farm operators. The act also introduced rules concerning the minimum distance between a wind turbine and residential houses or sites of high natural value. Additionally, a ban was imposed on increasing the productivity of existing wind farms; only maintenance and necessary repair are permitted. Consequently, the current legislative conditions pose a threat to the implementation of wind farm projects throughout Poland, including CEZ Group's projects developed by Eco-Wind Construction.

The process of market liberalization continued in Bulgaria; however, its successful completion is put at significant risk by lack of secondary legislation, the existence of cross subsidization, and the government's pressure on keeping residential energy prices low. On July 12, 2016, ČEZ, a. s. formally filed a Request for Arbitration against Bulgaria with the International Centre for Settlement of Investment Disputes, officially commencing international investment arbitration under the Energy Charter Treaty on the grounds of nonprotection of investment. It decided to do so after a number of interventions by Bulgarian authorities, which, in its opinion, injured CEZ Group companies' business in Bulgaria, and as a result of a long-term, unimproving critical situation in the country's energy market.

Now, dear shareholders, I would like to briefly discuss the financial performance and selected indicators of ČEZ, a. s. alone.

**See Figure 12 "ČEZ, a. s. Financial Results" in the Annex**

ČEZ, a. s. registered a year-on-year decrease in EBITDA of CZK 7.1 billion, to CZK 16.8 billion, in 2016. Net income decreased by CZK 19.3 billion year-on-year to CZK 8.8 billion. The main causes of the year-on-year decrease in net income included lower dividends received from CEZ Group companies, a decrease in the realization prices of generated electricity, and the refund of a portion of gift tax on emission allowances for 2011 and 2012 in 2015.

The assets of ČEZ, a. s. as at December 31, 2016 amounted to CZK 536.9 billion. Its return on assets was 1.7% and its return on equity was 4.2%.

Before making a proposal for the 2016 dividend, I would like to present to you CEZ Group's four goals and social tasks that determine the Company's dividend policy as well as its future direction.

**See Figure 13 "Four Partially Contradictory Goals and Social Tasks for CEZ Group" in the Annex**

The situation and fundamental changes in the energy market required a response from CEZ Group. Thus, in order to ensure long-term business continuity, our strategy presumes investments and company development in line with global trends and the course of regulation in Europe to pay reasonable dividends in the medium term. However, the primary goal—to respond actively to fundamental changes in the energy sector, investing in the development of renewables and decentralized energy—is in inherent contradiction to the second goal, or the expectation of some of you, our shareholders, namely to maximize current dividend payout. Therefore, the fundamental question for you, our shareholders, is whether to invest in company development and have faith in high dividends in the future or whether to maximize today's dividends at the expense of company development and future dividends. Another important factor to which CEZ Group reacts is the State Energy Policy, that is, the Czech state's policy for securing electricity in the future and especially the issue of building new nuclear power plants. The fourth goal, the importance of which is growing in Europe, is corporate social responsibility, the issue of employment and maintaining the energy know-how, or support for science and research.

These four partially contradictory goals and social tasks require a consensus, primarily among you, shareholders, over the Company's priorities, direction, and dividend policy in the next few years. In this context, we decided to update our dividend policy and we believe that the 2016 dividend proposed to this General Meeting by the Board of Directors is a well-balanced compromise.

**See Figure 14 "Proposed ČEZ, a. s. Dividend for 2016" in the Annex**

From 2015, ČEZ, a. s. applied a dividend policy that anticipated paying out 60–80% of consolidated net income adjusted for extraordinary effects generally unrelated to ordinary financial performance in a given year. In 2017, we updated ČEZ's dividend policy by temporarily widening the payout ratio to 60–100% of consolidated adjusted net income, and we expect to narrow the percentage range within two years following the specification of our development strategy.

In accordance with the Company's updated dividend policy, we are presenting you with a proposal for a dividend amounting to CZK 33 per share this year. The proposed amount to be paid corresponds to 90% of CEZ Group's consolidated net income adjusted for extraordinary effects. Naturally, the actual amount of dividend for 2016 will be determined by you, dear shareholders.

Finally, let us take a look at what we are expecting in 2017 from CEZ Group's point of view.

**See Figure 15 “As at May 11, 2017, CEZ Group Estimated 2017 EBITDA at CZK 52 Billion and Adjusted Net Income at CZK 17 Billion” in the Annex**

As at March 21, 2017, CEZ Group estimated 2017 EBITDA at CZK 52 billion, which is CZK 6 billion, or 10%, less than the actual 2016 figure. The expected financial performance reflects, in particular, decreasing realization prices of electricity from production sales made in previous years, the course of energy sector regulation in Europe, and an expected increase in electricity generation in both traditional and new energy segments.

Negative effects behind an expected decrease of CZK 3.7 billion in the Generation—Traditional Energy segment’s EBITDA include lower revenues from commodity trading, active balancing dispatching, and ancillary services for ČEPS, as well as higher expenses on emission allowances, a decrease in electricity realization prices, including the effect of hedging, and higher fixed expenses on maintaining nuclear power plant safety and their long-term operation. By contrast, there is a positive effect of an expected increase in nuclear power plants’ generation, in particular. The Mining segment is expected to decrease by CZK 0.4 billion year-on-year.

The Generation–New Energy segment is expected to grow by CZK 0.8 billion year-on-year, primarily due to renewables acquisitions made in 2016 and additions to impairments of Eco-Wind projects in 2016. By contrast, there is a negative effect of the nonrecurrent allocation of certificates for 2013 to 2015 to wind parks in Romania in 2016. In the Distribution segment, we expect a decrease of CZK 1.5 billion year-on-year, primarily due to the settlement of unbilled electricity in Czechia in 2016 and due to correction factors; by contrast, a positive effect is expected from an increase in permitted revenue. In the Sales segment, we expect a decrease of CZK 0.8 billion year-on-year, primarily due to the settlement of unbilled electricity in Czechia in 2016 and due to taking advantage of specific market opportunities in electricity and gas sales in 2016; by contrast, there is a positive effect of expected payment of the Czech Railway Infrastructure Administration’s debt from 2011 to ČEZ Prodej. The Other segment is expected to decrease by CZK 0.5 billion year-on-year.

As at May 11, CEZ Group estimated its EBITDA at CZK 52 billion. As at March 21, CEZ Group published its estimate for Adjusted Net Income of CZK 12 to 17 billion, where potential net income of CZK 4.8 billion (corresponding to the prediction interval) would be realized in 2017 in the hypothetical case that holders of convertible bonds exercised their right to take MOL shares instead of cash.

As at May 11, CEZ Group estimated its adjusted net income at CZK 17 billion.

