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Research Update:

University of Western Ontario 'AA' Ratings Affirmed On Solid Student Demand, Steady Government Support; Outlook Stable

Primary Credit Analyst:

Suleman Souleyman, Toronto (1) 416-507-2514;suleman_souleyman@standardandpoors.com

Secondary Credit Analyst:

Paul Judson, CFA, Toronto (1) 416-507-2523;paul_judson@standardandpoors.com

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Rationale

On June 8, 2009, Standard & Poor's Ratings Services affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario (Western or the university), in London, Ont. The outlook is stable.

In our opinion, the ratings on Western reflect the university's exceptional student demand and grounding in research, strong management team, and good government support. We believe the university's weaker-than-expected balance sheet and likely operating deficits constrain the ratings.

In our view, the following factors support the ratings:

- Strong student demand. Excluding its affiliates, Western had about 28,000 full-time equivalent students (FTEs) in fiscal 2008. The average entry grade of full-time first-year students was 86%, slightly below that of Queen's University (AA+/Stable/--). Western's selectivity is improving; its acceptance rate fell to 58% for fall 2008 students from 66% in fall 2005. Graduate students made up about 15% of fiscal 2008 enrolment. This is slightly lower than other rated Canadian research-intensive universities, although we believe Western is making excellent traction in increasing graduate enrolment;
- Superb grounding in research. Western ranks among the top 10 research-intensive Canadian universities. Robarts Research Institute and Lawson Health and Research Institute are leading Canadian medical research centers and form an integral part of the university's research activities. The university's research revenue was C\$194 million in fiscal 2008, or about 23% of total revenues. That number has risen 37% since fiscal 2003;
- A strong management team that has implemented several difficult initiatives to contain its expenditures and nonpension postemployment liabilities (such as dental and prescription drugs). Furthermore, management has stipulated that the university will maintain a minimum ongoing operating reserve. It is also addressing Western's capital maintenance backlog by raising its annual transfer from operations toward the backlog each year. However, due to operating shortfalls contributions will be frozen at the 2009 contribution level for the next two years; and
- Good government support. Province of Ontario (AA/Negative/A-1+) operating grants account for about 49% of Western's operating revenues. Although the province is facing significant financial challenges, it is keeping its commitments to universities, at least in the short term. One of these commitments is the operating and capital funding of additional 14,000 graduate student spaces. Furthermore, the province's fiscal 2009 budget

slightly increased its funding to colleges and universities.

We believe credit concerns include:

- A weaker-than-expected balance sheet. In fiscal 2008, Western's debt was about C\$233 million, or C\$8,331 per FTE, after issuing a C\$190 million senior unsecured amortizing debenture that matures in 2047. The university's total unrestricted financial resources dropped 22% from the previous year, to C\$121 million. Unrestricted financial resources were 52% of total debt; this falls to 27% when unfunded postemployment liabilities are included in the denominator. These ratios are weak for the rating. Standard & Poor's expects these metrics to further weaken in fiscal 2009. The preliminary fiscal 2009 market value of Western's endowment was C\$265 million, falling almost 19% from fiscal 2008, due to market volatility; and
- Likely operating deficits. Western's operating performance substantially weakened in fiscal 2008, just balancing. The most significant pressure was from salaries and benefits, which accounted for about 60% of total expenditures and increased 10% (or C\$48 million) from the previous year. Also in fiscal 2008, investment income fell almost 50% (or C\$22 million). Western expects its operations to balance in fiscal 2009, but be in deficit in fiscals 2010 and 2011, even though it is implementing some difficult cost-containment initiatives. To fill the gap during these years, management plans to draw down its operating reserve.

Outlook

The stable outlook reflects our expectation that Western's demand metrics, research profile, and management team will remain strong and help it work through its current financial constraints. The outlook also reflects our expectation that its balance sheet and operating performance will improve in the medium term. Standard & Poor's could lower the ratings if, in the next two years, unrestricted financial resources do not improve to at least fiscal 2007 levels, debt substantially rises, operations are in deficit, government financial support diminishes, or if changes in the tuition regime adversely affect the university's operations. We could upgrade Western if unrestricted financial resources rise substantially, the debt burden significantly drops, and operating performance significantly improves, all else being equal.

Ratings List

Ratings Affirmed

University of Western Ontario

Issuer credit rating	AA/Stable/--
Senior unsecured debt	AA

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