

SECTOR IN-DEPTH

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Cross-Sector – Russia

2018 FIFA World Cup will have varying short-lived effects for most rated issuers

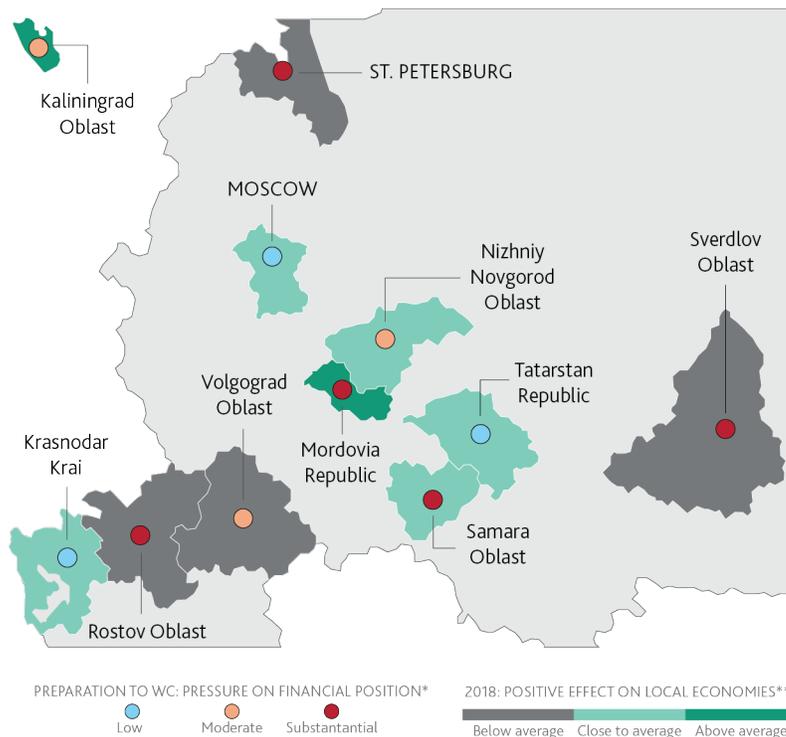
The 2018 FIFA World Cup tournament will put host country [Russia \(Ba1 positive\)](#) in the global spotlight, but it will have little lasting impact on most rated Russian companies, infrastructure providers, banks, regional governments, or the sovereign (see Exhibit 1).

- » **Impact of games will be muted at the sovereign level.** We see very limited economic impact at the national level given the limited duration of the World Cup and the very large size of the country's economy. While the extra boost in tourism will benefit Russia's already healthy external accounts, the added support will likely be short-lived.
- » **Sector-neutral, varying economic and fiscal impact for hosting regions.** Economies and revenue intake of the regions hosting the championship will see positive but mostly short-lived effect. New infrastructure will generate additional tax revenue and decrease future capital spending, with Mordovia Republic (unrated) and Kaliningrad Oblast (unrated) to benefit the most. Conversely, World Cup spending has negatively impacted government finances in other regions and lead to debt accumulation (e.g. [City of St. Petersburg \(Ba1 positive\)](#), [Samara Oblast \(Ba3 positive\)](#)).
- » **Overall credit impact for Russian corporates will be limited, but food retailers, hotels, telecoms, and transport will see a temporary boost in revenue.** Moscow-based airports are among the key beneficiaries in the transport sector because upgraded facilities will support higher passenger flows, even after the event. Construction companies are also among the key beneficiaries, but they would have already felt much of the impact.
- » **Global corporate sponsors will benefit from media exposure.** The World Cup is a very popular sporting event that offers an opportunity for global media exposure, benefitting big corporate sponsors including [Coca-Cola Co. \(Aa3 negative\)](#), Adidas AG (unrated), Budweiser (unrated) and [McDonald's Co \(Baa1 stable\)](#).
- » **No visible impact on the banking sector.** Any additional revenue linked to the World Cup will amount to less than 1% of the sector's bottom line. The loan portfolio aimed at financing construction of infrastructure is also negligible for the sector.