The increase in the prediction for CEZ Group’s adjusted net income in 2017 in the update made on May 11 was primarily due to the successful sale of MOL shares, as well as a refined outlook for depreciation and amortization and interest expenses.

Risks to the prediction of 2017 income, as seen by CEZ Group, include especially lower availability of generating facilities in Czechia and developments in regulatory and legislative conditions for the energy sector in Europe. At the same time, there is an opportunity in the prediction, consisting in potential income from the possible sale of the coal-fired Počerady Power Plant in 2017.

Capital expenditure expected by CEZ Group in 2017 is approximately CZK 31 billion, with a majority planned to be invested in generation and distribution assets in Czechia. No major change is expected in the overall structure of assets from which the 2017 income will be generated.

The 2017 net income of ČEZ, a. s. adjusted for extraordinary effects was estimated at approximately CZK 2 billion as at March 21 (and at approximately CZK 6 billion as at May 11), with positive expectations fueled especially by estimated dividends from subsidiaries of ČEZ, a. s.

We expect that the energy market in 2017 will continue to be affected by low commodity prices and persisting regulatory uncertainty. In such an environment, we will necessarily have to decide which of the goals that are naturally contradictory in some aspects CEZ Group should give priority to and what the best path to meeting your expectations will be. It remains our task to take care of the traditional energy segment, that is, our nuclear, coal-fired, and hydroelectric power plants. Stability of this segment will allow us to accelerate the development of our business in the new energy segment. This includes in particular renewables, comprehensive customer care, and above all promising, smart energy solutions, which I believe to be the future of the energy sector as a whole, as well as the future of CEZ Group.

Thank you for your attention and for your interest in what’s happening at ČEZ.

**Annex 1 Report on the Business Operations and Assets of ČEZ, a. s. for 2016**

# Annex 1:

# REPORT ON THE BUSINESS OPERATIONS AND ASSETS OF ČEZ, A. S. FOR 2016

Prague, June 21, 2017

# CEZ GROUP'S 2016 NET INCOME SURPASSES THE INITIAL ESTIMATE BY CZK 1.6 BILLION

## Selected CEZ Group Financial Results in 2016

- **EBITDA CZK 58.1 billion**
- **Net income CZK 14.6 billion**
- **Adjusted net income CZK 19.6 billion**

### Main Trends in Europe's Energy Sector Remain the Same

**1) Traditional energy is stagnating but remains an indispensable part of the energy sector**

- There is a surplus of capacities in the market; conventional facilities are being displaced by renewables
- Pressure on margins from regulators as well as from new players

**2) Renewable energy sources (RES) and decentralized energy are growing**

- RES and decentralized solutions represent the energy sector's future and, consequently, the biggest investment opportunity
- Main RES technologies already have cost effectiveness that will allow reducing subsidization
- Technology companies' market is evolving and consolidating (e.g., Tesla or GE), which results in decreasing costs of decentralized electricity generation and storage

**3) Customers focus on comprehensive services associated with energy utilization**

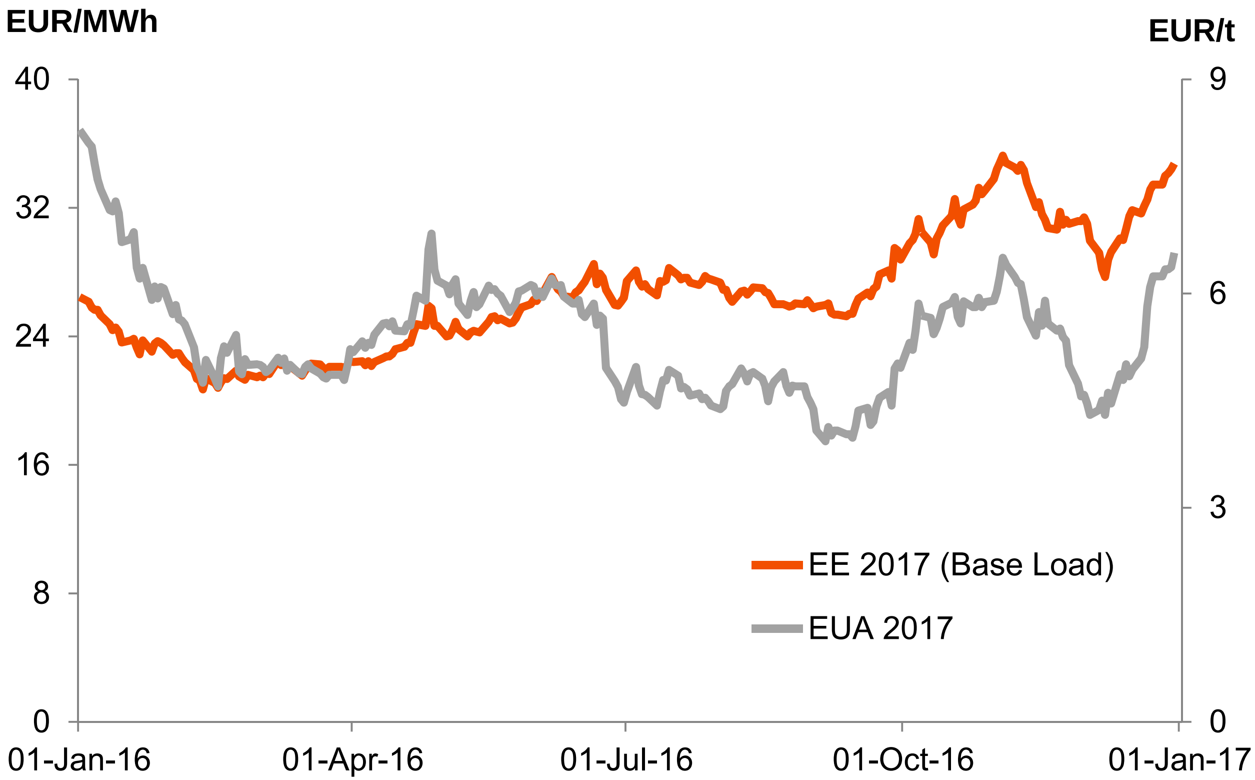
- End-use customers show growing interest in active control of consumption and self-generation
- Corporate customers are outsourcing energy and facility management as a whole



Note: Adjusted net income = Net income adjusted for extraordinary effects that are generally unrelated to ordinary financial performance in a given year

# CHANGES IN ELECTRICITY PRICES IN 2016 REFLECTED PRIMARILY CHANGES IN HARD COAL PRICES AND IN EXPECTATIONS ABOUT THE FUTURE OF THE EU EMISSION ALLOWANCE SYSTEM

**Changes in Wholesale Prices of Electricity (EUR/MWh) and Emission Allowances (EUR/t)**




- Electricity prices increased by 31% to 35 EUR/MWh in 2016; prices of emission allowances decreased to 6.6 EUR/t in 2016.
- On March 20, 2017, electricity prices in Germany for electricity to be delivered in 2018 were traded at **29 EUR/MWh** and the prices of emission allowances at **5 EUR/t**.

