MOODY'S
RATINGS

Rating Action: Moody's affirms CEZ's Baa1 rating; outlook changed to negative

26 Mar 2024

Paris, March 26, 2024 -- Moody's Ratings (Moody's) has today affirmed the Baa1/(P)Baa1 senior unsecured debt/senior unsecured MTN program ratings of CEZ, a.s. (CEZ) and the baa2 Baseline Credit Assessment (BCA). At the same time, Moody's has changed the outlook to negative from stable.

Today's rating action follows the company's announcement on 21 March whereby it said it would acquire a 55.21% stake in GasNet for EUR846.5 million.

RATINGS RATIONALE

Through the acquisition, CEZ will increase its share of lower risk regulated cash flows, which allows for CEZ to mitigate its high exposure to wholesale electricity markets. Nevertheless, the acquisition comes with a substantial debt burden as GasNet is heavily indebted. Whereas the addition of incremental regulated cash flows is credit enhancing – as also illustrated by Moody's loosening of rating thresholds for the current Baa1 – Moody's does not consider the acquisition to be transformative to CEZ's business profile. In Moody's view, CEZ will continue to remain heavily exposed to many of the same credit drivers that currently constrain its stand-alone rating. The rating agency also takes note of the falling power prices observed over the recent months. Whilst CEZ's hedging strategy provides some visibility to cash flows in 2024 (95% of production hedged), 2025 (65% of production hedged) and 2026 (29% of production hedged), the future evolution of credit metrics remain vulnerable to material movements in the wholesale power prices.

In Moody's view, the acquisition of a majority stake in GasNet makes strategic sense as it allows for CEZ to further consolidate its foothold in the domestic Czech energy market, albeit in a new a business line for CEZ (gas distribution). Furthermore, Moody's believes there could be benefits in the future of controlling both electricity and gas networks when capex is to be deployed for the development of hydrogen. GasNet displays a low-risk business profile underpinned by (1) a predominant position in gas distribution in the Czech Republic with a high market share (2) transparent, predictable and supportive regulation benefiting from a long track record; (3) asset remuneration that is supported by a high WACC in comparison with other European regulated networks, and (4) modest investment requirements in comparison to CEZ's own electricity distribution networks.

The consolidation of GasNet will give rise to increased structural subordination in CEZ's capital structure in view of the fairly substantial amount of debt that will remain at the level of GasNet. However, the structural subordination does not lead to any notching of CEZ's own debt instruments as (1) CEZ only has an immaterial amount of other priority debt sitting at other subsidiaries (2) Moody's expectations that the level of priority debt will – as a proportion of total debt – diminish over the next three years in tandem with increased debt issuance at CEZ to finance upcoming capital expenditures. Moody's notes, however, that there is limited room for further issuance of priority debt – as a portion of total debt - in CEZ's capital structure at the current rating level.

AFFIRMATION OF RATINGS

More generally, CEZ's Baa1 ratings continue to reflect (1) its leading position in the Czech electricity market and well-balanced vertical integration (2) the low-cost nature of its nuclear and lignite power generation fleet (3) the relatively stable and predictable cash flow generated by its electricity distribution activities in the Czech Republic.

These positives are counterbalanced by (1) the company's relatively high exposure to merchant power generation, which, together with the mining segment, accounted for 82% of EBITDA for 2023 (2) its limited geographical diversification (3) its exposure to decarbonisation policies because of its centralised and carbon-intensive (lignite and coal) power generation (4) the risks associated with its large investment plan.

OUTLOOK RATIONALE

The negative outlook reflects Moody's expectations that CEZ will display weakening credit metrics from 2025 onwards which will not be commensurate with its current Baa1 rating. However, Moody's continues to take comfort from CEZ's adherence to its internal financial policies. The company has shown a strong track record over the years whereby its reported net leverage has remained below or within the 2.5x-3.0x leverage target that CEZ seeks to operate within and Moody's believes there is scope for credit enhancing measures to be put in place that could cushion the impact of the acquisition.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

In view of the negative outlook, upward pressure is currently unlikely. Over time, upward pressure could build if the government continues to provide strong support and the company's fundamental strength remains commensurate with at least its current BCA of baa2. In addition, CEZ would have to implement adequate measures to mitigate risks arising from the development of new nuclear plants.

Moody's could downgrade CEZ's rating if the company fails to maintain a financial profile commensurate with the revised guidance of FFO/ net debt above 22% and RCF/net debt above 15%. Downward pressure could also build if the company's business risks increase because of, for example, its involvement in new nuclear development projects without any support mechanism; or the government support assumption currently incorporated into Moody's assessment weakens. Any rating downgrade would take into consideration the Czech government's credit quality and the likelihood of extraordinary support.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in December 2023 and available at https://ratings.moodys.com/rmc-documents/412151, and Government-Related Issuers methodology published in January 2024 and available at https://ratings.moodys.com/rmc-documents/406502. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

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Knut Slatten
VP - Senior Credit Officer
Infrastructure Finance Group
Moody's France SAS
21 Boulevard Haussmann
Paris, 75009
France
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Andrew Blease
Associate Managing Director
Infrastructure Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's France SAS
21 Boulevard Haussmann
Paris, 75009
France
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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