Research Update:

University of Nottingham Rating Affirmed At 'A+' On Solid Performance; Outlook Stable

Primary Credit Analyst:
Karin Erlander, London (44) 20-7176-3584; karin.erlander@spglobal.com

Secondary Contact, Sovereigns And International Public Finance:
Ratul Sood, London +44 (0) 20 7176 6536; ratul.sood@spglobal.com

Table Of Contents

Overview
Rating Action
Rationale
Outlook
Related Criteria And Research
Ratings List
Research Update:

University of Nottingham Rating Affirmed At 'A+'
On Solid Performance; Outlook Stable

Overview

• The University of Nottingham continues to benefit from high student demand, underpinned by strengthening academic standing in the U.K. and internationally, providing a solid financial performance.

• These strengths are tempered by an increase in debt funding over 2016 and 2017 to fund a step-up in investments.

• We are affirming our 'A+' long-term rating on the University of Nottingham.

• The stable outlook reflects our view that the University of Nottingham will continue to maintain its high levels of student demand, enabling it to generate net surpluses averaging 4% of revenues, further supported by a solid focus on cost control.

Rating Action


Rationale

The rating on Nottingham University reflects its stand-alone credit profile (SACP), which we assess at 'a+'. In our view, Nottingham University operates in a low risk industry. In addition, a strengthening of its academic standing and reputation in the U.K., as well as in China and Malaysia, where it holds an interest in two campuses, supports a high level of student demand.

As a Russell Group member, Nottingham University is recognized for its commitment to maintaining a high level of research, teaching, and links with business and the public sector. This is also reflected in Nottingham University's rankings both in the U.K. and globally; the university climbed three places to No. 18 in the Complete University Guide 2018, and remains solidly in the top 100 of the QS World University Rankings 2018, at No. 84 (although falling from a joint No. 75). Nottingham University also has a good track record with regard to attracting students, with nearly seven applications for each of the 11,500 students enrolled in the year to July 2016. Entry standards remain comfortably in the top quartile, as does Nottingham University's reputation for research.

In our view, Nottingham University's focus on foreign student intake at its campuses in the U.K., allied to its interests in campuses in China and Malaysia, make it one of the most international universities in the U.K. In 2016, 75% of students at Nottingham University's campuses were from the U.K., about 20% from the rest of the world outside the EU, mainly China and Malaysia, and 5% from the EU.
Given the relatively small proportion of students coming from the EU, we do not consider the U.K.’s decision to leave the EU as a major risk from a student demand perspective. More of a concern is the ability to retain and attract highly qualified staff from the EU. We also consider potential visa and immigration restrictions as a risk. As a result of continued lobbying efforts by U.K. universities, we expect the U.K. government will make strong attempts to limit an exodus by EU academic staff, although the outcome will depend on the final settlement between the U.K. and the EU. Brexit and its effects on student and academic talent retention therefore remain a risk to Nottingham University and the rest of the higher education sector from a reputational and financial standpoint.

The not-for-profit tertiary education sector typically posts very low operating margins. We think that Nottingham University's net operating performance is relatively strong in comparison, with net operating margins averaging 4% of revenues over the past three years. The reported margin was 6.3% in the financial year to July 2016, owing to a combination of higher fees, research grants, and other income, while staff costs declined. However, we forecast that margins will fall to less than 4% in 2017 because of a reduction in grants and lower income from other non-student-related activities, while staff costs are likely to increase, driven by inflation, and interest payments will rise due to higher debt levels. We consider that Nottingham University's endowment funds are relatively limited compared with those of peers, and this is a disadvantage in terms of flexibility to increase revenues, given that student fees are typically set across the sector.

Nottingham University's investments have seen a step change upward since last year, with capital expenditures exceeding £100 million in the year to July 2016, up from just less than £65 million the year before. Given Nottingham University's focus on investing in its campuses and enhancing the facilities available, we think that investments will remain relatively high over the next two years.

With internally generated cash flow funding half of the investment program, we also think that debt-funding will continue to be important, since grants are gradually declining. Hence, while noting that Nottingham University's debt remains lower than peers', we project that debt will fall only modestly over the next two years. Furthermore, we consider that Nottingham University's pension liability remains in deficit, which adds to its debt and contingent liabilities. We think that debt will remain above 10% of revenues in the year to July 2017, compared with more than 11% in 2016. This represents a clear increase on 2015, when it was just over 2%.

Unlike many of its peers, Nottingham University is not directly exposed to the performance of student accommodation projects, and so we view its contingent liabilities as minimal and mainly relating to its pension liabilities.

The rating also reflects our opinion of a moderately high likelihood that the U.K. government, through the Higher Education Funding Council for England (HEFCE), would provide extraordinary support in the unlikely event that the university becomes financially distressed. This view is based on our assessment of Nottingham University's:
Important role for the U.K. government, given the significance of U.K. higher education policy; and

Strong link with the U.K. government, demonstrated by its track record of providing support to the sector and ongoing regulatory supervision.

Liquidity

While Nottingham University's liquidity position is relatively weak when compared with peers, owing to a strategic decision to hold minimal levels of cash on the balance sheet, we assess that the liquidity position has strengthened through the inclusion of available funds under committed credit facilities in our calculation of sources. Cash, including available funds under committed bank lines, investments, and expendable endowments totaling £172.5 million covered just over 20% of operating expenditures in 2016.

