

| Utility | Update | Czech Republic |

# CEZ

## High electricity prices will boost earnings

### Buy

Price 07.06.22	<b>CZK 1,179</b>
12m target	<b>CZK 1,393</b>
Upside to TP	<b>18.2%</b>
Dividend	<b>CZK 44</b>
Total return	<b>21.9%</b>

#### Sector stance

Overweight

#### Investment type

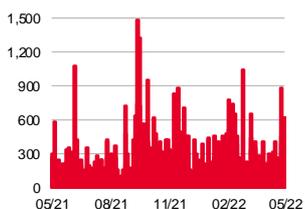
 Commodity price exposure  
 High dividend yield

#### 1 year performance



Source: Bloomberg

#### Trading volume (in ths of shares)



Source: Bloomberg

#### Share data

<b>RIC</b> CEZsp.PR	<b>Bloom</b> CEZ CP
52-week range	583.5 - 1180
Market cap. (CZKbn)	634.3
Market cap. (EURbn)	25.6
Free float (%)	30
<b>Performance (%)</b>	<b>1m 3m 12m</b>
Share	19.4 50.3 85.2
Rel. to PX Index	16.1 37.7 62.8

Source: Bloomberg

#### The latest analysis and report:

[https://bit.ly/CEZ\\_1Q22preview\\_EN](https://bit.ly/CEZ_1Q22preview_EN)  
[https://bit.ly/CEZ\\_1Q22\\_review\\_EN](https://bit.ly/CEZ_1Q22_review_EN)

**Investment case: We reiterate Buy recommendations for CEZ with a new target price of CZK1,393** (both the recommendation and target price were under revision).

Inflation in energy commodities, especially gas, translates into a substantial increase in electricity prices, which has a significantly positive impact on CEZ's performance. The impact will be mostly reflected in the next two years, when we project high EBITDA growth. The share of nuclear power plants in the generation segment will be around 60%. Their low emissions intensity production with low fixed costs will thus directly benefit from high electricity prices. Moreover, they generate the highest margins and thus we expect they will be used at full capacity. In addition to the suspension of coal-fired generation, CEZ will reduce its emissions intensity, which is key for CEZ's "green" vision. The advantage is further extended considering the high prices of emissions allowances, leading to higher profitability of the company's generation portfolio. Investments in the coming years might be directed toward distribution, renewables or the ESCO sector.

CEZ has updated its dividend policy and will not pay out 60-80% of adjusted net profit (previously 80-100%). This year, shareholders are expected to approve a dividend of CZK44 per share. The payout will still include a share from the sale of Bulgarian assets (CZK7). No further extraordinary payouts are expected. Nevertheless, given the expected strong earnings growth, the dividend will jump to CZK74 next year and up to CZK153 in the coming years, easily surpassing historic payouts. The gross dividend yield on the current price could potentially swing above 10%.

**Valuation:** Using the discounted cash flow model we set our new target price at CZK1,393, signifying a substantial 18.2% upside potential. Current market valuation reflects 14.9x P/E and 9.3x EV/EBITDA which provide mixed evidence for valuation compared to the Western European counterparts from the utility sector (14.2x P/E, 8.2x EV/EBITDA) and the whole Europe (10.8x P/E, 7.8x EV/EBITDA). The top-line growth in our projections, especially from 2023 onwards, lowers forward multiples thus, indicating significant discount. CEZ's 3.8% gross dividend yield is currently below competition's median of 5.1%, respectively 4.6%.

**Major risks:** One of the main factors is the availability of production facilities, especially nuclear, which carry the highest margins. Adverse development on the commodity markets might significantly affect the business, mainly the decline in electricity prices. Therefore, higher prices would further significantly foster the company's business in the coming years.

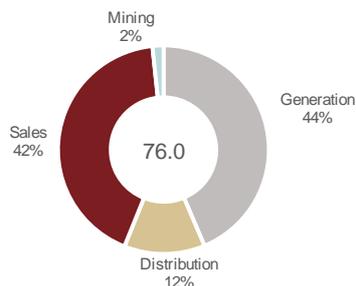
Financial data	2021	2022f	2023f	2024f	Ratios	2021	2022f	2023f	2024f
Revenues (CZK bn)	227.8	293.8	384.5	383.4	P/E (x)	19.9	12.4	7.5	7.6
EBITDA margin (%)	27.8	34.5	38.9	38.7	Price/free cash flow (x)	6.4	17.6	12.9	7.5
Net income (CZK bn)	9.9	49.6	82.2	80.7	Dividend yield (%)	6.3	3.8	6.4	13.2
EPS (CZK)	41.6	93.6	154.4	151.5	Price/book value (x)	2.8	3.3	2.7	2.7
Dividend/share (CZK)	52.0	44.0	74.0	153.0	P/S (x)	1.9	2.1	1.6	1.6
Interest cover (x)	4.3	26.0	36.9	34.1	EV/S (x)	2.4	2.5	1.9	1.9
Payout (%)	122.7	106.2	79.4	99.5	EV/EBITDA (x)	8.8	7.2	4.8	4.9
Net debt/equity (%)	0.7	0.6	0.4	0.4	EV/IC (x)	2.2	2.6	2.2	2.2

**Upcoming events:** CEZ's results for the half-year 2022 should be published in 9 August 2022.

## Company overview

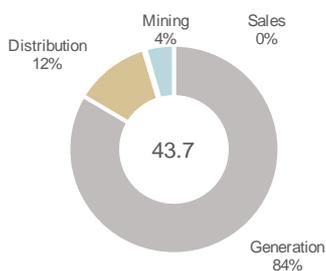
Strengths	Weaknesses
<ul style="list-style-type: none"> <li>Strong position of the company throughout Europe</li> <li>Vertical integration from coal mining and electricity generation to distribution</li> <li>A wide portfolio of production sources</li> <li>Provides services in the field of energy savings and smart solutions (ESCO services)</li> <li>Low emissions intensity</li> </ul>	<ul style="list-style-type: none"> <li>Government influence and impact of political decisions on the company's management</li> <li>Less efficient operation of some coal-fired power plants</li> <li>Strict state regulation of electricity generation and the distribution process</li> <li>Uncertainty of natural gas sourcing due to geopolitical tensions</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>Dividend policy with a chance of extraordinary dividend payment</li> <li>Subsidies from the Modernisation Fund for investments in RES</li> <li>Increasing carbon prices with a positive impact on CEZ profitability due to the anticipated decrease in their needs</li> <li>Closure of nuclear and coal-fired power plants in Western Europe</li> </ul>	<ul style="list-style-type: none"> <li>Construction of a new nuclear block without state guarantees</li> <li>Lower support for electricity generation from renewable sources</li> <li>Increased demand for emissions allowances in the case of production failure by non-emissions sources</li> <li>Sector taxation or other form of levy on the state budget or the specialised fund</li> </ul>

