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CREDIT OPINION
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Southern Methodist University, TX

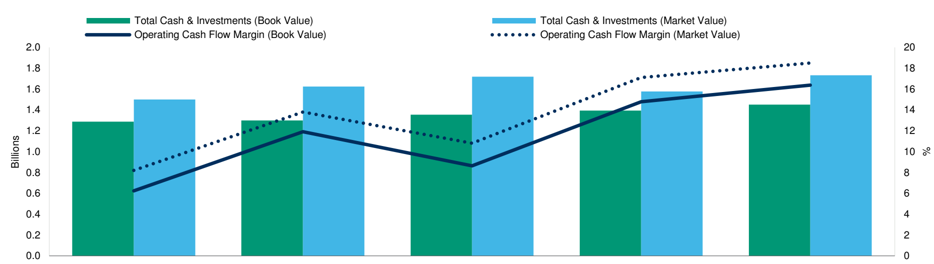
Update following revision of outlook to stable

Summary

Southern Methodist University has strong overall levels of cash and investments, which should continue to grow from healthy philanthropy. These wealth levels enhance SMU's competitive position, while its brand recognition supports sound student demand and good net tuition revenue growth. With two-thirds of revenues derived from student charges, sustaining steady enrollment is a key credit driver. Favorably, several years of efforts to identify and implement financial and operational efficiencies have resulted in improved operating performance, which we expect to be sustained. Strengthened operating cash flow will support increased debt service as the university undertakes additional infrastructure improvements that will contribute to further enhancing its already excellent strategic positioning. Credit challenges include comparatively thin liquidity and high leverage relative to peers. Further, financial resource growth has lagged peers as the university has heavily invested in its campus facilities in recent years.

On April 12, 2018, we revised the outlook to stable from negative.

Exhibit 1
Strong overall cash and investments underpin rating, with improved cash flow supporting stable outlook



SMU's Consolidated Financial Statements (CFS) are based on Book Value of Cash & Investments. Moody's also considers Market Value of Cash & Investments (included in the CFS Notes) in our credit analysis.
Source: Moody's Investors Service

Credit strengths

» Significant overall wealth levels, with $1.7 billion market value of cash and investments

» Healthy student market position demonstrated through growing enrollment and net tuition per student, up 9% and 13%, respectively, from 2013 to 2017

» High levels of philanthropic support, with three year average gift revenue of over $102 million

» Consistent investment in campus facilities, leading to limited deferred maintenance and enhanced strategic positioning

» Strong comprehensive planning to achieve operational efficiencies and direct strategic use of resources

Credit challenges

» High financial leverage, with total cash and investments cushioning debt by a low 2.9x (market value) compared to the Aa median of 4.4x and debt to revenue of over 1.1 times

» Improved though still thin liquidity compared to peers, at approximately 230 monthly days cash on hand compared to the Aa-rated private university median of 449 days

» Slower cash and investment growth than peers, resulting in weaker spendable cash and investment coverage of operations

Rating outlook

The stable outlook reflects expectations of continued improved operating performance with operating cash flow margins above 15% to support relatively high and increasing debt service. The outlook also incorporates of further strengthening of financial resources from retained operating cash flow and gifts.

Factors that could lead to an upgrade

» Above peer growth of resources with significant increase in unrestricted monthly liquidity and

» Sustained improvement to operating cash flow and stronger debt service coverage

Factors that could lead to a downgrade

» Inability to maintain improved operating performance and debt service coverage at or above current levels

» Weakened liquidity or failure to maintain financial resource growth in line with competitive peers

» Significant additional borrowing given already comparatively high leverage levels

Key indicators

Exhibit 2

SOUTHERN METHODIST UNIVERSITY, TX	2013	2014	2015	2016	2017	Pro forma	Median: Aa Rated Private Universities
Total FTE Enrollment	9,447	9,853	10,072	10,231	10,294	10,294	2,946
Operating Revenue ($000)	440,215	483,678	499,077	532,495	555,540	570,094	229,019
Annual Change in Operating Revenue (%)	-0.5	9.9	3.2	6.7	4.3	7.1	4.5
Total Cash & Investments ($000)	1,287,820	1,298,810	1,355,116	1,392,979	1,450,294	1,732,918	1,088,617
Total Debt ($000)	582,132	548,565	532,813	640,880	622,480	595,595	246,839
Spendable Cash & Investments to Total Debt (x)	1.3	1.3	1.4	1.2	1.2	1.7	3.0
Spendable Cash & Investments to Operating Expenses (x)	1.6	1.5	1.4	1.5	1.5	1.9	2.9
Monthly Days Cash on Hand (x)	186	146	148	180	228	228	449
Operating Cash Flow Margin (%)	6.2	11.9	8.6	14.8	16.4	18.5	14.6
Total Debt to Cash Flow (x)	21.2	9.5	12.4	8.1	6.8	5.6	5.3
Annual Debt Service Coverage (x)	1.3	2.1	1.3	1.4	2.3	2.7	3.1

Pro forma column incorporates $100 million in new debt, approximately $200 million in refunded debt not yet legally defeased and market value of investments, including impact on cash flow.
Source: Moody's Investors Service

Profile

Southern Methodist University is a private university located in the vibrant Dallas area with over $1.7 billion in cash and investments (market value), over 10,000 full-time equivalent students and operating revenue of over $550 million.

