

State of Aguascalientes

Full Rating Report

Ratings

Long-Term Local Currency IDR BBB+

National

Long-Term Rating AA+(mex)

IDR – Issuer Default Rating.

Rating Outlook

Long-Term Local Currency IDR Stable

National Long-Term Rating Stable

Financial Data

State of Aguascalientes

(MXN Mil.)	12/31/16	12/31/15
Operating Revenue	19,820.1	18,434.4
Debt	1,884.9	2,148.7
Operating Balance/ Operating Revenue (%)	4.04	9.24
Debt Service/Current Revenue (%)	2.47	1.82
Debt/Current Balance (Years)	2.8	1.4
Operating Balance/ Interest Paid (x)	3.80	7.30
Capex/Total Expenditure (%)	12.72	14.95
Surplus (Deficit) Before Debt Variation/Total Revenue (Excluding New Debt) (%)	(1.75)	3.36
Current Balance/ Capex (%)	23.66	51

Related Research

[Fitch Affirms Aguascalientes' and Guanajuato's International Ratings \(August 2017\)](#)

[Institutional Framework for Mexican Subnationals \(December 2011\)](#)

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Key Rating Drivers

Financial Strengthening: The current administration has strengthened local tax collection and controlled the operational expenditure (current expenditure plus non-earmarked transfers), resulting in adequate levels of operating margins and favorable liquidity indicators. In the past five years, average operating margins have been above 5% of the operating revenue.

Moderate Leverage Level: The state of Aguascalientes had a direct debt balance of MXN1.872 billion as of March 2017 that corresponds entirely to a credit with a commercial banking institution with maturity in 2031. The debt has favorable terms and conditions, resulting in manageable leverage and sustainability indicators. The state has not defined plans for additional bank debt; however, it foresees the possibility to carry out investment projects through public-private partnerships in 2018.

Strong Economic Development: Aguascalientes has a growing economy, well above the national level in the past three years. Its economic activity is based on the manufacturing sector, particularly the automobile industry. The state benefits from its geographic position and its efficient transport network. In addition, it has socioeconomic indicators above the national average. Recent U.S. foreign trade policies have not affected the economic activity in Aguascalientes.

Pension Liabilities Covered: Aguascalientes is in a very favorable position compared with other Mexican states, and maintains a sufficiency period of 112 years based on the latest results of the actuarial valuation, the Institute of Insurance and Social Services for the State Public Servants of Aguascalientes (ISSSSPEA). This institute carries out actuarial studies annually and shows progress in the strengthening of corporate governance.

Strong Liquidity Position: The liquidity level was strong in 2012–2016, with a balance equivalent to 7.9% of the total revenues, which is a higher percentage than the median of the state's peer group at 6.6%. In addition, current liabilities maintain a controlled evolution, with no use of short-term credit facilities or productive chains.

Dependency on Federal Revenues: Although local tax collection had a positive performance in 2012–2015, the state income represented 6.8% of the total income in fiscal 2016, below the peer group's median of 8.3%.

Rating Sensitivities

Potential Rating Actions: The Rating Outlook is Stable. Consequently, Fitch's sensitivity analysis does not currently anticipate developments that could likely lead to a change in the rating. A movement of the sovereign rating could result in a similar change in the rating for Aguascalientes. Although Fitch considers this scenario unlikely, the main factors that individually or collectively could lead to a negative rating action include an increase of additional debt beyond what is expected, and a substantial deterioration in operating margins.

Rating History

Date	Long-Term Foreign IDR	Long-Term Local IDR
May 18, 2017	—	BBB+
Dec. 14, 2016	—	BBB+
May 20, 2016	—	BBB+
May 28, 2015	—	BBB+
May 28, 2014	—	BBB+
Dec. 13, 2013	—	BBB
May 28, 2013	—	BBB
Feb. 27, 2013	—	BBB-

IDR – Issuer Default Rating.
Source: Fitch.

Principal Rating Factors

Summary: Strengths and Weaknesses

	Institutional Framework	Debt, Liabilities and liquidity	Economy	Fiscal Performance	Management and Admin.
Status	Neutral	Strength	Strength	Strength	Neutral
Trend	Stable	Positive	Stable	Stable	Positive

Source: Fitch.

