CEZ

Reuters: CEZ.WA Bloomberg: CEZ CP / CEZ PW

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CEE Utilities

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Healthy dividend but double whammy from lignite

Recommendation cut to Hold, TP up to CZK638

The rally in European carbon permits continues, so the market perception of CEZ as a nuclear generator has been supportive to the stock. The 2021 dividend announcement should come in days and we expect a post-disposal dividend payout of 105%, implying a dividend of CZK45 per share (dividend yield of 7.4%), which would be above consensus estimates. However, we believe the market underestimates the negative impact of CEZ's lignite operations, which should continue for another 20 years and are highly polluting. We expect EBITDA losses in the lignite division to be substantially higher than gains in nuclear. While falling electricity price sensitivity to carbon price changes may keep CEZ's EBITDA under pressure in coming years. Additionally, CEZ has upped its mid-term capex guidance to almost CZK40bn p.a., negative for the reported free cash flows. Our blended TP increases 12% (market changes, inclusion of 2025 RAB distribution target) to CZK638. We expect declines in lignite to outweigh the nuclear upside, and we think the 2022E dividend may be 20% lower than this year's. The potential upside to our price target falls to 5% resulting in our recommendation cut to Hold.

2021 guidance. CEZ guides for 2021 EBITDA of CZK60-63bn and net profit of CZK17-20bn. We expect EBITDA to consist of CZK54-57bn from strategic assets and CZK6bn from divestments. CEZ sees EBITDA from assets it sells at CZK2-3bn, which implies divestment-adjusted 2021 EBITDA guidance of CZK57-60bn. The company sees its nuclear and sales EBITDA moving higher year on year, with flat EBITDA from Distribution and Renewables, while Conventional Generation and Mining should decline versus 2020.

Positive 2021E dividend surprise… CEZ disposed of its Romanian assets, while the disposal of Bulgarian assets is scheduled for mid-2021. The company has made it clear that one-off disposals should result in 2021E dividend moving above its standard 80-100% payout ratio. We expect a 105% ratio applied to adjusted 2020 net profit, resulting in a CZK24bn dividend payment (DPS CZK44.5, DY 7.4%), which would be substantially above Bloomberg market consensus.

…but lignite double whammy? CEZ's market perception is that the company's results are positively correlated with rising carbon credit prices. We advocate this may be false, and carbon at EUR50/t may reduce CEZ's EBITDA vs. 2020: we expect the positive impact of zero-polluting nuclear generation to be outweighed by highly polluting lignite. Our analysis suggests that carbon at EUR100/t might exacerbate this trend, resulting in below-consensus EBITDA in coming years. Also, CEZ's capex is on the rise, with total capex expected close to CZK40bn to 2025E and lignite capex (modernizations) up by CZK12bn in 2021-23E.

Risks vs. upsides. CO2, thermal coal and gas prices drive the electricity price, and CEZ's EBITDAs and FCF (based on lignite and nuclear) are highly exposed to these prices in the long term. In the short term, multi-year electricity / CO2 / volume hedging in force limits volatility for CEZ. CEZ sees its nuclear volumes close to the maximum possible output, but we think potential downside here outweighs volume upside. Dividend payout at 110% in 2021E (and guidance for a flat payout in 2022E y/y) represents downside risk. Outlays on nuclear will start weighing on FCFs over several years, and details of the agreement on nuclear with the Czech government are still unknown. Potential continued rapid growth in the price of carbon credits could support CEZ's share price growth.

Forecasts, valuation, recommendation. We have adjusted our forecasts for market prices, with small increases to 2021-23E forecasts. Also, as 2021 disposals are later than we had expected, we have increased our 2021 forecasts for an extra contribution from the Romanian/Bulgarian assets. The 2025 RAB distribution target supports an 18% increase in our DCF valuation to CZK665, while there is minor growth in our DDM and comparables valuation. Our blended TP expands 12% to CZK638, although CEZ's 10% share price rally in April trims upside to 6%. We cut the stock to Hold from Buy.

CEZ: Financial summary

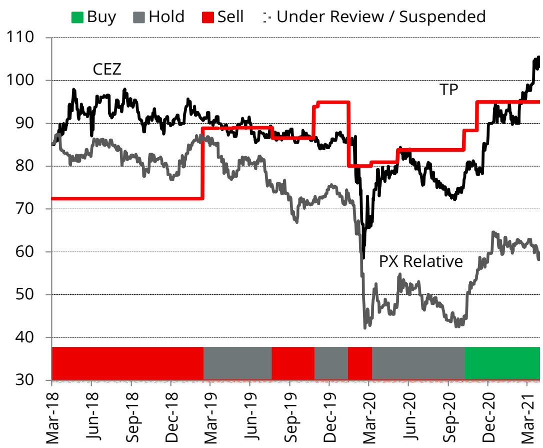
CZKmn	2018	2019	2020	2021E	2022E	2023E
Revenue	184,486	206,192	242,196	240,977	268,039	272,889
EBITDA	49,627	60,316	64,517	57,870	60,529	62,548
EBIT	19,759	26,429	12,585	32,654	35,402	37,813
Net profit	10,327	14,373	5,468	20,395	22,196	23,835
P/E (x)	28.2	19.8	45.9	15.9	14.6	13.6
EV/EBITDA (x)	9.1	7.5	5.6	7.7	7.5	7.4
DY	6.1%	4.5%	7.3%	7.4%	6.3%	6.2%

Source: Company data, Santander Brokerage Poland est., historical share prices for 2018-2020

Recommendation	Hold
Price (CZK, 04 May 2021)	601
Target price (CZK, 12M)	638
Market cap. (CZKbn)	323
Free float (%)	30
Number of shares (mn)	538

What has changed

- TP upped 12% to CZK638, recommendation cut to Hold
- Asset disposal may trigger 2021E DPS of CZK45, above consensus, but post-disposal 2022E DPS may fall 20% y/y
- CEZ is seen as CO2 price growth beneficiary, but lignite operations downside to EBITDA could outweigh nuclear upside, in our view…
- …and conventional capex upped CZK12bn y/y results in five-year capex almost at CZK40bn p.a.
- Later-than-expected asset disposal could offer upside to 2021E f'casts, minor changes as of 2022E
- Growth at thermal coal and gas prices represent key risk to our recommendation



The chart measures performance against the PX index, all values presented in PLN

Main shareholders	% of votes
State of the Czechia	69.8

Source: Company

Company description

Largest CEE & SEE vertically integrated utility, with capacity of 12GW. Key assets include Czech distribution segment, lignite mines, 5GW in lignite and 4.3GW in nuclear units.

