MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
4 May 2021

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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

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

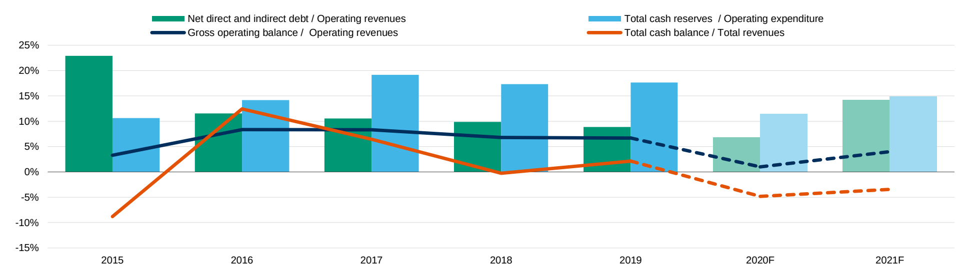
Region of Moravian-Silesian (Czech Republic)

Update to credit analysis

Summary

The credit profile of the Region of Moravian-Silesian (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 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 budgetary management. The MSR's rating is constrained by the pressure stemming from investment requirements.

Exhibit 1
Operating and cash financing deteriorated because of the pandemic



F = Forecast.
Sources: The MSR and Moody's Investors Service

Credit strengths

» Operating performance will recover because of economic growth

» Debt levels to remain low over 2021-23

» 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, strong liquidity and 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

» Sustained 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 a rating downgrade.

» A rating downgrade is currently unlikely because of the recent affirmation of the sovereign bond rating.

Key indicators

Exhibit 2
Moravian-Silesian Region

	2016	2017	2018	2019	2020
Local GDP per capita / National average	83.0%	82.4%	83.5%	84.6%	84.6%
Net direct And Indirect Debt /Operating Revenues (%)	11.6%	10.6%	9.9%	8.9%	6.4%
Debt Repayment / Operating Revenues (%)	9.5%	1.0%	3.0%	6.8%	3.0%
Interest Expenses / Operating Revenues (%)	0.2%	0.1%	0.1%	0.2%	0.1%
Gross Operating Balance / Operating Revenues (%)	8.3%	8.3%	6.8%	6.7%	2.5%
Cash Financing Surplus(Requirement) / Total Revenues (%)	12.4%	6.4%	-0.3%	2.1%	-1.4%
Cash and ST Investments (% Of NDID)	122.6%	172.0%	166.2%	189.7%	208.6%
Capital expenses / Total expenses (%)	6.6%	6.8%	12.7%	11.0%	9.1%
Cash and ST Investments / Operating Expenditures (%)	15.5%	19.8%	17.6%	18.1%	13.6%

Sources: The MSR, National Statistical Office and Moody's Investors Service

Detailed credit considerations

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

Operating performance will recover because of economic growth

In 2020, the MSR's operating revenue grew despite the pandemic and reached CZK28.6 billion, which translates into a 9.9% increase from that in 2019. The key drivers of this growth were the rise in central government operating transfers to cover increased salaries of teachers and social workers. Shared taxes, the most flexible source of revenue, declined to CZK7.0 billion in 2020 from CZK7.4 billion in 2019. Corporate income tax(CIT)was the largest contributor to this decline, falling by CZK300 million between 2019 and 2020. This was because of the contraction of the national economy (Czech real GDP growth was -5.6% in 2020).

In 2021, we expect the MSR's gross operating margin (GOB) to recover to around 4.5% of operating revenue from 2.9% in 2020. This improvement will be caused a recovery of the national economy (we expect real GDP to grow by 2.5% in 2021). In December 2020, the central government cancelled the supergross personal income tax, resulting in a fall in the effective tax rate to 15% from 20.1%. This was compensated by an increase in the share of taxes attributable to regions to 9.78% from 8.92%. We expect the shared tax revenue to reach around CZK7.2 billion for 2021.

In 2022, we expect a full recovery of the Czech economy (we expect Czech real GDP to grow by 4%) and a boost in shared tax revenue. This will lead to a recovery in the GOB margin to pre-pandemic levels.

Debt levels will remain low over 2021-23

The region's ratio of net direct and indirect debt (NDID) to operating revenue declined further to 6.4% in 2020 from 8.9% in 2019. This decline was caused by a decline in debt to CZK1.8 billion from CZK2.2 billion. The MSR's direct debt of CZK1.78 billion consisted of two loans totalling CZK1.4 billion from UniCredit Bank Czech Republic and Slovakia, and a CZK380 million loan from the European Investment Bank (EIB, Aaa stable).

The region has a high share of short-term debt (65.4% of total debt), this is represented by payments planned for the current year. However, this poses very little risk because of the high level of cash reserves and overall low level of debt. Most of the short-term debt is used to prefinance subsidies from the central government and the European Union (EU, Aaa stable). Indirect debt, consisting of the debt of the Mosnov airport (CZK32.4 million), accounts for 2.0% of NDID. Current cash reserves are sufficient to cover outstanding debt more than two fold.

We expect the region's debt to increase slightly because of its investment requirements. Its NDID will remain lower than 10% of operating revenue in 2021-23.

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 before the pandemic. In 2020 its accumulated cash and short-term investments declined, reaching almost CZK3.8 billion (13.3% of operating revenue), CZK800 million less than that as of year-end 2019. The decline in liquidity was caused by the repayment of a portion of the debt. The liquidity is available on very short notice, as it is held in current accounts. The region sold CZK200 million worth of bank bonds held and is currently using short-term term accounts to take interest on its liquidity reserves.

We expect the MSR's cash reserves to remain stable in 2021-22. The region will slightly increase its debt holding to fund the cash financing deficit (caused by high capital expenditure) planned for the years.

Pressure on financial performance stemming from investment requirements

In 2020, capital spending represented CZK2.76 billion, or 9.1% of total expenditure, which is lower than the long-term average (11%), and almost 43% was covered by central government and EU subsidies.

For 2021, the MSR budgeted CZK4 billion of capital spending. However, we expect only about CZK3 billion to be realised. The highest proportion of investments is intended to flow into the sectors of roads, social services and education.

The MSR's capital plan consists of two high-ticket projects — construction of a new library, and renovation of the Mosnov airport runway. The realisation of these two projects depends on available funding sources, mainly from own revenue and subsidies. The construction of the library and runway will commence in 2023-24 because these are the MSR's priorities, and the project documentation is already being prepared. The MSR is applying for a subsidy under the Just Transition Operating Programme for the library.

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 weaker districts (Bruntal, Karvina and Havirov) to decline further. We view the coronavirus pandemic as a social risk under our ESG framework. A longer lock down implemented by the central government is a risk, that could lead to lower tax returns than we expect.

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

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

Exhibit 3

Region of Moravian-Silesian

Regional and Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**5.20**	**20%**	**1.04**
Economic Strength [1]	7	84.47%	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				**3.50**	**30%**	**1.05**
Operating Margin [2]	5	4.32%	12.5%			
Interest Burden [3]	1	0.12%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	6.37%	25%			
Debt Structure [5]	9	65.36%	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						**3.39 (3)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**a2**

[1] Local GDP per capita as a percentage of national GDP per capita.
[2] Gross operating balance/operating revenue.
[3] Interest payments/operating revenue.
[4] Net direct and indirect debt/operating revenue.
[5] Short-term direct debt/total direct debt.
Source: Moody's Investors Service; Fiscal 2020

Ratings

Exhibit 4

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

Source: Moody's Investors Service

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CLIENT SERVICES

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

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