FitchRatings

Public Finance

Mexico

State of Aguascalientes

Full Rating Report

Ratings

Long-Term Local Currency IDR	BBB+
National	
Long-Term Rating	AA+(mex)

Rating Outlook

Long-Term Local Currency IDR	Stable
National Long-Term Rating	Stable

Financial Data

State of Aguascalientes

(MXN Mil.)	12/31/17	12/31/16
Operating Revenue	20,296.1	19,820.1
Debt	1,820.4	1,884.9
Operating Balance/ Operating Revenue (%)	8.36	4.04
Debt Service/Current Revenue (%)	1.70	2.47
Debt/Current Balance (Years)	1.11	2.8
Operating Balance/ Interest Paid (x)	1.09	3.80
Capex/Total Expenditure (%)	9.93	12.72
Surplus (Deficit) Before Debt Variation/Total Revenue (Excluding New Debt) (%)	1.56	(1.75)
Current Balance/ Capex (%)	71.75	23.66

Related Research

Fitch Affirms the State of Aguascalientes LC IDR at 'BBB+'; Outlook Stable (May 2018)

Institutional Framework for Mexican Subnationals (December 2011)

Analysts

Alfredo Saucedo
+52 81 8399-9163
alfredo.saucedo@fitchratings.com

Natalia Etienne
+52 81 8399-9136
natalia.etienne@fitchratings.com

Key Rating Drivers

Rating Capped by the Sovereign: The state of Aguascalientes' Issuer Default Rating (IDR) is capped by Mexico's sovereign rating of 'BBB+' with a Stable Outlook. Fitch Ratings believes a Mexican subnational cannot be rated above the sovereign.

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

Low Leverage Level: 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.

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 economic activity in Aguascalientes.

Pension Liabilities Covered: Aguascalientes is in a very favorable position compared with other Mexican states and Latin American governments, and the state maintains a sufficiency period of 100 years based on the latest results of the actuarial valuation by 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 2013–2017, with a balance equivalent to 10% of operating revenue. In addition, current liabilities maintain a controlled evolution, with no need to use short-term credit facilities.

Dependency on Federal Revenue: Although local tax collection has had a positive tax performance in the last three years, the state is dependent on federal transfers, 93% of operating revenue comes from federal transfers. This heavy dependence, captured in the institutional framework analysis, compares less favorably with peers in Latin America and European governments.

Rating Sensitivities

Potential Rating Actions: The Rating Outlook is Stable. Consequently, Fitch's sensitivity analysis does not currently anticipate developments that would 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.

Rating History

Date	Long-Term Foreign IDR	Long-Term Local IDR
May 16,2018	—	BBB+
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–

Source: Fitch Ratings.

Related Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (April 2016)

Principal Rating Factors

Summary: Strengths and Weaknesses

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

Source: Fitch Ratings.

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.

Aguascalientes is a Mexican state government whose main responsibilities are general infrastructure (highways, water, roads, basic and intermediate education and industrial logistics). Also, education, health and public security responsibilities are shared with the central government and municipalities. The state is located in the central region of Mexico and is constituted by 11 municipalities.

Subnational governments in Mexico are highly dependent on resources transferred from the federation, which has historically resulted in a mechanism that reduces the incentives to strengthen local revenue. For the Mexican states, only 8% of total revenue comes from autonomous revenue (taxes, fees and others); the rest are federal transfers for operating and capital expenditures.

Debt and Other Long-Term Liabilities

Debt is low. The direct debt of Aguascalientes had a balance of MXN1.820 billion as of December 2017. The entirety of this balance corresponds to a bank loan contracted in 2011 and restructured in September 2017. This loan was granted with a 20-year maturity, with a grace period of 24 months. The conditions of the 2017 restructuring allowed the state to reduce interest payments; the spread moved from 0.90% to 0.35%.