Overall Strengths

- Solid operating performance, as a result of strengthening fiscal policies and continued monitoring of spending.
- Low leverage and high sustainability.
- Strong socioeconomic profile.
- Pension liabilities fully covered.

Overall Weaknesses

- Reliance on federal revenues.

Institutional Framework

- Positive evolution in fiscal equalization system.
- Regulations have favored the development of subnational debt markets. However, there is a need to modernize regulation on issues such as debt limits, use of short-term debt and others.
- Favorable macroeconomic environment.
- Limited financial autonomy.
- Limited degree of transparency and access to information.

Debt and Other Long-Term Liabilities

The direct debt of the state of Aguascalientes had a balance of MXN1.872 billion as of March 2017. The entirety of this balance corresponds to a bank loan contracted in 2011, through which the direct debt was restructured. This loan was granted with a 20-year maturity with a grace period of 24 months; the conditions of this restructure allowed the release of a significant flow of resources utilized in investment projects.

In addition, the state contracted two bank loans with Banco Nacional de Obras y Servicios Públicos, S.N.C. (Banobras) in 2012, for MXN1.05 billion at a 20-year maturity. Both were used largely for public infrastructure related to an investment for the automobile industry, which had a positive effect on the region. The first loan was contracted for up to MXN255.5 million but MXN233.9 million has already been spent. For this loan Aguascalientes covers exclusively the payment of fixed rate interests, while the repayment of capital will be made through one single payment on the maturity date through the redemption of zero-coupon bonds provided by the federal government.

The second loan was subscribed with the zero-coupon project for up to MXN800 million, which were already spent at December 2016. The principal primary source, at its maturity, will be resources from the redemption of zero-coupon bonds acquired by the state through Banobras, thus in this case it is also responsible only for the interest payment. For that reason, Fitch does not consider the balance of these bank loans on the leverage level. However, the interest payment does add to the debt servicing ratios.

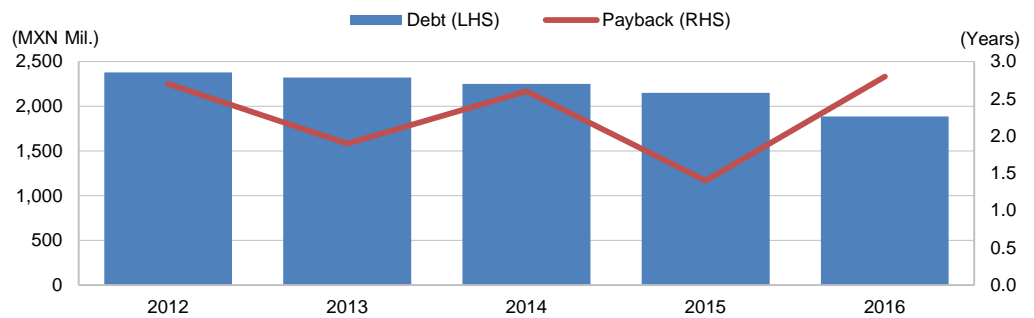
Related Criteria

[International Governments Rating Criteria - Outside the United States \(April 2016\)](#) and [Regional Rating Criteria - Outside the United States \(April 2016\)](#)

At year-end 2016 the leverage indicator resulted in a level equivalent to 9.5% of current revenues, while the debt servicing indicator was 61.3% of the operating balance. According to the financial behavior of the state, the debt-favorable conditions and assuming no bank finance is contracted in the remaining months of the year, Fitch estimates the debt service will be close to 10% of its operating balance in the next two years, which is manageable and consistent with the current rating.

The state does not have a balance of short-term bank loans or guaranteed indirect debt. In addition, nonbank liabilities maintain a controlled level. However, in the last five fiscal years, Aguascalientes presented mixed financial balances. In 2016 it had balance deficit equivalent to 1.8% of the income as cash available decreased to MXN1.709 billion (7.9% of the total income), which compares favorably with the peer group's median.

Debt and Payback



Source: Aguascalientes, Fitch calculations.

