MOODY'S INVESTORS SERVICE

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# Webster University, MO

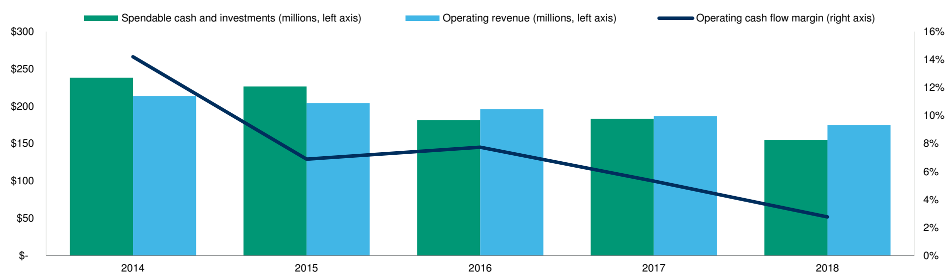
Update following downgrade to Baa1

## Summary


Webster University's (Baa1 negative) good credit quality is supported by its unique market niche with good programmatic and geographic diversification. With multiple delivery formats, it serves a diverse student population, including a large presence online and on military sites. However, it experienced significant weakening in its financial position as financial reserves and revenue declined precipitously during the last five years. The deficits, including a projected deficit for fiscal 2019, reflect a combination of heavy revenue declines and missed budget goals. Management has identified and is acting on spending reductions plans. A flexible expense base provides opportunities to adjust the cost structure, and management is trimming expenses with the intent to improve operations and restore a balanced budget by fiscal 2021.

On December, 17, 2018, Moody's downgraded Webster University's rating to Baa1 from A2.


Exhibit 1
**Five year trend of significant weakening in financial position**




*Source: Moody's Investors Service*

## Credit strengths

» Multifaceted market with geographically diverse campuses and various programs for undergraduate, graduate, military, nontraditional and international students

» Relatively flexible business model and an articulated strategy to restore balanced operations by fiscal 2021 through targeted spending reductions

» Stable to growing undergraduate enrollment trends at primary Webster Grove campus

» Solid absolute liquidity with 80 monthly days cash on hand to cushion heightened potential for liquidity calls due to narrowing coverage under a financial covenant

## Credit challenges

» Sustained deterioration in operations extending through at least fiscal 2019, resulting from significant revenue declines and missed budget projections

» Highly pressured student market leading to heavy reductions in enrollment and net tuition revenue, which accounts for over 90% of total operating revenue

» Weak debt affordability and steadily narrowing coverage of financial reserves relative to debt and operating performance since fiscal 2014

» Complex business model presents unique challenges, requiring significant central management oversight of 76 campuses worldwide

## Rating outlook

The negative outlook reflects expectations of continued deficit operations in fiscal 2019, leading to another decline in flexible reserves and resulting weakened cushion of debt. It also acknowledges narrowing headroom under one of two financial covenants and complexity of the university's business model requiring significant oversight and time to adjust the cost structure.

## Factors that could lead to an upgrade

» Stabilization of student demand providing for sustained growth in net tuition revenue

» Meaningful improvement in operating performance and debt service coverage

## Factors that could lead to a downgrade

» Inability to materially improve operations in fiscal 2020 and restore a balanced budget by fiscal 2021

» Additional reduction in financial reserves or liquidity beyond fiscal 2019

» Failure to restore revenue growth resulting in continued narrowing of coverage of financial covenant