Revenues by segment (1Q22)



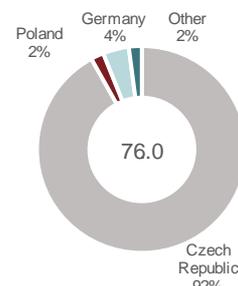
Source: CEZ; \* figures are in CZKbn

EBITDA by segment (1Q22)



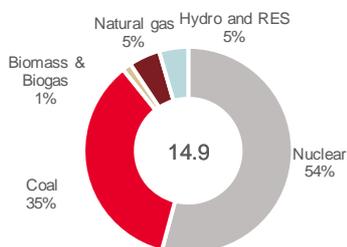
Source: CEZ; \* figures are in CZKbn

Revenues by region (1Q22)



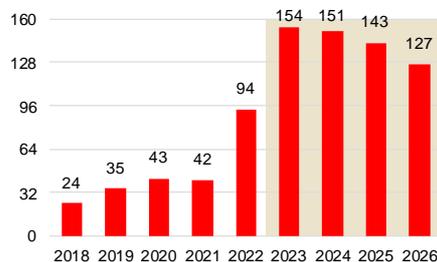
Source: CEZ; \* figures are in CZKbn

Electricity generation by fuel (1Q22)



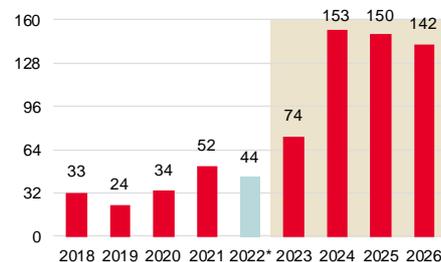
Source: CEZ; \* figure is in GW

EPS (CZK)



Source: CEZ; Economic & Strategy Research, Komerční banka

Dividend per share (CZK)



Source: CEZ; Economic & Strategy Research, Komerční banka, \*dividend proposal needs to be approved on GM on June 28, 2022

## Sector trends

### Electricity prices

Power prices continue to hold at very high levels. Toward the end of last year, prices began to fall from their highs of EUR320 per MWh to EUR120 per MWh at the start of this year. Currently prices hover around EUR230 per MWh, representing an almost 100% growth year-to-date. For comparison, the average electricity price in 2019 and 2020 was EUR44 per MWh. The exorbitant growth began in the second half of 2021, the main reason being the dramatic rise in the energy commodity prices, namely gas, coal, and emissions allowances, in particular gas, which has contributed the most to the present increase in electricity prices, as illustrated by the graph below.

For the coming years, futures contracts suggest that the price will fall from the current EUR230 per MWh to around EUR140 per MWh.

### Gas

Record gas prices due to supply uncertainty.

The current electricity prices currently find themselves primarily grappled by natural gas, respectively its market price. Exorbitant prices stemming from geopolitical tensions and the uncertainty of Russian gas supply have a significant influence on the whole energy market. While the global gas supply is plentiful, Russia constitutes Europe's most important supplier with a 45% share. Therefore, large uncertainty lingers regarding further supplies, restrictions or sanctions which translates into high natural gas prices. Current prices hover between EUR100 and EUR80 per MWh, after crossing EUR200 per MWh earlier this year. Average prices for 2019 and 2020 were around EUR12; moreover, in the first half of 2021 the price was still "just" EUR20. The following steep growth was stimulated by a longer winter, empty gas storage facilities and above all, large supply uncertainty.

Emissions allowed at all-time highs.

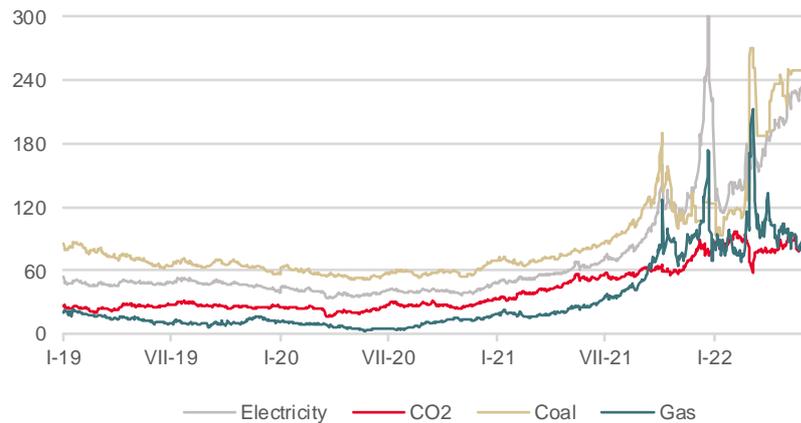
### CO<sub>2</sub> emissions allowances

The current price of CO<sub>2</sub> allowance above EUR85 per tonne is now just below the historic high of around EUR100 per tonne from earlier this year. Trading has been very volatile recently. Coinciding with the rise of natural gas prices in the middle of last year, price of CO<sub>2</sub> allowances also rose. The average for 2019 and 2020 was EUR25. The main factors behind the steep growth are obviously the climate policy and gas prices, which are forcing operators to replace the generation from the commodity for other mainly coal-fired sources. The latter is more emissions-intensive (producing twice as much CO<sub>2</sub>) and thus drive up demand for emissions allowances.

### Coal

With coal it is a similar story of a substantial price increase in the second half of last year and high volatility. Average coal prices between 2019-2020 were about USD65 per tonne. Currently they are around USD250 per tonne, about 170% growth YTD, only slightly below the record of USD270 reached in March this year. The key driver is likely high demand as operators substitute gas-fired generation for coal. We assume these operational coal-fired plants will remain in service despite the plans to shut them down.

Power prices (€/MWh), CO<sub>2</sub> (€/MWh), coal (\$/t) and gas (€/MWh)



Source: Bloomberg

**CEZ's share price lags behind the power price.**

The chart below shows the CEZ share price is more or less correlated with the development of power electricity prices. Although, we have seen a diversion lately as the CEZ share price (+35% YTD) could not cope with skyrocketing electricity prices, which have risen by almost 100% YTD.

Development of CEZ's shares vs. German electricity prices



Source: Bloomberg

## Company results

### The year 2020

Significant growth, guidance increased again.