Contingencies

The ISSSSPEA is the body responsible for the contingencies related to pension liabilities. According to its law, the total contributions represent 37.5% of the salary, with 28.5% to the state and the remaining to the worker. The number of ISSSSPEA affiliates reached 18,888 assets and 3,787 pensioners in December 2015, considering teacher pensioners are not a direct responsibility of the state, as they are affiliated to the Institute of Security and Social Services of State Workers.

Aguascalientes is at a very favorable position compared with other states in Mexico. Based on the last actuarial valuation results carried out by an external specialist at December 2015, the pension system has financial sufficiency for the next 112 years.

The ISSSSPEA seeks to strengthen its management through several amendments set forth in decrees published since 2014. The latest amendment is related to the migration to a new custodian, Banco Santander, as well as professionalizing the investment area by implementing new tools and financial information systems. Among the new administration plans are to modify the ISSSSPEA law to avoid disproportionate salary increases at a stage close to retirement, set schemes to tackle the past-due portfolio of municipalities and entities, and adjust the investment regulations and the master trust rules to make the decision making more flexible.

However, the water service provision is responsibility of the decentralized municipal bodies, thus its operation does not represent a contingency for the state finances. The state carries out investment focused primarily on the residual water treatment and drinkable water through the Water Institute of Aguascalientes (Inagua). The entity maintains a very good level of drinkable water, sewage and sanitation coverage.

Economy

The state is located in the central region of Mexico and is constituted by 11 municipalities, with population estimated at 1.31 million people (1.1% of the national population) at year-end 2015. The main urban concentration is the metropolitan area of Aguascalientes, Jesus Maria and San Francisco de los Romo. Population in these three municipalities represented approximately 80% of the total of the state's population.

According to the National Council of Population, the state has low social exclusion in terms of quality of housing, education and basic services coverage and is ranked fifth in Mexico.

The state's economic growth for 2006–2015 is higher or very similar to the national indicator, with an annual average growth of 5.8% in 2010-2016 and 6.8% in 2016. According to the quarterly state economic activity indicator, the state's economic activity growth will be positive in 2017 with an increase of 4.2%, remaining above the national indicator.

The economic dynamism of the state has been reflected in the improvement of labor indicators, recording a high rate of formal labor and high growth of the number of permanent insured people in the Mexican institute of social security. Aguascalientes has decreased its unemployment rate to 3.3% between 2010 and March 2017, at levels close to the national indicator.

The main economic activities of the state are concentrated in the secondary and tertiary sectors. Within the secondary sector, the manufacturing industry stands out for its machinery and transport equipment sectors. In the tertiary activity, trade and real estate sectors stand out.

The manufacturing production index has increased 3.6x more than the national average in 2006–2015. Success in the manufacturing sector is the result of the development of clusters in key industries, the availability of qualified labor and the low crime rates, among others. In addition, it benefits from a strategic geographic position in the country and an efficient communication network. Aguascalientes currently has 19 industrial parks: 12 at state level, two at municipal level and five private. Its high industrialization level has benefited the state's socioeconomic conditions.

From 2012 to 2016 the Foreign Direct Investment averaged USD488.5 million annually, with USD447.1 million in 2016. For 2017 there are 24 significant investment projects, 11 of which are new and 13 that are project expansions or within existent companies. It is expected that these projects will generate around 4,530 new jobs and represent a total investment of USD574 million. The expectation for the next five years is positive, as many of the benefits generated by the projects will be reflected in the short and medium term.

The main recipient of such investment has been the automobile sector, with the majority of the investment coming from Japanese companies. In 2014 Nissan announced a joint venture with Daimler to manufacture Infiniti and Mercedes Benz cars, which is expected to start in 2017. This is additional to the investment in a new plant, which opened at the end of 2013 and will allow the Japanese company to reach an annual production of 850,000 vehicles. The investment amounts to USD2.385 billion and is expected to strengthen the economy of the state, with approximately 11,600 direct jobs.