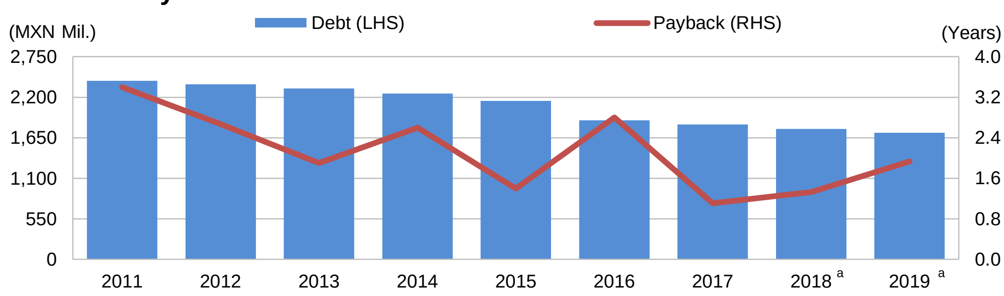
In addition, the state contracted two bank loans with Banco Nacional de Obras y Servicios Publicos, S.N.C. (Banobras) in 2012, for MXN1.05 billion at a 20-year maturity. Both were used largely for public infrastructure related to an investment for the automobile industry, which had a positive effect 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 interest, 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 was already spent at December 2016. The primary source for principal, at its maturity, will be resources from the redemption of zero-coupon bonds acquired by the state through Banobras; thus, Aguascalientes is responsible only for the interest payment. For that reason, Fitch does not consider the balance of these bank loans on the leverage level, but rather under other Fitch-classified debt. However, the interest payment does add to the debt servicing ratios.

At year-end 2017 the leverage indicator resulted in a level equivalent to 8.9% of current revenue, while the payback ratio (direct debt + other Fitch-classified debt / operating balance) was 1.68 years. 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 three years, which is manageable and consistent with the current rating.

The state does not present off-balance-sheet debt or indirect debt (state decentralized agencies do not have debt). The most relevant entities are three state universities and some technical institutes. They receive state and federal transfers for operating and capital expenditures and present balanced results.

Debt and Payback



[a]Fitch projections under a rating case scenario.
Source: Fitch Ratings.

Contingencies

The ISSSSPEA is the body responsible for the contingencies related to pension liabilities. According to its law, total contributions represent 37.5% of 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 with the Institute of Security and Social Services of State Workers.

Aguascalientes is in a very favorable position compared with other states in Mexico. Based on the results of the last actuarial valuation carried out by an external specialist at December 2017, the pension system has financial sufficiency for the next 100 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. The reform includes avoiding disproportionate salary increases at a stage close to retirement, setting schemes to tackle the past-due portfolio of municipalities and entities and adjusting the investment regulations and the master trust rules to make the decision-making more flexible.

Water service provision is the responsibility of the decentralized municipal bodies; thus, its operation does not represent a contingency for Aguascalientes' finances. The state carries out investment focused primarily on 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 2017. 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 state's total 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 during 2006–2016 is higher than the national indicator, with an annual average growth of 5.8% in 2010–2016 and 6.8% in 2016. According to Banamex projections, 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 in the number of people permanently insured by the Mexican institute of social security. Aguascalientes decreased its unemployment rate to 3.3% between 2010 and March 2017, a level 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. Among tertiary activity, the trade and real estate sectors stand out.

Success in the manufacturing sector is the result of the development of clusters in key industries, the availability of qualified labor and 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 the state level, two at the municipal level and five private. Its high industrialization level has benefited the state's socioeconomic conditions.

2017 was the highest year of foreign direct investment on record, registering MXN1.13 billion, more than doubling the amount in 2016. The state currently has 241 significant investment projects, 19 of which are new and 22 that are project expansions or within existent companies. It is expected that these projects will generate around off 6,500 new jobs and represent a total investment of USD1.0 billion. 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 auto, which started in 2017. This is in addition to Nissan's 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 contribute 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 per 100,000 and is significantly lower than the national rate of 36.9.

