MOODY'S
INVESTORS SERVICE

CREDIT OPINION
15 August 2022

Update

Send Your Feedback

RATINGS

Moravian-Silesian, Region of

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

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

Jacob Kasel +33.1.5330.3424
Associate Analyst
jacob.kasel@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

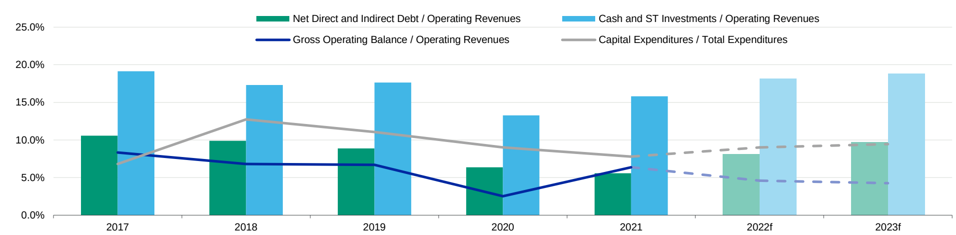
Moravian-Silesian Region (Czech Republic)

Update following outlook change to negative from stable

Summary

The credit profile of the Region of Moravian-Silesian (MSR, A1 negative) reflects its low debt level, solid operating performance, strong liquidity and a moderate likelihood that the Government of the Czech Republic (Aa3 negative) 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
Strong liquidity and low debt levels



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

Credit strengths

» Continued solid operating performance despite slower national economic growth in 2022-23 compared to pre-pandemic levels

» Debt levels to remain low over 2022-2023

» High level of liquid reserves

Credit challenges

» Pressure on financial performance stemming from investment requirements

» Growing inflation and resource constraints will exert additional pressure mainly on capital expenditures

Rating outlook

The negative rating outlook reflects the negative outlook on the sovereign and tight linkages to the national economy's performance.

Factors that could lead to an upgrade

An upgrade of MSR's rating is unlikely, given the negative outlook.

The outlook could be changed to stable if there is a similar change on the sovereign level and MSR maintains its operating performance and debt levels along with high cash levels.

Factors that could lead to a downgrade

Further downward pressure on the rating could result from a downgrade of the sovereign rating or deterioration in the MSR's operating margin, combined with a decline in liquidity and an increase in debt.

Key indicators

Exhibit 2
Moravian-Silesian Region

Moravian-Silesian Region							
(31th December)	2017	2018	2019	2020	2021	2022f	2023f
Local GDP per capita as % of National GDP per capita	82.4%	83.5%	78.3%	78.0%	78.3%	80.5%	80.5%
Net Direct and Indirect Debt / Operating Revenues	10.6%	9.9%	8.9%	6.4%	5.6%	8.1%	9.7%
ST Debt / Operating revenue	3.3%	7.9%	3.3%	2.7%	2.5%	3.5%	3.3%
Interest Expenses / Operating Revenues	0.1%	0.1%	0.2%	0.1%	0.0%	0.3%	0.4%
Gross Operating Balance / Operating Revenues	8.3%	6.8%	6.7%	2.5%	6.4%	4.6%	4.3%
Cash Financing Surplus / Total Revenues	6.4%	-0.3%	2.1%	-1.4%	3.9%	0.3%	-0.7%
Cash amd ST Investments / Net direct and indirect debt	181.3%	175.2%	198.4%	208.4%	283.3%	223.5%	193.4%
Capital Expenditures / Total Expenditures	6.8%	12.7%	11.0%	9.0%	7.8%	9.0%	9.4%

F = Forecast
Source: The MSR, National Statistical Office and Moody's Investors Service

Detailed credit considerations

On 10 August 2022, Moody's affirmed MSR's A1 long-term issuer rating and changed the outlook to negative from stable, following the change of outlook to negative from stable on the Czech Republic's government bond rating, on August 5, 2022. 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 slower national economic growth in 2022-23 compared to pre-pandemic levels

In 2021, the MSR's operating revenue grew despite pandemic related restrictions and reached CZK31.9 billion, which translates into a 11.8% increase from that of 2020. The key drivers of this growth were the rise in central government operating transfers to cover increased salaries of teachers and social workers, as well as to provide compensation for the financial burden of the extraordinary pandemic costs and therefore decreased revenues. Shared taxes, the most flexible source of revenue, increased to CZK8.0 billion in 2021 from CZK7.0 billion in 2020. The expected drop in personal income tax (-17% compared to 2021) caused by abolishing the super-gross salary was fully compensated by the growth in corporate income tax and value-added tax which posted the increase by 44% and 18% in 2021. Thus, MSR's operating performance improved in 2021, with a gross operating balance (GOB) at 6.4% of operating revenue compared to 2.5% in 2020.

In 2022, we expect the MSR's GOB to decrease to around 4.6% of operating revenue. This will be attributable to the expected economic slowdown at the national level (Moody's expects the real GDP to grow by 2.3% in 2022 which is below the 3.5% growth in

2021) and slight increase in operating expenses driven by higher financial support to contributory organizations and rising expenses related to transportation compared to 2021.

In 2023, we expect positive economic growth for the Czech economy with real GDP growth at 1.0%. This will lead to GOB margin's stabilization to 4.3%, which will, nevertheless, remain below the pre-pandemic levels. Our economic outlook for 2022 and 2023, however, remains highly uncertain due to the ongoing Russia-Ukraine military conflict and a risk of a further escalation and/or broadening of the military conflict. The economic spill-over effect from the military conflict stems from higher commodity prices and input costs in general with consecutive negative impact on the economic growth.

