Duquesne University of the Holy Spirit, PA

Update to credit analysis

Summary
Duquesne University’s (A2 stable) very good credit quality is supported by its solid financial profile and steady student demand. Its urban location, Catholic identity and diverse programs provide market distinction and support ongoing enrollment stability. However, the university continues to grapple with highly competitive conditions and weak regional high school demographics. These factors will continue to suppress net tuition revenue growth, which is a considerable credit challenge given its high 87% dependence on net student revenue.

Favorably, the university maintains good financial flexibility given its relatively sizable absolute wealth at the rating. In fiscal 2018, total cash and investments amounted to $408 million, which provides solid coverage of debt and operations. Aided by favorable excess cash flow generation and improving donor support, financial reserve growth will be in line with similarly rated peers. In addition, management’s strong fiscal oversight and history of effectively adjusting expenses enhances prospects for ongoing solid operations, even as net tuition revenue growth continues to hover around 2% annually.

Exhibit 1
Sizable absolute wealth and very good debt affordability highlight fiscal strengths

Pro forma includes $31 million of Series 2019 bonds
Source: Moody’s Investors Service
Credit strengths
» Consistently solid operating performance providing for strong debt affordability
» Market distinction as an urban, Catholic university with comprehensive undergraduate and graduate program offerings
» Very good strategic positioning supported by a strategic minded executive leadership team and solid financial position
» Predictable, entirely fixed rate debt structure with relatively level annual debt service

Credit challenges
» Highly competitive market conditions and weak regional demographics suppressing net tuition revenue growth
» Limited revenue diversity, with about 87% of total revenue deriving from net student revenue
» Modest fundraising, with average gifts per student of $1,856, which is well below the A-rated private university median

Rating outlook
The stable outlook reflects our expectations of continued favorable operations and net tuition revenue growth around 2% annually. It also incorporates expectations of maintenance of very good liquidity and no material increase in leverage.

Factors that could lead to an upgrade
» Substantial growth in flexible reserves at levels above peers, materially strengthening coverage of debt and operations
» Material strengthening in competitive profile, evidenced by substantially improved fundraising and sustainably stronger earned revenue growth

Factors that could lead to a downgrade
» Deterioration in operating performance
» Sustained weakening in student demand
» Significant increase in debt relative to financial reserves, operating revenue or cash flow

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.moodys.com for the most updated credit rating action information and rating history.
Key indicators

Exhibit 2

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>9,098</td>
<td>8,876</td>
<td>8,895</td>
<td>8,899</td>
<td>9,006</td>
<td>9,006</td>
<td>4,526</td>
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<td>Operating Revenue ($000)</td>
<td>280,050</td>
<td>284,954</td>
<td>287,112</td>
<td>284,763</td>
<td>290,432</td>
<td>290,432</td>
<td>196,259</td>
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<td>Annual Change in Operating Revenue (%)</td>
<td>3.6</td>
<td>1.8</td>
<td>0.8</td>
<td>0.6</td>
<td>2.0</td>
<td>2.0</td>
<td>3.4</td>
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<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>342,212</td>
<td>324,200</td>
<td>311,414</td>
<td>336,703</td>
<td>408,115</td>
<td>408,115</td>
<td>359,875</td>
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<tr>
<td>Total Debt ($000)</td>
<td>165,212</td>
<td>156,372</td>
<td>149,645</td>
<td>142,170</td>
<td>152,534</td>
<td>183,534</td>
<td>132,260</td>
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<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
<td>1.6</td>
<td>1.9</td>
<td>1.6</td>
<td>1.6</td>
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<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>1.0</td>
<td>0.9</td>
<td>0.8</td>
<td>0.8</td>
<td>1.0</td>
<td>1.0</td>
<td>1.3</td>
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<td>Monthly Days Cash on Hand</td>
<td>301</td>
<td>252</td>
<td>243</td>
<td>238</td>
<td>258</td>
<td>258</td>
<td>321</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>15.9</td>
<td>15.1</td>
<td>15.3</td>
<td>12.4</td>
<td>11.9</td>
<td>11.9</td>
<td>15.3</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>3.7</td>
<td>3.6</td>
<td>3.4</td>
<td>4.0</td>
<td>4.4</td>
<td>4.4</td>
<td>4.6</td>
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<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>3.6</td>
<td>2.9</td>
<td>3.0</td>
<td>2.5</td>
<td>2.4</td>
<td>2.4</td>
<td>3.0</td>
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Source: Moody’s Investors Service

Profile

Duquesne University of the Holy Spirit is a private, urban Catholic university located in Pittsburgh, PA. Originally established in 1878, the university now offers diverse undergraduate and graduate programs. Duquesne serves over 9,000 students and had total fiscal 2018 operating revenue of $290 million.