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Key Story: Lignite's double whammy?

Carbon price on the rise… Investors are perfectly aware of the positive impact of carbon on the final electricity price, and the recent rally to above EUR50/t in 2025 contracts has fuelled expectations of continued higher electricity prices.

Fig. 1. CEZ: Carbon certificate price [EUR/t]

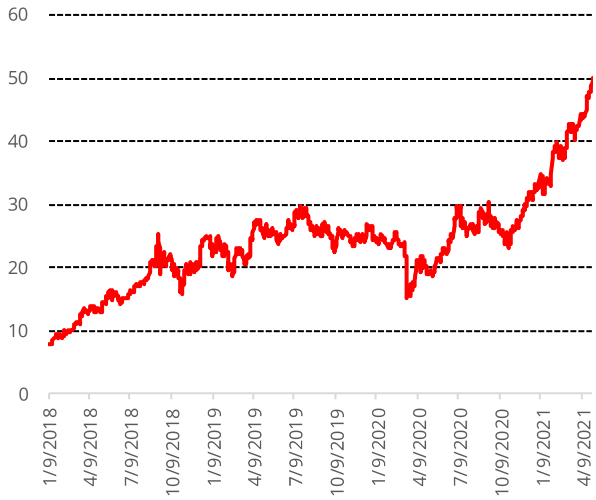
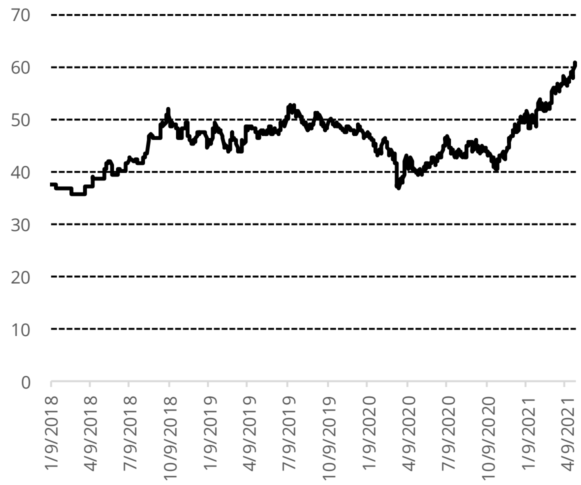


Fig. 2. CEZ: German electricity price [EUR/MWh]



Source for charts 1-2: Bloomberg, Santander Brokerage Poland.

…but carbon's impact on electricity prices has fallen. However, the environment is not static. European generation is transforming from lignite and coal to renewables/gas today, regardless of Germany´s decision to shut down its entire nuclear generating capacity. In 2017 EUR1/t change in the carbon certificate price resulted in EUR0.8/MWh change in the German electricity price, with that ratio falling to 0.6x in November 2019 and to 0.43x currently. We expect the generation mix pivot to renewables and gas may result in carbon´s impact on the electricity price falling to 0.25x by 2023E.

Fig. 3. CEZ: Changes in carbon to electricity price [t/MWh, calculated as CO2 price change vs. electricity price change]

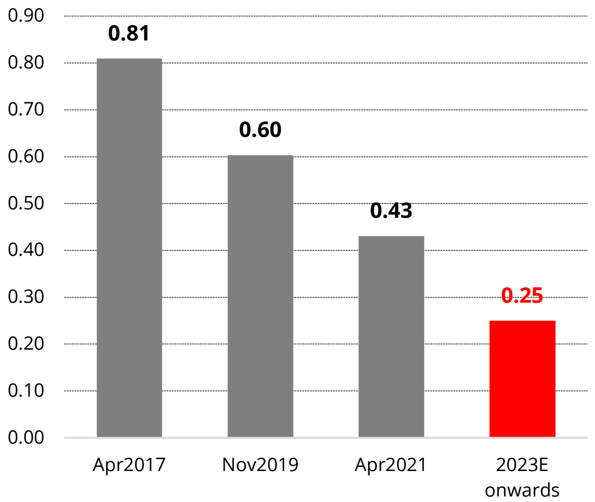
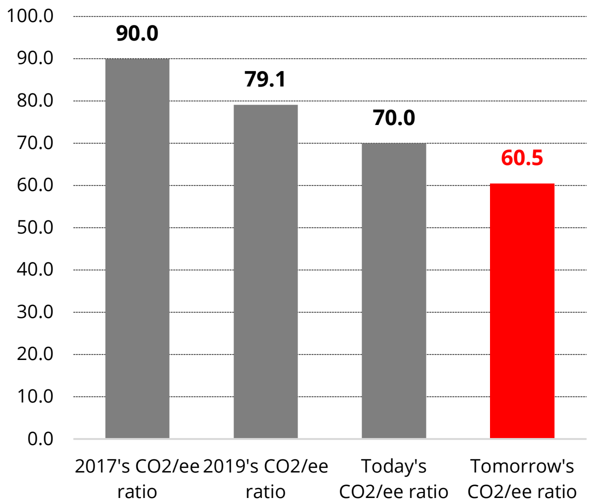