# ČEZ'S STRATEGY IS BASED ON THREE PRIORITIES
## SELECTED EVENTS IN 2016

### I — **Be among the best in the operation of conventional power facilities** and proactively respond to the challenges of the 21st century

- We received an operating license for Unit 1 of the Dukovany Nuclear Power Plant for an indefinite period of time.
- We completed the renovation of the brown coal-fired Prunéřov power plant.
- Our medium-term Czech portfolio operation strategy was updated in relation to changes in electricity prices and regulatory conditions concerning emission reduction.
- We keep developing projects for new nuclear units at Temelín and Dukovany; we started the EIA procedure for a new unit at Dukovany.

### II — Offer **customers a wide range of products and services** addressing their energy needs

- ČEZ Prodej became the second largest gas supplier in Czechia.
- We expanded our offer of services focusing on residential customers to include, in particular, services relating to energy comfort at home.
- We acquired 100% shares in AZ Klima and juwi (now ČEZ Solární), purchased an additional 25% share in EVČ, and founded ČEZ LDS.
- We joined startup accelerator Rockstart in order to be in touch with the latest innovative approaches for customers.
- We purchased the first alternative electricity and gas seller, Energie2 Prodej.

### III — **Strengthen and consolidate our position in** Europe

- We entered the German market in renewable generation. We acquired 39 operated onshore wind turbines with a total installed capacity of 98 MW.
- We invested in tado and ETF and increased our exposure in sonnen
- We commenced an arbitration for investment non-protection in Bulgaria.
- Standard & Poor's reaffirmed ČEZ's credit rating of A− with a stable outlook in December 2016.
- **We provided our shareholders with dividends for 2015 amounting to CZK 21.5 billion.**

# THE OPERATIONS TEAM AND DEVELOPMENT TEAM HAVE BEEN OPERATIONAL SINCE JANUARY 1, 2016— SELECTED EVENTS IN 2016

## OPERATIONS Team

### Mining

- Process of obtaining EIA and Mining License for the Bílina Mine until 2035 initiated
- A high-capacity coal storage site at the Nástup Mines upgraded

### Generation—Traditional Energy

- Operating license for an indefinite period of time obtained for Dukovany NPP Unit 1 and activities relating to conditions for further operation imposed by SÚJB carried out
- Introduced systemic measures improved performance and quality control for repair and maintenance at nuclear facilities
- Comprehensive renovation of coal-fired Prunéřov Power plant completed (3 x 250 MWe of installed capacity)

### Finance and Administration

- Increased efficiency across CEZ Group
- An agreement was signed between EBRD and CEZ Razpredelenie Bulgaria, allowing the company to take out a loan of up to CZK 3.1 billion without any guarantee by ČEZ, reducing financial exposure abroad

## DEVELOPMENT Team

### New Energy

- Successful entry into the German RES market
- Final accreditation for electricity generation support through green certificates obtained for wind farms in Romania
- Another two investments by INVEN CAPITAL

### Sales & Trading

- Offer of services focusing on residential customers expanded (e.g., PV, heat pumps / gas boilers, inspections)
- ESCO group's 2016 revenue exceeded CZK 3 billion, i.e., 57% more year-on-year
- ČEZ ESCO expanded its competences and amended its portfolio through AZ Klima, ČEZ Solární, and ČEZ LDS
- Proprietary trading results surpassed its ambitious goals in 2016 and trading activities were further expanded to new markets (in particular, Spain, Italy, and Belgium)

### Distribution

- As at July 1, 836 employees were transferred from ČEZ Distribuční služby to ČEZ Distribuce
- Independent customer service started by the distributor in Czechia
- On July 12, an international investment arbitration against the Republic of Bulgaria was officially commenced on the grounds of investment non-protection


SÚJB—Státní úřad pro jadernou bezpečnost (Czech State Office for Nuclear Safety); RES—Renewable energy sources; PV—Photovoltaics

