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Key rating assessment factors

ACRA affirms Krasnodar Krai's credit rating at A(RU), outlook Stable, and affirms bond issues credit rating

The credit rating assigned to the [Krasnodar Krai](#) (hereinafter, the Krai, or the Region) is based on sufficient diversification of the regional economy and tax revenues, high self-sufficiency and low flexibility of the budget's revenue side, favorable debt repayment schedule, and relatively high debt load.

The Krasnodar Krai is part of the Southern Federal District. Almost 4% of Russia's population live in the Krai, and around 3% of the total GRP of Russian regions is generated in the Krai. The Krasnodar Krai is a consistent leader among Russian regions in terms of agricultural production. It is also a large Russian health resort and an important transportation hub.

A diversified economy with prospective growth of added value in the agribusiness.

The Krai is a consistent leader among Russian regions in terms of agricultural production volume: in 2017, the Region outperformed the Rostov Region (ranking second in agricultural production volume in monetary terms) by 42%. In addition, agribusiness accounted for only 13% in the Krai's GRP structure according to the Krai's 2016 data, with wholesale and retail trade and repair (18%) and transportation and communications (18%) being the largest sectors. Around a third of the industrial production (around 15% of GRP) is attributable to food production, and crude oil refining (around 8% of Russian refinery production) accounts for a quarter of the industrial production. In ACRA's opinion, the Krai's economy has a significant potential for development by virtue of increasing the depth of agricultural processing (which is currently low) and active utilization of export infrastructure (sea ports), which will have effect on both economic (GRP per capita is consistently below the national average) and fiscal indicators.

Insufficient flexibility of budget spending with high own revenues and sufficient diversification of tax revenues. While self-sufficiency of the Krai's budget is high (86% in 2015-2018 (plan)), it is not flexible due to significant mandatory spending (76% in the period under consideration) and average values of the operating balance and regular revenues (22%). Trade and repair and transportation and communications are the two sectors with the largest contributions to the Region's GRP: in the last five years their share in tax revenues of the Krai's budget were the largest (18% and 17% on average, respectively). At the same time, the Krai's budget has no significant dependence on the only taxpayer. The Krai's budget is marked growth of the operating balance (28% in 2017 vs 20% in 2014); however, due to planned reduction of capital expenditures, this indicator may return to the 2014 level as early as this year. Tax revenues increased 13% (RUB 22 bln) in 2017. 37% of the above increase was driven by property tax gains (by virtue of phasing out regional benefits and changes in the federal law), 29% of the increase is attributed to personal income tax gains, and another 26% to corporate income tax gains (as large taxpayers in the infrastructure industry have completed the loss write-off period as well as the result of temporary limitation to reduce the tax base by the amount of accumulated losses).

A well-balanced debt structure in terms of maturity will offset the negative effect from high debt load. 44% of the current debt is payable in 2023 and beyond offsetting high debt load of the Krai (direct debt to operating balance ratio was 2.31x as at year-end 2017, and would exceed 3x according to 2018 forecast). In 2017, the operating balance excluding interest expenses was more than double the debt repayment amount. According to ACRA estimates, this indicator would also stay around 2x in 2018-2019. By virtue of a substantial share of long-term fiscal loans in the Krai's debt portfolio (47%), the relative value of the debt is low (10% of the operating balance in 2017). The surplus recorded in 2017 was partially used to repay the direct debt of (RUB 12 bln) and partially

credited to accounts (RUB 5.6 bln). However, the need to issue a guarantee to a public sector company every year did not allow lowering the debt load substantially: in absolute numbers, the reduction totaled 0.6% y/y.

Significant level of the budget's liquidity. The Region has a significant liquidity to timely perform expenditure commitments including interest payments, and also has the right to place funds in deposits. Loans from the Federal Treasury Department are rarely raised, and the excess liquidity is used to early repay debt commitments. The Krai raises loans from credit institutions for a period of over one year, and therefore, the intra-year turnover in raising and repaying debts does not exceed one fifth of the total revenues of the budget.

Key assumptions

- Capital expenditures remain at 10% or higher;
- The amount of transfers to the Krai in 2019-2020 will remain at the level seen in 2015-2016;
- The Region stays compliant with fiscal loans restructuring agreements;
- A 20%-25% savings on interest expenses versus the budget plans.

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:

- A positive economic and tax effect from an increased share of manufacturing with high added value;
- Increased flexibility of budget spending;
- A decrease in relative debt burden;
- End of the period when the Krai has to issue a guarantee in favor of a public sector company.

A negative rating action may be prompted by:

- A decrease in own revenues of the Krai by 5% or more from the level estimated by ACRA for 2018-2020;
- A lower self-sufficiency of the Krai's budget;
- A higher debt load on the Krai's budget;
- A critical decline in capital expenditures in the Krai's budget.

Issue ratings

Credit rating rationale. In ACRA's opinion, the above bonds issued by the Krasnodar Krai are senior unsecured debt instruments, and their credit rating is equal to the rating assigned to the [Krasnodar Krai](#).

Key issue properties

[The Krasnodar Krai, 34005 \(ISIN RU000A0JVZE0\)](#), redemption: November 27, 2018, issue volume: RUB 4.8 bln. — **A(RU)**.

[The Krasnodar Krai, 35001 \(ISIN RU000A0JXYS9\)](#), redemption: August 9, 2024, issue volume: RUB 10.0 bln. — **A(RU)**.

Regulatory disclosure

The credit ratings have been assigned to the Krasnodar Krai and to bonds issued by the Krasnodar Krai (ISIN RU000A0JXYS9, ISIN RU000A0JXYS9) under the national scale for the Russian Federation based on the [Methodology for Credit Rating 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](#). In the process of credit rating assignment to the above issues, the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also used.

For the first time, the credit rating of the Krasnodar Krai and credit ratings of government securities of the Krasnodar Krai (ISIN RU000A0JXYS9, ISIN RU000A0JXYS9) were published by ACRA on October 18, 2017.

The credit rating of the Krasnodar Krai and its outlook as well as the credit ratings of government securities issues of the Krasnodar Krai (ISIN RU000A0JVZE0, ISIN RU000A0JXYS9) are expected to be revised within 182 days after the rating action date (April 16, 2018) in compliance with the [2018 calendar of planned sovereign credit rating revisions and publications](#).

The credit ratings were assigned based on the data provided by the Krasnodar Krai, 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 Krasnodar Krai Administration participated in its assignment.

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

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

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