Research Update:

Outlook On U.K.-Based University of Nottingham Revised To Stable From Positive; 'A+' Rating Affirmed

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Overview

- We expect the University of Nottingham (Nottingham) will continue to benefit from strong student demand and an experienced management team.
- However, given sector-wide pressures and hence weakening scope for Nottingham to strengthen its academic standing and operating margins, we have revised our outlook on Nottingham to stable from positive.
- We are affirming our 'A+' issuer credit rating on Nottingham.
- The stable outlook reflects our expectation that the university's creditworthiness will remain underpinned by strong student demand, contained debt burden, and robust operating margins as management invests in operational efficiencies.

Rating Action

On June 28, 2019, S&P Global Ratings revised its outlook on U.K.-based University of Nottingham to stable from positive. We affirmed the 'A+' long-term issuer credit rating on Nottingham.

Rationale

The outlook revision reflects continued headwinds in the higher education sector, which we think renders Nottingham less likely to significantly improve its academic standing and fully reach its ambitious operating surplus targets over the next two years. Nottingham and its U.K.-based peers face sector pressures with rising staff costs, declining grants, and risks arising from potential reforms to the tuition fees following the Augar review, to name a few.

The affirmation of the 'A+' rating reflects our view that Nottingham's creditworthiness will remain supported by strong financial performance and limited debt intake over the rating horizon. Furthermore, Nottingham's management has a clear strategy aimed at more efficient operational processes and more effective research output. We base our rating on Nottingham on its 'a+' stand-alone credit profile (SACP).

Despite some slippage in university rankings (to 96 in the QS World University Ranking in 2020 from 82 in 2019), Nottingham retains strong business fundamentals and competitiveness with around six applications per undergraduate enrolment. The university enrolled around 32,000 full-time equivalent (FTE) students on the Nottingham campus in 2019 (30,476 FTE students in financial year 2018 [FY]) and projects continued student demand boosted by overseas partnerships and online courses. We do not anticipate a further rise in students at the Nottingham campus, meaning needs for significant capital expenditure are contained for the coming year.

At FY2018, around 20% of Nottingham's student base was from overseas (non-EU) compared to 74% from the U.K., which is comparatively low compared to peers such as King's College London, and the universities of Lancaster and Sheffield. Nottingham is aiming to further increase its intake of international students, who pay higher tuition fees than domestic students. This is a similar strategy adopted by many U.K. peers that are facing headwinds from higher operating expenditure and capped tuition fees. Nottingham's international exposure with its China and Malaysia campuses fosters brand recognition abroad and attracts foreign students. Furthermore, Nottingham maintains a contingency reserve to minimize the impact of any shortfall in international student recruitment should it not meet its internal targets.

More generally, we view the breadth of expertise of the management team and the strategy favorably. Management is focusing on making Nottingham a global university, delivering world-class research, and making operational processes more efficient. Its "Getting in Shape--Investing in Our Future" program seeks to capture around £65 million in savings over the next five years by improving procurement processes and driving cultural change throughout the university, among other initiatives. This, in our view, would offset some of the sector headwinds and support a stable operating performance.

We view Nottingham's financial performance as strong in comparison to our rated portfolio with operating margins estimated at 4.2% in FY2019, from 4% in FY2018. This is mainly driven by growth in tuition fees from international (14%) and domestic students, representing roughly half of Nottingham's revenues. Our base-case factors in strategic investments in the Getting in Shape program, with cost-savings continuing to be delivered over the rating horizon. We expect that revenues will also be positively supported by growth in income from commercial activities (catering services, hotel and conferences centers), which management is intending to expand. Growth in research income on the other hand will remain muted until the publication of REF 2021's findings (Research Excellence Framework).

Consistent with its strategy, the university also expects to invest in its existing estate and bring up all the university's buildings to a similar standard of quality, instead of expanding the estate's footprint. Another important theme of the capital program relates to investing in digital services and leveraging technology to improve processes and research output. We estimate that capital expenditure will decrease from £85 million in FY2018 to £51 million in FY2019 and remain around that level over the rating horizon. The five-year investment program stands at £443 million and will be funded through internally generated earnings as the management is committed to minimizing the debt burden.

Nottingham's debt position is relatively low compared to peers--estimated at £70 million as at FY2019 from £82 million in FY2018. We understand that Nottingham is aiming to keep its debt burden below a target of £100 million.

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.

Liquidity

Unlike peers, Nottingham holds low levels of cash on balance sheet (£5.8 million in FY2018). Instead, it favors committed credit facilities to manage working capital needs. We exclude the RCFs from our calculation of available resources to debt because drawings on the RCFs would only increase the university's debt burden. That said, we believe Nottingham's debt burden is contained and the university's debt and liquidity management policies are managed on a weekly basis. The undrawn amount of the revolving credit lines stood at around £135 million as at June 2019, contributing to total available resources to operating expenditures averaging 26% over the past three years.

Outlook

The stable outlook reflects our expectation that Nottingham's creditworthiness will remain underpinned by strong student demand, a contained debt burden, and robust operating margins as management invests in operational efficiencies. Our base case forecast is for operating margins to average 4% and available sources to operating expenditures staying around 29% over the rating horizon.

We could raise the ratings if Nottingham's net operating margins structurally increased above 5%, and if we observed the proportion of overseas students to Nottingham's student base exceeding 30% alongside improved academic standing. In our upside scenario, we would also expect to see Nottingham continuing to strengthen its reputation for research and limit its debt burden.

We could lower the rating on Nottingham over the next two years if we observe a structural decline in student demand marked by a falling selectivity rate. Deteriorating operating margins, available sources to operating expenditures falling below 25%, and a deterioration in the debt profile and management could also put downward pressure on the ratings.

Table 1

University of Nottingham Selected Indicators

	2019e	2018a	2017a	2016a
Enterprise Profile				
Full-time equivalent enrolment	32,000	30,476	29,492	29,075
Selectivity rate (%)	69.0	66.1	54.3	51.8
Undergraduates as a % of total enrolment (%)	79.2	81.0	82.3	84.8
Retention rate (%)	96.4	96.4	96.3	97.3
Graduation rates (five years) (%)	95.5	95.5	95.6	95.9

Table 1

University of Nottingham Selected Indicators (cont.)

	2019e	2018a	2017a	2016a
Financial Profile				
Operating revenue	688.5	664	646.1	635.4
Adjusted operating expense*	661.1	638.7	620.6	593.3
Adjusted net operating margin (%)	4.2	4.0	4.1	7.1
Student dependence (%)	51.0	50.3	47.9	46.9
Research dependence (%)	18.1	18.1	19.1	19.6
Funding council grant dependence (%)	13.1	13.6	13.9	14.7
Endowment and investment income dependence (%)	1.1	1.1	1.7	1.4
Outstanding debt*	70.0	81.0	81.7	70.8
MADS / total operating expense (%)	0.72	0.87	0.90	0.82
Cash, investments & expendable endowments	178.6	178.6	181.7	126.0
Available resources to adjusted operating expenses (%)	27.0	28.0	29.3	21.2
Available resources to total debt (%)†	9.4	8.2	8.0	26.8

*Adjusted to include interest and depreciation relating to capitalized operating leases and finance leases. §Adjusted to include net present value of capitalized operating leases. †Does not include revolving credit facilities as an available resource. a--Actual. e--Estimate

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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Nottingham (University of)		
Issuer Credit Rating	A+/Stable/--	A+/Positive/--

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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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.