CEZ's results for the first quarter increased substantially year-on-year. The company's management has once again raised its 2022 guidance.

EBITDA grew 119% yoy to CZK43.7bn, with sales growing 28.6% yoy to CZK76bn this year. Net profit adjusted for extraordinary items reached CZK26.7bn, up 219% yoy. The increase was driven by the rise in electricity prices and trading profit. CEZ revised its EBITDA guidance for this year upward to CZK95-99bn as well as net profit to CZK45-49bn. The update came along with the publication of 1Q22 results on May 10. The previous guidance (announced on March 15) included EBITDA in the range CZK85-89bn and net income between CZK38-42bn. The key driver is realised electricity prices and trading profits. The expected realised electricity price for this year is EUR95-98 per MWh (compared to the previous EUR79).

In our projections, EBITDA this year should reach CZK101.5bn, slightly above the upper limit of CEZ's guidance. Net profit we estimate at CZK50.1bn, with a strong top-line growth as sales are expected to reach CZK293.8bn. The volume of procured electricity should increase only slightly to 56.2TWh from 56TWh last year. Meanwhile, the realised electricity price in our projections is EUR97.3, which is very high compared to last year's EUR50.

#### 1Q22 results

CZK bn	1Q21	1Q22	y/y	KB estimate	consensus
Sales	59.1	76.0	28.6%	74.9	77.1
EBITDA	20.0	43.7	119%	30.0	30.0
Operating income	33.8%	57.6%	23.8pps	40.0%	38.9%
Net profit	11.2	36.2	222%	21.7	21.6
Adjusted net profit	8.4	26.7	219%	16.1	15.8

Source: CEZ, Economic & Strategy Research, Komerční banka

### Construction of a new nuclear unit

Politicians are considering restructuring however, that would not solve the current crisis.

It has been reported in recent weeks that politicians are considering the possible restructuring of CEZ. The discussions are, however, at a very early stage. This would potentially mean a breakup of CEZ into parts. The production side of the business would be fully controlled by the state, meaning it would have to buy out minority shareholders. In such a case, we would expect a hefty premium in tens of percent. The main motivation behind this proposal is the solution to the energy crisis caused by high electricity prices. However, from our point of view, we do not see how it would solve the current situation. The process of splitting up and squeezing out minority shareholders would certainly take several months or years, while the government needs to resolve the issue at hand as soon as possible. An alternative could be approving a higher dividend using the state's 70% stake at the upcoming general assembly meeting scheduled for 28 June.

Split-up would allow the government to decide regarding the construction of new nuclear blocks.

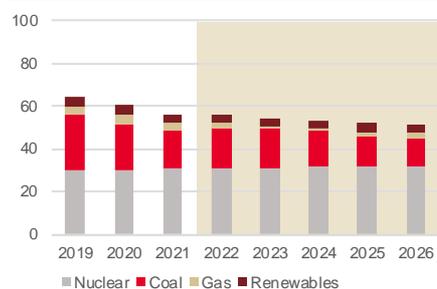
Restructuring, respectively dissection of the business, would give the government relative freedom regarding the construction of new nuclear units, regardless of minority shareholders. The tender offer period has begun, and initial bids are expected by the end of November 2022 with final bids to come in late 2023. The process is expected to be finalised at the end of 2024. Current bidders include French EdF, Canadian Westinghouse and Korean KHNP. CEZ's new nuclear units would be 100% financed by the state.

## Long-term forecasts

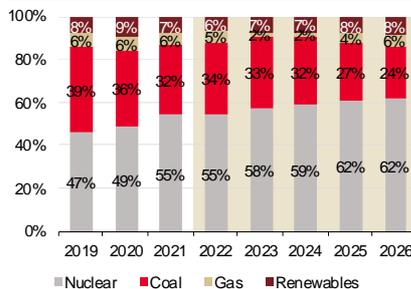
Nuclear power plants play the main role.

Unsurprisingly, the decisive share of the current generation business will be accounted for by the existing nuclear power plants for the explicit period. Production should reach up to 32.1 TWh in 2026 from this year's expected 30.8 TWh. Expansion of the current nuclear power plant portfolio cannot be expected in the forecasted period. Coal-fired generation is expected to decline. The installed capacity of coal-fired power plants will accordingly decrease from 4.3 GW in 2021 to 2.2 GW in 2030. Only the modernised plants in Prunerov, Tushumice and Ledvice should remain operational. CEZ's goal is complete diversion from coal-burning power plants in 2038. CEZ has a single gas-fired power plant in Pocerady, the installed capacity of which is expected to remain unchanged around 1 GW. Generation from renewable resources should increase along with the growth of their installed capacity. The current planning involves adding 1.5GW of renewable capacity by 2025 and 6 HW by 2030 thus, increasing the installed capacity from last year's 2.2 GW to 3.7 GW in 2025.

CEZ electricity generation (TWh)



Generation by source



CEZ generation capacity estimate (GW)



Source: CEZ, Economic & Strategy Research, Komerční banka

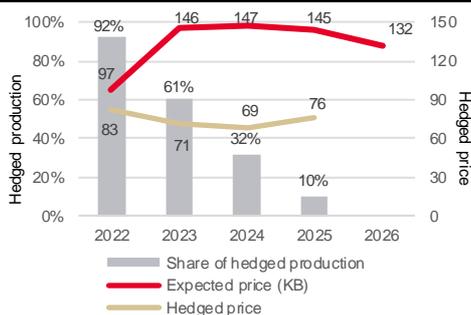
## Realised prices will increase

The sharp rise in electricity prices will have a positive effect on company's numbers.

Electricity price has been steadily rising since the beginning of this year, as shown by the chart on page 4. The main reason being the rising prices of energy commodities, especially natural gas. The current market price is around EUR240 after trading around EUR120 at the start of the year. The futures contracts show that future prices are gradually falling from EUR240 for 2023 to EUR150 in 2026.

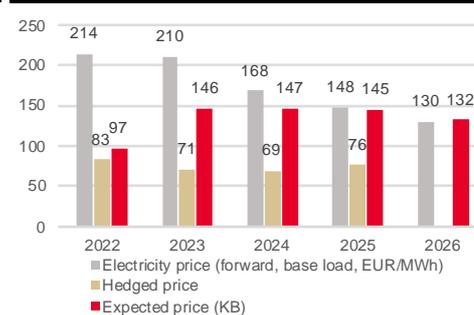
According to our projections, CEZ sold this year's electricity production at an average price of EUR97.3 per MWh. For the next year, we expect an almost 50% increase to EUR145 per MWh. We estimate the selling price of the assured electricity supply (base load) in the following years at about EUR130-140 per MWh. The overall selling price will, however, be higher due to the inclusion of peak load prices. Therefore, the final calculated price nears EUR145. See the hedged prices, our estimated prices and forward market prices on the righthand graph below.