Exhibit 1

A short-lived and/or muted effect on the country overall, its regions, corporates and banks

-  Sovereign: very low economic impact, some benefits for external finances
-  Sub-sovereigns: sector-neutral with different impact on hosting regions
-  Food retailers: most impact on Auchan and O'KEY
-  Hotel operators, consumer goods producers: temporary boost in revenues
-  Big corporate sponsors – mostly promotional benefits
-  Construction: investments for WC is only 2% of total, effect has been felt already
-  Transport: a short-lived contribution of below 3% to the total annual traffic
-  Airports: Domodedovo and Sheremetyevo benefit most among airports from renewed infrastructure
-  Electricity: benefited from additional investments
-  Mobile services: growth of revenue will not exceed 3%-4%, MegaFon benefit most
-  Banks: no visible impact



* Analysis based on the changes in debt burden due to preparation to the World Cup 2018

** Analysis based on additional economic activity relative to nominal GRP (Gross Regional Product) due to the World Cup 2018

Source: Moody's Investors Service

Impact of games will be muted at the sovereign level

We view the World Cup as neutral for the Russian sovereign's credit quality. Despite potential benefits from the boost in tourism (which will further support Russia's already-strong external finances), we do not expect the World Cup to make a meaningful contribution to the broader economy. The games will last just one month and the associated economic stimulus will pale in comparison to Russia's \$1.3 trillion economy. Much of the macroeconomic impact has already been felt through infrastructure spending, and even there the impact has been limited. World Cup-related investments in 2013-17 accounted for only 1% of total investments. That said, hosting cities have seen an improvement in transport and utility infrastructure as a result.

Recent news reports quoting deputy prime minister Vitaliy Mutko suggest that about 2.5 million, or 90% of the tickets for the various games of the competition, have already been sold. Tens of thousands of visitors are expected to attend the games from all over the world, with Western countries such as the [US \(Aaa stable\)](#), [Germany \(Aaa stable\)](#), [France \(Aa2 positive\)](#) and the [UK \(Aa2 stable\)](#) apparently topping the list so far. The ruble exchange rate is currently very favorable for visitors from these countries after last month's depreciation when new US sanctions were launched, which could ultimately encourage higher spending on ancillary items such as retail services.

Nevertheless, we do not expect the games to have an ongoing favorable impact on the economy, indeed, the impact is likely to be even lower than that of the Sochi Olympic games, which developed an under-built resort area that is more accessible than many of the regions where the World Cup will be staged.

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Sector-neutral, varying economic and fiscal impact for hosting regions

The World Cup will generate limited additional own source revenue at the sub-sovereign level and will be short-lived, in line with the broader economic effect. Preparation for the games has not affected the sub-sovereign sector's overall fiscal performance because federal government sources covered the largest share of World Cup-related expenses.

Economic impact will be mostly short-lived, regions will benefit from improvements in public infrastructure

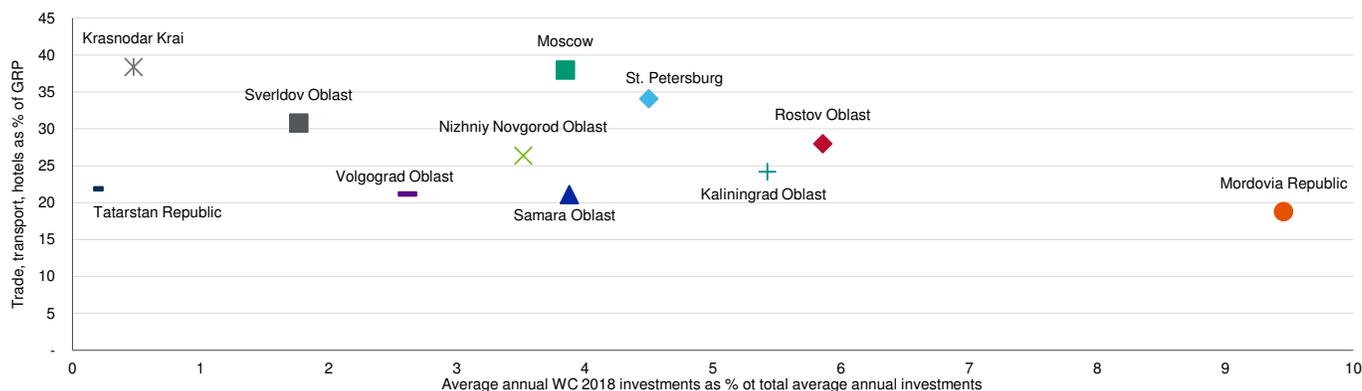
We expect the economic impact from the games to be mostly short-lived for the regions hosting the championship and to vary significantly based on the number of tourists and the size of their economies. In most cases, the positive effect on the region's nominal gross regional product (GRP) will be capped at 1%-2% and will not boost any region's GRP beyond 3% in 2018. In our view, the regions that will benefit most are Mordovia and Kaliningrad, given the relatively small size of their respective economies.