# CEZ GROUP FINANCIAL RESULTS

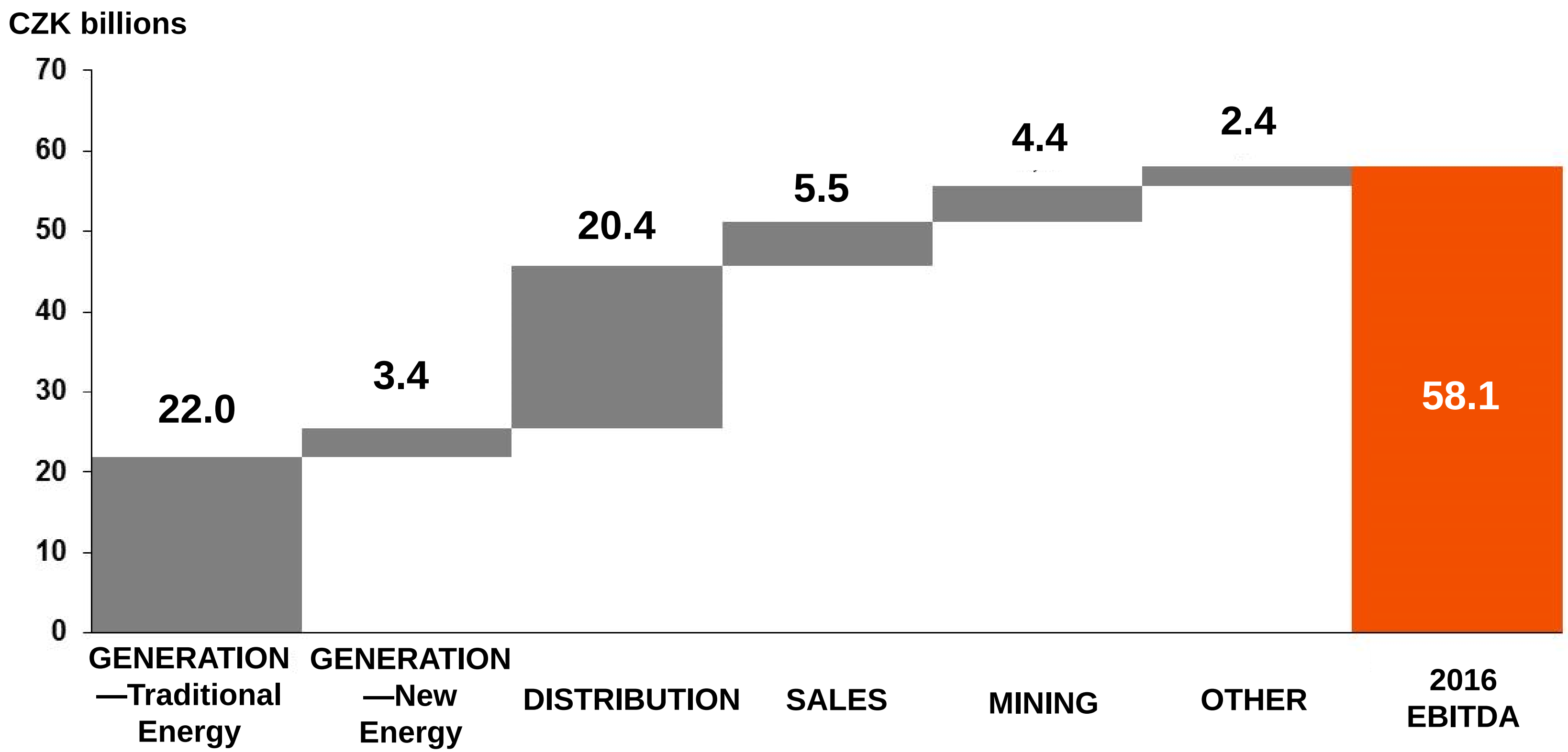
| | Unit | Year 2015 | Year 2016 | Change (%) |
|---|---|---|---|---|
| Operating revenues | CZK millions | 210,167 | 203,744 | -3.1% |
| EBITDA | CZK millions | 65,104 | 58,082 | -10.8% |
| EBIT | CZK millions | 28,961 | 26,114 | -9.8% |
| Net income | CZK millions | 20,547 | 14,575 | -29.1% |
| Net income—adjusted* | CZK millions | 27,666 | 19,640 | -29.0% |
| Total assets | CZK millions | 602,686 | 630,841 | +4.7% |
| Property, plant, and equipment and intangibles (including nuclear fuel) | CZK millions | 441,528 | 448,878 | +1.7% |

| | | | | |
|---|---|---|---|---|
| ROE | % | 7.8 | 5.4 | -30.5% |
| ROA | % | 3.4 | 2.3 | -31.3% |
| ROIC | % | 5.0 | 4.5 | -10.0% |



* Adjusted net income = Net income adjusted for extraordinary effects that are generally unrelated to ordinary financial performance in a given year

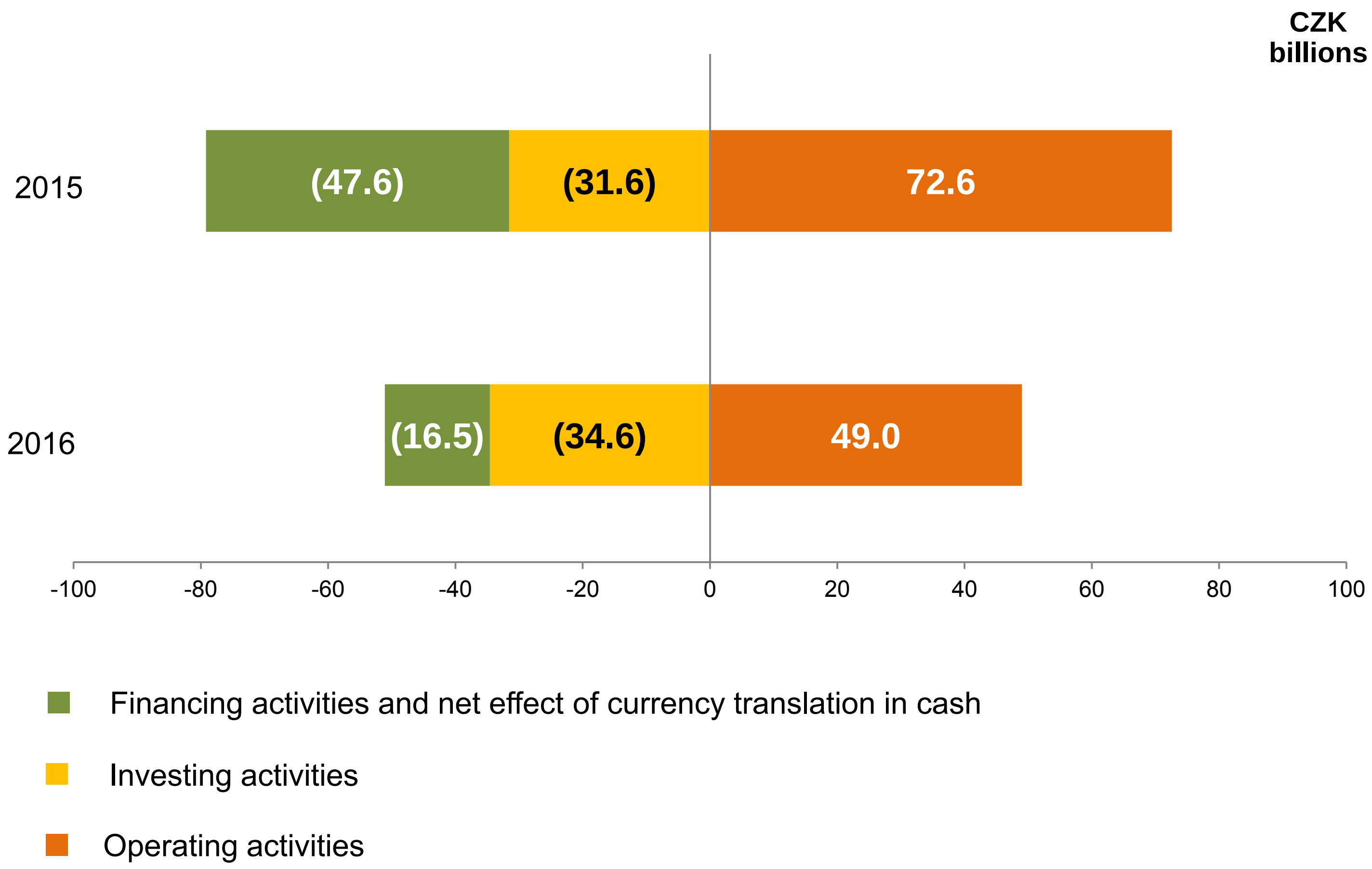
# CONTRIBUTION TO 2016 EBITDA BY SEGMENT