Detailed credit considerations

Market profile: urban Catholic university with steady student demand despite difficult market conditions

Ongoing steady student demand will continue to be supported by careful enrollment management practices and a solid academic reputation. An urban, Catholic university, Duquesne offers comprehensive undergraduate and graduate programs and has a demonstrated history of adjusting programs according to market conditions. Over the last five years, enrollment has remained relatively stable at around 9,000 full-time equivalent students. Along with its aforementioned distinctions, the university’s willingness to continuously invest in programmatic, capital and other student-centered initiatives will support incremental enrollment gains beyond fall 2018.

Despite these market strengths, Duquesne continues to grapple with considerable competitive challenges such as weak high school demographics and heightened competition. Within the region, there is a high concentration of both public and private universities that compete directly with Duquesne. As a result, growth in net tuition revenue will continue to be suppressed and likely below inflationary levels. Since fiscal 2014, net tuition revenue grew less than 2% compounded annually, which is a significant credit challenge because 87% of total operating revenue derives from net student revenue.

Operating performance: consistently favorable operations reflect sound fiscal oversight

Despite ongoing low revenue growth, close fiscal oversight will help maintain favorable operations. In fiscal 2018, the university generated an 11.9% operating cash flow margin, which covers pro forma maximum annual debt service a solid 2.3x. Based on university forecasts, fiscal 2019 operating results will be comparable to fiscal 2018. Beyond fiscal 2019, prospects for maintaining this performance are strong given the university’s demonstrated record of adjusting expenses according to revenue conditions. Compared to similarly rated peers, operations are lean, with educational expenses per student of $26,344, lower than the A-rated private university median of $33,280.
Wealth and liquidity: sizable absolute wealth relative to similarly rated peers with good prospects for additional accumulation

Absolute wealth is substantial at the rating level, with total cash and investments amounting to $408 million. Aided by the monetization of a housing asset, spendable cash and investments increased 18% over the last five years, strengthening coverage of operating expenses to 1.0x in fiscal 2018 from 0.8x in fiscal 2016. In upcoming years, growth will likely be comparable to similarly rated peers given steady excess cash flow generation and improving philanthropic support. However, fundraising remains relatively modest, with three-year (fiscal 2016-2018) average gifts per student of $1,856 still well below the A-rated private university median of $4,171.

Liquidity

Liquidity will continue to provide a favorable cushion relative to operating expenses. In fiscal 2018, monthly liquidity amounted to $185 million, which provided a solid 258 monthly days cash on hand. Additional liquidity is provided by a $20 million line of credit, which had no outstanding balance as of June 30, 2018. Potential liquidity risks are manageable given an all fixed rate debt structure, surplus operations and limited exposure to unfunded private capital commitments.

Endowed investments are managed by the board’s investment committee, with assistance from a third party adviser. Slightly more than two-thirds of the $317 million portfolio (as of December 31, 2018) are held in equities, which is not materially different from universities with similarly sized endowments. In fiscal 2018, the investment return was a solid 8.5%.

Leverage: manageable debt relative to operating revenue and cash flow

Debt will remain manageable relative to financial reserves, operating revenue and cash flow. Spendable cash and investments cushion pro forma debt 1.6x, while pro forma debt to operating revenue is 0.6x. Each of these are comparable to the A-rated private university median. Good prospects for ongoing revenue and financial reserve growth, coupled with regular debt amortization, enhance the likelihood of improved leverage.

Debt structure

Duquesne’s debt structure is relatively conservative and does not add material credit risk. All bonds are fixed rate through the fiscal 2039 final maturity. Principal pay down is steady and annual debt service payments are relatively level before a significant step down in fiscal 2035.

Legal security

All of the university’s rated debt is a general obligation of the university, secured by student tuition and fees. There is no debt service reserve fund.

Debt-related derivatives

There are no debt-related derivatives.

Pensions and OPEB

Exposure to post-employment benefit obligations is modest. The university does not offer a defined benefit pension plan. Rather, eligible employees participate in one of two defined contribution plans. For fiscal 2018, the university’s expenses for the defined contribution plans amounted to just 3% of total operating expenses.

Certain university retirees are eligible for post-retirement health benefits (OPEB) which are funded on a pay-as-you-go basis. In fiscal 2018, the OPEB related liability was about $8 million and has not remained relatively steady over the last five years.

Governance and management: commitment to adjusting programs and investing in strategic initiatives

Duquesne’s strategic minded executive leadership team will contribute to maintenance of its solid financial profile. Budgets incorporate reasonable assumptions and management regularly identifies opportunities to generate sustainable cost savings. To combat competitive conditions, the university adjusts programs and enters into strategic partnerships. For example, it recently entered into a partnership with a third party to purchase, renovate and operate a residence hall. This, along with the 2019 bonds, is part of the university’s strategy to address capital needs.
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