Debt levels will remain low over 2022-23

The region's low ratio of net direct and indirect debt (NDID) to operating revenue declined further to 5.6% in 2021 from 6.4% in 2020. The MSR's direct debt of CZK1.75 billion consisted at year end 2021 of two loans totaling CZK1.06 billion from UniCredit Bank Czech Republic and Slovakia, CZK307 million loan from the European Investment Bank (EIB, Aaa stable) and a new CZK388 million loan (total limit CZK3 billion, to be drawn in phases till 2024) from Česká spořitelna to support investment projects.

The region has traditionally a high share of short-term debt (45.3% of total debt in 2021; 43% in 7 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 and provided guarantee for the debts of VaK Bruntál (water management company operating in MSR), accounted for 5.7% of NDID in 2021. Cash reserves at the end of 2021 were sufficient to cover outstanding debt by almost three times.

We expect the region's direct debt to increase slightly because of its investment requirements. Nevertheless, NDID will remain below 10% of operating revenue in 2022-23 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 2021 its accumulated cash and short-term investments increased, reaching upwards of CZK5.1 billion (15.8% of operating revenue), CZK1.26 billion more than that as of year-end 2020. The increase in liquidity in 2021 was attributable mainly to the strong operating performance compared to 2020 when the pandemic started.

The liquidity management remained conservative using mainly term deposit for the free liquidity to take interest on free liquidity. MSR has term deposit in the amount of CZK 350 million (6.9% of total liquid reserves as of 12/2021) in Sberbank CZ (ultimately owned by Russian entities) which Czech National Bank revoked the licence as the result of significant deposits' outflow. Currently MSR does not have access to these funds but we don't assess it as material given the comfortable level of liquidity and easy access to financial market in case of liquidity stress. As a reaction on this unprecedented situation MSR has reduced the deposits in selected banks and uses term deposit with notice period up to 14 days.

We expect the MSR's cash reserves to remain stable in 2022-23 at 18-19% of operating revenue. The region will only slightly increase its debt to fund its investment projects in 2022-23.

Pressure on financial performance stemming from investment requirements

In 2021, capital spending represented CZK2.53 billion, or a very low 7.8% of total expenditure, which is lower than the long-term average (9%), and almost 47% was covered by central government and EU subsidies.

For 2022, the MSR budgeted CZK4 billion of capital spending. The highest proportion of investments is intended to flow into the sectors of traffic infrastructure, social services 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 has prepared several strategical projects planned to be co-financed with the Operational programme Just Transition Fund which is dedicated to addressing the social, economic and environmental impacts of the transition to a climate-neutral economy in selected Czech regions.

Growing inflation and resource constraints will exert additional pressure mainly on capital expenditures
Due to the current market situation with rising inflationary pressures and energy prices, as well as lack of raw materials, we estimate lower execution rate of the capital plan for 2022 at about CZK3.1 billion (or 9% of total expenditure in 2022). SMR shows sufficient flexibility in capital spending and given region's liquidity reserves, we assess the risk connected with higher pricing is as mitigated.

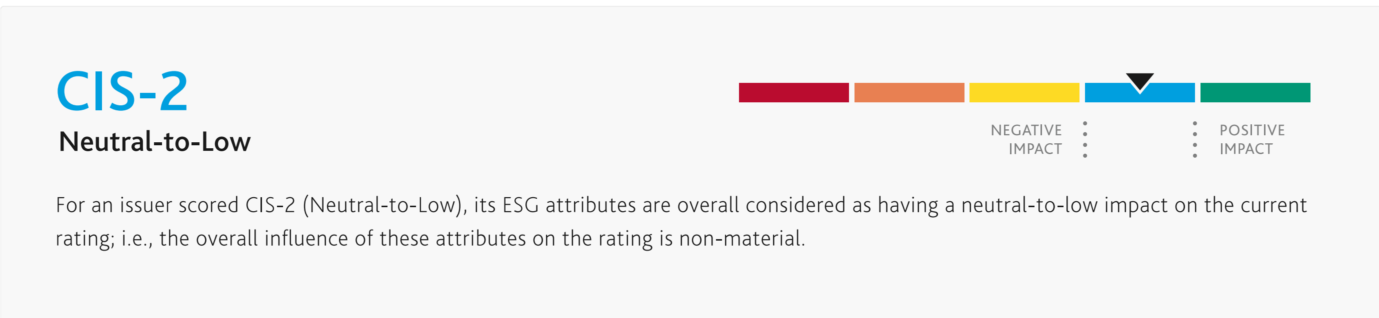
Extraordinary support considerations

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 of's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Moravian-Silesian Region's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting moderate exposure to environmental and social risks along with solid institutions and governance strength.

Exhibit 4
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

The region's overall environmental issuer profile score is moderately negative (**E-3**), reflecting moderate exposure to physical climate risks and waste and pollution risks. The region's main risk stems from air pollution (the most exposed region in the Czech Republic), the Moravian-Silesian Region's position as one of the two industrial centers of the Czech Republic, and cross-border pollution from Poland. 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. Exposure to environmental risks is partly mitigated by investments in environmental protection which are significantly above the long term per-capita national average.

Social

We assess its social issuer profile score as moderately negative (**S-3**), reflecting moderate exposure to social risks across most categories. 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. Demographic change in the form of negative population change and therefore relatively fast population ageing (above the national average) poses another material long-term challenge to the region.

Governance

Moravian-Silesian Region's solid institutions and governance profile is captured by a neutral-to-low G issuer profile score (**G-2**). 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	78.20%	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	5.32%	12.5%			
Interest Burden [3]	1	0.07%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	5.58%	25%			
Debt Structure [5]	9	44.43%	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**
Scorecard-Indicated BCA Outcome						**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 2021.

Ratings

Exhibit 6

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

Source: Moody's Investors Service

REPORT NUMBER 1338126

CLIENT SERVICES

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

MOODY'S
INVESTORS SERVICE