S&P Global Ratings

RatingsDirect®

Village Tech Schools, Texas; Charter Schools

Primary Credit Analyst:
Beatriz Peguero, New York (1) 212-438-2164; beatriz.peguero@spglobal.com

Secondary Contact:
Brian J Marshall, Dallas (1) 214-871-1414; brian.marshall@spglobal.com

Table Of Contents

Village Tech Schools, Texas; Charter Schools

Credit Profile		
US$0.0 mil ICR		
Long Term Rating	BB/Stable	New

Rationale

S&P Global Ratings assigned its 'BB' issuer credit rating (ICR) and stable outlook to Village Tech Schools, Texas.

We assessed Village Tech's enterprise profile as adequate, characterized by its consistently high enrollment growth; decent student retention; and good relationship with Texas Educational Authority (TEA), its charter authorizer. We assessed Village Tech's financial profile as vulnerable, reflecting its slim pro forma lease-adjusted maximum annual debt service (MADS) coverage, very high pro forma MADS burden, and debt per student due to somewhat rapid expansion-and-growth plans. This offsets the school's materially improved unrestricted days' cash on hand at Aug. 31, 2018. Combined, these credit factors led to an indicative stand-alone credit profile of 'bb' and final rating of 'BB'.

More specifically, the rating reflects our opinion of the school's:

- Slim pro forma MADS coverage of 1.07x in fiscal 2018;
- Short operating history with its first year in fiscal 2014;
- Very high debt and debt per student; and
- General risks associated with charter schools, such as charter renewal and revocation, as well as the need for enrollment growth to absorb pro forma MADS.

We believe somewhat offsetting factors are, what we consider, Village Tech's:

- Consistently high enrollment growth, which should continue during the next few years, and sound retention;
- Good relationship with the authorizer, receiving an expedited 10-year renewal through July 2028;
- Academic results that meet state standards; and
- Stable and capable management team.

An ICR reflects the obligor's general creditworthiness, focusing on its capacity and willingness to meet financial commitments when they come due. It does not apply to any specific financial obligation because it does not take into account an obligation's nature and provisions, bankruptcy or liquidation, statutory preferences, or legality and enforceability.

Village Tech has three pro forma bond series (2017A, 2017B, and 2018) outstanding, totaling about $29.5 million, including $8.35 million of bonded debt with Equitable School Revolving Fund. These bond series are a general obligation of the school, secured by available revenue and a mortgage on the Duncanville campus.

Bond covenants include an operating covenant that requires 1.1x annual debt service coverage and 45 days' cash on hand. Village Tech does not have any existing or contemplated swap obligations. These issuances financed the acquisition, expansion, and renovation of the Duncanville campus.

Village Tech opened in the 2013-2014 school year and served 636 prekindergarten through eighth-grade students in Cedar Hill. It opened a second facility in the Cedar Hill area in the 2015-2016 school year. Since that time, the school somewhat established its operating history and expanded from its former campuses into its recently opened Duncanville campus, which currently houses 1,096 prekindergarten through 12th-grade students. Village Tech used short-term borrowing--such as credit lines, facility leases, and leasehold improvement loans--to finance the Cedar Hill campuses while it searched for a Duncanville campus. Once it discovered the Duncanville campus in 2017, Village Tech issued the combined $20.5 million of series 2017A and 2017B bonds and used proceeds to refinance a line of credit and leasehold improvement loan and purchase the Duncanville facility and Cedar Hill facility leases. In anticipation of building out the Duncanville campus to include a gymnasium and storm shelter, as well as additional classroom space, Village Tech partnered with Equitable School Revolving Fund to issue $8.4 million of series 2018 bonds to finance the project.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that during the next year, management will likely continue to meet budgeted enrollment projections and maintain positive, full-accrual operations, allowing it to sustain lease-adjusted MADS coverage above 1x and unrestricted cash consistent with the rating.

Downside scenario

We could lower the rating or revise the outlook to negative if Village Tech were to fail to meet enrollment projections, such that it generates weakened operating results and lease-adjusted MADS coverage below 1x, or if unrestricted liquidity were to weaken materially from Aug. 31, 2018, levels.

