MOODY'S
INVESTORS SERVICE

CREDIT OPINION
1 December 2023

Update

Send Your Feedback

RATINGS

Moravian-Silesian, Region of

Domicile	Czech Republic
Long Term Rating	A1
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Irena Krizkovska +420.23.474.7528
Analyst
irena.krizkovska@moodys.com

Maksym Rudnichenko +44.20.7772.8725
Ratings Associate
maksym.rudnichenko@moodys.com

Massimo Visconti, MBA +39.02.9148.1124
VP-Sr Credit Officer/Manager
massimo.visconti@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

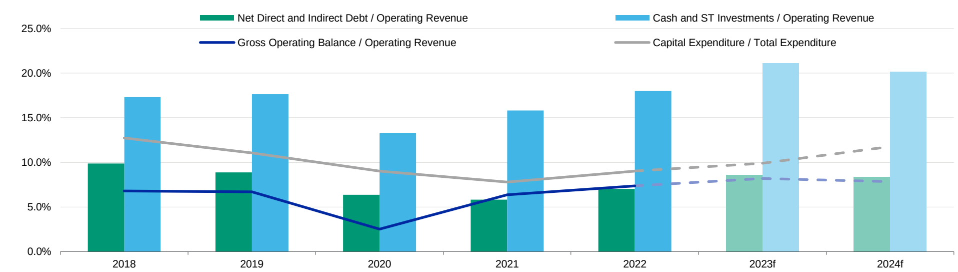
Moravian-Silesian Region (Czech Republic)

Update following outlook change to stable from negative

Summary

The credit profile of the Moravian-Silesian Region (MSR, A1 stable) reflects its very low debt level, solid operating performance, strong liquidity and a moderate likelihood that the Government of the Czech Republic (Aa3 stable) will provide support if the region faces acute liquidity stress. The MSR's operating performance is tightly linked to the development of the national economy, while its good self-funding capacity is attributable to the region's prudent and conservative budgetary management. The MSR's rating is constrained by the pressure stemming from investment requirements and its significant reliance on the transfers from the central government to meet its responsibilities. These transfers together with shared taxes constitute about 98% of operating revenue and limit MSR's revenue flexibility.

Exhibit 1
Strong cash position and very low debt levels will be preserved in 2023-24



F = Forecast.
Source: The MSR and Moody's Investors Services

Credit strengths

» Continued solid operating performance despite the economic slowdown at the national level

» Debt levels will remain very low over 2023-2024

» High level of liquid reserves

Credit challenges

» Pressure on financial performance stemming from investment requirements

» Limited revenue and expense flexibility

Rating outlook

The stable outlook reflects the region's capacity to maintain solid operating performance, high liquidity and very low debt levels over the medium term.

Factors that could lead to an upgrade

An upgrade of the sovereign rating and / or indications of strengthening government support, along with MSR's continued sound operating performance, strong liquidity and contained debt burden, would exert upward pressure on the region's rating.

Factors that could lead to a downgrade

Downward pressure on the rating could result from a downgrade of the sovereign rating and/or indications of weakening government support. Additionally, deterioration in the region's operating performance, combined with a decline in liquidity and an unexpected increase in debt would lead to downward pressure on the rating.

Key indicators

Exhibit 2

Moravian-Silesian Region

(31th December)	2018	2019	2020	2021	2022	2023f	2024f
Net Direct and Indirect Debt / Operating Revenue	9.9%	8.9%	6.4%	5.8%	7.0%	8.6%	8.4%
ST Debt / Operating revenue	7.9%	3.3%	2.7%	2.5%	3.7%	3.0%	2.7%
Interest Expense / Operating Revenue	0.1%	0.2%	0.1%	0.0%	0.3%	0.4%	0.3%
Gross Operating Balance / Operating Revenue	6.8%	6.7%	2.5%	6.4%	7.4%	8.2%	7.8%
Cash Financing Surplus / Total Revenue	-0.3%	2.1%	-1.4%	3.9%	2.7%	2.1%	-0.4%
Cash and ST Investments / Net direct and indirect debt	175.2%	198.4%	208.4%	272.0%	255.9%	245.1%	240.6%
Capital Expenditure / Total Expenditure	12.7%	11.0%	9.0%	7.8%	9.0%	9.9%	11.8%
Cash and ST Investments / Operating Revenue	17.3%	17.6%	13.3%	15.8%	18.0%	21.1%	20.2%

The forecasts (F) are our opinion and do not represent the view of the issuer.
Source: MSR, Moody's Investors Service

Detailed credit considerations

On 28 November 2023, Moody's has affirmed the MSR's A1 long-term issuer rating and changed the outlook to stable from negative, following the change of outlook to stable from negative on the Czech Republic's government bond rating on 24 November 2023. This reflects region's tight linkages to the national economy.