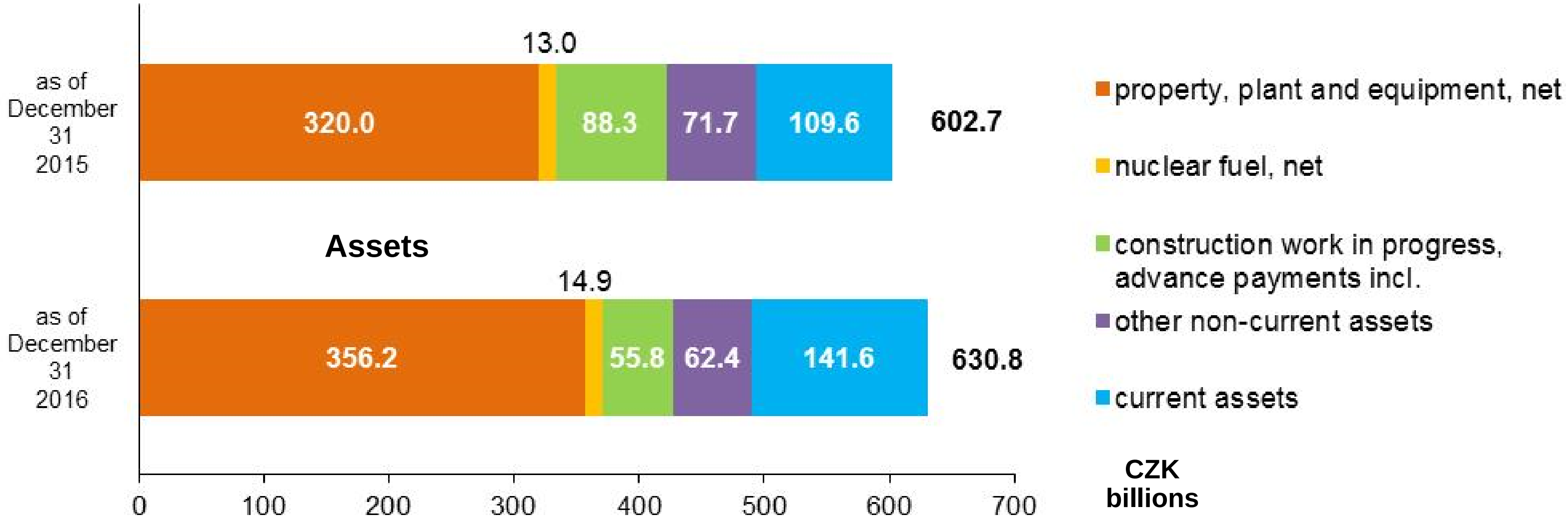

## 2016 vs. 2015 Change in EBITDA

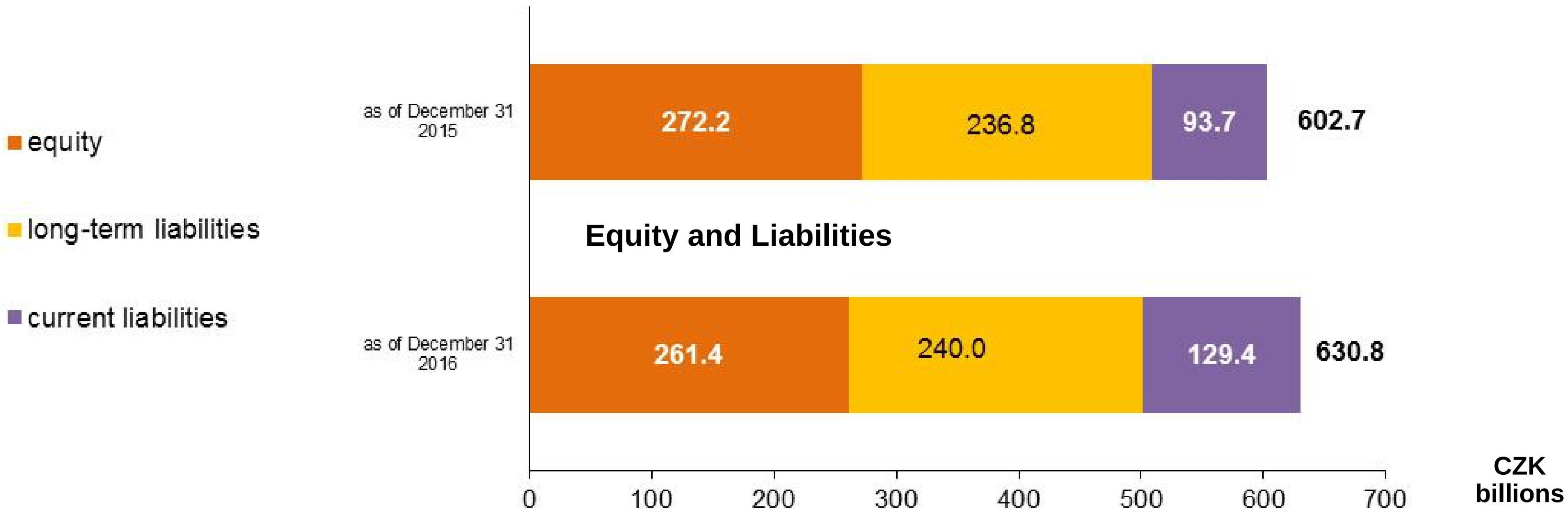
| | | | | | | | |
|---|---|---|---|---|---|---|---|
| % | -24% | 43% | 2% | -20% | 2% | -2% | -11% |
| CZK billions | -7.0 | 1.0 | 0.3 | -1.4 | 0.1 | -0.1 | -7.0 |