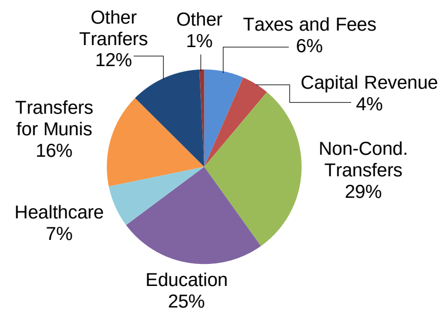
According to *Doing Business in Mexico 2016*, published by the World Bank, the state of Aguascalientes ranked first nationally for its ease of doing business. This index includes property registration as a favorable aspect, as well as construction permit management.

Finances

Revenue

Aguascalientes' total income trend was positive in 2017 due to management actions targeted to strengthen local revenue while federal transfers increased through increases in the federal tax collection. In 2017, total revenue were MXN21.27 billion, with a 6.6% increase over fiscal 2016.

Revenue Breakdown
(State of Aguascalientes)



Source: Fitch Ratings.

The main revenue sources for taxes and fees are the payroll tax and the car matriculation fee. The revenue base has increased, though the levy is difficult to increase: the payroll tax rate is 2% of private and public enterprises' payroll; if employment levels rise, normally the collection increases. Car matriculation fee is dependent on automobiles in circulation. For Aguascalientes, we expect the same positive trend for further years given its economic dynamism.

To achieve more financial flexibility, the state administration has carried out several actions to strengthen local revenue, which are expected to be reflected in tax collection for 2018. In 2017, the dynamic of the state's own revenue was limited, local revenue did not grow compared with 2016. 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.

Relative to international peers, Aguascalientes has a high dependence on federal revenue. Only 5% of operating revenue comes from local tax and fee collection, while the peer average is 50% tax revenue share.

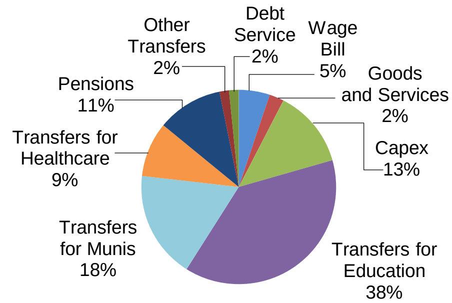
For the first time in the last five years, capital revenue decreased 45% in 2017 due to a reduction in the federal capex budget. However, this was counterbalanced by federal non-earmarked transfers increasing 4% in the same period.

Expenditure

In 2017, total expenditure was MXN23.03 billion. Throughout the year, a surplus before net financing was generated equivalent to 1.6% of the revenue.

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

Expenditure Breakdown
(State of Aguascalientes)



Source: Fitch Ratings.

Control of salary increases and vacancies in the workforce are maintained due to the actions implemented in terms of expenditure rationalization. In addition, in 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 strong budget performance and operating expenditure. According to the expenditure budget for 2018, operating expenditure is expected to grow in line with revenue.

Investment

As part of the current state administration's financial strategy, the level of investment increased significantly in 2017, equivalent to 10% of total expenditure.

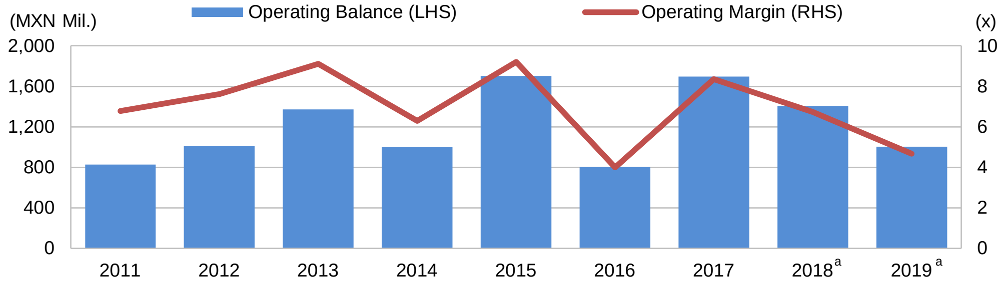
Total investment in 2017 was MXN2.3 billion, financed through state revenue (73%) and federal revenue (27%). Investment represented 13% of the state's total expenditure for the year, comprised of road works, community centers, hospitals, education, cultural and tourist infrastructure.