Hedged sales and average prices (EUR/MWh)



Source: CEZ, Economic & Strategy Research, Komerční banka

Expected higher realised prices (EUR/MWh)



Source: CEZ, Bloomberg

EBITDA is headed above CZK100bn.

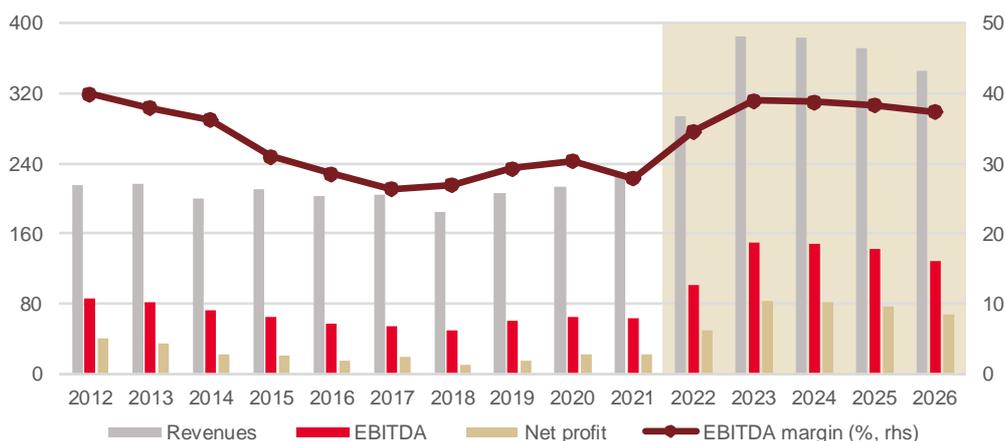
### CEZ's earnings projections

We expect sales to grow at a compound annual average rate of 8.7% over the 2022-2026 period. From CZK228bn in 2021, it should reach CZK346bn in 2026. Most substantial growth will occur between 2022 and 2023 primarily due to peaking realised electricity prices, when they will reach up to CZK145.

We estimate large EBITDA growth from CZK63.2bn in 2021 to this year's CZK101.5bn, growing 15.3% on average. The highest figures are expected to be achieved in 2023 and 2024 as EBITDA will near CZK150bn. In the last year of our forecast, we expect EBITDA to reach CZK129bn. Management's projections for this year include EBITDA in the CZK95-99 range.

Similarly, adjusted net income should peak around CZK80bn in 2023 and 2024, then reaching CZK68bn in 2026. For this year, we estimate CZK50.1bn while CEZ's projection reads CZK45-49bn. This is a reminder that adjusted net income serves as the basis for the calculation of dividends. Therefore, an excellent performance in the following years should translate into more generous payouts; see below.

CEZ results forecasts (CZKbn)



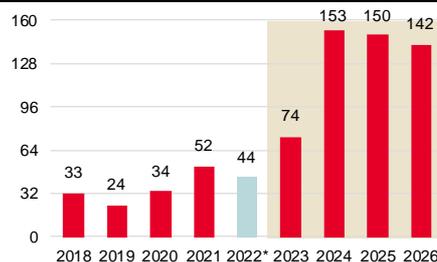
Source: CEZ, Economic & Strategy Research, Komerční banka

## Dividend policy

Dividend for the next year will be CZK74, representing 6.4% gross dividend yield.

At the beginning of the year, **CEZ updated its dividend payout from 80-100% of adjusted net income to the current 60-80%. The planned dividend due from last year's earnings is CZK44.** The payout composes of the standard dividend (CZK37), constituting a 90% payout ratio and extraordinary dividend (CZK7) due from the sale of Bulgarian assets. Shareholders will approve the dividend **at the general assembly meeting on 28 June.** Using its 70% majority stake, the Finance Ministry could potentially propose and approve a higher dividend. Nonetheless, the government usually follows the management's recommendation.

Expected dividend payment per share (CZK)



Source: CEZ, Economic & Strategy Research, Komerční banka

Further, we see a potential return to higher payout ratios.

Dividends containing an extraordinary payout in addition to the standard part delighted investors last year and will continue to do so this year. While the extraordinary payouts cannot be further expected, dividends in the coming years will be fostered by extremely good figures, resulting in generous payouts. We project **next year's dividend at CZK74, constituting an 80% payout ratio** and 6.4% gross dividend yield. CEZ's guidance is in the range of CZK67-73.

In light of the strong performance in our projections, we do not expect the conservative dividend policy of 60-80% payout to last long. We assume that **the company will return to more generous payout ratios in the future. From 2024 onward, we project dividends up to CZK153**, primarily fostered by good results and strong cash flow.

## Indebtedness

Leverage is significantly below CEZ's projections (2.5x for 2025 and 3.0x for 2030)

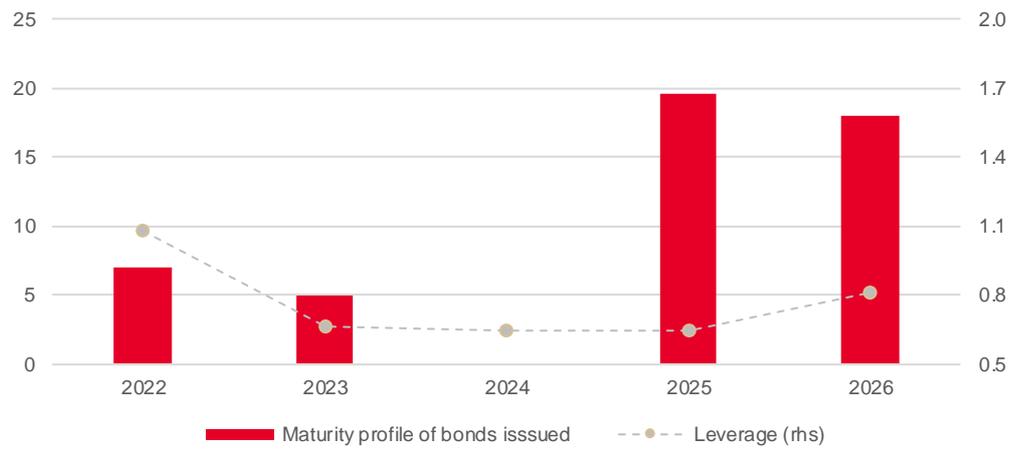
CEZ projects leverage (Net Debt / EBITDA) at 2.5x in 2025 and further 3.0x in 2030, including projected annual Capex at around CZK48bn for the period of 2021-25 and a range of CZK50-55bn in 2026-30. Published figures for **1Q22 show leverage at an already low 0.9x**, primarily given by the large EBITDA increase.