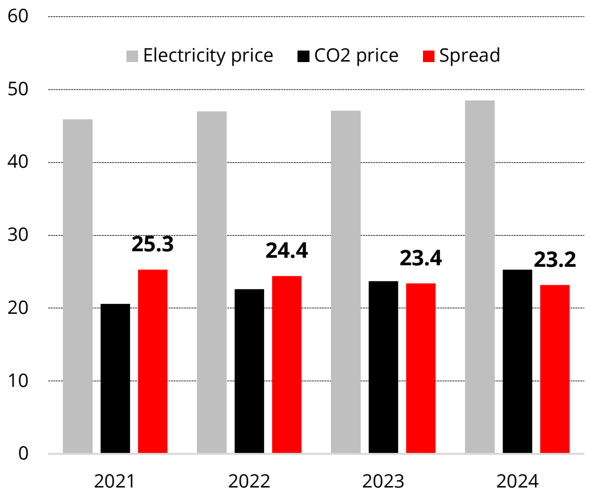
Fig. 4. CEZ: German electricity price in a scenario where carbon is priced at EUR100/t [EUR/MWh]



Source for Charts 1-2: Company data, Santander Brokerage Poland estimates

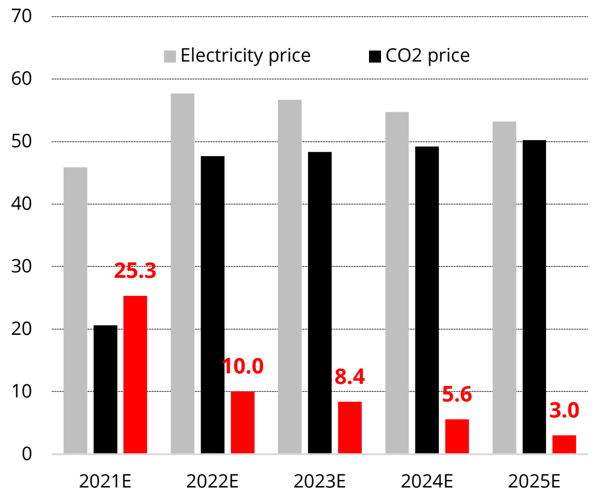
Electricity-carbon spreads strongly moving downwards... For years CEZ has been securing its future energy market exposure via simultaneous electricity and CO2 hedging. This policy has resulted in CEZ securing its electricity-CO2 spread at EUR23.2/MWh in 2024 from EUR25.3/MWh in 2021. However, market prices (official German electricity and carbon futures) result in very different outlook for European electricity price to carbon spreads, more than halving y/y to EUR10/MWh in 2022E and falling to EUR3/MWh in 2025E.

Fig. 5. CEZ: 2021-24 hedging [EUR/MWh]



Source: Company data

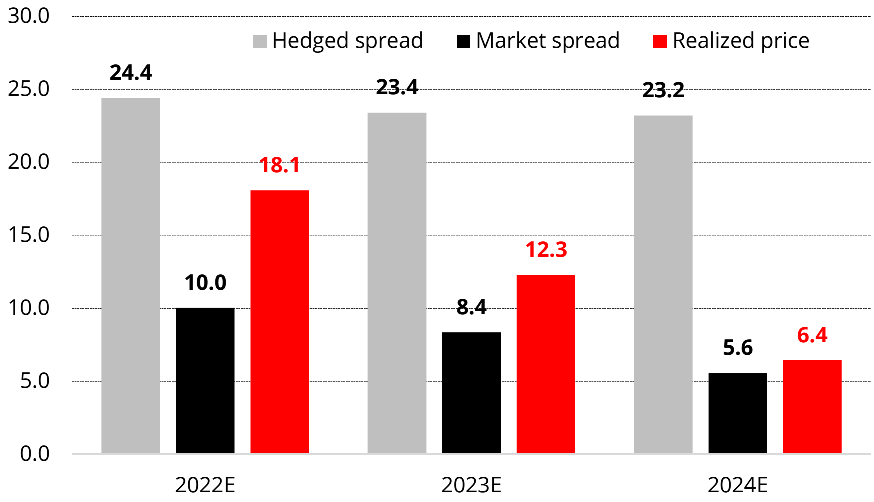
Fig. 6. CEZ: 2021-25 market prices and spreads [EUR/MWh]



Source: Bloomberg, stooq.pl, Santander Brokerage Poland estimates

Market prices matter to CEZ, as the company's share of electricity / CO2 hedging in total production is 56% in 2022E, 26% in 2023E and only 5% in 2024E. In this light, market prices and spreads remain very important to CEZ's future realized spreads.

Fig. 7. CEZ: Hedged spread vs. realized spread * [EUR/MWh]



*Source: Company data, Santander Brokerage Poland estimates, * based on official 2020 year-end share of hedging in years 2022-2024*

EBITDA discussion. In 2020, CEZ's realized electricity price (EUR43/MWh) was comfortably above lignite's cash cost of EUR25/MWh, offering a reasonable EUR18/MWh spread. In the current environment (rallying CO2 prices, with electricity prices growing at a slower pace) we expect CEZ's lignite clean spread to keep sliding to EUR17/MWh in 2021E and EUR8/MWh in 2023E (CEZ's last hedged year). In 2025E, with both electricity and carbon priced at some EUR50/MWh, we see lignite's clean spread moving into negative territory. We also tested CEZ's lignite spread for a carbon price of EUR100/t (implying an electricity price of EUR65/MWh, assuming a new CO2-to-electricity ratio of 0.25x), and we found the spread falling to negative EUR34.1/MWh.