We don't expect the World Cup to significantly boost long-term economic growth because World Cup-related investments account for a very small share of annual investments in most hosting regions. Moreover, the sectors (hotels, trade, transport, etc.) that will benefit most from increased tourist flows are not key growth drivers in most hosting local economies. And infrastructure alone will not attract a more permanent tourist base – the regions' remoteness, climate, and availability of alternative destinations will limit the tourism industry's long-term growth potential.

That said, we still expect regions to benefit from more developed public infrastructure (roads, public transportation, health and sports facilities, and other utilities), which will provide some long-term economic benefits for the capital cities of the hosting regions. The region that will benefit most from improved infrastructure is Mordovia, where World Cup-related investments account for a larger share of total annual investments (see Exhibit 2). The [City of St. Petersburg \(Ba1 positive\)](#), the [City of Moscow \(Ba1 positive\)](#), Rostov Oblast (unrated), Kaliningrad, and [Nizhny Novgorod Oblast \(B1 positive\)](#) will also see some tangible benefits. Kaliningrad will particularly benefit from newly built energy supply facilities because it is a Russian exclave between [Poland \(A2 stable\)](#) and [Lithuania \(A3 stable\)](#) on the Baltic Sea that currently depends on transit energy supply from other parts of the country.

Exhibit 2

Long term economic impact will varies per regions



Russia's Ministry of Sport provided all World Cup-related expenses, except St. Petersburg, [Krasnodar Krai \(B1 positive\)](#), Nizhny Novgorod Oblast (B1 positive) which directly provided such data.

Source: [State Statistical Committee](#), [Ministry of Sport](#), regions

World Cup spending has affected some regions; boost in revenue will decline after 2018

Higher economic activity in 2018 will provide some boost to the hosting regions' own source revenue intake, which we expect will grow from almost zero up to 2%-4% depending on the region. But the boost in revenue will decline after 2018. Regions with relatively low own source revenue, like Mordovia and Kaliningrad, will benefit most from revenue growth in 2018.

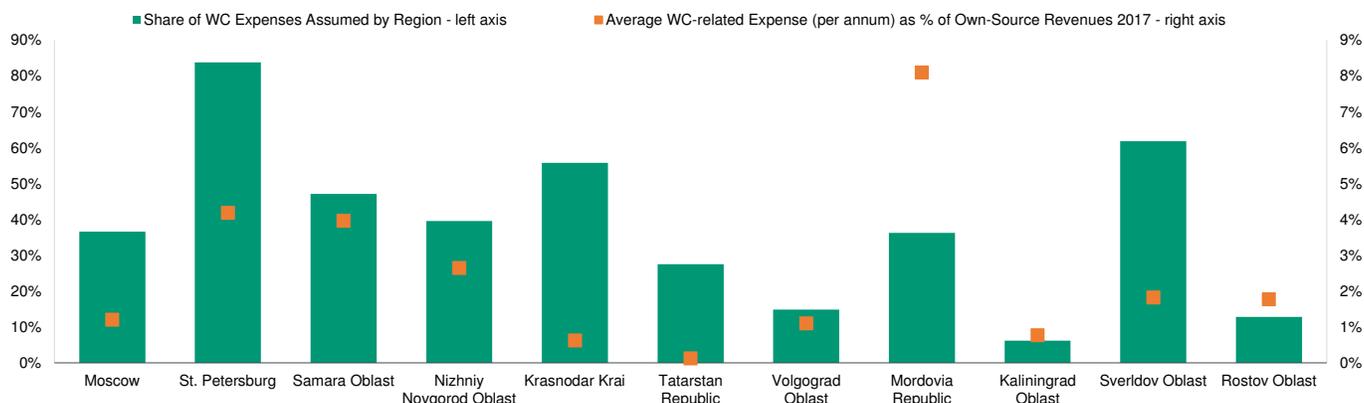
Expenses related to maintaining the new sports facilities will emerge after 2018 but will be negligible at the aggregate sub-sovereign level. For most hosting regions, these annual expenses will unlikely exceed 2%-3% of total annual spending. And part of the maintenance costs will be covered through commercial activities such as ticket sales from future football matches. In most regions, a

significant part of World Cup-related spending has been directed towards roads, metros, and utilities, rather than sports facilities. Better public infrastructure will likely generate additional tax revenue and reduce capital spending needs for the hosting regions in the coming years. This is particularly beneficial for regions with low own source revenue streams, such as Mordovia and Kaliningrad.

