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CREDIT OPINION
6 May 2024

Update

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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

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

Cora-Lynn von Dungern +49.69.86790.2157
Ratings Associate
cora-lynn.vondungern@moodys.com

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

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Moravian-Silesian Region (Czech Republic)

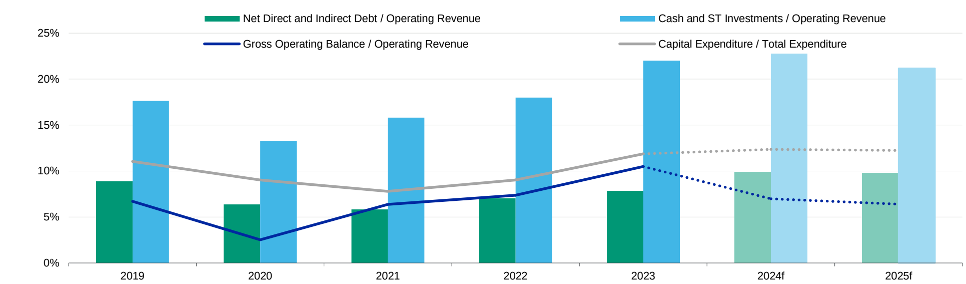
Update to the credit analysis

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 rating is constrained by the pressure stemming from investment requirements and its significant reliance on transfers from the central government to meet its responsibilities. These transfers, together with shared taxes, constitute about 98% of operating revenue and considerably limit MSR's revenue flexibility.

Exhibit 1

Strong cash position and very low debt levels will be preserved over 2024-25



F is Moody's forecast.
Source: MSR, Moody's Ratings

Credit strengths

» Continued solid operating performance

» Debt levels will remain very low over 2024-2025

» 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)	2019	2020	2021	2022	2023	2024f	2025f
Net Direct and Indirect Debt / Operating Revenue	8.9%	6.4%	5.8%	7.0%	7.8%	9.9%	9.8%
ST Debt / Operating revenue	3.3%	2.7%	2.5%	2.6%	2.0%	2.4%	2.4%
Interest Expense / Operating Revenue	0.2%	0.1%	0.0%	0.3%	0.4%	0.5%	0.6%
Gross Operating Balance / Operating Revenue	6.7%	2.5%	6.4%	7.4%	10.5%	7.0%	6.4%
Cash Financing Surplus / Total Revenue	2.1%	-1.4%	3.9%	2.7%	4.2%	-0.9%	-1.1%
Cash and ST Investments / Net direct and indirect debt	198.4%	208.4%	272.0%	255.9%	280.1%	230.2%	216.8%
Capital Expenditure / Total Expenditure	11.0%	9.0%	7.8%	9.0%	11.9%	12.4%	12.2%
Cash and ST Investments / Operating Revenue	17.6%	13.3%	15.8%	18.0%	22.0%	22.7%	21.2%

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

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

Continued solid operating performance

MSR has a good track record of operating surpluses, with an average gross operating balance (GOB) at 6.5% of operating revenue over the past decade.

In 2023, MSR recorded a sharp increase in operating revenue by 12%, reaching CZK 38 billion. This growth was attributable to a considerably strong collection of shared taxes and generous intergovernmental transfers, which posted 16% and 12% increase respectively. The shared taxes collection benefitted not only from the inflationary environment during 2023 but also from changes in payment calendar scheme applied to company income tax by the central government, valid since 2023. The strong operating revenue base provided sufficient cover for the 8% increase in operating expenditure in 2023, resulting in a very solid GOB at 10.5% of operating revenue, compared to 7.4% in 2022.

In 2024, we expect GOB to stabilize at 7% of operating revenue. This stabilization will be attributable to the lower participation in shared taxes implemented since 2024 within the consolidation package by the central government and the expected slowdown in inflation. Moody's forecasts average inflation at 3.3% in 2024 (compared to 12.1% in 2023) and the expected real economic growth at the national level to be 1.5% (after the contraction of 0.4% in 2023). We anticipate operating expenditures to grow, reflecting higher financial support to contributory organizations and rising expenses related to regional transportation compared to 2023.

In 2025, we expect positive economic growth for the Czech economy, with real GDP growth projected at 2.7% and an additional slowdown in inflationary pressures, averaging 2%. This favorable economic environment will lead to GOB margin around 6.4%. We believe that MSR will continue to manage its operating performance in prudent manner, with tight monitoring over the operating expenditures.

Debt levels will remain very low over 2024-25

The region is in line with its rated Czech peers, maintaining a very low ratio of net direct and indirect debt (NDID) to operating revenue below 10%. In 2023, the NDID to operating revenue marginally increased to 7.8% in 2023 from 7.0% in 2022. MSR primarily relies on long-term bank loans to finance investment projects. As of year end 2023, MSR' direct debt consisted of two loans totaling CZK0.8 billion from UniCredit Bank Czech Republic and Slovakia, CZK153 million loan from the European Investment Bank (EIB, Aaa stable) and CZK1.8 billion loan (total limit CZK3 billion, to be drawn in phases until 2024) from Česká spořitelna to support investment projects. Notably, 95% of the direct debt carries a floating interest rate. Despite the interest rate acceleration and additional loan drawing during 2023, the interest expenses to operating revenue ratio remained very low at 0.4% in 2023 (0.3% in 2022) and we expect interest expenses to remain below 1% of operating revenue in 2024-25.