The credit profile of the MSR, as expressed in its A1 rating, combines a Baseline Credit Assessment (BCA) of a1 and a moderate likelihood of extraordinary support from the national government in the event that the region faces acute liquidity stress.

Baseline credit assessment

Continued solid operating performance despite the economic slowdown at the national level

MSR has a good track record of operating surpluses with average gross operating balance (GOB) at 5.9% of operating revenue over the past decade.

In 2022, the MSR's operating revenue grew modestly by 7% and reached CZK34 billion. This growth was attributable to considerably strong collection of shared taxes which posted 14% increase. Shared taxes, the most flexible source of revenue consisting of value-added tax, personal and corporate income tax, benefitted from stubbornly high inflation. Inflationary environment (in average 15.1% in 2022, significantly above the average 3.8% in 2021) contributed to a 16% increase of value-added tax despite the national economic slowdown. Higher collection of shared taxes provided sufficient cover for the 5.5% increase in operating expenditure in 2022. Operating expenditure did not contain any extraordinary items as during the pandemic. The Czech government almost fully compensated expenses related to the Ukrainian refugees. Thus, MSR's operating performance improved in 2022, with GOB at 7.4% of operating revenue compared to 6.4% in 2021.

In 2023, we expect GOB to stabilize at 8.2% of operating revenue. This will be attributable to the strong shared tax collection supported by expected average inflation at 11.6% in 2023, the expected economic slowdown at the national level (Moody's expects the real GDP to contract by 0.3%) and slight increase in operating expenses driven by higher financial support to contributory organizations and rising expenses related to transportation compared to 2022.

In 2024, we expect positive economic growth for the Czech economy with real GDP growth at 1.9%. This will lead to GOB margin's stabilization to 7.8%. We believe that MSR will continue to manage its operating performance in prudent manner with the tight grip over operating expenditure and further supported by the expansion of shared tax revenue.

Debt levels will remain low over 2023-24

The region has in line with its rated Czech peers a very low ratio of net direct and indirect debt (NDID) to operating revenue below 10%. NDID to operating revenue increased to 7.0% of operating revenue in 2022 from 5.8% in 2021. MSK uses bank loans to finance investment projects. The MSR's direct debt of CZK2.2 billion consisted at year end 2022 of two loans totaling CZK1.06 billion from UniCredit Bank Czech Republic and Slovakia, CZK230 million loan from the European Investment Bank (EIB, Aaa stable) and CZK910 million loan (total limit CZK3 billion, to be drawn in phases till 2024) from Česká spořitelna to support investment projects. Only the EIB loan, representing 10% of the loan portfolio, has fixed interest rate. All the remaining loans have floating interest rate. The interest rate acceleration in 2022 significantly hit the amount of interest expenses related to these loans. Nevertheless, the interest expenses to operating revenue ratio remained very low at 0.3% in 2022 (0.04% in 2021) and we expect interest expenses to remain below 0.5% of operating revenue in 2023-24.

The region has traditionally a high share of short-term debt (56.5% of total direct debt in 2022; 43.7% in 8 years average), this is represented by payments planned for the current year. However, this poses very little risk because of the high cash reserves' level and overall low level of debt. Most of the short-term debt is dedicated to prefinance subsidies from the central government and the European Union (EU, Aaa stable). Indirect debt, consisting of the debt of the Mosnov airport, the debt of regional hospitals and provided guarantee for the debts of VaK Bruntál (water management company operating in MSR), accounted for 8.0% of NDID in 2022. Cash reserves at the end of 2022 were sufficient to cover outstanding debt more than 2.5 times.