Fiscal pressure from additional spending in preparation for the games has varied across hosting regions. The regions with the highest share of World Cup-related expenses relative to own source revenue and the highest proportion of expenses assumed by their budgets are St. Petersburg, Samara, Mordovia, and Sverdlov Oblast (unrated) (see Exhibit 3).

Exhibit 3

Russian regional governments benefited to different degrees from federal government support and non-budget sources



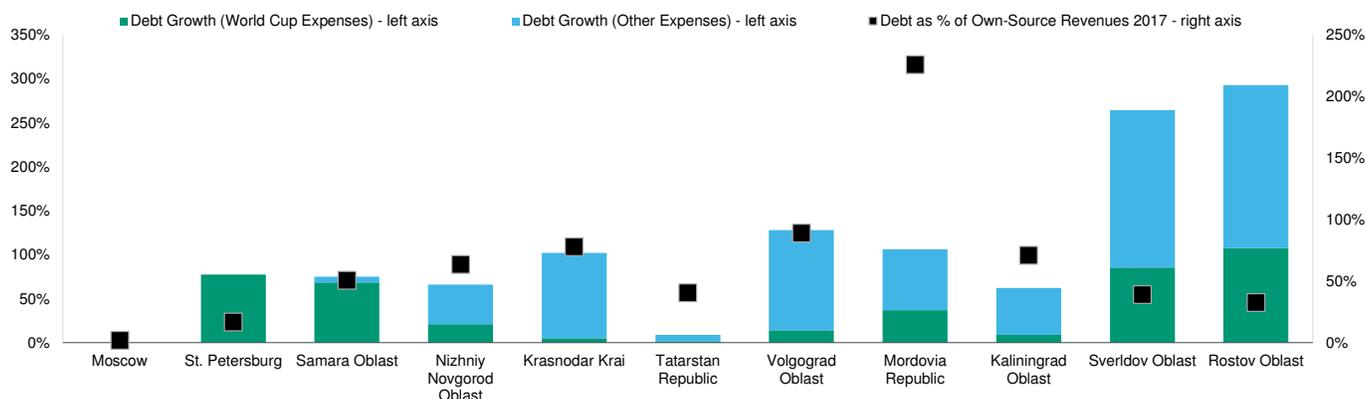
Russia's Ministry of Sport provided all World Cup-related expenses, except Moscow, St. Petersburg, Krasnodar Krai (B1 positive), Nizhniy Novgorod Oblast (B1 positive) which directly provided such data.

Source: Moody's Investors Service, [Russian Federal Treasury](#), [Ministry of Finance](#), [Ministry of Sport](#), regions

As seen in Exhibit 4, such expenses made up a significant part of the debt buildup¹ for St. Petersburg, Samara Oblast, Mordovia, Sverdlov and Rostov.

Exhibit 4

World Cup expenses drove the increase in debt in St. Petersburg and Samara (Debt growth since 2012 (%) and total debt as a % of own source revenue at end-2017)



Russia's Ministry of Sport provided all regional World Cup-related expenses, except Moscow, St. Petersburg, Krasnodar Krai, Nizhniy Novgorod Oblast which directly provided such data. Moscow's debt burden declined since 2012.

Sources: Moody's Investors Service, [Russian Federal Treasury](#), [Ministry of Finance](#), [Ministry of Sport](#), regions

Moscow, with its exceptionally flexible budget, was able to avoid an increase in debt despite taking on substantial World Cup-related expenses, while Rostov accumulated debt despite having one of the lowest proportions of World Cup-related expenses.