# CEZ GROUP CASH FLOWS

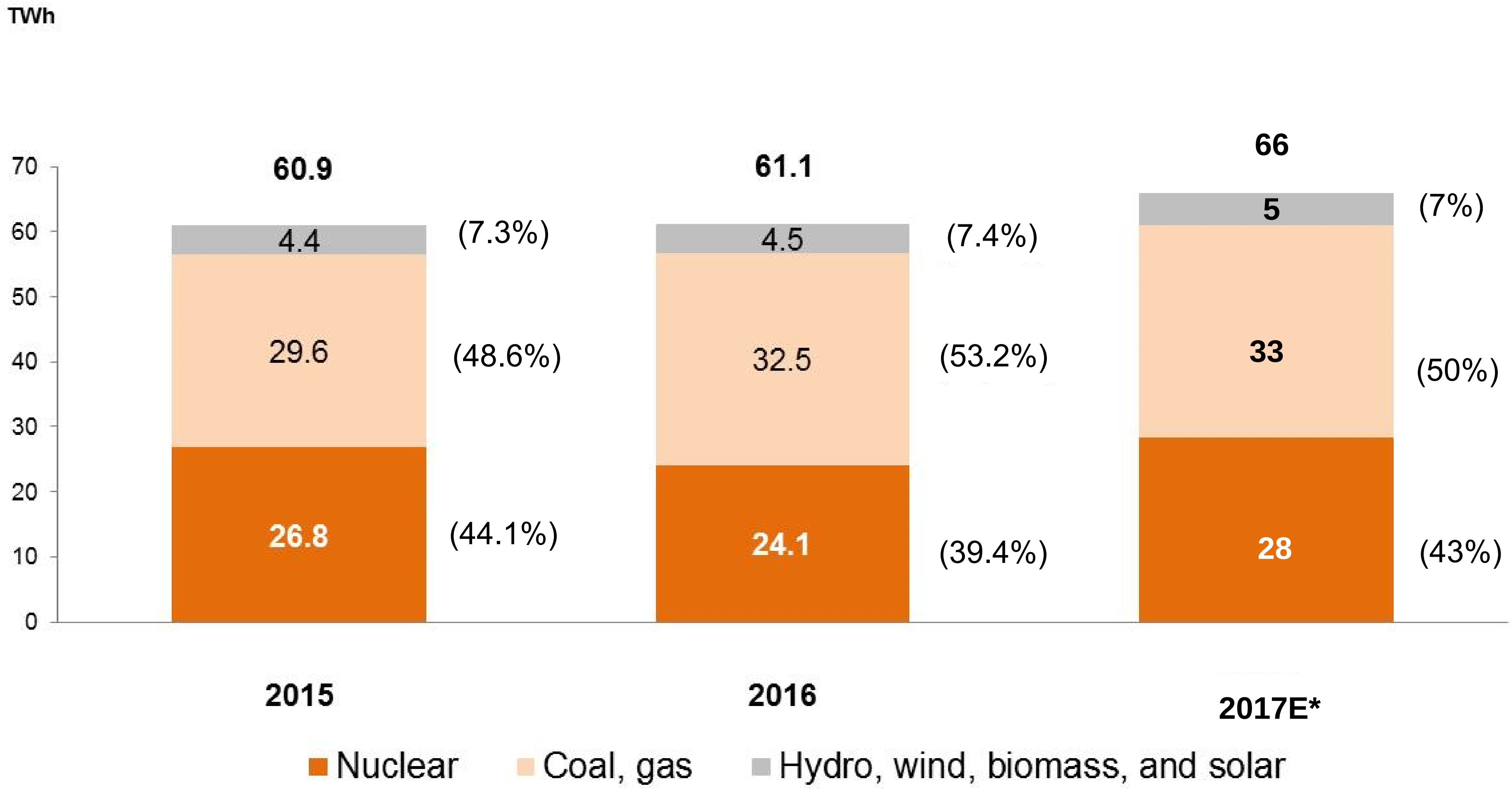


# CEZ GROUP ASSETS, EQUITY, AND LIABILITIES



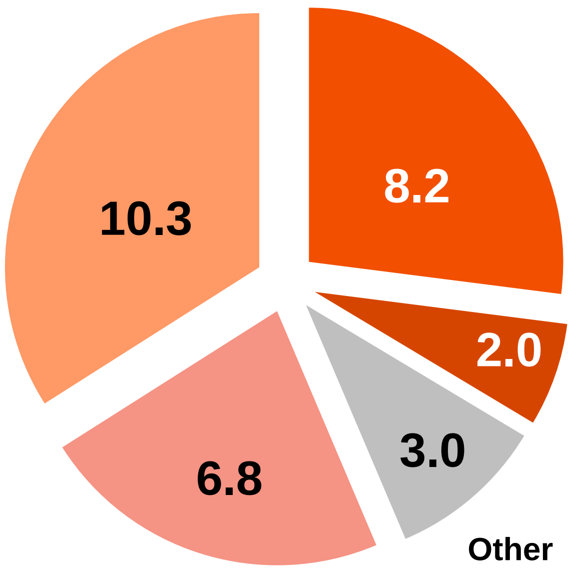
# CEZ GROUP ELECTRICITY GENERATION




 * Based on facts known as at March 20, 2017 

# CEZ GROUP CAPEX

**CZK 30.2 billion in total (2016)**




**Electricity distribution:**

- Czechia: CZK 8.7 billion
- Abroad: CZK 1.6 billion

**Conventional and other generating facilities:**

- Comprehensive renovation of Prunéřov Power Plant
- Construction of a new supercritical facility in Ledvice
- Investments are made primarily in the renovation of technology and maximization of operational safety and generation efficiency and environmental friendliness

**Mining:**

- Projects reacting to the progress of extraction in the two mines (deliveries, renovation, and upgrades of mining equipment and dressing and crushing plants, construction of stabilization measures and water management structures)