» Weakening in leverage profile or debt affordability

## Key indicators

Exhibit 2

**WEBSTER UNIVERSITY, MO**

| | 2014 | 2015 | 2016 | 2017 | 2018 | Median: Baa Rated Private Universities |
|---|---|---|---|---|---|---|
| Total FTE Enrollment | 11,011 | 10,133 | 9,256 | 8,572 | 8,114 | 3,220 |
| Operating Revenue ($000) | 213,880 | 204,288 | 196,259 | 186,721 | 175,025 | 83,748 |
| Annual Change in Operating Revenue (%) | -0.5 | -4.5 | -3.9 | -4.9 | -6.3 | 1.5 |
| Total Cash & Investments ($000) | 251,452 | 241,914 | 199,429 | 202,459 | 174,530 | 127,447 |
| Total Debt ($000) | 76,033 | 72,457 | 70,778 | 109,471 | 103,472 | 60,235 |
| Spendable Cash & Investments to Total Debt (x) | 3.1 | 3.1 | 2.6 | 1.7 | 1.5 | 1.2 |
| Spendable Cash & Investments to Operating Expenses (x) | 1.2 | 1.1 | 0.9 | 0.9 | 0.8 | 0.9 |
| Monthly Days Cash on Hand | 436 | 387 | 321 | 318 | 280 | 240 |
| Operating Cash Flow Margin (%) | 14.2 | 6.9 | 7.7 | 5.3 | 2.8 | 13.4 |
| Total Debt to Cash Flow (x) | 2.5 | 5.1 | 4.7 | 11.0 | 21.4 | 4.8 |
| Annual Debt Service Coverage (x) | 7.1 | 2.2 | 2.3 | 1.0 | 0.8 | 2.7 |

*Source: Moody's Investors Service*

## Profile

Founded in 1915 as a Catholic women's college, Webster University became an independent, non-denominational and coeducational institution in 1967. The university has a distinctive business model, with a primary residential undergraduate campus in Webster Groves, outside of St. Louis. The university also has multiple metropolitan and military base campuses in 19 states and seven foreign countries (Switzerland, Netherlands, Austria, Ghana, Greece, Thailand and China) as well as extensive online programming. In fiscal 2018, Webster had approximately $175 million of operating revenue and over 8,100 full-time equivalent students in fall 2018.

## Detailed credit considerations

### Market profile: unique market niche with good programmatic and geographic diversification, but confronting sustained enrollment declines and high competition

Webster will continue to confront material net tuition revenue stress as it grapples with enrollment declines. In fall 2018, the university enrolled 8,114 full-time equivalent students which is down a sizeable 26% from fall 2014. Management is undertaking a multifaceted strategy to stabilize enrollment, although this will be difficult given the highly competitive student market, particularly in the online space. Among other actions, management is modifying its marketing strategy, adjusting programs, and forging new strategic partnerships. Webster heavily relies on net tuition revenue, which accounts for over 90% of total operating revenue. As a result, its longer term credit profile is closely tied to its ability to resume net tuition revenue growth.

Positively, Webster's good geographic and programmatic diversity adds unique credit strength and flexibility to adapt to changes in any one market. This strength underscores the university's good strategic positioning. However, this uniqueness also exposes it to multiple levels of competition and requires significant oversight of various locations and delivery formats to ensure effective execution. While enrollment is growing at the residential St. Louis campus, the university continues to sustain heavy declines in the graduate, metro, and military campuses. These factors constrain pricing flexibility, with net tuition per student growth below 1% in fiscal 2018.

### Operating performance: sustained contraction in operating performance expected to persist through fiscal 2019

Deficit operations will persist through fiscal 2019 as the university struggles to adjust its cost structure amid declining revenue. In fiscal 2018, Webster's operating cash flow margin was a very thin 2.8% and failed to cover annual debt service for the second consecutive year, as calculated by Moody's. This reflects a sustained weakening from the fiscal 2014 cash flow margin of 14.2% and a material departure from the university's budget. Based on university projections, its fiscal 2019 operations will remain weak but modestly better than its fiscal 2018 performance.

Management has identified a balanced fiscal 2021 budget as a key priority, although achieving this will prove challenging absent revenue stabilization. Since fiscal 2014, the university reduced its expenses by 5% while revenues declined a substantial 18%. Favorably, Webster's $189 million expense base is relatively large and has a flexible cost structure with widespread use of adjunct faculty. Among other recent expense measures, management has discontinued programs, closed site locations, and implemented an early retirement incentive plan, although noticeable operating improvements will lag as expenses are adjusted. While additional opportunities to sustainably reduce spending were identified, failure to resume revenue growth would make it difficult to sustain balanced budgets over the longer term.