Fig. 8. CEZ: Lignite prices / cash cost / spread [EUR/MWh]

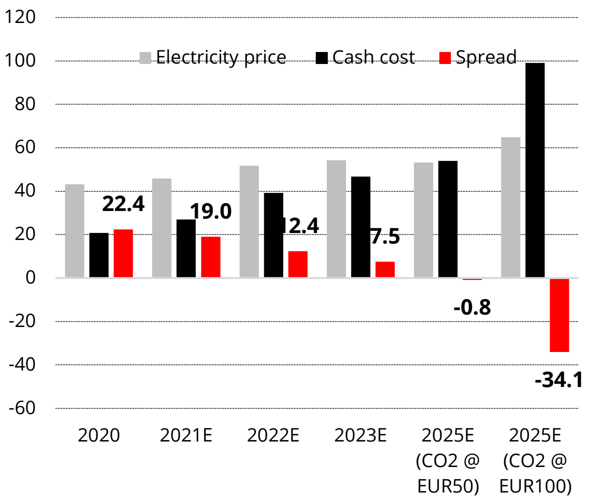
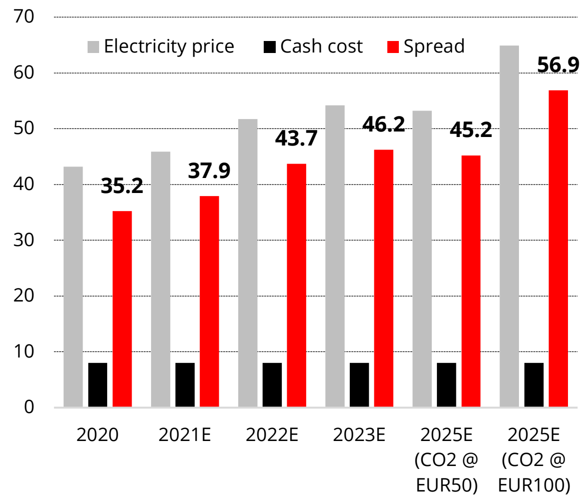


Fig. 9. CEZ: Nuclear prices / cash cost / spread [EUR/MWh]



Source for both graphs: Company data, Bloomberg, stooq.pl, Santander Brokerage Poland estimates

In nuclear generation, an all-time flat cash cost of EUR8/MWh simplifies this technology's clean spread calculations. We see nuclear's cash cost spread expanding to EUR38/MWh in 2021E and EUR46/MWh in 2023E. Using current 2025 market prices (electricity and carbon futures) suggests a nuclear spread of EUR45/MWh, and with carbon priced at EUR100/t (and our own calculation of the electricity price at EUR64/MWh in such a scenario) implies nuclear's cash cost spread expansion at EUR57/MWh.

Fig. 10. CEZ: Simplified EBITDA impact by technology, y/y change [CZKbn]

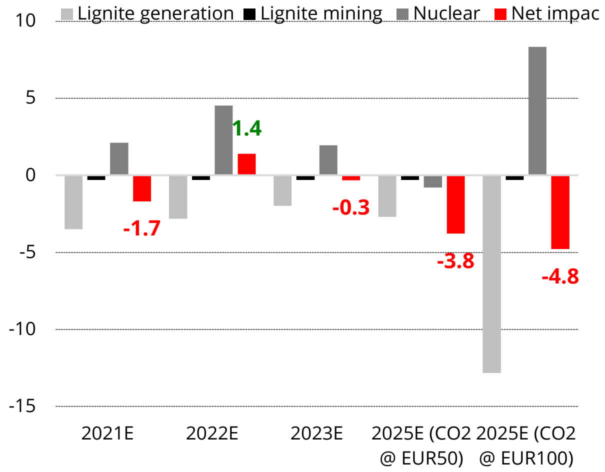
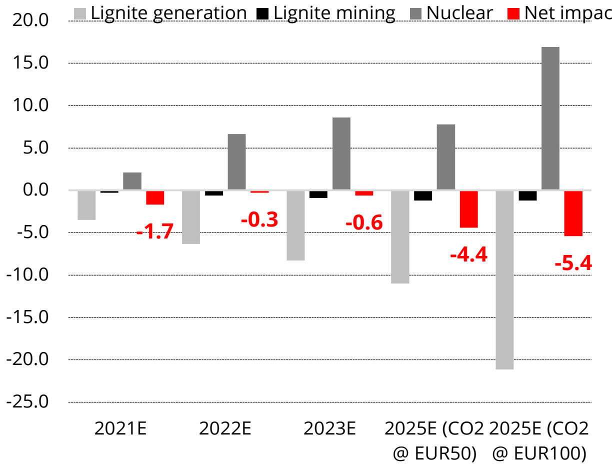


Fig. 11. CEZ: Simplified EBITDA impact by technology, compounded vs. 2020 [CZKbn]



Source for both graphs: Santander Brokerage Poland estimates

In the light of contracting spreads and volumes, we expect CEZ's lignite gross profit to fall, weakening annually and dropping CZK8.3bn in 2023E vs. 2020. In hypothetical scenarios for 2025E, we could see lignite's gross profit falling to CZK-0.2bn (CO_2 @ EUR50/t) or to CZK-6.6bn vs. 2023E (CO_2 @ EUR100/t). Nuclear's EBITDA should keep expanding y/y until 2023E, and different CO_2 scenarios could result in 2025E nuclear EBITDA coming in flat vs. 2023E (CO_2 @ EUR50/t) or growing CZK8.3bn vs. 2023E (CO_2 @ EUR100/t).

With the inclusion of the lignite mining segment's results, which we expect to fall CZK0.3bn p.a. due to contracting volumes, we see conventional generation, lignite mining and nuclear supporting CEZ's EBITDA by CZK0.4bn in 2021-23E. However, we believe lignite´s shrinking EBITDA may outweigh nuclear's potential upside in an environment of rising carbon prices, which would result in an overall negative impact for 2025E generation EBITDA vs. 2020.

Investment outlays. Last year CEZ guided for total five-year capex (2020-2024E) of CZK186bn, annually averaging CZK37bn. This year, while disposals reduced official capex guidance in distribution by CZK6bn, new five-year guidance is for capex to rise to CZK193bn (CZK38.6bn p.a.). New guidance assumes outlays on traditional generation rises by CZK12bn, mostly due to BAT modernization of lignite units.