Outlook

The stable outlook reflects our view that Nottingham University will maintain its high levels of student demand, underpinned by a strong reputation and improving rankings in U.K. and international league tables, and well invested campuses in the U.K., as well as China and Malaysia. We forecast that Nottingham University will be able to generate net surpluses averaging 4% of revenues, further supported by a solid focus on cost control. We also think that Nottingham University's debt levels will remain modest because grant funding from HEFCE and internally generated cash flows will be solid enough to fund most of its investment program.

We could raise the ratings if the university were to see a continued strengthening of its academic reputation both at home and internationally, in a manner that enables it to produce greater levels of income from research and from overseas students, thereby further strengthening its financial performance. An upgrade could also follow if management significantly addressed the pension deficit, although we consider that this is a weakness of the financial profile that Nottingham University shares with the rest of the sector at present.

We could lower the ratings on Nottingham University during the next 24 months if we observed a significant deterioration of the financial profile. For instance, steadily declining student demand, gradually lower government grants, and an inability to contain costs, could put pressure on operating margins. In combination with a substantially larger debt-funded investment program than we assume in our base case, this could result in pressure on the financial profile and a lower rating.

### University of Nottingham Key Statistics

<table>
<thead>
<tr>
<th>(000s £)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017bc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full-time equivalent enrollment</td>
<td>29,403</td>
<td>29,403</td>
<td>28,620</td>
<td>29,075</td>
<td>29,492</td>
</tr>
<tr>
<td>Selectivity rate (%)</td>
<td>59.7</td>
<td>59.7</td>
<td>62.3</td>
<td>62.8</td>
<td>62.5</td>
</tr>
<tr>
<td>Matriculation rate (%)</td>
<td>19.9</td>
<td>19.3</td>
<td>24.2</td>
<td>25.5</td>
<td>23.8</td>
</tr>
</tbody>
</table>
University of Nottingham Key Statistics (cont.)

<table>
<thead>
<tr>
<th>(000s £)</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017bc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undergraduates as a % of total enrollment (%)</td>
<td>83.6</td>
<td>83.7</td>
<td>87.2</td>
<td>84.8</td>
<td>82.3</td>
</tr>
<tr>
<td>Freshman retention (%)</td>
<td>97.3</td>
<td>97.2</td>
<td>97.0</td>
<td>97.3</td>
<td>97.0</td>
</tr>
<tr>
<td>Graduation rates (five years) (%)</td>
<td>95.4</td>
<td>94.8</td>
<td>95.5</td>
<td>95.9</td>
<td>95.5</td>
</tr>
</tbody>
</table>

Financial Profile

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017bc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted operating revenue</td>
<td>560.9</td>
<td>572.1</td>
<td>594.1</td>
<td>635.4</td>
<td>611.6</td>
</tr>
<tr>
<td>Adjusted operating expense</td>
<td>536.2</td>
<td>544.7</td>
<td>565.8</td>
<td>587.8</td>
<td>594.9</td>
</tr>
<tr>
<td>Net operating margin (%)</td>
<td>4.4</td>
<td>4.9</td>
<td>3.8</td>
<td>6.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Student dependence (%)</td>
<td>39.3</td>
<td>44.3</td>
<td>46.5</td>
<td>46.9</td>
<td>51.6</td>
</tr>
<tr>
<td>Research dependence (%)</td>
<td>19.9</td>
<td>18.4</td>
<td>20.0</td>
<td>19.6</td>
<td>19.0</td>
</tr>
<tr>
<td>Funding council grant dependence (%)</td>
<td>22.3</td>
<td>19.2</td>
<td>16.3</td>
<td>14.7</td>
<td>14.6</td>
</tr>
<tr>
<td>Endowment and investment income dependence (%)</td>
<td>0.3</td>
<td>0.2</td>
<td>1.3</td>
<td>1.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Outstanding debt*</td>
<td>32.7</td>
<td>7.1</td>
<td>13.3</td>
<td>70.8</td>
<td>63.4</td>
</tr>
<tr>
<td>MADS / total operating expense (%)</td>
<td>0.4</td>
<td>0.1</td>
<td>0.2</td>
<td>0.8</td>
<td>0.7</td>
</tr>
<tr>
<td>Net debt / revenues</td>
<td>5.8</td>
<td>1.2</td>
<td>2.2</td>
<td>11.1</td>
<td>10.4</td>
</tr>
<tr>
<td>Cash, investments &amp; expendable endowments</td>
<td>5.6</td>
<td>119.9</td>
<td>119.2</td>
<td>126.0</td>
<td>106.3</td>
</tr>
<tr>
<td>Available resources to annual operating expenses (%)</td>
<td>1.0</td>
<td>22.0</td>
<td>21.1</td>
<td>21.4</td>
<td>17.9</td>
</tr>
<tr>
<td>Available resources to total debt (%)</td>
<td>17.1</td>
<td>1,688.7</td>
<td>722.4</td>
<td>178.0</td>
<td>167.7</td>
</tr>
<tr>
<td>Pension funded status (%)</td>
<td>64.5</td>
<td>55.0</td>
<td>61.0</td>
<td>57.2</td>
<td>57.2</td>
</tr>
</tbody>
</table>

MADS—Maximum annual debt service. bc—Base case, reflects S&P Global Ratings' expectations of the most likely scenario.

Related Criteria And Research

Related Criteria

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities - January 06, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Research Update: Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 28, 2017

Ratings List
Research Update: University of Nottingham Rating Affirmed At 'A+' On Solid Performance; Outlook Stable

Rating

To

From

Nottingham (University of)

Issuer Credit Rating

Foreign and Local Currency A+/Stable/-- A+/Stable/--

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Additional Contact:
International Public Finance Ratings Europe; PublicFinanceEurope@spglobal.com