Leverage will drop to 0.7x.

In the coming years, almost CZK50bn of debt matures, including the EUR269m bond still due this year. In the next two years (2023 and 2024), there are no substantial maturities whereas considerable amounts are due in 2025 and 2026 (see below). **Considering the strong EBITDA growth in our projections, we expect leverage to drop to 0.7x.** In line with our assumption of falling leverage, we expect debt service expenses to decrease from last year's CZK4.2bn to approx. CZK3.5bn this year. Furthermore, we **project debt service around CZK3.8-3.9bn.**

On account of rising interest rates and further upside pressure, additional debt emissions and consequently higher leverage would pose a heightened risk to the company's financials. Nevertheless, considering the **current low levels of indebtedness and projected strong bottom-line growth additional debt service burden ought to be comfortably covered.**

**Maturity profile of the issued bonds (CZKbn)**



Source: CEZ, Economic & Strategy Research, Komerční banka

## Valuation

### Sector comparison

Relative comparison is mixed.

We have selected competitors operating in both Western and Central Europe. CEZ's valuation corresponds more to its Western European counterparts, as shown by the table below. Current P/E and EV/EBITDA multiples indicate a premium compared to its peers. Considering the strong growth in our projections, forward multiples for 2023 indicate a significant discount. CEZ currently offers an below-median gross dividend yield compared to its Western European counterparts and the whole Europe (3.8% vs 5.1%, respectively 4.6%).

#### Peer comparison

	P/E akt.	P/E 2022	P/E 2023	P/S akt.	P/S 2022	P/S 2023	EV/ EBITDA akt.	EV/ EBITDA 2022	EV/ EBITDA 2023	EV/S akt.	EV/S 2022	EV/S 2023	Div. yield 2022
<b>CEZ (KB estimate)</b>	<b>19.9</b>	<b>12.4</b>	<b>7.5</b>	<b>1.9</b>	<b>2.1</b>	<b>1.6</b>	<b>8.8</b>	<b>7.2</b>	<b>4.8</b>	<b>2.4</b>	<b>2.5</b>	<b>1.9</b>	<b>3.8</b>
<b>CEZ (consensus)</b>	<b>14.5</b>	<b>11.3</b>	<b>11.5</b>	<b>2.4</b>	<b>2.1</b>	<b>2.1</b>	<b>0.7</b>	<b>0.6</b>	<b>0.6</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>3.7</b>
EDP-ENERGIAS DE PORTUGAL SA	22.0	18.2	16.5	1.3	1.2	1.2	9.9	8.9	8.3	2.6	2.4	2.4	4.0
E.ON SE	10.8	10.9	11.2	0.3	0.3	0.3	7.8	8.0	8.1	0.8	0.8	0.7	5.1
EDF	n/a	8.8	5.2	0.4	0.4	0.4	12.7	4.3	3.7	1.0	1.0	0.9	6.8
ENDESA SA	12.1	11.6	11.2	1.0	1.0	1.1	7.7	7.1	6.9	1.4	1.4	1.5	6.9
ENEL SPA	10.8	9.9	9.3	0.7	0.7	0.7	7.6	7.2	6.9	1.6	1.6	1.6	6.4
ENGIE	7.8	8.5	8.3	0.5	0.5	0.5	5.1	5.3	5.1	1.0	1.0	0.9	6.8
EVN AG	16.8	15.2	14.5	1.6	1.4	1.3	8.2	8.1	7.8	2.0	1.8	1.7	2.3
FORTUM OYJ	9.9	10.8	10.6	0.1	0.1	0.1	7.4	7.1	7.1	0.2	0.2	0.2	6.7
IBERDROLA SA	16.7	15.3	14.3	1.6	1.6	1.5	10.1	9.4	8.7	2.9	2.8	2.7	4.0
RWE AG	16.4	23.1	23.1	1.2	1.2	1.2	8.3	9.5	9.3	1.5	1.5	1.5	2.2
VERBUND AG	19.7	17.5	17.1	5.4	4.9	4.7	13.7	11.6	11.4	6.1	5.5	5.3	1.1
<b>MEDIÁN západní Evropa</b>	<b>14.2</b>	<b>11.6</b>	<b>11.2</b>	<b>1.0</b>	<b>1.0</b>	<b>1.1</b>	<b>8.2</b>	<b>8.0</b>	<b>7.8</b>	<b>1.5</b>	<b>1.5</b>	<b>1.5</b>	<b>5.1</b>
PGE SA	8.4	7.4	6.1	0.3	0.3	0.3	3.4	3.6	3.3	0.4	0.3	0.3	n/a
ENERGA SA	n/a	n/a	n/a	n/a	n/a	n/a	n/a						
ENEA SA	2.5	2.7	2.6	0.2	0.1	0.1	2.2	1.9	2.2	0.3	0.2	0.2	0.4
TAURON POLSKA ENERGIA SA	4.3	4.1	3.5	0.2	0.1	0.1	4.5	4.3	4.0	0.6	0.5	0.5	n/a
<b>MEDIAN Central Europe</b>	<b>4.3</b>	<b>4.1</b>	<b>3.5</b>	<b>0.2</b>	<b>0.1</b>	<b>0.1</b>	<b>3.4</b>	<b>3.6</b>	<b>3.3</b>	<b>0.4</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>
<b>SECTOR MEDIAN</b>	<b>10.8</b>	<b>10.8</b>	<b>10.9</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>	<b>7.8</b>	<b>7.2</b>	<b>7.0</b>	<b>1.2</b>	<b>1.2</b>	<b>1.2</b>	<b>4.6</b>
CEZ vs. sector (consensus)	35%	5%	6%	306%	264%	268%	-91%	-92%	-92%	-81%	-83%	-83%	-18%
CEZ vs. sector (KB estimate)	85%	14%	-31%	236%	258%	184%	14%	1%	-30%	105%	107%	57%	-17%
CEZ vs. WE (KB estimate)	40%	6%	-33%	104%	110%	52%	7%	-10%	-38%	65%	67%	24%	-25%

Source: Bloomberg, Economic & Strategy Research, Komerční banka

### Target price

Using the DCF model, we establish a new target price at CZK1,393.

