

CREDIT OPINION

12 April 2018

Rate this Research >>

Contacts

Susan E Shaffer +1.212.553.4132
 VP-Sr Credit Officer
 susan.shaffer@moodys.com

Susan I Fitzgerald +1.212.553.6832
 Associate Managing Director
 susan.fitzgerald@moodys.com

Mary Kay Cooney +1.212.553.7815
 AVP-Analyst
 marykay.cooney@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

Southern Methodist University, TX

Update following revision of outlook to stable

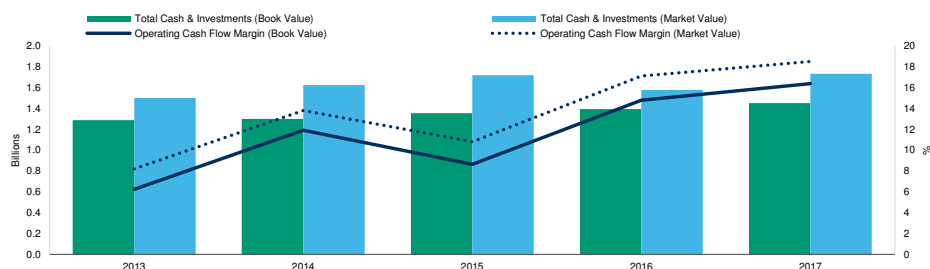
Summary

[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

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody.com for the most updated credit rating action information and rating history.

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.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454