S&P Global Ratings

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Research Update:

U.K.-Based University of Nottingham 'A+' Rating Affirmed; Outlook Stable

June 19, 2020

PRIMARY CREDIT ANALYST

Christopher Mathews
London
+ 44 20 7176 7115
christopher.mathews
@spglobal.com

SECONDARY CONTACT

Karin Erlander
London
(44) 20-7176-3584
karin.erlander
@spglobal.com

RESEARCH CONTRIBUTOR

Gauthier Robinet
London
44-20-7176-0637
gauthier.robinet
@spglobal.com

Overview

- The University of Nottingham (Nottingham) has improved its financial resources, putting it in a good position to weather COVID-19-related headwinds.
- While uncertainty plagues the enrolment of overseas students, Nottingham's strong reputation should continue to attract domestic students.
- We are therefore affirming our 'A+' long-term issuer credit rating on Nottingham.
- The stable outlook reflects our expectation that the university will successfully achieve its identified cost savings, easing pressure on its financial resources.

Rating Action

On June 19, 2020, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on Nottingham. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Nottingham will achieve the cost savings it has identified in light of reduced income. These should limit a deterioration in financial performance and ease pressure on Nottingham's financial resources.

Downside scenario

We could lower the rating on Nottingham if its income falls by more than we expect under our base case, or if cost savings do not materialize. In such a scenario, we would expect financial resources to reduce materially such that they fall below 50% of debt and below 15% of operating expenditure (opex) on a structural basis.

Upside scenario

We could raise the rating on Nottingham over the next two years if it strengthens its financial resources position without a corresponding increase in debt. In such a scenario, we would expect financial resources to stay structurally above 35% of opex, with debt unchanged.

Rationale

The affirmation reflects our view that Nottingham is well placed to navigate the uncertainties brought by the COVID-19 pandemic. Student enrolment looks almost certain to be disrupted for the academic year starting September 2020 as people stay at home and practice social distancing, in an attempt to combat the spread. Consequently, our base case assumes a significant reduction in fees from overseas students and no growth in fees from domestic students. We believe other income generated from sources such as student residences could also be lower if social distancing affects students' return to campus. This roughly equates to a £140 million loss of income. In response, we believe management will be able to reduce both opex and capital expenditure (capex) by around £140 million, which mitigates this loss.

Nottingham's planned cost savings should protect its financial resources, which it strengthened in financial year (ending July 31, 2020; FY2020) through a £100 million private placement. This liquidity buffer should help Nottingham navigate this period of uncertainty without the need to increase debt further.

Given the uncertainty COVID-19 brings to the higher education sector for the upcoming academic and financial year, our base case covers the actual financial year ending July 31, 2019, an estimate for FY2020, and projection for FY2021.

Our rating on Nottingham is supported by its industry risk, which is naturally anticyclical and has high barriers to entry. With the pandemic weakening the labor market globally and restricting travel, people may turn to universities to learn new, or improve existing, skills.

Strong enrolment and a low selectivity rate support Nottingham's market position. Nottingham increased the number of full-time equivalent students (FTEs) for four consecutive years, from 29,072 in 2016 to 32,885 in 2020. We estimate that FTE enrolment will fall for the academic year to around 27,200, largely due to the assumption of fewer international students.

Nottingham's selectivity rate has remained relatively low, averaging around 62% between 2016 and 2020, reflecting its strong reputation. We understand that applications continue to remain high despite COVID-19, as students plan to enroll despite the uncertainty. We would not view short-term deterioration in Nottingham's student numbers as material given the external factors influencing demand in the sector as a whole.

Nottingham's international operations could mitigate reduced travel. Campuses in China and Malaysia, which award Nottingham degrees, maybe be used to offset international enrolment in the U.K. if enrolment is materially affected.

We view positively management's approach to the challenges Nottingham will face in September; management has a clear strategy on how it plans to offset COVID-19-related headwinds. Nottingham is looking to right-size the university's cost base, reducing inefficiencies in its estate. On the capital account, over £50 million of capital spending will be deferred to limit the effect on Nottingham's cash balances.

Financial performance will deteriorate in FY2021 due to loss of income. Of the £140 million cost savings Nottingham has identified, £85 million relate to opex. Consequently, we forecast that Nottingham will record an operating deficit of 4.1% in FY2021. We are conservative regarding our assumption on loss of tuition fee income given that Nottingham will be equipped to start the next academic year online. That said, social distancing measures may reduce other lines of income that Nottingham usually collects. In particular, vacancies in nominated student halls could result in reduced rental income.