### Wealth and liquidity: outsized decline in flexible reserves in recent years due to deficit operations and spending on strategic initiatives

An additional decline in financial reserves will materialize in fiscal 2019, following an outsized 31% reduction in total cash and investments from fiscal 2014 to fiscal 2018. This decrease was a result of a combination of spending on strategic initiatives and deficit operations. In fiscal 2018, spendable cash and investments' cushion of operating expenses was 0.8x, significantly lower than the 1.2x cushion in fiscal 2014. Given modest amounts of philanthropic support, prospects for restoring financial reserve growth are directly tied to the university's ability to return to surplus operations. Philanthropy is low, reflecting its alumni base from its business model. As a result, three-year average gift revenue of $2.4 million equates to just $290 on a per student basis.

#### Liquidity

Despite a steady weakening during the last five years, Webster still maintains good unrestricted liquidity. However, narrowing coverage under a financial covenant presents increasing risk of a claim on liquidity in the event of debt acceleration beyond a cure period.

In fiscal 2018, unrestricted monthly liquidity totaled $133 million, which provides 280 monthly days cash on hand. We expect additional moderation in liquidity in fiscal 2019 before stabilizing in fiscal 2020. Additional liquidity support is provided by a $30 million line of credit which was established after May 31, 2018.

The university's investment allocation is relatively conservative, with about three-quarters held in equities and fixed income. There is no exposure to unfunded private equity commitments. The equity allocation does expose Webster to market risk and a lower liquidity in the event of a serious market decline.

### Leverage: material weakening in leverage profile and debt affordability, but no new debt plans

Debt affordability will remain very weak through at least fiscal 2019 as the university grapples with thinning cash flow generation. In fiscal 2018, debt to cash flow was an elevated 21.4x, well above the 2.5x coverage in fiscal 2014. Similarly, during this period the cushion of financial reserves to debt narrowed materially due to a combination of new debt and a large decline in spendable cash and investments. In fiscal 2018, spendable cash and investments provided 1.5x coverage of debt, still solid at the rating level but well below the 3.1x coverage in fiscal 2014. While management reports no near-term debt plans, a material near-term improvement in the university's leverage profile is unlikely.

#### Debt structure

Webster's all fixed rate and regularly amortizing debt provides strong budgeting predictability. However, there is some variability in annual debt service payments, which escalate from the $5.8 million in fiscal 2018 to $11.7 million in fiscal 2022 before leveling off at $8-$9 million through fiscal 2027. A bullet payment in fiscal 2028 results in the university's maximum annual debt service at $14 million. Beyond fiscal 2028, debt service steps down again until the fiscal 2040 final maturity.

The Series 2015 bonds are directly placed with UMB Bank, N.A. for the life of the bonds until final maturity in 2040. The Series 2015 bonds are on parity with the same financial covenants: unrestricted resources to debt of at least 75% (156% at May 31, 2018) and Maximum Annual Debt Service no more than 10% of Unrestricted Gross Revenues (8.24% at May 31, 2018). None of the bonds have debt service reserve funds.

#### Debt-related derivatives

There are no debt-related derivatives.

#### Legal security

The bonds are unconditional obligations of the university with a secured interest in general revenue.

**Pensions and OPEB**

The university has very limited exposure to retirement obligations, with a defined contribution retirement plan, and a small postretirement health benefit (OPEB) plan. The OPEB plan now requires all new early retiree enrollees to pay 100% of premiums, and has a very modest $132,732 accrued benefit obligation as of May 31, 2018. University contributions towards the defined contribution plan represented just 2.3% of total operating expenses in fiscal 2018.

## Governance and management: focus on restoring balanced operations by fiscal 2021

Management is undertaking a series of strategies in an effort to stabilize its financial position and student demand. However, to date it has not demonstrated an ability to fundamentally adjust its cost structure to align with a lower revenue base. Favorably, management has taken measures to improve its budget process and implemented a number of strategies intended to increase the accuracy of financial forecasts.

Webster has recently undergone a period of transition within its executive leadership team, although the president and COO have been in place since 2009 and 2010, respectively. Recent hires were made to improve fundraising and identify revenue diversification opportunities, which are two key priorities of the university. Additionally, a new Chief Financial Officer is in place, bringing a long record of private sector experience. Maintaining leadership continuity is critical as the university navigates through a challenging environment and seeks to achieve the goals set forth in the 2016 strategic plan.

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