Overall credit impact for Russian corporates will be limited, but food, hotels, telecoms and transport will see a temporary boost to revenue

Food retailers and hotel operators will see a temporary boost in revenue

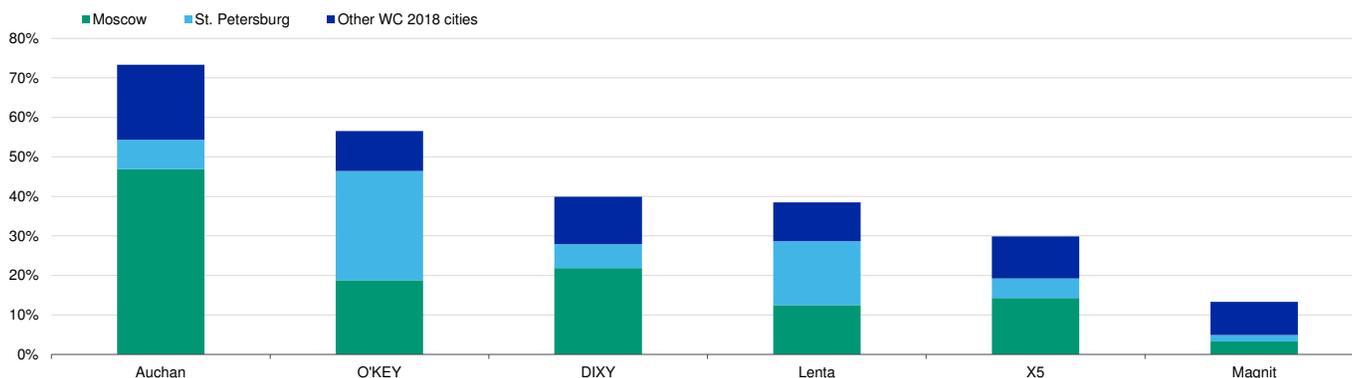
Food retailers and hotel operators are likely to report a temporary boost in sales during the World Cup games. The event will attract additional foreign tourists, and domestic consumers will be willing to spend more than usual. However, for most companies, the effect will be a one-off with no material changes to their business fundamentals or credit profiles.

Despite a short-lived and moderate impact, the increase in consumer spending during the tournament will provide much needed relief to food retailers' quarterly results. Like-for-like sales growth has been close to zero or negative for many food retail companies because of slowing food inflation and contracted real disposable income. The influx of visitors will likely increase both traffic and average sales at stores, potentially improving second and third quarter results. We expect retailers to use incremental profits earned during the World Cup for operational improvements, store refurbishment, and new openings.

Grocery chains with substantial concentration in the tournament's key host cities (Moscow, St. Petersburg) or in other relatively easily accessible host regions (Kazan, Sochi, Nizhniy Novgorod) will benefit the most from the event. As shown in Exhibit 5, Auchan and O'KEY have a large concentration in the host cities, particularly in Moscow and St. Petersburg, and, therefore, will likely record higher sales during the tournament. DIXY, with its convenience stores and supermarkets, is also well positioned to profit from the event. However, [X5 Retail Group \(Ba2 positive\)](#) and Magnit, the leaders of the Russian food retail market, will be less impacted by the tournament because of their more widespread geographical locations.

Exhibit 5

FIFA World Cup 2018 will benefit Auchan and O'KEY because of their large concentration in Moscow and St. Petersburg (Share of stores in host cities for the largest public food retailers in Russia)



Sources: Companies' data, Moody's Investors Service estimates

The Russian hotel sector will also benefit from a substantial inflow of foreign and domestic tourists, resulting in higher occupancy and room rates in host regions during the event. The positive effect could be extended into 2019 if the World Cup successfully increases tourist interest in Moscow and St. Petersburg, which could translate into higher room occupancy rates in those cities in 2019 compared to 2017. Hotel capacity has not increased substantially in Moscow and St. Petersburg, particularly compared to the massive increase in the supply of rooms during the 2014 Winter Olympic in Sochi. We therefore expect the sector to enjoy elevated demand during the tournament and return to normal afterwards, avoiding post-event overcapacity issues.

