Rating Update: Moody's affirms Kalamazoo College's, MI, A1 issuer rating; outlook stable

Global Credit Research - 08 May 2014

No rated debt outstanding

KALAMAZOO COLLEGE, MI
Private Colleges & Universities
MI

Opinion

NEW YORK, May 08, 2014 --Moody's Investors Service has affirmed Kalamazoo College's (MI) A1 issuer rating. The outlook is stable. The college has no rated debt.

SUMMARY RATING RATIONALE

The A1 rating reflects Kalamazoo College's ample balance sheet resources and unrestricted liquidity, favorable operating performance and cash flow generation driven by conservative budgeting and established student demand as a small liberal arts with a unique curriculum. Challenges are stagnant net tuition revenues reflecting high tuition discounting due to significant competition for students, growing reliance on gifts to fund operations and debt refinancing risk in 2021.

STRENGTHS

*Balance sheet resources are strong and growing, with expendable financial resources cushioning debt 3.1 times.

*Favorable operating performance and cash flow generation, despite constrained net tuition revenues, reflect conservative budgeting. The FY 2013 operating cash flow margin was 17% despite a 2.4% decline in net tuition revenues, bolstered by gift revenues. FY 2014 is expected to be positive but not as strong as FY 2013.

*Kalamazoo College continues to enjoy established student demand with its unique and academically challenging curriculum under its K-Plan focusing on study abroad, experiential learning experiences and the senior project. Enrollment for fall 2013 was 1,453 full-time equivalent (FTEs) students, up from the prior year and reflecting a strong freshman class.

*The college evidences best practices of governance and management, including conservative budgeting practices, five-year financial forecasts and self-evaluation processes for the board and senior management.

CHALLENGES

*The competitive market position is reflected in declining net tuition per student, with a 3% decrease to $18,153 in FY 2013 from $18,716 in FY 2011. The challenge to grow net tuition revenues reflects rising tuition discounting to respond to high competition from lower-cost public universities and regional private institutions. The college projects stagnant net tuition per student for the current FY 2014 due to a higher tuition discount rate for fall 2013.

*Operating leverage is moderately high, with debt-to-revenues of 0.63 times, although improved from 0.73 times in FY 2011 from debt pay-down and revenue growth.

*Reliance on gift revenues is high and rising, accounting for 26% of FY 2013 total operating revenues (compared to 20% in FY 2011), critical for operations as reflected in a negative 21% operating margin excluding gifts.

*Debt structure requires careful liquidity planning, with a mandatory tender in 2021 of its $33 million of currently outstanding directly placed Series 2011A bonds, although the balance will be $24 million due to principal repayment.

DETAILED CREDIT DISCUSSION
RECENT DEVELOPMENTS/RESULTS

Kalamazoo College saw a strong freshman class of 453 for fall 2013, up from 334 the prior year and well above budget. Further, matriculation was 27%, up from 21% the prior year. The college continued to show favorable demand from outside Michigan at 38% of freshmen, including international students. For the fall 2014 semester, the college is budgeting for first-time freshmen well below actual enrollment for the prior year. With its distinctive curriculum and academic experience under the K-Plan, demand should remain sound. However, the college will be challenged to grow net tuition revenues, particularly net tuition per student, as it finds it must offer substantial tuition discounting to compete with lower-cost publics and other private colleges. The total tuition discount rose to 51.6% for FY 2013 from 44.5% in FY 2009, with another increase expected for FY 2014.

The college has no debt plans for the next few years. It does have a few capital projects in the preliminary or design phase, including a fitness and wellness center and a natatorium, with total costs of about $21 million. However, funding is intended to come from gifts, with construction for the projects anticipated to start only when the gifts are raised. With a calculated 20.7 years age-of-plant, the college will need to address deferred maintenance in the longer-term to maintain its competitive standing.

Kalamazoo has raised about $89 million against a $125 million goal for its "Campaign for Kalamazoo College", with about $64 million in cash, $23 million pledges and $2 million in deferred gifts. Of the $89 million, $40 million are from trustees. The campaign's public phase was launched in September 2013, with a planned end of June 2015. Annual giving has been consistent at about $2 million per year. The college is highly reliant on unrestricted gift revenues to support its budget, reflected in an operating margin excluding gifts (operations excluding both unrestricted operating gifts and net assets released from restriction, including the annual distribution from the Heyl Scholarship Fund) of negative 20% for both FY 2012 and FY 2013, with expectations of continued high reliance for the next few years as campaign gifts are received. Once the campaign is concluded, the college will need to either continue the momentum for unrestricted gifts or address its expense structure to generate operations consistent with recent years.

DEBT STRUCTURE: The college's Series 2011A and 2011B bonds are directly placed with PNC Bank, N.A. and are an unsecured obligation. The Series 2011A bonds ($33.1 million outstanding) have a mandatory tender date of December 1, 2021, with a final maturity of December 1, 2040. The Series 2011B bonds ($1.4 million outstanding) mature on December 1, 2015. Both series have annual principal repayment. Under the Guaranty Agreement between the college and PNC Bank, N.A., Kalamazoo must maintain no less than 100% of Minimum Unrestricted and Temporarily Unrestricted Cash and Investments to Long-Term Debt, reported semi-annually. Reported coverage has consistently been stronger, with a 297% cushion for 12/31/2013. There are no debt service reserve funds.

The A1 issuer rating reflects the unsecured general obligation credit characteristics of the college and does not incorporate an analysis of the legal security of the organization's pro forma debt.

INTEREST RATE DERIVATIVES: None

OUTLOOK

The stable outlook reflects expectations of continued favorable operating cash flow generation, maintenance of ample unrestricted liquidity and balance sheet resources and no additional debt. Also expected are at least stable net tuition revenues and enrollment.

WHAT COULD MAKE THE RATING GO UP

A rating upgrade could result from strengthened student demand reflected in growing net tuition revenue and stable enrollment, significant growth in financial resources and consistently strong operating performance and cash flow generation from fundamental operations.

WHAT COULD MAKE THE RATING GO DOWN

A rating downgrade could result from stagnant to declining revenues, driven by falling net tuition revenues or declining enrollment, resulting in consistently weaker operating cash flow; reduced balance sheet resources and liquidity; additional debt resulting in higher operating leverage and debt service burden.

KEY INDICATORS (FY 2013 financial data, fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 1,453 students
Primary Selectivity: 66.9%
Primary Matriculation: 26.8%
Net Tuition per Student: $18,153
Educational Expenses per Student: $30,710
Average Gifts per Student $13,597
Total Cash and Investments: $199.8 million
Total Direct Debt: $34.5 million
Expendable Financial Resources to Direct Debt: 3.1 times
Expendable Financial Resources to Operations: 2.2 times
Monthly Days Cash on Hand: 581.1 days
Monthly Liquidity to Demand Debt: 215.9%
Operating Revenue: $55.4 million
Operating Cash Flow Margin: 17.1%
Three-Year Average Debt Service Coverage: 3.5 times
Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 58.2%

RATING METHODOLOGY
The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES
For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts
Diane F. Viacava
Lead Analyst
Public Finance Group
Moody's Investors Service
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, licensees 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, licensees 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, licensees 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, licensees 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.

MIS, 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 MIS have, prior to assignment of any rating, agreed to pay to MIS 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.moodys.com under the heading “Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy.”

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 clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY’S credit rating. If in doubt you should contact your financial or other professional adviser.