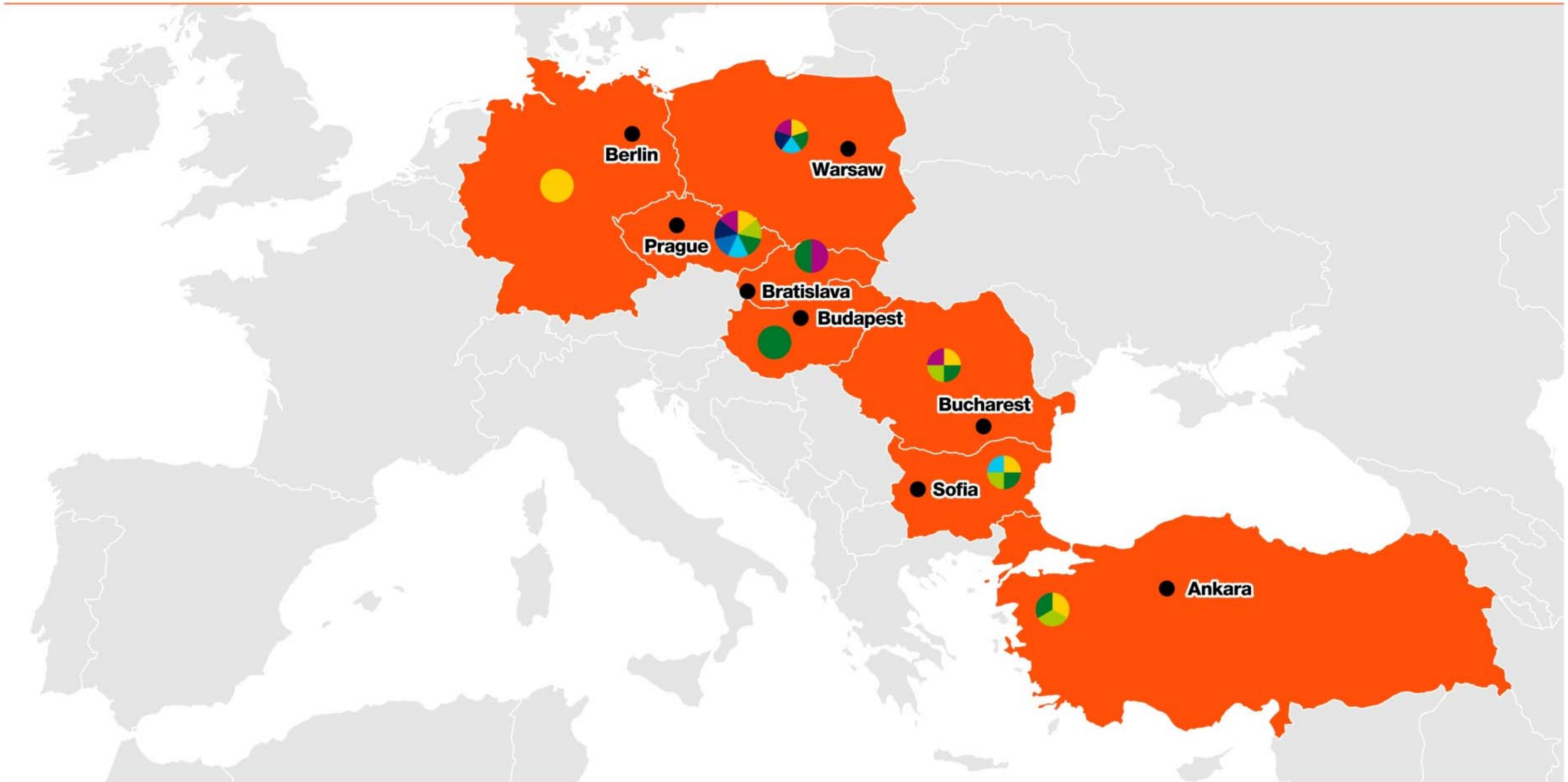
**Nuclear facilities (including nuclear fuel procurement):**

- Existing Temelín & Dukovany NPPs—Continued implementation of projects fulfilling requirements from the National Action Plan for Nuclear Safety Enhancement, drawn up after the events at the nuclear power plant at Fukushima, Japan
- New nuclear power plants at Temelín and Dukovany sites—Preparation of projects at both the Temelín and Dukovany sites continues in accordance with the approved National Action Plan for Nuclear Energy. Temelín and Dukovany NNPP projects were spun off into subsidiaries, ETE II and EDU II, at October 1, 2016.



Due to precise mathematical rounding, the sum of partial values can sometimes differ from the total value.

# ENERGY SECTOR REGULATION SIGNIFICANTLY AFFECTS CEZ GROUP IN ALL COUNTRIES WHERE IT OPERATES




Electricity
- Generation
- Distribution
- Sales to end-use customers

Natural gas
- Sales to end-use customers

Heat
- Generation
- Distribution
- Sales to end-use customers

# ČEZ, a. s. FINANCIAL RESULTS

| | Unit | Year 2015 | Year 2016 | Change (%) |
|---|---|---|---|---|
| Operating revenues | CZK millions | 83,320 | 81,793 | -1.8% |
| EBITDA | CZK millions | 23,918 | 16,793 | -29.8% |
| EBIT | CZK millions | 8,410 | 1,455 | -82.7% |
| Net income | CZK millions | 28,115 | 8,834 | -68.6% |
| | | | | |
| Total assets | CZK millions | 518,380 | 536,934 | 3.6% |
| Long-lived tangible and intangible assets* | CZK millions | 241,316 | 241,811 | 0.2% |
| | | | | |
| ROE | % | 13.2 | 4.2 | -68.2% |
| ROA | % | 5.3 | 1.7 | -68.6% |



* Including nuclear fuel

# FOUR PARTIALLY CONTRADICTORY GOALS AND SOCIAL TASKS FOR CEZ GROUP

### Maximize dividends

- Maximum dividend payout now vs. company development to ensure dividends in the future
- Maintain financial stability, i.e., ability to pay back future debts and liabilities

### Actively respond to changes in the energy sector

- Ensure company growth and development in line with global trends and the course of European regulation (i.e., renewables development and investments, decentralized energy, and comprehensive energy services for end-use customers)

***These four goals of ČEZ reflect business and social tasks and shareholders' expectations. The question is how to determine priorities and find a suitable manner to fulfill the partially contradictory tasks.***

### Respond to SEP (Czechia's State Energy Policy)

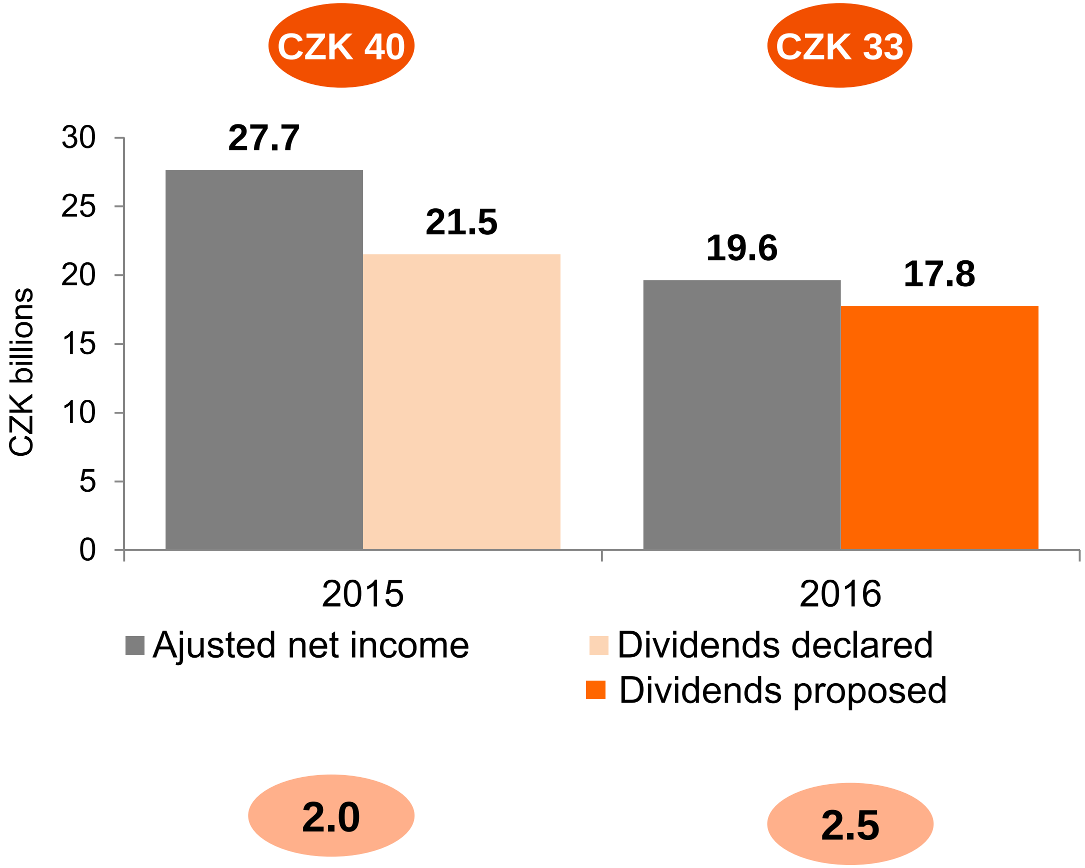
- Obtain operating licenses for all existing units of the Dukovany and Temelín nuclear power plants
- Prepare the construction of new nuclear units in Czechia
- Make optimal use of local coal reserves in Czechia