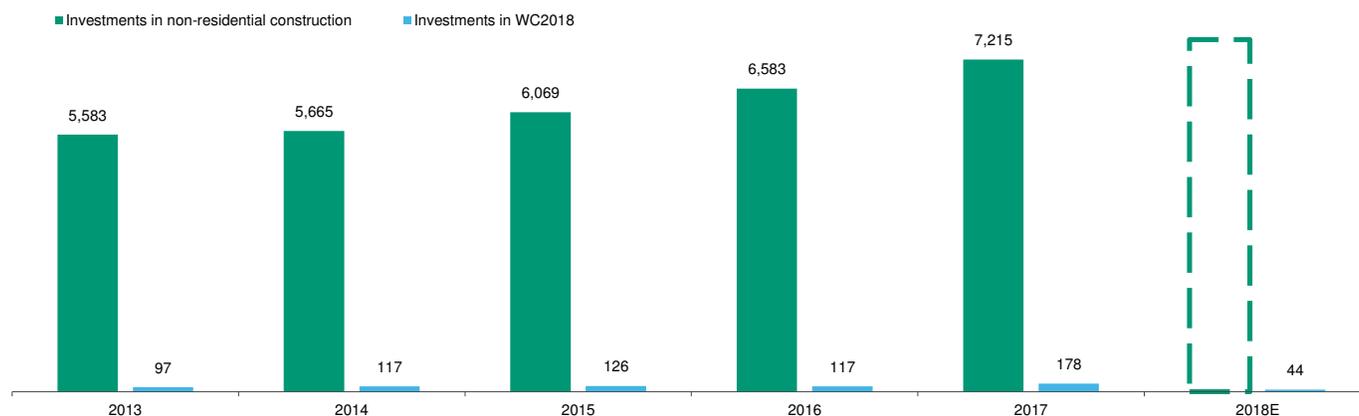
Construction sector is a key beneficiary, but much of the impact has already been felt

Construction companies are among the key beneficiaries of World Cup-related investment, but the positive effects are softening as projects near completion. Total investments related to the event are set at around RUB680 billion (around \$11 billion at the current market exchange rate) in 2013-18 and focus on construction and renovation of stadiums in 10 Russian cities, expansion and reconstruction of 12 airports and construction of one new airport in Rostov-on-Don, modernization of 31 rail stations, as well as road and energy infrastructure projects.

While the investment spending supports individual construction companies by increasing their revenue and backlog, much of the impact has already been felt with only around RUB44 billion (over \$700 million) left to be spent in 2018. In addition, the spending remains relatively minor in the context of the whole industry, and represents only around 2% of Russia's annual investments in industrial construction (see Exhibit 6).

Exhibit 6

World Cup spending is very small relative to Russia's total investment spending in construction



Sources: [State Statistical Committee](#), Russian Government Decree No1277 dd. 20.10.2017, Moody's Investors Service

Transport infrastructure will experience a short-lived boost

Domestic airlines and passenger railway operators, [Federal Passenger Company OJSC \(Baa3 positive\)](#) and its parent company [Russian Railways Joint Stock Company \(Baa3 positive\)](#), will benefit from an increase in passenger traffic associated with the World Cup. According to different estimates, significant number of additional international tourists will visit the country during the event. In addition, domestic and international visitors will be traveling across 11 host cities driving regional air and rail travel. The positive impact, however, will be short-lived with only marginal contributions of less than 3% to total annual traffic.

The upside for transportation companies with regards to profits will be further constrained because of restrictions set by the federal government to prevent fare increases in line with the increase in demand. In particular, Federal Passenger Company will receive a fixed lease payment from the state for its 728 trains, which will be used to provide free transportation for fans during the World Cup.

Transport infrastructure operators, such as airports, will benefit from extended and upgraded facilities. While addressing a temporary peak in traffic during the World Cup, investments in airport infrastructure should help to accommodate the expected longer-term development of air travel in the country.

Airports, such as [Domodedovo \(DME Limited, Ba1 positive\)](#) and Sheremetyevo (unrated), will be among the key beneficiaries with good growth potential supported by the high concentration of traffic in the Moscow Air Cluster and its strong market fundamentals. At the same time, the impact on airport operators in other host cities may be more muted as we don't expect any material growth in regional tourism following the World Cup.

Electricity sector has benefited from additional investments

Russia's electricity sector has been allocated around RUB6.0 billion (more than \$95 million, around 3% of the national electricity grid company [Rosseti PJSC's \(Ba1 positive\)](#) annual capital expenditure budget) from the federal budget to modernize and enhance the capacity of electricity distribution networks in the 11 host cities. In addition, two newly launched gas-fuelled thermal power generation stations will support sustainability of supply in Kaliningrad during the championship. After the event, two 156 megawatt plants (part of a larger four plants' project), built by a joint venture between [Inter RAO, PJSC \(Baa3 stable\)](#) and Rosneftgas OJSC (unrated), will back up the region's energy supply.