Aguascalientes has very low crime rates, which contributes to a favorable investment environment. According to interior ministry data, intentional homicide rates per 100,000 inhabitants was 3.0 in 2016, the second lowest in the country, and significantly lower than the national indicator of 17. Automobile theft with violence was 3.8 and is significantly lower than the national rate of 36.9.

According to [Doing Business in Mexico 2016](#), published by the World Bank, the state of Aguascalientes ranked first nationally for its ease of doing business. This index includes the registry of properties as a favorable aspect, as well as the construction permits management.

Finances

Revenues

Aguascalientes' total income trend was positive in 2012–2016 due to management actions targeted to obtain higher federal revenues and strengthen local revenues. In 2016 the total income was MXN21.69 billion, with a 5% increase compared with fiscal 2015.

To achieve more financial flexibility, the state administration has carried out several actions to strengthen local revenues, which are reflected in a dynamic tax collection for 2012–2016, and it is expected to continue in the following fiscal years. In 2016 such revenues amounted to MXN1.485 billion, equivalent to 6.8% of the total revenues, but lower than the 8.3% median of the peer group.

In 2016 the dynamic of the state's own revenues was limited. In the last fiscal year, the state income grew only 1% compared with 2015. The administration is trying to drive this dynamic through strategies, such as the past-due portfolio recovery of local liens, the implementation of the Program to Update Tax Payers Registry, and collaboration agreements with municipalities for tax and municipal rights collection.

Federal contributions registered an increase of 12.8% in 2016. However, in the last three years Aguascalientes received a significant amount of revenues from federal agreements averaging MXN4.22 billion.

The state's operating revenues presented a CAGR of 10.6% in the last five years as result of the own revenues and the available federal revenues. Fitch expects the positive trend in revenues to continue, as seen in first-quarter 2017.

Expenditure

In 2016 the total expenditure was MXN22.07 billion. Throughout the year, a deficit equivalent to 1.8% of the revenues was generated.

Operating costs showed an annual average growth rate similar to the operating revenues, as a result of the policies of budget discipline implemented in the past few years, which has allowed Aguascalientes to have a financial flexibility that compares favorably against peers at its rating levels.

Control in salary increases in the work force and vacancies are maintained due to the actions implemented in terms of expenditure rationalization. In addition, in the current expenditure increases, priority is given to strategic areas, such as public security and public services.

Fitch expects Aguascalientes to continue carrying out measures to maintain a strong budget performance and operating expenditure. According to the expenditure budget 2017, the operating expenditure is not expected to grow, primarily due to an expected decrease in nonconditional transfers account.

Investment

As part of the current state administration’s financial strategy, the level of investment has increased significantly. In the past three years the total investment average of Aguascalientes presented a level equivalent to 17.1% of the total expenditure, which is significantly higher than the peer group median of 8.0%.

In 2016 there was a total investment of MXN2.845 billion, financed through state revenues (40%) and federal revenues (60%). Investment represented 13% of the state’s total expenditure of the year, comprising road works, community centers, hospitals, education, cultural and tourist infrastructure.

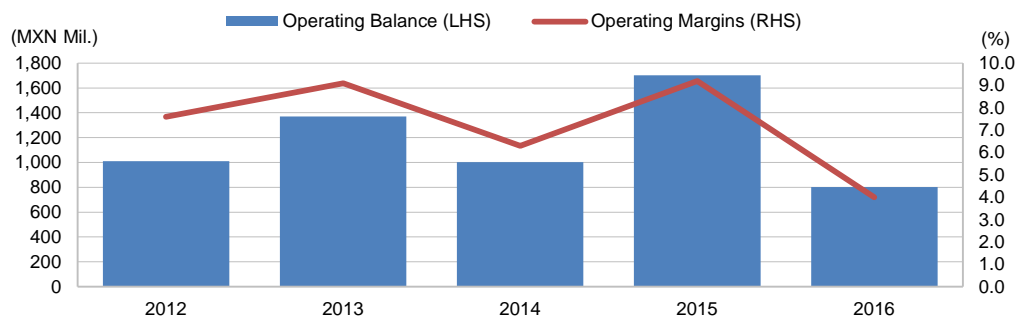
Aguascalientes estimates a total investment of MXN2.016 billion in 2017, with 60% financed through federal resources. Within the investment program the sectors that stand out are health, infrastructure and urban development, as well as the transport and communications sectors. It is expected that the federal infrastructure program generates investment of more than MXN14 billion in infrastructure, energy, health and tourism programs in the state of Aguascalientes.