Last year's capex outlook guided for only one year (2022E) with outlays close to CZK40bn, 2021E capex at CZK35bn and 2024E capex sliding to CZK33bn. The latest guidance is for annual capex remaining relatively stable just below CZK40bn.

Summary. CEZ's market perception is that results are positively correlated with rising CO_2 prices. In this research, we advocate this as likely to be false: CO_2 at EUR50/t could cut CEZ's EBITDA vs. 2020, because we expect the positive impact of clean nuclear generation could be lost at the EBITDA level by lignite, which is highly polluting. Our analysis suggests that CO_2 at EUR100/t might exacerbate this EBITDA-depressing trend, which may result in below-consensus EBITDA in future years. Also, CEZ's capex is rising, and close to CZK40bn p.a. up to 2025E with lignite capex (modernizations) CZK12bn higher in 2021-23E. **Our view is that lignite weakens CEZ's EBITDA profile: lignite's negative impact outweighs the benefit of nuclear generation and the extra capex required may keep CEZ's cash profile under pressure for several years**.

Results preview 1Q21E

[Presented in a separate sales note published on 23 April, 2021]

Fig. 12. CEZ: 1Q2021E results preview

CZKmn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21E	y/y	q/q
Sales	51,849	48,151	48,027	58,173	57,000	49,300	49,297	58,140	**59,591**	*4.5%*	*2.5%*
EBITDA	19,294	12,806	9,861	15,500	25,900	12,800	12,206	13,894	**23,200**	*-10.4%*	*67.0%*
EBITDA margin	*37.2%*	*26.6%*	*20.5%*	*26.6%*	*45.4%*	*26.0%*	*24.8%*	*23.9%*	***38.9%***	*-6.5*	*15.0*
EBIT	11,793	5,307	2,246	1,600	18,800	3,200	1,162	-10,577	**16,100**	*-14.4%*	*n.m.*
EBIT margin	*22.7%*	*11.0%*	*4.7%*	*2.8%*	*33.0%*	*6.5%*	*2.4%*	*-18.2%*	***27.0%***	*-6.0*	*45.2*
Net profit	8,299	2,901	167	900	14,200	2,200	-1,115	-9,817	**11,680**	*-17.7%*	*n.m.*
Net margin	*16.0%*	*6.0%*	*0.3%*	*1.5%*	*24.9%*	*4.5%*	*-2.3%*	*-16.9%*	***19.6%***	*-5.3*	*36.5*

Source: Company data, Santander Brokerage Poland estimates

Comment: Neutral outlook. The company's strong 1Q21 nuclear generation volumes and a high electricity price should be supportive to 1Q21E results. The Romanian asset disposal took place at end March, so we believe 1Q21E EBITDA will be the last quarter we can compare y/y EBITDA on the same asset base. The company delivered CZK65bn EBITDA in 2020 and guides for CZK60-63bn (pre-divestments), so that we expect 1Q21E EBITDA to come in 10% weaker vs. a strong 1Q20.

Non-adjusted EBITDA guidance for 2021 at CZK60-63bn

[presented in sales note published on 17 March, 2021]

Fig. 13. CEZ: EBITDA guidance and actual numbers, from 2019 to 2021

CZKmn	2019 guidance	2019 actual	2020 guidance	2020 actual	2021 guidance*
EBITDA	58	60.2	63-65	64.8	**60-63**
Adj. net profit	17-18	18.9	21-23	22.8	**17-20**

*Source: Company data, Santander Brokerage Poland estimates, * assumes full-year contribution of to-be-disposed assets*

- **2021 guidance**. CEZ guides for EBITDA ranging at CZK60-63bn and net profit at CZK17-20bn. EBITDA consists of CZK54-57bn from strategic assets and CZK6bn from those to be divested. For comparison, strategic assets' EBITDA was CZK54.2bn in 2019 and CZK 57.2bn in 2020, while assets held for sale delivered CZK6.0/7.6bn respectively in 2019/2020. Based on official estimates of divestments, CEZ sees EBITDA of assets-for-sale at CZK2-3bn, which would imply divestment-adjusted 2021 EBITDA guidance at CZK56-60bn;
- **2021 guidance in detail**. In its strategic assets' EBITDA, CEZ sees flat Distribution and Generation-Renewables y/y. Sales to grow by CZK0.4-1.4bn y/y, and Generation-Nuclear to increase by CZK1.3-2.4bn y/y. EBITDA of Generation-Emission is to decline by CZK3.3-4.1bn, and y/y change at Generation-Trading may range from negative CZK2.0bn to positive CZK0.5bn. EBITDA of Mining is to slide by CZK0.0-0.6bn y/y. CEZ expects share of Mining / Polluting Generation in its core assets' EBITDA mix to decline to 9% in 2021 from 16% in 2020;

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- **2021 guidance: volumes**. CEZ sees its generation volume at 54.1TWh in 2021, down 5% y/y vs 57.1TWh in 2020. The company expects its nuclear generation at 30.5TWh, up 2% y/y, while coal-fired generation is expected to slide 19% y/y to 15.9TWh due to units' closures / prolonged outages. CEZ expect negligible change at renewable volume, up 0.1TWh y/y to 3.5TWh;
- **Issues (all acc. to management)**. CEZ's CO2 pollution factor fell 10% y/y to 0.33x in 2020, and the company expects is at 0.28x at year-end 2021E. CEZ expects to build 1,000MW in renewables in Czech, with first auctions in 1-2 months. Nuclear project: CEZ and the government might agree on anything from CEZ's lack of involvement to EUR1bn equity input, the latter to be compensated with long-term PPAs. At net debt-to-EBITDA, CEZ's long-term targets settles below 3.0x, the company wants to keep some room in coming years ahead of renewable investments. Premiums in Czech electricity prices vs. German electricity prices to keep widening. CEZ's trading team (responsible for several CZK billion of extra profit in 2020) "had a good start of 2021". Also, low temperatures in 2021 year-to-date come in supportive to distribution's EBITDA.