We expect the region's direct debt to remain broadly stable because of its investment requirements. Nevertheless, NDID will remain very low at about 9% of operating revenue in 2023-24 and region's liquidity reserves will be sufficient to fully cover NDID.

High level of liquid reserves

The region's track record of solid financial performance has led to a comfortable liquidity buffer over the last few years. In 2022 its accumulated cash and short-term investments increased, reaching upwards of CZK6.1 billion (18.0% of operating revenue), almost CZK1.1 billion more than that as of year-end 2021. The increase in liquidity in 2022 was attributable mainly to the strong operating performance.

The liquidity management remained conservative using mainly term deposit for the free liquidity to take interest. Mirroring the same situation for interest expenses, interest revenue posted a growth representing 0.8% of operating revenue from 0.1% in 2021.

The high level of cash reserves correlates with the investment plan. According to the Czech law, public entity has to hold liquidity for financing of all investment projects planned for respective fiscal year. MSR widely uses national or EU subsidy for financing but these are often received ex post and the law doesn't distinguish between own share on financing and external sources and requires the respective amount to be available on request.

We expect the MSR's cash reserves to peak at 21.1% of operating revenue in 2023 and range around that level in 2024 as the region will increase its investment activity. Overall strong liquidity position further supports region's credit quality and offers flexibility to accommodate extraordinary cash outflows.

Pressure on financial performance stemming from investment requirements

In 2022, capital spending represented CZK3.13 billion, or 9.0% of total expenditure, which is below the 10 years average (11%), and almost 48% was covered by central government and EU subsidies. Compared the real execution to the budgeted amount, MSR reached the execution rate at 78%. The under-execution on capital spending stemmed from the project documents' insufficient quality for some tendered projects which causes delays in the execution.

For 2023, the MSR budgeted CZK4.9 billion of capital spending. The highest proportion of investments is intended to flow into the sectors of traffic infrastructure, health care and education. MSR monitors the investment plan on quarterly basis and revises the level of capital spending in the budget of respective year. The MSR's capital plan consists of two high-ticket projects — construction of a new library with the digital workplace, and renovation of the Mosnov airport runway. The realisation of these two projects depends on available funding sources, mainly from own revenue and subsidies.

MSR is one of the three regions in the Czech Republic eligible for funds under Just Transition Programme provided by EU for 2021-2027. This programme aims to address the social, economic and environmental impacts of the transition to a climate-neutral economy. MSR's area can use totally CZK18.9 billion for further development and improvement of social and environmental aspects in the region.

Limited revenue and expense flexibility
The institutional framework for Czech regions is mature with stable financial predictability and stability. However, the MSR has very limited control over its revenue base. The vast majority (72.0% of the MSR's operating revenue in 2022) stemmed from central government transfers in the form of earmarked grants for education, health care and social services. Shared taxes represented 26.6% of operating revenue in 2022 and constitute of the national pool of value-added tax, personal and corporate income tax. They are redistributed from the central government, MSR does not benefit from the regional economic performance. However, the proceeds from shared taxes represent the key revenue source for spending flexibility. Czech regions don't have any leeway to impose and collect regional taxes.

On the spending side, around 78% of MSR's operating spending match with the central government subsidies. The region has some leeway to control costs by maximizing the efficiency of its operations and streamlining the structure of its organizations. MSR closely monitors its contributory organizations focusing on their efficiency. Capital spending remains the most flexible and can be partially scaled down during the negative economic climate.

We believe that the fiscal consolidation package adopted by the central government will not have material negative impact on the region's budget.

Extraordinary support considerations

The MSR has a moderate likelihood of receiving extraordinary support from the central government, reflecting the central government's promotion of greater accountability for Czech regions. The system of oversight implemented by the central government requires regular monitoring of the regions' debt and liquidity. Reputational risk issues for the central government appear modest, given the regions' debt structure, which relies more on bank loans than on bonds.

