MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION

4 May 2020

Rate this Research

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

Martin Pavlis +420.23.474.7548
Associate Analyst
martin.pavlis@moodys.com

Vojtech Zelezny +420.23.474.7540
Analyst
vojtech.zelezny@moodys.com

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

Moravian-Silesian Region (Czech Republic)

Update to credit analysis

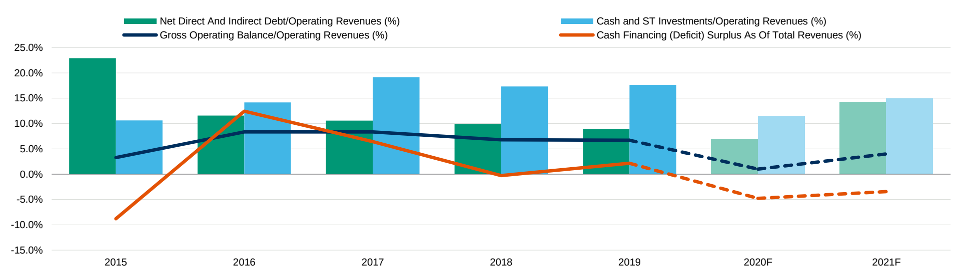
Summary

The credit profile of the Moravian-Silesian Region (MSR, A1 stable) reflects its low debt levels, 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 region's solid operating performance is tightly linked to the growth of the national economy, while its good self-funding capacity is attributable to the MSR's prudent budgetary management. The MSR's rating is constrained by the pressure stemming from investment requirements.

The rapid and widening spread of the coronavirus outbreak and the associated deterioration in the global economic outlook, combined with falling oil prices and asset price declines, are creating a severe and extensive credit shock across many sectors and regions, including the MSR.

Exhibit 1

Operating and cash financing performance likely to deteriorate because of the coronavirus outbreak



F = Forecast.

Sources: Moravian-Silesian Region and Moody's Investors Service

Credit strengths

» Solid operating performance

» Debt levels to remain low over 2020-21

» High level of liquid reserves

Credit challenges

» Pressure on financial performance stemming from investment requirements

Rating outlook

The stable rating outlook reflects our expectation that the region will maintain its solid operating performance, satisfactory liquidity and already low debt levels over the next 12-18 months. The stable rating outlook also reflects the stable outlook on the sovereign rating.

Factors that could lead to an upgrade

» Improvement in operating performance, along with sustained high cash levels and debt reduction

» An upgrade of the sovereign rating

Factors that could lead to a downgrade

» A deterioration in the MSR's operating margin, combined with a decline in liquidity and an increase in debt, would lead to downward pressure on the rating.

» Negative pressure is not expected, given the recent upgrade of the sovereign bond rating.

Key indicators

Exhibit 2

Moravian-Silesian Region

	2015	2016	2017	2018	2019
Local GDP Per Capita/National Average	83.0%	83.0%	82.4%	83.5%	84.6%
Net Direct And Indirect Debt/Operating Revenues (%)	22.9%	11.6%	10.6%	9.9%	8.9%
Debt Repayment / Operating Revenue (%)	8.2%	9.5%	1.0%	3.0%	6.8%
Interest Expenses/Operating Revenues (%)	0.3%	0.2%	0.1%	0.1%	0.2%
Gross Operating Balance/Operating Revenues (%)	3.3%	8.3%	8.3%	6.8%	6.7%
Cash Financing (Deficit) Surplus As Of Total Revenues (%)	-8.8%	12.4%	6.4%	-0.3%	2.1%
Cash And St Investments/Net Direct And Indirect Debt (%)	46.4%	122.6%	172.0%	166.2%	189.7%
Capital Expenses/Total Expenses (%)	21.2%	6.6%	6.8%	12.7%	11.0%
Cash And St Investments/Operating Expenditures	11.0%	15.5%	19.8%	17.6%	18.1%

Sources: Moravian-Silesian Region, National Statistical Office and Moody's Investors Service

Detailed credit considerations

The credit profile of the MSR, as expressed in its A1 rating, combines (1) a Baseline Credit Assessment (BCA) of a1, and (2) a moderate likelihood of extraordinary support from the national government in the event that the region faces acute liquidity stress.

Baseline Credit Assessment

Solid operating performance

In 2019, the MSR's operating revenue reached CZK26 billion, which translates into a 15% increase from that in 2018. The key drivers of this growth were the rise in central government operating transfers to cover increased salaries of teachers and social workers, and the increase in shared taxes, mainly Corporate income tax and Personal income tax (CIT and PIT), driven by growth in the national economy (2.6% real GDP growth in 2019). Moreover, the MSR received a CZK510 million one-off payback from previously provided loans to regional companies and institutions, including a part from the regional facility programme called Jessica.

In 2020, we expect the MSR's operating margin to deteriorate to around 2% of operating revenue from 6.7% in 2019. This deterioration will be caused by the coronavirus outbreak, which will lead to a fall in the national GDP (we expect real GDP to shrink by 4.1% in 2020), resulting in lower income from national shared taxes (including PIT, VAT and CIT). In addition, we expect operating expenditure to increase, mainly driven by the rising demand for health and social care services. Transfers from the central government will increase as the central government announced further hikes in teachers' salaries. However, these transfers are earmarked and cannot be used for other purposes. In response to the expected worsening of the operating performance, the MSR plans to cut subsidies for other organisations.

