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## Research Update:

# University of Western Ontario 'AA' Ratings Affirmed On Very Strong Enterprise And Financial Profiles

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## Research Update:

# University of Western Ontario 'AA' Ratings Affirmed On Very Strong Enterprise And Financial Profiles

## Overview

- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario.
- The ratings reflect our assessment of the university's stand-alone credit profile, which reflects our combined assessment of Western's very strong enterprise and financial profiles.
- The stable outlook reflects our expectation that Western will maintain a healthy market position and demand profile, it will continue to generate positive net adjusted margins, and available resources will remain superior.

## Rating Action

On Feb. 28, 2017, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario in London, Ont. The outlook is stable.

## Rationale

The ratings on Western reflect the university's stand-alone credit profile (SACP), which S&P Global Ratings assesses at 'aa'. The ratings also reflect our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support in the event of financial distress. The SACP on Western reflects our combined assessment of the university's very strong enterprise profile, with a healthy enrollment and demand profile and strong management and governance practices; and its very strong financial profile, with a history of sound financial performance and excellent levels of available resources. In our opinion, a moderate debt burden and the fiscal challenges facing the provincial government that could affect operating grants offset some of these strengths.

We believe the university benefits from a very strong enterprise profile, characterized by excellent economic fundamentals given Ontario's very strong economy, a robust market position, and steady student demand and enrollment. Western's full-time equivalent students (FTEs) increased 2.1% to 32,476 in fall 2016, supported by growth in both graduate and undergraduate enrollment. The university has planned for a modest increase in FTEs in the next few years, characterized by flat first-year enrolment but robust graduate student

growth; graduate students accounted for 18.5% in fall 2016, which was lower than the most research-intensive universities in the country such as McGill University, University of Toronto, and University of British Columbia. In our opinion, student quality continues to be strong: average entering grades, retention, and graduation rates continue to improve and are among the highest in the province. Although Western's selectivity ratio weakened somewhat in fall 2016 (as result of higher first-year applications and offers), its level remains in line with that of similarly rated Canadian universities.

In our opinion, Western's very strong financial profile is primarily supported by a fairly strong financial performance, excellent levels of available resources, and a moderate debt burden. The university's adjusted operating margin improved to 10.8% in fiscal 2016 from 4.5% in the previous year, in line with operating performance of similarly rated peers in Canada. We expect Western's financial profile will remain very strong in the next two years through the university maintaining abundant financial resources (with available resources in excess of 35% of adjusted operating expenses) and positive adjusted net margins, despite the operating pressures it faces--primarily the tuition framework, potential for flat or even lower government grants, and increasing salaries and benefits expenditures. Although the university expects its debt burden to increase in the near term, we do not expect the pro forma debt to materially affect its debt metrics; specifically, we expect that available resources will continue to exceed debt outstanding and our estimate of the pro forma maximum annual debt service to remain moderate, at about 4% of adjusted operating expenditures.

In accordance with our criteria for government-related entities (GREs), we base our view of Western's moderately high likelihood of extraordinary government support on our assessment of its important role in the province, given that postsecondary education is one of Ontario's priorities in both expenditure and mandate (after health care and school boards), and that there are no viable private alternatives. Its important role in the province also reflects our view of the university's solid reputation, which Western's very strong student quality and research profile demonstrate. The province's oversight, program approval rights, and tuition regulation over Western suggest a strong link to the university. Also supporting this view is that the province provides substantial operating grants, which account for about a quarter of the university's total revenue, and it appoints four of 28 board members.

We rate Western two notches above Ontario. The maximum differential allowed is three notches, in accordance with our methodology for rating GREs that we believe depend on ongoing government support. The difference reflects our view of the university's substantial financial assets. We believe there is a measureable likelihood that Western's financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the difference reflects Western's ownership structure, in which the government is neither an owner nor shareholder. We consider the risk of extraordinary negative government intervention to be low, given the university's operational

independence, important public policy role, and the government's hands-off approach to the sector. Although the Ontario government faces fiscal challenges and projects it will not return to fiscal balance until fiscal 2017-2018, we do not expect provincial operating grants for postsecondary education to diminish significantly, given this sector's vital public policy role.

Founded in 1878, Western is a research-intense, doctoral university. It is in the southwestern Ontario city of London, which has a population of about 384,000. Western has about 32,476 FTEs on its main campus (and close to 38,000 FTEs with its three affiliated colleges), and is the 10th-largest university in Canada in terms of full-time students (it's the fourth-largest in Ontario). It has 12 faculties and schools, including a school of medicine and dentistry, law, engineering, and business. It also has affiliations with three research institutes, three university colleges, and two teaching hospitals. The university is a member of the U15, a group of leading research-intensive universities in Canada. In fiscal 2016, it received C\$234 million in research-related grants and contracts, which have been slowly increasing in the past several years.

### **Liquidity**

The university's liquidity is excellent, in our view. At fiscal year-end 2016, Western had almost C\$1.4 billion in cash and investments; equal to over 4x our pro forma debt estimate. Its available resources (internally restricted net assets plus internally restricted endowments) were what we consider high at C\$603.5 million, or 55.8% of adjusted operating expenditures and 173.7% of pro forma debt. Although we expect these ratios could be lower in the next two years if weaker investment returns persist, we believe they will remain more than sufficient to finance all debt service requirements and provide a sufficient buffer to withstand any likely medium-term stress scenario.

### **Outlook**

The stable outlook reflects our expectations that, within our two-year outlook horizon, the university will maintain a healthy market position and demand profile; it will continue to generate positive net adjusted margins; and available resources will remain superior. We expect its available resources to remain in excess of 35% of adjusted operating expenses and cash and investments to be over 3x total debt; and that provincial support to the university will not decline beyond our current estimates. The outlook also reflects our expectation that Western's relationship with the province will be stable.

### **Downside scenario**

We could revise the outlook to negative or lower the ratings if decreasing enrollment or funding grants resulted in adjusted net margins weakening to near balance or sustained deficits, or available resources eroded to less than

35% of adjusted expenditures or less than 100% of debt outstanding. Moreover, negative intervention from Ontario, or a significant reduction in Western's resilience to a provincial default scenario as our GRE criteria specify could cause us to lower the ratings, potentially to on par with or below those on Ontario, depending on the severity.

### Upside scenario

A significantly improved enterprise profile, with a selectivity ratio below 50% and increased geographic diversification of the student body, with out-of-province students accounting for more than 30% of total FTEs, could result in a positive rating action.

### Related Criteria

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

### Related Research

- 2017 Outlook For Not-For-Profit Public Universities In Australia, Canada, Mexico, And The U.K.: A Stable Trend For All, Despite Funding Concerns, Jan. 17, 2017
- Slower Growth And Volatile Markets Loom Over North America's Stable Credit Conditions, July 11, 2016

### Ratings List

Ratings Affirmed

University of Western Ontario

Issuer credit rating	AA/Stable/--
Senior unsecured	AA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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