ESG considerations

Moravian-Silesian Region's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score

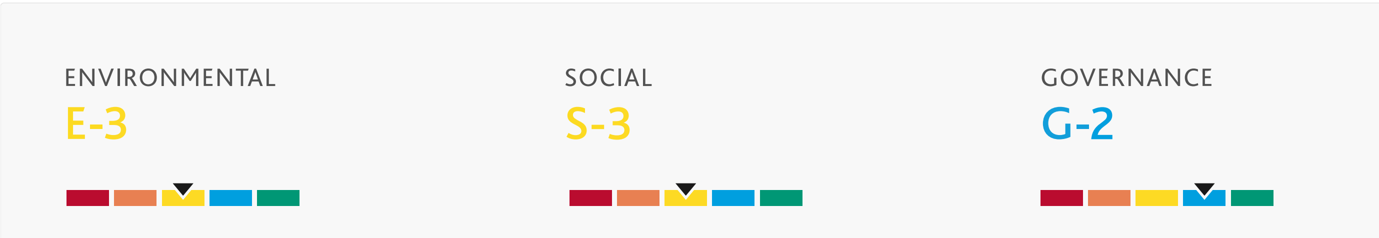
CIS-2

ESG considerations do not have a material impact on the current rating.

Source: Moody's Investors Service

Moravian-Silesian Region's ESG Credit Impact Score (**CIS-2**) indicates that ESG considerations do not have a material impact on the rating. The score reflects limited impact of governance risks on the rating, along with only moderate exposure stemming from environmental and social risks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Investors Service

Environmental

The **E-3** issuer profile score (IPS) reflects moderate exposure to physical climate risks and waste and pollution risks. The region's main risk stems from air pollution, MSR has the lowest air quality among the Czech regions. The air pollution reflects region's industrial character, cross-border pollution from Poland (A2 stable) and geomorphology (area of Ostrava basin). Despite recent considerable environmental improvement resulting from the decline in industrial production, coal mining and associated industrial sectors such as steel production influenced the character of the region's landscape for a long period. Other risks include contamination of soil and groundwater, mining subsidence and pollution of surface waters. The improvement in environmental area will need significant investments by both private and public institutions, the investments in environmental protection in the region are significantly above the long term per-capita national average and partially mitigate environment's risks. The regional role in environmental protection is mostly defined by the national law and regulations but the region has introduced several initiatives for improving environmental aspects.

Social

The **S-2** IPS reflects moderate exposure to social risks across most categories. Some of the social factors are closely impacted by the slowdown of the heavy industry in the region and its industrial character. Emigration from the region used to be higher in the past because of the shutdown of the coal industry (which employed 15% of the workforce in 1990) but it remains the highest in national comparison. Like other Czech regions, demographic change in the form of relatively fast population ageing poses a long-term fiscal sustainability challenge to the region. Regional unemployment rate is in long-term period above the national average meanwhile the average salary lags behind the national average approximately by 10% which might constrain further economic development of the region. The region has presented several projects to make the region more attractive from social and economic perspective.

Governance

Moravian-Silesian Region's solid institutions and governance profile is captured by **G-2** IPS. The region operates in an overall strong institutional framework. The region has a long history of conservative budgetary management with low debt appetite and has a set of sound internal controls in place. Coupled with solid financial position, this supports a high degree of resilience, mitigating E and S risks.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of a1 is higher than the scorecard-indicated BCA of a3. The matrix-generated BCA of a3 reflects an Idiosyncratic Risk score of 4 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aa3, as reflected in the Czech Republic's sovereign bond rating.

The two-notch differential reflects a number of factors that the scorecard does not capture. These include limited impact of local GDP per capita on the region's fiscal income and the low amount of the short term debt in the absolute value, in addition fully covered by the cash reserves.

Exhibit 5

Moravian-Silesian, Region of

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**6.60**	**20%**	**1.32**
Economic Strength [1]	9	78.03%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**5**	**20%**	**1.00**
Legislative Background	1		50%			
Financial Flexibility	9		50%			
Factor 3: Financial Position				**3.25**	**30%**	**0.98**
Operating Margin [2]	3	6.39%	12.5%			
Interest Burden [3]	1	0.17%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	7.03%	25%			
Debt Structure [5]	9	56.54%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**3.60 (4)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**a3**
Assigned BCA						**a1**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2022.

Ratings

Exhibit 6

Category	Moody's Rating
MORAVIAN-SILESIAN, REGION OF	
Outlook	Stable
Baseline Credit Assessment	a1
Issuer Rating	A1

Source: Moody's Investors Service

REPORT NUMBER 1387778

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454