Using a two-stage discounted cash flow model with a five-year explicit forecasting period, we determine the fair value of the company. Key parameters and outputs of the model can be found in the table below. Free cash flow is discounted using a weighted average cost of capital (WACC) in the range of 6.8-7.5% for the explicit period. The horizon value is calculated using a terminal rate of WACC, which reflects normalised values of risk-free interest rates and equity risk premia. The terminal growth rate is assumed at 2%. Based on the DCF model we obtain and set our new target price at CZK1,393, the key driver being the positive impact of growing electricity prices on the company's profitability and cash flow creation.

CEZ valuation

	2022	2023	2024	2025	2026	LT
<b>Calculation of the required rate of return</b>						
risk-free rate	5.3%	4.6%	3.8%	3.4%	3.2%	3.2%
beta	0.90	0.90	0.90	0.90	0.90	0.90
equity risk premium	4.8%	4.8%	4.8%	4.8%	6.3%	6.3%
country risk premium	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
cost of equity	10.2%	9.5%	8.8%	8.4%	9.4%	9.4%
weight of debt	36.6%	30.0%	29.4%	28.7%	32.4%	32.4%
cost of debt (after tax)	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%
<b>WACC</b>	<b>7.5%</b>	<b>7.5%</b>	<b>7.0%</b>	<b>6.8%</b>	<b>7.3%</b>	<b>7.3%</b>
<b>Discounted cash flow model (CZKbn)</b>						
EBITDA	101.5	149.5	148.5	141.9	129.1	
Amortization of nuclear fuel	4.2	4.2	4.2	4.3	4.3	
Taxes paid	-12.5	-20.7	-20.4	-19.2	-17.1	
Change in working capital and provisions	-17.8	-42.9	-5.6	-0.3	-14.7	
CAPEX	-40.0	-42.0	-44.0	-48.0	-50.0	
<b>FCFF</b>	<b>35.3</b>	<b>48.0</b>	<b>82.8</b>	<b>78.7</b>	<b>51.6</b>	
price / free cash flow	17.6	12.9	7.5	7.9	12.0	
Present value of FCFF	32.8	41.5	67.0	59.7	36.5	
Sum of present values of FCFF until 2026	237.5					
Present value of FCFF after 2026	704.4					
Net debt	111.2					
Nuclear, mining and other provisions	86.0					
Financial investments	1.9					
Joint ventures and associates	3.9					
Minorities	0.9					
Estimated value of equity	749.6					
Fair value (CZK per share)	1,393					
<b>Target price (CZK per share)</b>	<b>1,393</b>					

Source: Economic & Strategy Research, Komerční banka

The following table provides a snapshot of the sensitivity of CEZ's target price to changes in key parameters of the valuation, namely forward electricity prices, WACC and the long-term growth rate.

Sensitivity analysis

		WACC					WACC						
		-100bps	-50bps	7.2 % / 7.3 % *	+50bps	+100bps			-100bps	-50bps	7.2 % / 7.3 % *	+50bps	+100bps
Long-term growth	1.0%	1,396	1,276	1,176	1,090	1,017	Forward prices	-20%	1,151	1,031	933	852	784
	1.5%	1,541	1,396	1,276	1,176	1,090		-10%	1,425	1,280	1,163	1,066	984
	2.0%	1,715	1,537	<b>1,393</b>	1,274	1,174		0%	1,699	1,530	<b>1,393</b>	1,280	1,185
	2.5%	1,945	1,719	1,541	1,396	1,276		10%	1,973	1,780	1,624	1,494	1,386
	3.0%	2,239	1,945	1,719	1,541	1,396		20%	2,247	2,030	1,854	1,708	1,586

Note: \* the first value corresponds to the average for the years 2022-26, the second value after 2026; Source: Economic & Strategy Research, Komerční banka

## Major risks

- **Electricity prices** - CEZ share prices are significantly affected by the development of electricity prices on European markets. A significant deviation of German electricity prices from our forecasts may cause a different development of CEZ's profits than we currently expect.
- **Production mix** - In the coming years, we expect full utilisation of nuclear power plants. This has an impact on the development of profit margins. Should longer nuclear block shutdowns occur, it would lead to lower margins.
- **Renewal of the production portfolio** - CEZ has completed the modernisation of its coal-fired power plants. The highest share of investment should go to distribution, renewables and the closure and transformation of production from coal to low emissions. Any contribution to the construction of a new nuclear unit could have a strong negative impact on our valuation.
- **Regulation** - The energy sector suffers from strict regulation and in some countries also comes under political and public pressure. The potential reduction in support for electricity production from renewable sources is also a major risk.
- **Exchange rate developments** – Although the company is naturally hedged against fluctuations of the EUR/CZK exchange rate, the stronger-than-expected appreciation of CZK against EUR would be negative for CEZ. The impact on electricity prices (Czech prices are derived from German prices in EUR) could outweigh the euro-debt reduction. The weakening of the Turkish lira against USD leads to a decline in profits from affiliates and joint ventures and an increase in financial liabilities due to the loan guarantee provided to the Turkish company AkCEZ.
- **Acquisitions** – Potential acquisitions are not included in our forecasts. Big M&A deals would likely increase CEZ's consolidated profits as well as its debt. The impact on our target price and recommendation might be either positive or negative depending on the parameters of the transaction.
- **Tax reform** – From time to time, politicians appear to increase taxation on big companies. There is no additional tax on energy companies on the table for now. However, the introduction of a sectoral tax would result in lower net profit, which would be reflected in a lower dividend payout.