Operating Balance

The operating balance as a percentage of current revenues showed a decrease and was at 4.04% compared with 9.24% in 2015 due to operating expenditure growth, which is higher than the operating revenue growth. However, this percentage compares favorably against the median of the group of Mexican states in the same rating level. In the last five years the CAGR of operating expenditure and operating revenue has been almost the same (11.6% and 10.6%, respectively), so even if the operating balance showed intra-annual movements, it has remained stable in the last five fiscal years.

The rating affirmation reflects Fitch’s expectation Aguascalientes will maintain the budget discipline and generate strong operational margins in 2017–2019.

Budgetary Performance



Source: Aguascalientes, Fitch calculations.

Management and Administration

The current administration, which began on Dec. 1, 2016 and will end on Sept. 30, 2021, is led by the Partido Acción Nacional. The previous administration (2010–2016) was led by the Partido Revolucionario Institucional.

Changes in ministries, trusts and decentralized bodies have taken place; however, the implementation of innovative practices and programs promoting efficiency and quality in public

service continues. The Development State Plan 2016–2022 (PED) contains general strategies that provide continuity to the good practices of previous administrations.

In 2016 the Law of Budget, Public Expenditure and Fiscal Responsibility was reformed to create the stabilization fund of the state of Aguascalientes, which operates through an irrevocable public trust to create a financial reserve that can be used to offset decreases in federal transfers received. If there are not decreases, its surpluses can be targeted to debt repayment or to finance projects not included in the expenditure budget.

Aguascalientes was the first sub-national entity in Mexico with an assigned local currency IDR of 'BBB+'.

Appendix A — State of Aguascalientes

(MXN Mil.)	2012	2013	2014	2015	2016
Taxes	655.3	837.0	857.4	924.0	926.4
Transfers Received	12,170.1	13,878.7	14,605.1	17,025.1	18,416.9
Fees, Fines and other Operating Revenue	437.8	341.6	384.3	485.3	476.8
Operating Revenue	13,263.2	15,057.3	15,846.8	18,434.4	19,820.1
Operating Expenditure	(12,252.8)	(13,686.2)	(14,844.7)	(16,731.6)	(19,018.7)
Operating Balance	1,010.4	1,371.1	1,002.1	1,702.8	801.4
Financial Revenue	49.1	46.3	73.6	62.0	81.4
Interest Paid	(168.6)	(214.2)	(222.9)	(234.3)	(209.9)
Current Balance	890.9	1,203.2	852.8	1,530.5	672.9
Capital Revenue	2,471.8	2,718.8	3,152.2	2,164.3	1,791.3
Capex	(3,786.4)	(3,366.3)	(4,574.2)	(3,000.7)	(2,844.6)
Capital Balance	(1,314.6)	(647.5)	(1,422.0)	(836.4)	(1,053.3)
Surplus (Deficit) Before Debt Variation	(423.7)	555.7	(569.2)	694.1	(380.4)
New Borrowing	491.1	208.7	0.0	180.0	154.1
Debt Repayment	(48.8)	(58.1)	(68.9)	(102.4)	(282.0)
Net Debt Movement	442.3	150.6	(68.9)	77.6	(127.9)
Overall Results	18.6	706.3	(638.1)	771.7	(508.3)
Debt					
Short-Term	—	—	—	—	—
Long-Term	2,377.6	2,319.7	2,250.8	2,148.7	1,884.9
Direct Debt	2,377.6	2,319.7	2,250.8	2,148.7	1,884.9
+ Other Fitch Classified Debt - Pre-Financing	491.0	—	—	—	1,033.9
Direct Risk	2,868.6	2,319.7	2,250.8	2,148.7	2,918.8
- Cash, Liquid Deposits, Sinking Fund	1,338.5	2,049.1	1,499.5	2,220.9	1,709.1
Net Direct Risk	1,530.1	270.6	751.3	(72.2)	1,209.7
Guarantees and Other Contingent Liabilities	0.0	0.0	0.0	0.0	0.0
Net Indirect Debt (Public Sector Entities Excluding Guaranteed Amount)	—	—	—	—	0.0
Net Overall Risk	1,530.1	270.6	751.3	(72.2)	1,209.7
Memo for Direct Debt:					
% in Foreign Currency	0.0	0.0	0.0	0.0	0.0
% Issued Debt	0.0	0.0	0.0	0.0	0.0
% Fixed Interest Rate Debt	9.4	6.6	4.7	2.7	0.0