Comment: Positive. Asset disposals should reduce official 2021 guidance from CZK60-63bn to CZK56-60bn, we believe, and a strong decline in coal-related EBITDA should keep CEZ's core EBITDA growth muted in 2021, partially due to its hedging policies in place (CEZ cannot take advantage of widening of its nuclear spread already in 2021). In our view, CEZ is suggesting that the first months of 2021 are strong in distribution and trading, which would lift FY2021 EBITDA closer to upper guidance range. CEZ's pollution factor should slide to 0.28x in 2021 acc. to the company, positive from ESG perspective. Also, the management suggested 2020 dividend pay-out (proposal to be announced in Apr 2021) may come in higher than CEZ's long-term 80-100% range. If CEZ made a 110% pay-out, investors could expect DPS at CZK47, implying 8.7% DY with record-day scheduled in several weeks.

Valuation

In valuation process we use DCF, DDM and comparable valuation methodologies. DCF remains our preferred valuation tool, as it relies more on the company's long-term outlook. As changes in financial results or changes in investors' preferences drive the comparable valuation, and management's decisions may alter DDM valuation outcomes, we see these as supportive to the DCF valuation. Hence, we use DCF as the primary valuation tool (60% weight), with 20% weight each for DDM and comparable valuation.

DCF valuation

Fig. 14. CEZ – WACC Assumptions

	Regulated business*	Non-regulated business**
Risk-free rate	**1.44%**	**1.44%**
Unlevered beta	0.70	0.90
Levered beta	1.05	1.35
Equity risk premium	4.50%	4.50%
Cost of equity	**6.15%**	**7.50%**
Risk free rate	1.4%	1.4%
Debt risk premium	0.3%	0.3%
Tax rate	19.0%	19.0%
After tax cost of debt	**1.41%**	**1.41%**

%D	38%	38%
%E	62%	62%
WACC [May 2021]	**4.35%**	**5.18%**

*Source: Company data, Santander Brokerage Poland estimates. * relates to Distribution segment, ** relates to all other segments*

Fig. 15. CEZ – DCF Valuation (free cash flows and terminal value)

CZKmn	PV FCF	PV TV	Total	Previous valuation	*Diff.*
Regulated businesses					
Distribution CZ ***			155,150	111,225	39%
Distribution SEE			0	0	*n.m.*
Renewables **	19,182	77,925	97,106	54,218	79%
Sub-total	***19,182***	***77,925***	***252,256***	**165,443**	**52%**
Non-regulated businesses					
Systemic generation **	83,162	129,716	212,878	240,086	-11%
Coal extraction	-921	-5,265	-6,185	-1,066	*n.m.*
Sales & others	27,513	52,458	79,971	81,119	-1%
Sub-total	***109,755***	***176,909***	***286,664***	**320,138**	**-10%**
Net debt and provisions*			208,942	214,112	-2%
Total DCF valuation [CZKmn, Jan 2021]			**329,978**	**271,469**	**22%**
Number of shares [mn]			538.0	538	0%
SOTP / DCF valuation per share [CZK, Jan 2021]			613	505	22%
SOTP / DCF valuation per share current [CZK, May 2021]			626	529	18%
12-month target price [CZK]			**655**	**554**	**18%**

*Source: Santander Brokerage Poland estimates, * includes nuclear provisions, minorities, also includes CZK40bn of Bulgarian, Romanian, Polish, Turkish assets-for-disposal, large hydro sub-segment in Czech (CZK2.2bn EBITDA p.a.) reclassified by CEZ to renewables from generation as of 2021, *** distribution valued at target 2025 Regulatory Asset Base, approved by the regulator*

DDM Valuation

Fig. 16. CEZ: DDM valuation

CZKmn	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Net profit	20,395	22,196	23,835	24,819	22,224	23,572	23,921	23,921	23,921	23,921
Payout *	438%	100%	90%	90%	90%	90%	90%	89%	89%	89%
Dividend paid	23,940	20,395	19,976	21,451	22,338	20,002	21,215	21,215	21,215	21,215
Cost of equity	6.82%									
Equity value per share [CZK]	**610**									

*Source: Company, Santander Brokerage Poland estimates, * calculated vs. previous year's reported net profit*

Comparative Valuation

Fig. 17. CEZ – Basics of comparable valuation approach

	2021E	2022E	2023E
Share of coal-based / sales / other activity *	18%	29%	29%
Share of New generation & nuclear *	47%	43%	43%
Share of Distribution segment *	35%	28%	27%

*Source: Santander Brokerage Poland estimates, * percentage of EBITDA in total EBITDA*

Fig. 18. CEZ vs Western European Utilities – Valuation Metrics, Impl. Valuation Ratios and Impl. Share Prices

	Western European utilities	P/E (x)			EV/EBITDA (x)		
		2021E	2022E	2023E	2021E	2022E	2023E
Generation – Polluters	*Segment median*	*19.8*	*14.5*	*13.9*	*7.9*	*7.4*	*7.2*
Generation – Clean	*Segment median*	*19.6*	*18.0*	*17.0*	*8.7*	*8.3*	*8.0*
Regulated	*Segment median*	*15.6*	*15.7*	*14.2*	*9.1*	*9.0*	*9.5*
CEZ	***Implied ratio****	**18.3**	**16.3**	**15.3**	**8.7**	**8.2**	**8.2**
CEZ	**Implied share price (CZK)** / *****	**722**	**701**	**707**	**544**	**508**	**513**

*Source: Bloomberg, Santander Brokerage Poland estimates, * weighted by company's business profile. Share prices on May 04, 2021, ** includes nuclear provisions in net debt calculation, *** blended comparable valuation calculated as simple average of 2021-23E P/E and EV/EBITDA outcomes*
Generation – Polluters: Public Power Corp, Drax, Enel, RWE
Generation – Clean: Iberdrola, Endesa, EDP, Verbund, EdF
Regulated: EVN, MVV Energie, Elia Group, Terna, Iren, REN, Red Electrica, SSE