**CEZ financials**

<b>CZKm</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022f</b>	<b>2023f</b>	<b>2024f</b>	<b>2025f</b>	<b>2026f</b>
<b>INCOME STATEMENT</b>									
Sales	184,486	206,192	213,737	227,793	293,832	384,473	383,379	371,189	346,309
Cost of materials, services and fuel	-105,564	-118,395	-120,320	-127,285	-157,016	-200,606	-199,825	-194,070	-182,054
Salaries (total)	-25,620	-28,820	-30,855	-30,591	-32,906	-33,564	-34,235	-34,578	-34,924
Other costs	-4,213	-6,282	-3,753	-1,924	-2,450	-836	-820	-637	-264
EBITDA	49,535	60,175	64,783	63,240	101,459	149,467	148,499	141,904	129,068
D&A and impairments	-29,905	-33,876	-52,346	-47,427	-33,526	-38,947	-38,838	-37,619	-35,131
Operating profit (loss)	19,759	26,429	12,585	16,098	67,933	110,519	109,661	104,285	93,937
Interest income	315	403	377	431	868	970	725	301	269
Interest expense	-5,177	-5,473	-5,269	-4,206	-3,482	-3,964	-3,939	-3,913	-3,888
Interest on provisions	-1,800	-1,893	-1,955	-2,014	-2,127	-2,171	-3,037	-3,195	-3,354
Other financial income/expense	420	-1,055	2,168	3,117	-1,138	-2,587	-2,587	-2,487	-2,487
Profit (loss) before taxes	13,517	18,411	7,906	13,426	62,054	102,767	100,824	94,991	84,478
Taxes	-3,017	-3,911	-2,438	-3,517	-12,411	-20,553	-20,165	-18,998	-16,896
Net profit (loss)	10,500	14,500	5,468	9,909	49,643	82,214	80,659	75,993	67,582
Impairments	-2,600	-4,400	-17,332	-12,391	-500	-500	-500	-500	-500
Guided net profit (loss)	13,100	18,900	22,800	22,300	50,143	82,714	81,159	76,493	68,082
<b>BALANCE SHEET</b>									
Share Capital	50,265	50,914	50,954	52,376	52,376	52,376	52,376	52,376	52,376
Retained Earnings	184,456	199,847	182,917	108,722	134,792	177,362	176,053	171,686	163,194
Shareholders' Funds	234,721	250,761	233,871	161,098	187,168	229,738	228,429	224,062	215,570
Long-term Debt	142,440	142,570	122,102	95,924	95,444	94,967	94,492	94,020	93,550
Other Long-term Liabilities	31	31	34	32	32	32	32	32	32
Capital Employed	377,192	393,362	356,007	257,054	282,645	324,737	322,954	318,114	309,151
Fixed Assets	415,908	428,088	410,372	403,083	399,688	396,134	392,268	388,722	385,267
Intangible Assets	31,127	37,429	24,244	23,677	31,370	32,377	33,384	34,391	35,397
Financial Investments	142,943	113,332	138,768	533,820	531,937	353,186	132,045	103,951	104,604
Cash and Marketable Securities	7,278	9,755	6,064	26,640	27,700	36,688	39,039	43,280	28,843
Inventories	26,458	37,682	48,951	33,480	39,159	46,982	52,370	52,300	52,240
Receivables	73,855	67,218	65,140	148,548	147,969	126,985	105,648	82,303	77,531
Other Assets	9,874	11,070	8,919	13,674	14,084	14,507	14,942	15,390	15,852
Short Term Debt	18,526	29,323	29,725	41,957	41,537	41,122	40,711	40,304	39,901
Payables	63,346	66,872	73,744	88,177	90,801	112,851	107,284	98,860	87,640
Trade Provisions	92,497	110,138	124,709	129,911	127,578	134,804	142,031	149,259	156,489
Other Liabilities	155,882	104,879	118,273	665,823	649,346	393,344	156,715	113,800	106,553
Capital Employed	377,192	393,362	356,007	257,054	282,645	324,737	322,954	318,114	309,151
Total assets	707,443	704,574	702,458	1,182,922	1,191,907	1,006,858	769,694	720,336	699,734
<b>CASH FLOW</b>									
Profit (loss) before taxes	13,517	18,411	7,906	13,426	62,054	102,767	100,824	94,991	84,478
Depreciation	28,139	29,016	28,284	31,628	33,026	38,447	38,338	37,119	34,631
Amortization of nuclear fuel	4,027	4,096	4,197	4,110	4,151	4,193	4,235	4,277	4,320
Other non-cash items	7,986	21,409	19,596	-14,732	3,450	6,252	6,474	6,774	6,783
Change in working capital	-10,396	-20,990	21,206	32,312	-17,970	-43,133	-5,740	-447	-14,874
Tax paid	-3,327	-4,136	-3,748	-3,550	-12,527	-20,746	-20,354	-19,177	-17,054
Interest paid, net	-4,777	-5,023	-5,307	-4,051	-2,614	-2,994	-3,213	-3,612	-3,619
Dividend received	182	148	23	13	13	13	13	13	13
Operating cash flow	35,351	42,931	72,157	59,156	69,582	84,799	120,576	119,939	94,677
Cash flow from investing activities	-25,901	-32,363	-33,723	-7,118	-40,000	-42,000	-44,000	-48,000	-50,000
Dividends paid	-17,613	-12,861	-18,139	-27,963	-23,572	-39,645	-81,968	-80,361	-76,075
Cash flow from financing activities	-14,795	-8,091	-42,125	-31,462	-28,522	-33,811	-74,225	-67,698	-59,114
Change in cash	-5,345	2,477	-3,691	20,576	1,060	8,988	2,350	4,241	-14,437

Source: Economic &amp; Strategy Research, Komerční banka

## CEZ financials

	2018	2019	2020	2021	2022f	2023f	2024f	2025f	2026f
<b>RATIOS (%)</b>									
EBITDA margin	26.9	29.2	30.3	27.8	34.5	38.9	38.7	38.2	37.3
Operating margin	10.7	12.8	5.9	7.1	23.1	28.7	28.6	28.1	27.1
Pre-tax margin	7.3	8.9	3.7	5.9	21.1	26.7	26.3	25.6	24.4
Net margin (adjusted)	7.1	9.2	10.7	9.8	17.1	21.5	21.2	20.6	19.7
EBIT/Interest (x)	4.1	3.6	2.6	4.3	26.0	36.9	34.1	28.9	26.0
Net debt/Equity (x)	0.7	0.6	0.6	0.7	0.6	0.4	0.4	0.4	0.5
Net debt/EBITDA (x)	3.1	2.7	2.3	1.8	1.1	0.7	0.6	0.6	0.8
ROE	5.4	7.8	9.4	11.3	28.8	39.7	35.4	33.8	31.0
ROA	2.0	2.7	3.2	2.4	4.2	7.5	9.1	10.3	9.6
ROCE	3.4	4.9	6.1	7.3	18.6	27.2	25.1	23.9	21.7
Dividend payout	85.8	98.6	96.8	122.7	106.2	79.4	99.5	99.4	99.9
<b>DATA PER SHARE (CZK)</b>									
EPS (adj.)	24.5	35.3	42.6	41.6	93.6	154.4	151.5	142.8	127.1
Book value	438.7	468.7	437.2	300.7	349.4	428.8	426.4	418.2	402.4
Free cash flow	31.2	18.0	103.8	128.3	65.9	89.5	154.6	147.0	96.4
Gross dividend	33.0	24.0	34.0	52.0	44.0	74.0	153.0	150.0	142.0
<b>MARKET VALUATION</b>									
P/E (x)	21.8	14.4	12.1	19.9	12.4	7.5	7.6	8.1	9.1
Price/Operating cash flow (x)	6.6	5.2	3.4	6.6	7.3	5.7	4.3	4.3	5.4
Price/free cash flow (x)	17.1	28.3	5.0	6.4	17.6	12.9	7.5	7.9	12.0
Price/book value (x)	1.2	1.1	1.2	2.8	3.3	2.7	2.7	2.8	2.9
Price/sales (x)	1.6	1.3	1.3	1.9	2.1	1.6	1.6	1.7	1.8
Dividend yield (%)	6.2	4.7	6.6	6.3	3.8	6.4	13.2	13.0	12.3
EV/revenues (x)	2.4	2.1	2.0	2.4	2.5	1.9	1.9	1.9	2.1
EV/EBITDA (x)	9.0	7.3	6.6	8.8	7.2	4.8	4.9	5.0	5.7
EV/IC (x)	1.2	1.1	1.2	2.2	2.6	2.2	2.2	2.3	2.4