A £100 million private placement issued in FY2020 supports Nottingham's strong financial resources. Combined with an undrawn £80 million revolving credit facility (RCF), we expect total resources of around £210 million in FY2020. This would result in available resources of around 30% of opex. We assume Nottingham will need to use around £15 million of its cash balances to offset its revenue loss in FY2021. That said, should Nottingham reduce its overall cost base, its resources could still account for around 30% of opex in FY2021.

Nottingham's debt levels remain lower than peers'. Debt has increased in line with the £100 million private placement. If Nottingham does not meet its cost saving targets, we expect it to use its financial resources to offset the lost income. We expect Nottingham's Maximum Annual Debt Service burden to remain low, below 2%.

Nottingham's decision to issue a private placement results in a stronger financial resources-to-debt ratio. Previously, Nottingham held little cash, preferring to use three RCFs that were not included in the aforementioned calculation. As a result, resources were structurally below 10% of debt. Including the private placement however, we now expect resources to average 70% of debt over FY2020 and FY2021.

Pension contributions to the Universities Superannuation Scheme pension program will increase, helping fund its deficit. As per the agreed contributions on the 2017 valuation, Nottingham's contributions toward the scheme have increase to 24.2% from 18.0%. In our view, this will help fund the current deficit, which reduces the likelihood of it materializing as a contingent liability for Nottingham.

While neutral for the rating, we see a moderately high likelihood that the U.K. government, through the Office for Students (OfS), would provide extraordinary support in financial distress. Our view of a moderately high likelihood of extraordinary government support is based on our assessment of Nottingham's:

- Important role for the U.K. government, given the significance and profile of U.K. higher education policy; and
- Strong link with the U.K. government, demonstrated by the government's track record of providing support to the sector and ongoing regulatory involvement.

Environmental, social, and governance factors

In S&P Global Ratings' view, higher education entities face higher social risk due to ongoing uncertainty regarding the duration of the COVID-19 pandemic and the effect on enrolment levels in the second half of 2020 and beyond. We view the risks posed by COVID-19 to public health and safety as a social risk under our environmental, social, and governance (ESG) framework. Nottingham's environmental and governance risks are broadly in line with our view of the sector as a whole.

Our coronavirus assumptions

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: ww.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Key Statistics

Selected Indicators

	--Financial year end July 31--				
(Mil. £)	**2021p**	**2020e**	**2019a**	**2018a**	2017a
Enterprise Profile					
Full-time equivalent enrollment (no.)	27,234	33,196	31,300	30,579	29,492
Selectivity rate (%)	N.A.	66.1	70.2	66.1	54.0
Undergraduates as a % of total enrollment	95.6	75.9	76.5	81.9	84.7
Retention rate (%)	N.A.	93.4	93.4	93.4	93.9
Graduation rates (five years) (%)	N.A.	95.6	95.6	95.5	95.6
Financial Profile					
Operating revenue	616.5	721.7	701.2	664.0	646.1
Operating expense	643.0	697.0	682.0	644.2	621.5
Net operating margin (%)*	(4.1)	3.5	2.8	3.1	4.0
Student dependence (%)	47.2	53.3	50.9	50.3	47.9
Research dependence (%)	22.5	17.3	17.7	18.1	19.1
Government grant dependence (%)	15.4	13.0	13.0	12.1	13.4
Endowment and investment income dependence (%)	0.9	0.8	0.6	1.1	1.7
Adjusted outstanding debt	173.7	173.7	73.7	79.7	79.9
Maximum annual debt service/total operating expense (%)	1.8	1.7	0.7	0.9	0.9
Available resources to adjusted operating expenses (%)	31.9	30.1	26.1	27.6	28.6
Available resources to total debt (%)†	72.2	74.9	8.1	7.3	7.3

*Net income/Operating expense.†Does not include revolving credit facilities as an available resource. a--Actual. e--Estimate. p--Projected. N.A.--Not available.

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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 2020
- COVID-19 Means International Students Could Give English Universities A Pass, April 9, 2020
- Universities Superannuation Scheme Strike Action At U.K. Universities Could Lead To Cost Increases, Nov. 26, 2019

Ratings List

Ratings Affirmed	
Nottingham (University of)	
Issuer Credit Rating	A+/Stable/--
Analytical Factors	a+