Valuation summary `

Fig. 19. CEZ – Valuation Summary*

	Valuation CZK per share	*Upside / downside*	Weight	*Valuation outcomes Dec 2020*	*Difference*
DCF	655	9%	60%	554	18%
DDM	610	1%	20%	578	6%
Comparables	616	2%	20%	608	1%
Blended average target price	**638**	**6.2%**		**570**	**12%**

*Source: Santander Brokerage Poland estimates, * 1.2GW nuclear unit assumed to be neutral to valuation (CEZ may have option to sell the project to the State)*

Fig. 20. CEZ: Changes to Forecasts

CZKmn	2021E			2022E			2023E		
	Current	Previous	*Change*	Current	Previous	*Change*	Current*	Previous	*Change*
Sales	240,977	240,977	*0.0%*	268,039	268,039	*0.0%*	272,889	272,889	*0.0%*
EBITDA	57,870	54,046	*7.1%*	60,529	60,571	*-0.1%*	62,548	60,315	*3.7%*
EBIT	32,654	29,382	*11.1%*	35,402	35,743	*-1.0%*	37,813	36,000	*5.0%*
Net profit	20,395	18,095	*12.7%*	22,196	22,852	*-2.9%*	23,835	22,961	*3.8%*

Source: Santander Brokerage Poland estimates

Fig. 21. CEZ: Santander forecasts vs consensus

CZKmn	2021E			2022E			2023E		
	SANe	Consensus	*Diff.*	SANe	Consensus	*Diff.*	SANe*	Consensus	*Diff.*
Sales	240,977	215,928	*11.6%*	268,039	218,931	*22.4%*	272,889	208,791	*30.7%*
EBITDA	57,870	58,495	*-1.1%*	60,529	59,351	*2.0%*	62,548	61,232	*2.1%*
EBIT	32,654	30,131	*8.4%*	35,402	31,547	*12.2%*	37,813	31,415	*20.4%*
Net profit	20,395	19,464	*4.8%*	22,196	21,002	*5.7%*	23,835	22,056	*8.1%*

Source: Santander Brokerage Poland estimates

Financial statements

Fig. 22. CEZ – P&L, Per Share Ratios, Market Ratios, 2017-23E

CZKmn (year to December)	2017	2018	2019	2020	2021E	2022E	2023E
Revenues	167,717	184,486	206,192	242,196	240,977	250,933	186,582
Consolidated EBITDA, o/w:	**53,846**	**49,627**	**60,316**	**64,517**	**57,870**	**60,529**	**62,548**
New Generation	4,639	2,940	4,029	4,629	4,614	4,638	5,074
Old Generation	19,062	16,600	25,632	29,027	23,400	26,927	28,315
Distribution	19,350	20,001	20,600	21,500	17,488	19,186	19,643
Mining	4,900	4,500	4,991	3,429	3,346	3,082	2,635
Sales & Other	5,895	5,586	5,064	5,933	9,022	6,695	6,881
Consolidated EBIT, o/w:	**25,620**	**19,759**	**26,429**	**12,585**	**32,654**	**35,402**	**37,813**

New Generation	2,344	1,343	2,398	3,012	3,241	3,130	3,566
Old Generation	4,308	-535	10,245	14,055	8,848	12,679	14,465
Distribution	13,253	13,207	14,427	6,951	13,264	14,962	15,419
Mining	2,587	2,168	2,682	-2,541	746	462	67
Sales & Other	3,795	3,596	-3,323	3,106	6,555	4,168	4,295
Net financial income (costs)	-2,867	-6,242	-8,018	-4,679	-6,358	-6,797	-7,109
Net interests	-3,526	-4,862	-5,070	-4,892	-4,095	-4,476	-4,768
Interests on nuclear	-1,618	-1,800	-1,893	-1,955	-1,950	-2,010	-2,029
Others	4,664	728	-1,073	1,980	-500	-500	-500
Income from associates	-2,387	-308	18	188	188	188	188
Profit before tax	**22,753**	**13,517**	**18,411**	**7,906**	**26,296**	**28,605**	**30,704**
Income tax	3,794	3,017	3,911	2,438	5,775	6,281	6,743
Minorities	194	173	127	127	127	127	127
Net profit	**18,765**	**10,327**	**14,373**	**5,468**	**20,395**	**22,196**	**23,835**
*Net profit for dividend**	*18,765*	*13,100*	*18,900*	*22,800*	*20,395*	*22,196*	*23,835*
EPS	34.9	19.2	26.7	10.2	37.9	41.3	44.3
CEPS	87.3	74.7	80.7	62.7	84.8	88.0	90.3
BVPS	472.7	444.8	474.7	443.4	437.1	440.7	448.1
DPS	33.0	33.0	24.0	34.0	44.5	37.9	37.1
Div. yield	7.5%	6.1%	4.5%	7.3%	7.3%	6.3%	6.1%
P/E	12.6	28.2	19.8	45.9	15.9	14.6	13.6
P/CE	5.0	7.2	6.6	7.4	7.1	6.8	6.7
EV/EBITDA	**7.1**	**9.1**	**7.5**	**5.6**	**7.7**	**7.5**	**7.4**
EV/EBITDA (incl. nuclear provision)	***8.3***	***10.4***	***8.7***	***7.1***	***9.5***	***9.2***	***9.1***
EV/sales	2.3	2.5	2.2	1.5	1.9	1.7	1.7

*Source: Company Data, Santander Brokerage Poland estimates, * adjusted for one-offs, represents the basis for dividend payout*

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Fig. 23. CEZ – Balance Sheet Forecasts, 2017-23E