Source: Economic &amp; Strategy Research, Komerční banka

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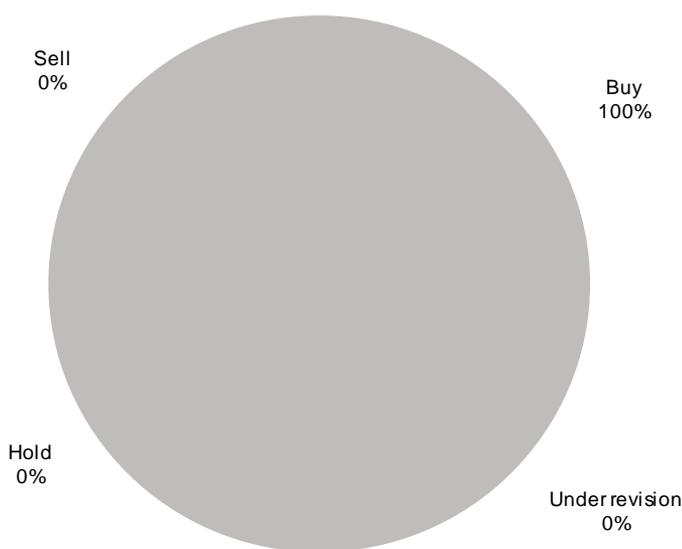
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The chart below shows the structure of grades of valid investment recommendations of equity research of KB Economic & Strategy Research (8 recommendations).

**Investment recommendations of KB equity research**



Source: Economic & Strategy Research, Komerční banka

**KB Equity Research ratings on a 12 month period**

**BUY:** absolute total shareholder return forecast of 15% or more over a 12 month period.

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Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

Overview of recommendations published by KB and relationships with particular issuers

	Avast	Colt CZ Group SE	CEZ	Kofola	MONETA Money Bank	O2 CR	PFNon-wovens	Philip Morris CR	Vienna Insurance
<b>Overview of last investment research and recommendations related to stocks of particular issuers</b>									
Recommendation	Buy	Buy	Buy	Buy	Buy	End of coverage	End of coverage	Buy	End of coverage
Target price	GBP 600	CZK 645	CZK 1 393	CZK 381	CZK 109.7			CZK 18183	
Date	11.02.2021	17.01.2022	07.06.2022	12.05.2022	31.08.2021	25.02.2022	15.02.2021	11.02.2022	22.11.2019
Price on the day of the publication	CZK 147	CZK 506	CZK 1 154	CZK 293	CZK 87.1	CZK 270	CZK 800	CZK 16760	EUR 24.7
Investment horizon	12 months	12 months	12 months	12 months	12 months			12 months	
Author	B. Trampota	B. Trampota	B. Trampota	B. Trampota	B. Trampota			B. Trampota	
<b>Overview of investment researches and recommendations for last 12M (quarterly)</b>									
Recommendation	Buy	In revision	In revision	In revision	In revision	Buy	In revision	Buy	Buy
Target Price	GBP 466	In revision	In revision	In revision	In revision	CZK 362	In revision	CZK 16 512	EUR 27
Date	30.08.2019	31.03.2021	10.05.2022	15.02.2022	07.05.2021	26.03.2021	30.04.2020	20.11.2020	11.09.2018
Recommendation	In revision	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy
Target Price	In revision	CZK 357	CZK 905	CZK 367	CZK 97	CZK 293	CZK 924	CZK 18308	EUR 26
Date	14.08.2019	27.11.2020	10.12.2021	12.01.2021	29.10.2019	08.01.2020	01.04.2019	03.12.2018	03.03.2017
Recommendation	Buy		Buy	In revision	Buy	Buy	Hold	Buy	
Target Price	GBP 342		CZK 621	In revision	CZK 97	CZK 298	CZK 924	CZK 17546	
Date	15.06.2018		23.07.2020	26.11.2020	07.03.2019	12.12.2018	26.10.2018	22.08.2017	
Recommendation			Buy	Buy	Buy	Hold	In revision	Hold	
Target Price			CZK 717	CZK 482	CZK 93	CZK 270	In revision	CZK 13500	
Date			10.06.2019	04.07.2019	06.03.2018	18.08.2017	17.05.2018	25.05.2017	
Valuation methods	DFCF	DFCF	DFCF	DFCF	DFCF DDM ERM	DFCF DDM	DFCF	DDM	DDM ERM
Frequency of rec. (per year)	once	once	once	once	once	once	once	once	once
Direct or indirect share (5% or more) of the issuer of the registered capital of KB	no	no	no	no	no	no	no	no	no
Other significant financial interest of KB and/or its linked persons in the issuer	no	no	no	no	no	no	no	no	no
KB direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no	no
Author's direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no	no
Signific. fin. interest in the issuer of the persons partic. in elaboration of inv. research and rec.	no	no	no	no	no	no	no	no	no
<b>Relationships of Komerční banka with particular issuers</b>									
KB Management or co- management of public offerings in the past 12 month	no	yes	no	no	no	no	no	no	no
Agreements or contractual relations for providing investment services with the issuer	KB can have concluded agreements with the issuer for providing investment services. This information is protected by bank secret and could not be disclosed.								
Agreement with the issuer on production and dissemination of the research	no	no	no	no	no	no	no	no	no
KB market making for common stocks of the issuer	no	no	no	no	no	no	no	no	no

Note: DFCF – Discounted free cash flow model, DDM – Discounted dividend model, ERM – Excess return model  
 Source: Economic & Strategy Research, Komerční banka