In addition to a temporary increase in electricity consumption during the championship, we expect some positive effect on the overall quality of electricity generation capacity and reliability of electricity transmission systems in the 11 host cities and their respective regions.

Telecoms revenue will grow 3%-4%, MegaFon will benefit the most

Telecommunications operators will likely see a temporary increase in revenue from mobile data and voice services, including inbound roaming, data exchange, and video streaming as well as sales of smartphones during the one month championship. According to [MegaFon PJSC \(Ba1 positive\)](#), which was the 2014 Olympic Games' mobile telecommunications partner, more than 300,000 customers from 70 countries used its services during the Winter Olympic games, and more than 660 terabytes of data traffic was used by the participants and guests of the event. Mobile internet, including in the then-innovative LTE-Advanced mode allowing for mobile internet speed of up to 300 Mbit per second was made available to subscribers of other telecom operators through inter-network roaming. Revenue from subscriber outgoing data traffic in February 2014 increased sixfold compared to a regular month of operations; as a result of active data usage, the company's first quarter 2014 revenue rose by 10.6% compared to the first quarter of 2013. The company expects similar results during the championship, which will last longer than the Olympics. Other mobile operators will also benefit from an increase in voice and data traffic through their networks by offering visitors SIM cards with specifically-tailored tariffs, although the positive effect will likely be less pronounced for them. We expect overall revenue growth from mobile services in 2018 to remain around 3%-4% across the board given the challenges related to severe competition and cancellation of intra-network roaming charges in Russia.

Total planned investment in telecommunications infrastructure amounts to RUB11 billion (over \$175 million), of which around RUB4.25 billion (approximately \$70 million) will have been invested by MegaFon PJSC, which acts as the main provider of mobile telecommunication services and infrastructure at the stadiums, training and headquarter facilities of the event in the host cities, and has an exclusive contract with FIFA. The scope of investment is considerably lower than the RUB10.0 billion spent by MegaFon in preparation for the Winter Olympics, where communications infrastructure was largely built from scratch. This time upgrades were mainly made to existing infrastructure to enhance data transfer rates and network capacity, and should support the operator's technical competitiveness in the future. In some locations the company will also test its 5G service to set the ground for a roll-out in 2020.

Global corporate sponsors will benefit from media exposure

Global companies will also benefit. The World Cup is a notably popular and highly attended sporting event that offers an opportunity for global media exposure, benefitting big corporate sponsors such as Coca-Cola, Adidas AG, Qatar Airways (unrated), [Hyundai Motor Company \(Baa1 stable\)](#), [Kia Motors Corporation \(Baa1 stable\)](#), [China Mengniu Dairy Company Limited \(Baa1 stable\)](#), [McDonald's Corporation \(Baa1 stable\)](#) and Budweiser (part of [Anheuser-Busch InBev SA/NV \(A3 stable\)](#)). Marketing exposure at the matches and on television will increase brand awareness for corporate sponsors, although the benefits are difficult to measure. Regional sponsorship is represented by locally well-known companies such as [ALROSA PJSC \(Baa3 positive\)](#), [Russian Railways Joint Stock Company \(Baa3 positive\)](#), [Alfa-Bank \(Ba1 stable\)](#) and Rostelecom PJSC (unrated). The World Cup may also facilitate expansion of global tech companies such as [Booking Holdings, Inc \(Baa1 stable\)](#) and Airbnb (unrated) in Russia and promote local tech champions to both foreign and domestic customers.

No visible impact on the banking sector

Russian banks' profitability in 2018 will unlikely see tangible benefits from the World Cup. We estimate that additional revenue from higher transactions from the influx of tourists will unlikely exceed 1% of the total sector's profit in 2018. Given that the majority of the payment system flows are concentrated in federal level banks, on average the regional banking systems will unlikely see a significant increase in transaction revenue.

We do not expect added exposures related to construction activity for the World Cup to negatively affect Russian banks' asset quality. While no official data is available, we estimate that this portfolio is below 1% of the systemwide loan portfolio because the majority of expenditure is financed by the local and federal governments.

Moody's related publication

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- » [Banking System Outlook - Russia : Improving capital adequacy supports stable outlook](#), 23 Oct 2017

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Endnotes

- ¹ We assume that without these additional expenses, the regions would have avoided the accumulation in debt and would not have redirected additional spending towards something else.

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