CZKmn (year to December)	2017	2018	2019	2020	2021E	2022E	2023E

Current assets	**135,953**	**223,911**	**202,638**	**230,513**	**219,918**	**226,388**	**226,329**
Cash and equivalents	12,623	4,193	9,755	46,437	36,163	35,521	34,187
Other short-term investment	43,098	93,303	61,114	61,894	61,894	61,894	61,894
Accounts receivable	50,559	72,234	65,030	63,648	63,328	70,439	71,714
Inventories	18,716	26,458	37,682	48,951	48,951	48,951	48,951
Pre-paid expenses	10,957	27,723	29,057	9,583	9,583	9,583	9,583
Fixed assets	**487,953**	**483,532**	**501,936**	**471,945**	**483,601**	**496,248**	**510,786**
PPE	428,019	415,908	428,088	410,372	422,028	434,675	449,213
Long-term investments	3,520	3,361	3,282	4,075	4,075	4,075	4,075
Intangibles	28,313	31,655	31,655	32,426	32,426	32,426	32,426
Long-term receivables	26,804	31,127	37,429	24,244	24,244	24,244	24,244
Long-term deferred charges	1,297	1,481	1,482	828	828	828	828
Total assets	**623,906**	**707,443**	**704,574**	**702,458**	**703,520**	**722,636**	**737,115**
Current liabilities	**127,981**	**218,140**	**186,771**	**207,636**	**207,268**	**215,446**	**216,911**
Bank debt	21,832	18,526	29,323	29,725	29,725	29,725	29,725
Accounts payable	48,087	63,093	66,244	73,189	72,821	80,999	82,464
Other current liabilities	176	253	628	555	555	555	555
Short-term provisions	57,886	136,268	90,576	104,167	104,167	104,167	104,167
Long-term liabilities	**241,603**	**250,022**	**262,439**	**256,259**	**261,107**	**270,117**	**279,146**
Bank debt	132,475	142,440	142,570	122,102	125,000	132,000	139,000
Deferred charges	61,616	63,646	75,762	98,860	100,810	102,820	104,849
Other long-term liabilities	19,993	16,699	20,626	19,383	19,383	19,383	19,383
Provisions	27,519	27,237	23,481	15,914	15,914	15,914	15,914
Equity	**254,322**	**239,281**	**255,364**	**238,563**	**235,145**	**237,073**	**241,058**
Share capital	53,799	53,799	53,799	53,799	53,799	53,799	53,799
Capital reserves	177,454	170,595	182,589	174,604	156,132	156,132	158,352
Net income	18,765	10,327	14,373	5,468	20,395	22,196	23,835
Minority interest	4,304	4,560	4,603	4,692	4,819	4,946	5,073
Total liabilities and equity	**623,906**	**707,443**	**704,574**	**702,458**	**703,520**	**722,636**	**737,115**
Net debt	**141,684**	**156,773**	**162,138**	**105,390**	**118,562**	**126,204**	**134,538**

Source: Company data, Santander Brokerage Poland estimates

Fig. 24. CEZ: Cash Flow Statement Forecasts, 2017-23E

CZKmn (year to December)	2017	2018	2019	2020	2021E	2022E	2023E
Cash flow from operations	**72,973**	**38,943**	**36,043**	**78,626**	**47,513**	**50,399**	**50,790**
Net profit	18,765	10,327	14,373	5,468	20,395	22,196	23,835
Provisions	18,480	-282	-3,756	-7,567	0	0	0
Depreciation and amortisation	28,226	29,868	29,016	28,284	25,216	25,127	24,736
Changes in WC, o/w	-20,017	-14,411	-869	-2,942	-48	1,066	191
Inventories	-6,885	-7,742	-11,224	-11,269	0	0	0
Receivables	-9,718	-21,675	7,204	1,382	320	-7,112	-1,275
Payables	-3,413	15,006	3,151	6,945	-368	8,178	1,466
Other, net	27,519	13,441	-2,721	55,383	1,950	2,010	2,029
Cash flow from investment	**-37,089**	**-28,664**	**-43,118**	**391**	**-36,872**	**-37,773**	**-39,274**
Additions to PPE and intangibles	-29,666	-21,099	-41,196	-11,339	-36,872	-37,773	-39,274
Change in long-term investments	4,469	159	79	-793	0	0	0
Other, net	-11,892	-7,724	-2,001	12,523	0	0	0
Cash flow from financing	**-35,992**	**-18,709**	**12,637**	**-42,335**	**-20,915**	**-13,268**	**-12,849**
Change in long-term borrowing	-8,100	9,965	130	-20,468	2,898	7,000	7,000
Change in short-term borrowing	1,832	-3,306	10,797	402	0	0	0
Change in equity and profit distribution	-11,970	-7,614	14,622	-3,977	127	127	127
Dividends paid	-17,754	-17,754	-12,912	-18,292	-23,940	-20,395	-19,976
Other, net	0	0	0	0	0	0	0
Net change in cash and equivalents	**-108**	**-8,430**	**5,562**	**36,682**	**-10,274**	**-642**	**-1,334**
Beginning cash and equivalents	12,731	12,623	4,193	9,755	46,437	36,163	35,521
Ending cash and equivalents	12,623	4,193	9,755	46,437	36,163	35,521	34,187

Source: Santander Brokerage Poland estimates

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EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)
PEG - P/E to growth ratio
EPS - earnings per share
CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity
P/BV – price-book value

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In preparing this document Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.
The discounted cash flows (DCF) valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.
The mid-cycle multiple valuation is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we usually use Bloomberg or Damodaran databases). Simplicity and average through-cycle value allowing to capture over- as well as under-valuation of a given stock are the main advantages of this methodology.
The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.
Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The warranted equity method (WEV) is based on the formula P/BV = (two year forward ROE less sustainable growth rate)/(Cost of equity less sustainable growth rate) which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.
SOTP valuation - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.
Liquidation value method – liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

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