Source: Issuer, Fitch calculations.

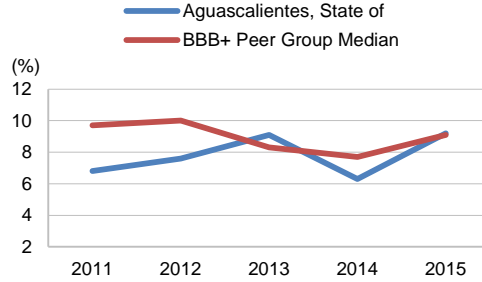
Appendix B — State of Aguascalientes

(%)	2012	2013	2014	2015	2016
Fiscal Performance Ratios					
Operating Balance/Operating Revenue	7.62	9.11	6.32	9.24	4.04
Current Balance/Current Revenue ^a	6.69	7.97	5.36	8.27	3.38
Surplus (Deficit) before Debt Variation/Total Revenue ^b	(2.6)8	3.12	(2.98)	3.36	(1.75)
Overall Results/Total Revenue	0.12	3.96	(3.35)	3.74	(2.34)
Operating Revenue Growth (Annual % Change)	N.A.	13.53	5.24	16.33	7.52
Operating Expenditure Growth (Annual % Change)	N.A.	11.7	8.46	12.71	13.67
Current Balance Growth (Annual % Change)	N.A.	35.05	(29.12)	79.47	(56.03)
Debt Ratios					
Direct Debt Growth (Annual % Change)	N.A.	(2.44)	(2.97)	(4.54)	(12.28)
Interest Paid/Operating Revenue	1.27	1.42	1.41	1.27	1.06
Operating Balance/Interest Paid (x)	6.0	6.4	4.5	7.3	3.8
Direct Debt Servicing/Current Revenue	1.63	1.8	1.83	1.82	2.47
Direct Debt Servicing/Operating Balance	21.52	19.86	29.12	19.77	61.38
Direct Debt/Current Revenue	17.86	15.36	14.14	11.62	9.47
Direct Risk/Current revenue	21.55	15.36	14.14	11.62	14.67
Direct Debt/Current Balance (Years)	2.67	1.93	2.64	1.4)	2.8
Net Overall Risk/Current revenue (%)	11.49	1.79	4.72	(0.39)	6.08
Direct Risk/Current Balance (Years)	3.22	1.93	2.64	1.40	4.34
Direct Debt/GDP	—	1.57	1.35	1.24	1.02
Direct Debt Per Capita (Local Currency)	1,924	1,842	1,764	1,636	1,406
Revenue Ratios					
Operating Revenue/Budget Operating Revenue	N.A.	N.A.	N.A.	N.A.	N.A.
Tax Revenue/Operating Revenue	4.94	5.56	5.41	5.01	4.67
Modifiable Tax Revenue/Total Tax Revenue	100.00	100.00	100.00	100.00	100.00
Current Transfers Received/Operating Revenue	91.76	92.17	92.16	92.36	92.92
Operating Revenue/Total Revenue ^b	84.03	84.49	83.09	89.22	91.37
Total Revenue ^b Per Capita (Local Currency)	12,770	14,156	14,947	15,736	16,177
Expenditure Ratios					
Operating Expenditure/Budget Operating Expenditure	N.A.	N.A.	N.A.	N.A.	N.A.
Staff Expenditure/Operating Expenditure	9.2	8.55	8.1	7.64	5.94
Current Transfer Made/Operating Expenditure	87.44	88.3	88.68	89.26	91.03
Capex/Budget Capex	N.A.	N.A.	N.A.	N.A.	N.A.
Capex/Total Expenditure	23.29	19.43	23.21	14.95	12.72
Capex/Local GDP	—	2.28	2.75	1.73	1.54
Total Expenditure Per Capita (Local Currency)	13,153	13,761	15,447	15,285	16,670
Capex Financing					
Current Balance/Capex	23.53	35.74	18.64	51	23.66
Capital Revenue/Capex	65.28	80.77	68.91	72.13	62.97
Net Debt Movement/Capex	11.68	4.47	(1.51)	2.59	(4.50)