### Be a socially responsible company

- Maintain the level of employment in the energy sector and related industries
- Support innovation and science and research


State Energy Policy (SEP)—national strategy document providing specifications for the development of the Czech energy sector until 2040

# PROPOSED ČEZ, A. S. DIVIDEND FOR 2016




**Dividend (CZK/share)**

- The dividend for 2016 is proposed as **CZK 33/share**.
- The proposal reflects the Company's updated dividend policy and corresponds to 90% of CEZ Group's consolidated net income in 2016 adjusted for extraordinary effects.

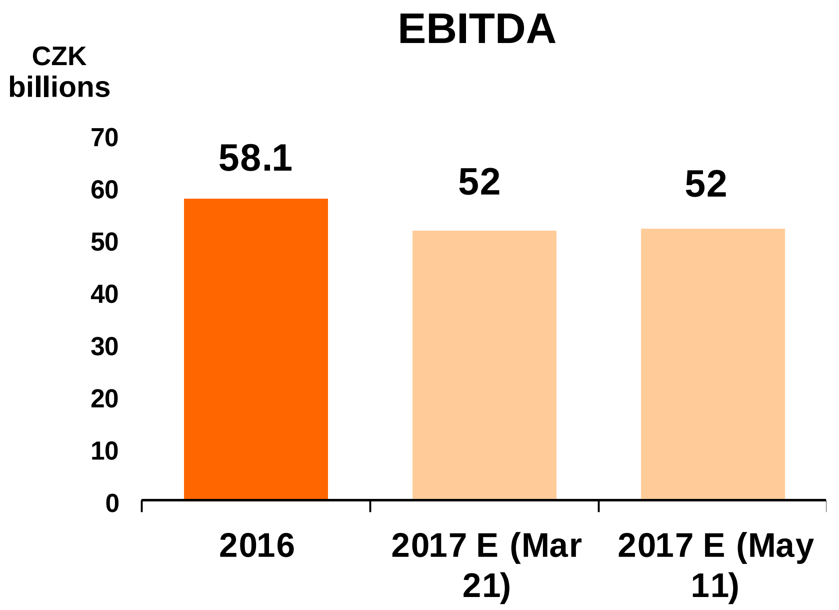
**Net debt / EBITDA**

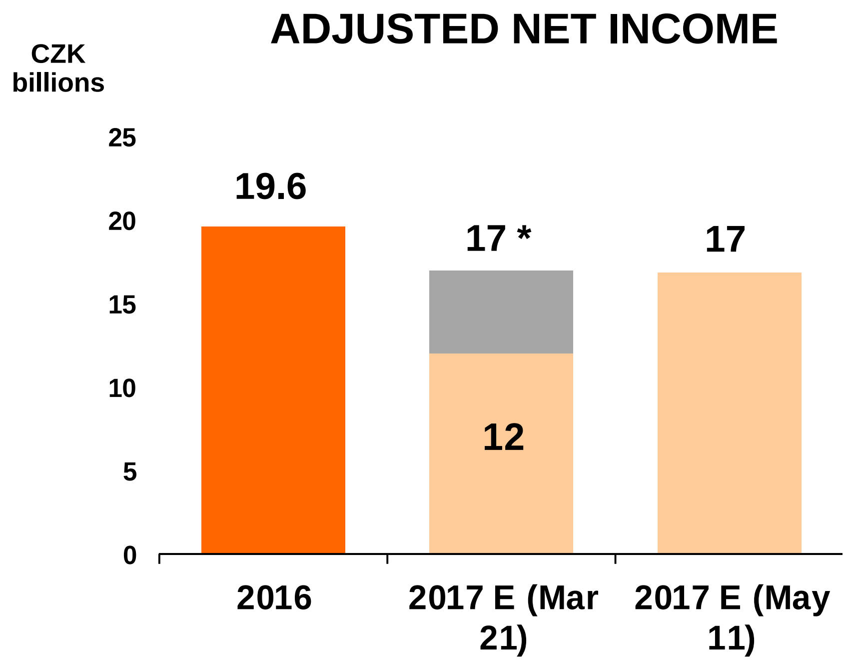
Note: The dividend out of a given year's profits affects the Net Debt / EBITDA indicator in the next year.



The above values of declared/proposed dividends correspond to 100% of shares issued (i.e., including treasury shares).

# AS AT MAY 11, 2017, CEZ GROUP ESTIMATED 2017 EBITDA AT CZK 52 BILLION AND ADJUSTED NET INCOME AT CZK 17 BILLION




**Causes of improvement in performance predictions from March 21 for 2017 (updated as at May 11):**

- Successful sale of MOL shares
- Lower depreciation and amortization and higher capitalization of interest expenses especially in connection with shifting the deadline of final acceptance of Ledvice Power Plant into use
- Other effects

* As at March 21, CEZ Group published its estimate for Adjusted Net Income of CZK 12 to 17 billion, where potential net income of CZK 4.8 billion (corresponding to the prediction interval) would be realized in 2017 in the hypothetical case that holders of convertible bonds exercised their right to take MOL shares instead of cash.



Note: Adjusted net income = Net income adjusted for extraordinary effects that are generally unrelated to ordinary financial performance in a given year.