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ACRA assigns **BBB(RU)** to the **Kemerovo Region**, outlook **Stable**

The credit rating assigned to the Kemerovo Region (hereinafter, the Region) stems from the financial situation of the largest taxpayers in the Region (coal mining and metallurgical companies), low flexibility of budget expenditures, declining but still high debt burden and high liquidity.

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 about 2.7 million people, of which 75% live within the two agglomerations: Kemerovo (0.7 million people) and Novokuznetsk (1.3 million people). In 2015, the regional GRP amounted to RUB 842.6 billion (the 20th place in the RF).

Key rating assessment factors

The coal-mining region with relatively high unemployment and average per capita income below the Russian average. The basis of the economy of the Kemerovo region is the mining industry (high-quality power plant and coking coals), metallurgy and chemical industry, oil refining. Export of regional enterprises is about 72% of GRP (as of 2016). The intensity of investment processes is significantly (by 21%) higher than the Russian average. More than a half of the investments in fixed assets is concentrated in the coal-mining sector and mostly aimed at maintaining the current production level. The average monthly wages of employees hired by organizations, individual entrepreneurs, and individuals were 82.4% of the Russian average in 2016. In this regard, the burden on the regional budget caused by the need to perform the decrees issued by the Russian president in May 2012 to increase salaries in the public sector is much milder than in the regions with higher average monthly incomes of the population.

Restoration of coal prices drives an increase in the operating balance sheet and a budget surplus. Four quarters in a row, the regional budget has been performed with a surplus, which totaled RUB 12.1 billion (9.9% of total revenues for the period from 3Q2016 to 2Q2017). For the Region's budget, it is the longest surplus period in the last nine years. The regional budget demonstrates a high proportion of tax and non-tax revenues and a high level of mandatory expenditures (82% on average in 2014–2017). The operating balance has grown from negative values in 2014 to +15.8% in 2017. The losses suffered by the regional budget due to the lower profit tax rate are compensated by restrictions imposed on the application of losses of previous periods against profit of current period, as well as by growing subsidies from the federal budget. The share of capital expenditures in the budget was about 11.0% in 2014–2016. According to ACRA forecast, the dollar prices for coking coal and power plant will be 45% and 20% higher in 2018–2019, respectively, against the price level of 2015, therefore, ACRA expects the Region's operating balance to remain not less than 14% in 2018–2019.

The budget surplus allows for gradual optimization of the level and the profile of the debt burden. In 2017, debt servicing costs will amount to 18% of the operational balance. Early repayment of budget loans (due to a breach of the terms of such loans) is compensated by new medium-term budget loans with similar or longer maturities. In 2017, the Region replaces expensive bank loans (received in 2015-2016) with a cheaper market debt. The budget surplus in 2017, which may exceed RUB 6 billion, will be applied to repay existing debt obligations.

Growing profit tax earnings have substantially improved the budget liquidity. Since 2Q2017, the beginning-of-month budget account balances have been comparable with the next-month expenses of the Region. High own liquidity allows the Region to place deposits and receive additional interest income (over RUB 110 million in 1H2017).

Key assumptions

- World coal prices in 2018–2019 to remain the same as in 2017;
- Tight control over mandatory expenses and budget deficit not higher than 1% of tax and non-tax incomes;
- Debt decrease by RUB 6 billion in 2017;
- Capital expenses to remain not lower than 9.5% of the total expenditures.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Budget surplus over RUB 7.5 billion in 2017;
- Decline in the debt burden for more than RUB 7 billion (against the beginning of 2017);
- Higher share of capital expenses in the budget expenditures;
- Lower unemployment.

A negative rating action may be prompted by:

- Shrinking profit tax base for mining and metallurgy companies;
- Substantial growth of mandatory budget expenses without corresponding growth of tax and non-tax incomes;
- Higher debt burden.

Issue ratings

None.

Rating history

None.

Regulatory disclosure

The credit rating has been assigned 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 the Analytical Credit Rating Agency Within the Scope of Its Rating Activities.

A credit rating has been assigned to the Kemerovo Region for the first time. The credit rating and its outlook are expected to be revised within 182 days following the rating action date (August 25, 2017).

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

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

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

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