Aguascalientes forecasts similar investment of MXN2.1 billion in 2018. Within the investment program, the sectors that stand out are health (conclusion of a state hospital), infrastructure and urban development (overpass), as well as transport (acquisition of new buses) and the communication sector.

Operating Balance

Operating balance as a percentage of current revenue was at 8.36%, in 2017 compared with 4.0% in 2016, the increase due to operating expenditure growth control in staff (100 employees cut). Nevertheless, margins remain lower than peers. In the last five years the CAGR of operating expenditure and operating revenue has been almost the same (8.7% and 8.9%, respectively). Moreover, even if operating balance showed intra-annual movements, it has remained stable in the last five fiscal years.

Budgetary Performance



[a]Fitch projections under a rating case scenario.
Source: Fitch Ratings.

The rating affirmation reflects Fitch's expectation Aguascalientes will maintain the budget discipline and generate strong operational margins in 2018–2019.

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.

Despite changes in ministries, trusts and decentralized bodies, the implementation of innovative practices and programs promoting efficiency and quality in public service continues. The Development State Plan 2016–2022 contains general strategies that provide continuity with 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 decreases in federal transfers are not realized, surpluses can be targeted to debt repayment or to finance projects not included in the expenditure budget.

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

Appendix A — State of Aguascalientes

(MXN Mil.)	2013	2014	2015	2016	2017
Taxes	837.0	857.4	924.0	926.4	933.9
Transfers Received	13,878.7	14,605.1	17,025.1	18,416.9	18,892.2
Fees, Fines and Other Operating Revenue	341.6	384.3	485.3	476.8	470.0
Operating Revenue	**15,057.3**	**15,846.8**	**18,434.4**	**19,820.1**	**20,296.1**
Operating Expenditure	(13,686.2)	(14,844.7)	(16,731.6)	(19,018.7)	(18,600.3)
Operating Balance	**1,371.1**	**1,002.1**	**1,702.8**	**801.4**	**1,695.8**
Financial Revenue	46.3	73.6	62.0	81.4	167.1
Interest Paid	(214.2)	(222.9)	(234.3)	(209.9)	(221.8)
Current Balance	**1,203.2**	**852.8**	**1,530.5**	**672.9**	**1,641.1**
Capital Revenue	2,718.8	3,152.2	2,164.3	1,791.3	980.1
Capex	(3,366.3)	(4,574.2)	(3,000.7)	(2,844.6)	(2,287.2)
Capital Balance	(647.5)	(1,422.0)	(836.4)	(1,053.3)	(1,307.1)
Surplus (Deficit) Before Debt Variation	**555.7**	**(569.2)**	**694.1**	**(380.4)**	**(94.6)**
New Borrowing	208.7	0.0	180.0	154.1	239.4
Debt Repayment	(58.1)	(68.9)	(102.4)	(282.0)	(54.5)
Net Debt Movement	150.6	(68.9)	77.6	(127.9)	(54.5)
Overall Results	**706.3**	**(638.1)**	**771.7**	**(508.3)**	**(151.9)**
Debt					
Short-Term	—	—	—	—	—
Long-Term	2,319.7	2,250.8	2,148.7	1,884.9	1,820.4
Direct Debt	**2,319.7**	**2,250.8**	**2,148.7**	**1,884.9**	**1,820.4**
+ Other Fitch Classified Debt — Pre-Financing	—	—	—	1,033.9	1,033.9
Direct Risk	**2,319.7**	**2,250.8**	**2,148.7**	**2,918.8**	**2,854.3**
– Cash, Liquid Deposits, Sinking Fund	2,049.1	1,499.5	2,520.4	2,028.7	2,271.8
Net Direct Risk	**270.6**	**751.3**	**508.1**	**890.1**	**582.5**
Guarantees and Other Contingent Liabilities	0.0	0.0	0.0	0.0	0.0
Net Indirect Debt (Public Sector Entities Excluding Guaranteed Amount)	—	—	—	—	—
Net Overall Risk	**270.6**	**751.3**	**508.1**	**890.1**	**582.5**
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	6.6	4.7	2.7	0.0	0.0

Source: Issuer, Fitch Ratings calculations.