The region traditionally has a high share of short-term debt (27.1% of total direct debt in 2023), 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 regional hospitals and provided guarantee for the debts of VaK Bruntál (a water management company operating in MSR), accounted for 8.0% of NDID in 2023. Cash reserves at the end of 2023 were sufficient to cover the total outstanding debt more than 3 times.

We expect the region's direct debt to moderately increase due to its investment requirements. Nevertheless, NDID will remain very low, below 10% of operating revenue in 2024-25, and the 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, further boosted by the strong operating balance generated in 2023. In 2023, its accumulated cash and short-term investments increased, reaching upwards of CZK8.4 billion (22.0% of operating revenue), which is CZK2.2 billion more than that as of year-end 2022. The liquidity management remained conservative, mainly using term deposit for the free liquidity to earn interest.

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

We expect MSR’s cash reserves to peak at 22.7% of operating revenue in 2024 and remain around that level in 2025 as the region further increases its investment activity. The overall strong liquidity position further supports the region's credit quality and offers flexibility to accommodate extraordinary cash outflows.

Pressure on financial performance stemming from investment requirements

In 2023, capital spending represented CZK4.6 billion, or 11.9% of total expenditure, which is slightly above the 10-year average (10.9%). The investments eligible for EU subsidy are usually co-funded by EU from 80-95%. Comparing the real execution to the budgeted amount, MSR achieved an execution rate of 93%, significantly higher than the previous years' execution rate of around 70%. Generally, the under-execution on capital spending is related to insufficient quality in project documents for some tendered projects and an overall higher level of bureaucracy, causing delays in the execution.

For 2024, the MSR budgeted CZK5 billion of capital spending. The highest proportion of investments is intended for the sectors of traffic infrastructure, health & social care, and education. MSR is one of the three regions in the Czech Republic eligible for funds under the Just Transition Programme provided by the 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 utilize a total of CZK18.9 billion for further development and improvement of social and environmental aspects in the region, which will further support capital spending.

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 (70.4% of the MSR's operating revenue in 2023) stems from central government transfers in the form of earmarked grants for education, health care and social services. Shared taxes represented 27.6% of operating revenue in 2023 and constitute of the national pool of value-added tax, personal and corporate income tax. These taxes are redistributed from the central government, and 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 do not have any leeway to impose and collect regional taxes, significantly limiting its ability to increase operating revenue.

On the spending side, around 79% of MSR's operating spending matches 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 from both operational and financial perspectives. Capital spending remains the most flexible spending and can be partially scaled down during negative economic climates.

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' accounts, debt or liquidity. Reputational risk issues for the central government appear modest, given the regions' debt structure, which relies more on bank loans than on bonds.

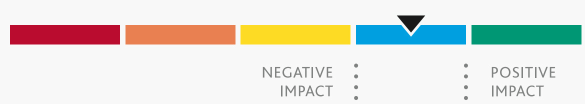
ESG considerations

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

Exhibit 3

ESG credit impact score

CIS-2

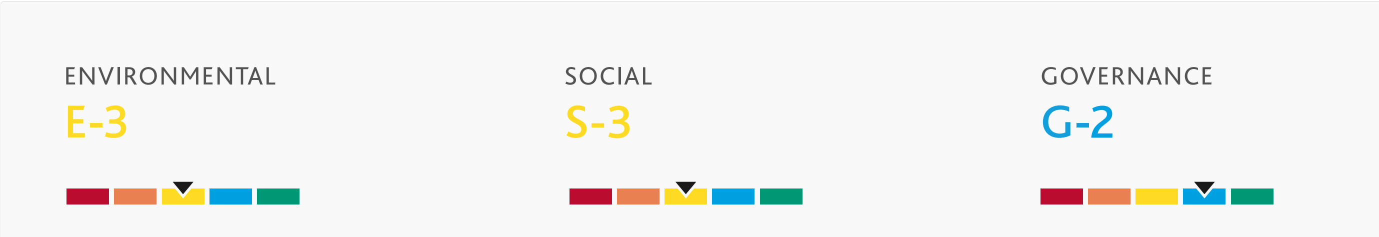


ESG considerations do not have a material impact on the current rating.

Source: Moody's Ratings

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 Ratings

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-3** 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 a2. The matrix-generated BCA of a2 reflects an Idiosyncratic Risk score of 3 (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.

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	79.31%	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				**2.25**	**30%**	**0.68**
Operating Margin [2]	3	9.01%	12.5%			
Interest Burden [3]	1	0.30%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	7.84%	25%			
Debt Structure [5]	5	27.11%	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						**3.30 (3)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**a2**
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 Ratings; Fiscal 2023.

Ratings

Exhibit 6

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

Source: Moody's Ratings

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