ACRA affirms BBB(RU) to the Kemerovo Region, upgrades outlook to Positive, and affirms BBB(RU) to bond issues

The credit rating outlook has been upgraded for the Kemerovo Region (the Region) following the budget surplus of RUB 22.6 billion, 12% debt decrease, and higher standalone budget liquidity in 2017. The rating is restricted by low flexibility of budget expenditures and regional economy metrics per capita.

The Kemerovo Region is a part of the Siberian Federal District, bordering six other administrative entities of the Russian Federation. The Region’s population is 2.7 million people, two third of which reside within the Kemerovo and Novokuznetsk agglomerations.

The coal-mining region with relatively high unemployment and per capita income below the Russian average. The regional economy is based on mining industry (high-quality steam and coking coals), metals and chemical industry, and oil refining. In 2016, the amount of exports by regional enterprises amounted to 74.6% of the GRP. The intensity of investment processes is significantly (by 21%) higher than the Russian average. Over a half of investments in fixed assets goes to the coal-mining sector, mostly to maintain current production levels. The average per capita income and the per capita GRP are lower than the national average indicators by 29% and 30%, respectively. In 2017, the ILO unemployment rate declined by 1.2 times to 6.5%.

The record high budget surplus hinges on restoring coal prices. In 2017, the Region demonstrated the highest budget surplus among other Russian regions: RUB 22.6 billion or 20.1% of tax and non-tax revenues. The budget surplus stemmed from the substantial growth of income tax revenues (RUB 50.2 billion) against annual average of RUB 22.6 billion in 2014–2016. Income tax revenues have grown against the 2016 level in the following sectors: mining (by RUB 18.5 billion), trading (by RUB 2.7 billion), and real estate and services (by RUB 1.1 billion).

The Region’s budget is characterized by high shares of tax and non-tax revenues and mandatory (as defined in the ACRA methodology) expenditures: on average, 83% each in 2014–2017. In that period, the social security expenditures (education, healthcare, social policy) were stable, RUB 71.0 billion on average, but, taken as a percentage of the total budget expenditures, social expenditures have decreased from 66.0% in 2014 to 62.9% in 2017. The operating balance has grown from the negative figure in 2014 to +23.6% in 2017. According to ACRA forecast, dollar prices for steam and coking coals will exceed those seen in 2015 by 45% and 20%, respectively. In such conditions, ACRA expects that the operating balance of the Region will not be lower than 14% in 2018–2019.

The budget surplus has allowed the Region to cut debts and form financial reserves. A substantial portion of budget surplus has been applied to repay debts (net repayments amounted to RUB 6.95 billion) and to form financial reserves: as of January 01, 2018, the total balance on deposit accounts was comparable with the monthly average budget expenditures.

The debt portfolio profile underwent certain changes in 2017. The share of bank loans declined from 44% to 37%, and the share of budget loans declined from 42% to 32%. Budget loans were restructured and their average repayment deadlines were extended at least by seven years. The share of bonds in the portfolio grew from 1% to 17%.
In 2017, the debt service costs amounted to 9.6% of the operating balance, which indicates to a minimal risk.

The high standalone budget liquidity allowed the Region to earn RUB 441 million from placement of temporarily free funds.

Key assumptions

- World market coal prices will remain favorable;
- In 2018, mandatory budget expenses will be strictly controlled, and budget deficit will not exceed 5% of tax and non-tax revenues;
- Employment trends will remain positive.

Potential outlook or rating change factors

The Positive outlook assumes that the credit rating will most likely change within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- The 2018 budget execution with a deficit of not more than 3% of tax and non-tax revenues;
- A stably high standalone liquidity;
- A higher share of capital expenditures in the budget.

A negative rating action may be prompted by:

- A substantial decline of the income tax base in the mining sector;
- A substantial growth of mandatory budget expenditures not supported by tax and non-tax budget revenues;
- A higher debt burden.

Issue ratings

Assigned:

Kemerovo Region, 34001 (ISIN RU000A0JUAZ0), maturity date: November 28, 2018, issue volume: RUB 1 billion — BBB(RU);

Kemerovo Region, 35002 (ISIN RU000A0ZYB40), maturity date: September 26, 2024, issue volume: RUB 9 billion — BBB(RU).

Rationale. ACRA is of the opinion that the above bonds issued by the Kemerovo Region are senior unsecured debt instruments, which credit ratings are equal to that of the Kemerovo Region.

Regulatory disclosure

The credit ratings have been assigned to the Kemerovo Region and bonds (ISIN RU000A0JUAZ0, ISIN RU000A0ZYB40) issued by the Kemerovo Region under the national scale for the Russian Federation based on the Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation, and the Key Concepts Used by Analytical Credit Rating Agency within the Scope of Its Rating Activities. In the course of assigning a credit rating to the bond issues above, the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation has also been used.

The credit rating assigned to the Kemerovo Region and the credit ratings assigned to the government bonds (ISIN RU000A0JUAZ0, ISIN RU000A0ZYB40) issued by the Kemerovo Region were first published by ACRA on August 29, 2017 and October 02, 2017, respectively.

The credit rating of the Kemerovo Region and its outlook, as well as the credit ratings assigned to the government bonds (ISIN RU000A0JUAZ0, ISIN RU000A0ZYB40) issued by the Kemerovo Region are expected to be revised within 182 days following the rating action date (February 20, 2018) as per the 2017-2018 Calendar of planned sovereign credit rating revisions and publications.

The credit ratings were assigned based on the data provided by the Kemerovo Region, information from publicly available sources (the Ministry of Finance, the Federal State
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Statistics Service, and the Federal Tax Service), as well as ACRA’s own databases. The credit ratings are solicited, and the Kemerovo Region participated in their assignment.

No material discrepancies between the provided data and the data officially disclosed by the Kemerovo Region in its financial reports have been discovered.

ACRA provided no additional services to the Kemerovo Region Administration. No conflicts of interest were discovered in the course of credit rating assignment.
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