^aIncludes financial revenue. ^bExcluding new borrowing. N.A. — Not available.
Source: Issuer, Fitch calculations.

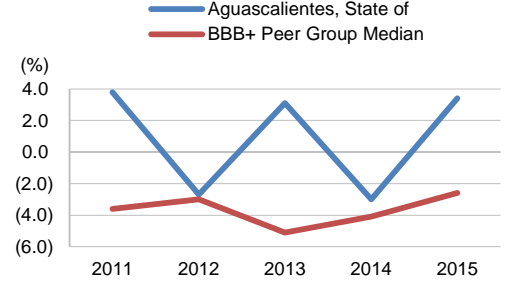
Appendix C

Operating Balance
(Operating Revenue)



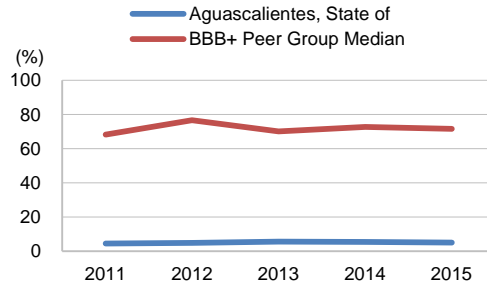
Source: Issuers, Fitch.

Surplus (Deficit)
(Total Revenue)



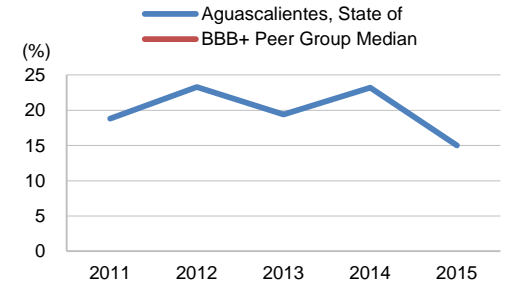
Source: Issuers, Fitch.

Taxes
(Operating Revenue)



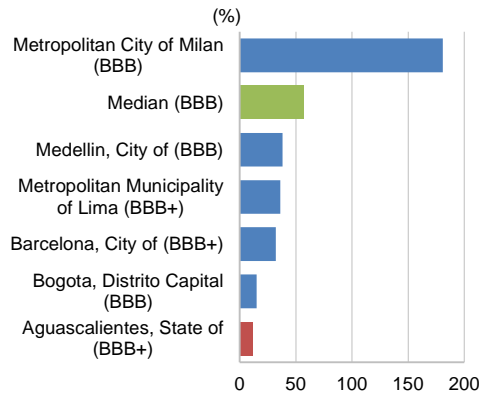
Source: Issuers, Fitch.

Capex
(Total Expenditure)



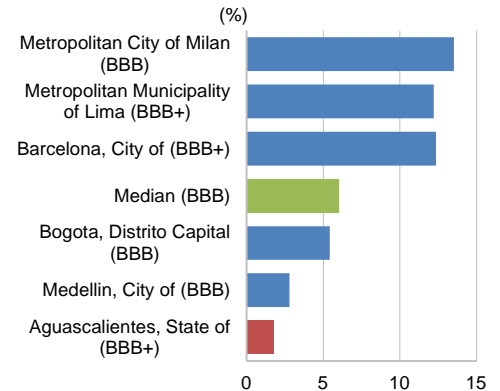
Source: Issuers, Fitch.

Debt/Current Revenue — 2015



Source: Issuers, Fitch.

Debt Servicing/Current Revenue — 2015



Source: Issuers, Fitch.

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