Detailed credit considerations

Market profile: strong student market benefits from national reputation and vibrant Dallas location

Student demand will remain strong as the university benefits from its excellent strategic position, diverse programs of study and location in the vibrant Dallas area. Favorably, total enrollment has grown almost 10% over the past five years, largely at the graduate level as law school enrollment has stabilized and other graduate programs have seen stronger demand.

Despite a high level of student market competition from private universities and strong state public university systems, undergraduate enrollment remains consistently healthy and stable in the 6,300 student range. Ongoing solid demand is reflected by highly consistent selectivity, matriculation and discount rates and growth of net tuition revenue per student in the 2-4% range annually. Enrollment from outside Texas has grown slightly to 65%, reflecting SMU's strong national reputation.

Operating performance: improved operating performance reflects management's emphasis on financial and operational improvements

Improved operating performance will continue, with surplus operations and strengthened cash flow reflecting several years of management efforts to identify and implement operational efficiencies. Positively, SMU delivered operating surpluses in fiscal 2016 and 2017 (May 31 fiscal year end) after several years of breakeven or slight deficit operations. Cash flow also improved significantly, to 16% in fiscal 2017 from 9% in fiscal 2015. Cash flow further strengthens to almost 20% when endowment spending is based on the market value of SMU's investments rather than book value, as presented in the university's financial statements.

Ongoing strengthened operating performance will provide SMU with additional financial flexibility as it invests in strategic priorities, such as heightening its research profile, investing in additional capital improvements and diversifying revenue.

Wealth and liquidity: solid financial resource base tempered by thin, though improved,liquidity

Though cash and investment growth has slightly lagged peers in recent years, SMU's overall healthy financial resources are a key element supporting its overall credit profile. Because SMU reports its cash and investments at book value of $1.45 billion rather than market value, total cash and investments are understated by almost $300 million relative to peers. Using market value of $1.7 billion, spendable cash and investment coverage of operations increases from 1.5x (book value) to 2x, still below the median for Aa-rated peers of 3x.

The university's strong philanthropic support, reflected in three year average gift revenue of over $100 million is another favorable credit element. After completing a $1 billion campaign in 2015, gift flow has moderated although still remains healthy, at almost $80 million for fiscal 2017.

Liquidity

Liquidity has improved but remains thin relative to peers, with $303 million of monthly liquidity (book value) resulting in a modest 228 monthly days cash on hand compared to the Aa-rated private university median of 449 days. Incorporating market value of investments adds an additional cushion of approximately $30 million. Favorably, calls on capital are relatively limited given a conservative debt structure and improved positive cash flow.

Leverage: high leverage associated with significant infrastructure investment

Leverage is high though manageable, with spendable cash and investment (market value) coverage of $594 million of pro forma debt of 1.7x compared to a Aa-rated peer median of 3x. Pro forma debt includes a recent $100 million private bank loan and excludes approximately $200 million of debt that was refunded but is not yet legally defeased; currently, funds are held in escrow. Given improved cash flow, this increase in debt is manageable at the current rating level. For fiscal 2017, debt to cash flow of 6x is in line with peers, significantly improved from over 12 times in fiscal 2015. However, weakened cash flow or increased debt could pressure the rating.

SMU will continue to benefit from investment in plant, including the recent $100 million new debt. The university has completed significant infrastructure improvements that support potential development on its east campus and is currently undertaking central plant and utility projects that limit deferred maintenance of these key physical assets.

Debt structure

SMU's debt structure is conservative, with all fixed-rate pro forma debt. Debt service coverage, which improved to 2.3x in fiscal 2017 from under 1.5x in the prior two years, will remain above 2x given improved cash flow and annual debt service in the $40-$45 million range through fiscal 2030.

Debt-related derivatives

Not applicable.

Pensions and OPEB

Exposure to contingent liabilities through defined contribution and postretirement benefit plans is manageable. The university contributed a combined $21 million to these plans in fiscal 2017, comprising a modest 4% of total operating expenses.

Legal Security

Rated debt is an unsecured general obligation of the university.

Effective January 2018, the Master Indenture was amended to eliminate financial covenants with respect to funded debt and limitations with respect to granting mortgages, liens and other encumbrances on university property.

Governance and management: strong financial and operational planning and implementation reflected in improved operating performance

SMU's leadership team continues to demonstrate strong financial and operational planning, reflected in the both the undertaking and implementation of comprehensive financial and operational evaluations. The university shows disciplined fiscal management in implementing both broad changes, such as salary adjustments, and small operational efficiencies that generate cumulatively substantial expense reductions.

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