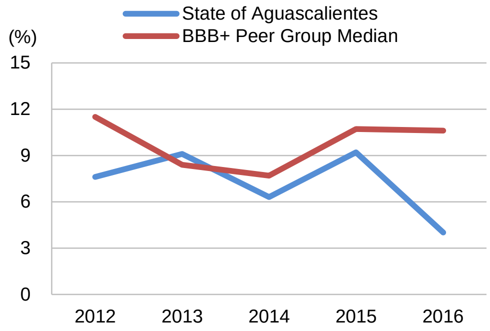
Appendix B — State of Aguascalientes

(%)	2013	2014	2015	2016	2017
Fiscal Performance Ratios					
Operating Balance/Operating Revenue	9.11	6.32	9.24	4.04	8.36
Current Balance/Current Revenue[a]	7.97	5.36	8.27	3.38	8.02
Surplus (Deficit) before Debt Variation/Total Revenue[b]	3.12	(2.98)	3.36	(1.75)	1.56
Overall Results/Total Revenue	3.96	(3.35	3.74	(2.34)	1.12
Operating Revenue Growth (Annual % Change)	13.53	5.24	16.33	7.52	2.40
Operating Expenditure Growth (Annual % Change)	11.7	8.46	12.71	13.67	(2.20)
Current Balance Growth (Annual % Change)	35.05	(29.12)	79.47	(56.03)	49.89
Debt Ratios					
Direct Debt Growth (Annual % Change)	(2.44)	(2.97)	(4.54)	(12.28)	(3.42)
Interest Paid/Operating Revenue	1.42	1.41	1.27	1.06	1.09
Operating Balance/Interest Paid (x)	6.4	4.5	7.3	3.8	7.6
Direct Debt Servicing/Current Revenue	1.8	1.83	1.82	2.47	10.51
Direct Debt Servicing/Operating Balance	19.86	29.12	19.77	61.38	126.88
Direct Debt/Current Revenue	15.36	14.14	11.62	9.47	8.90
Direct Risk/Current revenue	15.36	14.14	11.62	14.67	13.95
Direct Debt/Current Balance (Years)	1.93	2.64	1.4)	2.8	1.11
Net Overall Risk/Current revenue (%)	1.79	4.72	(0.39)	6.08	2.85
Direct Risk/Current Balance (Years)	1.93	2.64	1.40	4.34	2.84
Direct Debt/GDP	1.57	1.35	1.24	1.02	0.63
Direct Debt Per Capita (Local Currency)	1,842	1,764	1,636	1,406	1,330
Revenue Ratios					
Operating Revenue/Budget Operating Revenue	N.A.	N.A.	N.A.	N.A.	N.A.
Tax Revenue/Operating Revenue	5.56	5.41	5.01	4.67	5.42
Modifiable Tax Revenue/Total Tax Revenue	100.00	100.00	100.00	100.00	100.00
Current Transfers Received/Operating Revenue	92.17	92.16	92.36	92.92	91.76
Operating Revenue/Total Revenue[b]	84.49	83.09	89.22	91.37	91.37
Total Revenue[b] Per Capita (Local Currency)	14,156	14,947	15,736	16,177	17,009
Expenditure Ratios					
Operating Expenditure/Budget Operating Expenditure	N.A.	N.A.	N.A.	N.A.	N.A.
Staff Expenditure/Operating Expenditure	8.55	8.1	7.64	5.94	5.99
Current Transfer Made/Operating Expenditure	88.3	88.68	89.26	91.03	91.98
Capex/Budget Capex	N.A.	N.A.	N.A.	N.A.	N.A.
Capex/Total Expenditure	19.43	23.21	14.95	12.72	9.93
Capex/Local GDP	2.28	2.75	1.73	1.54	0.79
Total Expenditure Per Capita (Local Currency)	13,761	15,447	15,285	16,670	16,829
Capex Financing					
Current Balance/Capex	35.74	18.64	51	23.66	71.75
Capital Revenue/Capex	80.77	68.91	72.13	62.97	42.85
Net Debt Movement/Capex	4.47	(1.51)	2.59	(4.50)	(4.10)