In 2021, we expect a partial recovery of the Czech economy and a boost in shared tax revenue. We do not expect the central government to change the share of taxes attributable to the regions in this time frame.

Debt levels will remain low over 2020-21

The region's ratio of net direct and indirect debt (NDID) to operating revenue declined further to 8.9% in 2019 from 9.9% in 2018. This decline was caused by a rise in operating revenue, rather than a decline in debt. The MSR's direct debt of CZK2.2 billion consisted of (1) a CZK1.5 billion loans from UniCredit Bank Czech Republic and Slovakia a.s., (2) a CZK460 million loan from the European Investment Bank (EIB, Aaa stable), and (3) a CZK229 million revolving credit facility from Ceskoslovenska Obchodni Banka, a.s. (CSOB), which the region will pay off this year.

Indirect debt, consisting of the debt of regional hospitals (CZK90.8 million) and the Mosnov airport (CZK36.7 million), accounts for 5.8% of NDID.

Short-term direct debt represented 58.8% of total direct debt as of year-end 2019. However, we do not expect the MSR's debt profile to become a significant risk for the region, mainly because of a sufficient cash pile, covering 1.9x the value of NDID.

Because 2020 is an election year, we expect debt levels to remain stable. Following the elections, the region plans to take a new loan of CZK2 billion to boost the funding of new capital projects. We project NDID to remain below 8% of operating revenue in 2020 and below 15% in 2021. The region has full access to multiple sources of financing and will prefer either the local banks or the EIB.

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. Its accumulated cash and short-term investments strengthened in 2019, reaching almost CZK4.6 billion (17.6% of operating revenue), CZK600 million more than that as of year-end 2018. The liquidity is available on very short notice, with CZK2.1 billion allocated to the region's checking account, CZK1.4 billion to the region's fund accounts that are earmarked for specific purposes and CZK900 million to savings accounts for value appreciation. Furthermore, CZK200 million is allocated for bonds with a quarterly liquidation.

We expect the MSR's cash reserves to decrease in 2020 because of the deterioration in operating performance and the repayment of the outstanding debt. The cash financing deficit is projected to reach 5% of total revenue in 2020 and 3% in 2021.

Pressure on financial performance stemming from investment requirements

In 2019, capital spending represented 11.2% of total expenditures, which is in line with the long-term average, and almost 45% was covered by the central government and the European Union (Aaa stable) subsidies.

For 2020, the MSR budgeted CZK3 billion of capital spending, which is roughly the same amount that was realised in 2019. The highest proportion of investments is intended to flow into the fields of social services and education. We expect the final execution of investment budget to be lower because of the fact that the region would reschedule or resize projects that were not started before the coronavirus outbreak.

The MSR's capital plan consists of three high-ticket projects. These are construction of a new gallery and a library, and renovation of the Mosnov airport runway. The realisation depends on available funding sources, mainly from own revenues and subsidies. We estimate the construction of the gallery and the library to commence in 2021-22 because these are MSR's priorities, and the project documentation is already being prepared. The renovation of the new runway can be postponed in case of financial distress. Nevertheless, the possibility of a delay is limited because the runway is reaching the end of its technical life span and had to be closed for several days in 2019 because of needed repairs.

Extraordinary support assumptions

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

How environmental, social and governance risks inform our credit analysis of the MSR

We take account of the impact of environmental, social and governance (ESG) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of the MSR, the materiality of ESG considerations to its credit profile is as follows:

Environmental considerations are not material to the MSR's credit profile. The highest risk stems from air pollution because of the fact that the region is one of the two industrial centres of the Czech Republic and suffers from cross-border pollution coming from Poland (A2 stable).

Social considerations are material to the MSR's credit profile. 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 is still prevalent. We expect the population of the economically slower parts (Bruntal, Karvina and Havirov) to further decline. We view the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety in the MSR and the risk of a continued spread of the outbreak within the region.

Governance considerations are material to the MSR's credit profile. The region has a long history of conservative financial management. The set of internal controls in place are sound.

Further details are provided in the “Detailed credit considerations” section . Our approach to ESG is explained in our cross-sector rating methodology General Principles for Assessing ESG Risks.

Rating methodology and scorecard factors

The assigned BCA of a1 is close to the scorecard-indicated BCA of a2. The scorecard-generated BCA of a2 reflects (1) an Idiosyncratic Risk score of 3 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a Systemic Risk score of Aa3, as reflected in the sovereign bond rating of the Czech Republic.

Exhibit 3

Regional and local governments

Rating Factors						
Moravian-Silesian, Region of						
Baseline Credit Assessment	**Score**	**Value**	**Sub-factor Weighting**	**Sub-factor Total**	**Factor Weighting**	**Total**
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	7	83.97	70%	5.2	20%	1.04
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	5	20%	1.00
Financial flexibility	9		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	3	6.96	12.5%	3.25	30%	0.98
Interest payments / operating revenues (%)	1	0.17	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	8.89	25%			
Short-term direct debt / total direct debt (%)	9	58.82	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						**3.32(3)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**a2**

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
MORAVIAN-SILESIAN, REGION OF	
Outlook	Stable
Issuer Rating	A1

Source: Moody's Investors Service

Moody's related publications

» Regional & Local Governments – Czech Republic: Exceptional liquidity and strong fundamentals will mitigate significant coronavirus effects, published in April 2020

REPORT NUMBER 1224215

CLIENT SERVICES

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

MOODY'S
PUBLIC SECTOR EUROPE