[a]Includes financial revenue. [b]Excluding new borrowing. N.A. – Not available.
Source: Issuer, Fitch Ratings calculations.

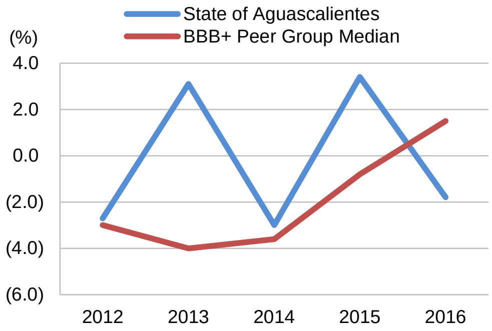
Appendix C

Operating Balance
(Operating Revenue)



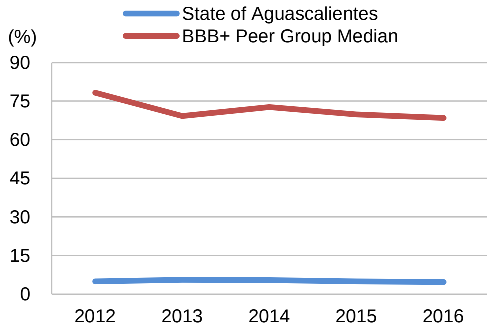
Source: Issuers, Fitch Ratings.

Surplus (Deficit)
(Total Revenue)



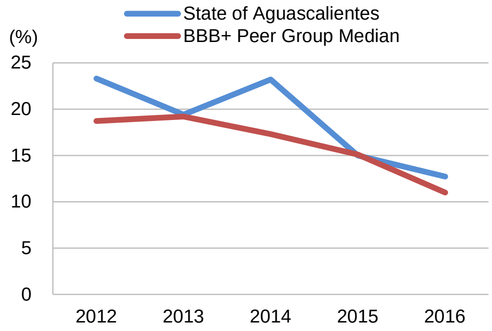
Source: Issuers, Fitch Ratings.

Taxes
(Operating Revenue)



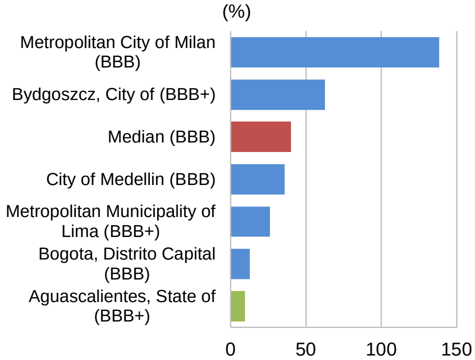
Source: Issuers, Fitch Ratings.

Capex
(Total Expenditure)



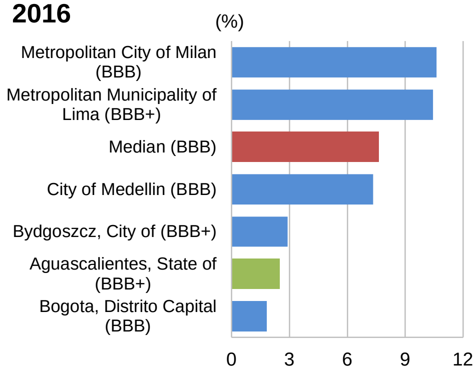
Source: Issuers, Fitch Ratings.

Debt/Current Revenue — 2016



Source: Issuers, Fitch Ratings.

Debt Servicing/Current Revenue — 2016



Source: Issuers, Fitch Ratings.

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