Upside scenario

We are unlikely to raise the rating during the two-year outlook period due to Village Tech's high debt load, inconsistent unrestricted reserves, and planned expansion and additional capital plans.

Enterprise Profile

Economic fundamentals

Village Tech is in Dallas County, which surrounds Dallas. The county's minor population is relatively substantial, in our view, at about 961,000, with a projected five-year school-age population growth of 1.5% through 2024.

Industry risk

Industry risk addresses the charter-school sector's overall cyclicality and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, profitability levels and trends, substitution risk, and growth trends observed in the industry. We believe the charter-school sector represents a moderately high credit risk compared with other industries and sectors.

Market position

We view Village Tech's enrollment-and-demand profile as sound, supported by its history of growing enrollment and decent student retention. Historically, total enrollment grew as the organization expanded into a larger campus in 2018. For fall 2016, student enrollment totaled 807. This growth trend has continued consistently with a fall 2017 enrollment of 929 and a fall 2018 enrollment of an estimated 1,096, up by about 36% from fall 2016. Management is projecting enrollment of 1,199 for fall 2019, a 14.8% increase from fall 2018. Management attributes this growth to its relocation to Duncanville, which draws students from the fast-growing Dallas-Fort Worth-Arlington metropolitan area. We view Village Tech's continued growth positively, and we do not expect changes to the school's demand profile during the next few years.

Village Tech achieved a "Met Standard," the highest possible ranking for academic performance under 2018 state-accountability ratings. We view Village Tech's standing with TEA, the charter authorizer, as good. Village Tech has held its charter with TEA for six consecutive years, and it received an expedited 10-year charter renewal in July 2018 through 2028.

The statutory framework assessment reflects our opinion that while there could be some areas of risk, the framework is not likely to negatively affect Village Tech's future ability to pay debt service. Charter schools in Texas rely on the state for per-pupil funding. Per-pupil funding has increased by about 10% during the past three fiscal years, which we view favorably. With the recent passage of House Bill 1, charter schools began receiving facility funding during the 2018-2019 school year, which we view positively.

Management and governance

A five-member board governs Village Tech. Board members serve three-year terms, and the board can renew its members' terms indefinitely. Board members have diverse backgrounds, including technology, education, and organizational health. We view Village Tech's management team as experienced and capable. A superintendent, chief technology officer, and chief financial officer currently lead Village Tech.

Other management positions reporting to the superintendent include an assistant superintendent, a curriculum-and-innovation director, a forge director, a prekindergarten through fifth-grade campus director, and a sixth- through 12th-grade campus director. Overall, management has strategically developed its growth-and-development plan while maintaining sound financial-and-operational oversight.

Financial Profile

Financial performance

Village Tech's financial operations are variable. During the past four fiscal years of operations, the school has posted full-accrual margins, ranging from roughly 20% in fiscal 2015 to a negative 6% in fiscal 2018. Management largely attributes negative full-accrual results to accelerated depreciation expenses of about $1.5 million in fiscal 2018 due to its moving into the Duncanville campus.

Village Tech, however, has consistently posted positive EBIDA margins. In fiscal 2018, the school posted a roughly 24% EBIDA margin, up from 14% in fiscal 2017. Operating performance should improve as the school grows into its capacity and debt service.

Management also expects a modest funding increase for fiscal 2019. Decent revenue growth due to growing enrollment and increased state funding support operations. Using fiscal 2018 audited results, pro forma lease-adjusted MADS coverage was 1.07x, which we deem slim, albeit acceptable, for the rating. We expect lease-adjusted MADS coverage to improve as enrollment and operations grow. Lease-adjusted pro forma MADS is $2.4 million, occurring in fiscal 2028.

Liquidity and financial flexibility

We consider Village Tech's unrestricted reserves variable and a credit weakness. Unrestricted-reserves-to-pro-forma-debt ratios were 6% and 2.3% in fiscal years 2018 and 2017, respectively. Village Tech issued substantial debt in 2017 and 2018, and we expect it will likely take the school some time before the ratio moves above 10%. Days' cash on hand for fiscal 2018 was 114 days', up from 43.2 days' in fiscal 2017. We view current sustained days' cash on hand positively. Management indicates it does not currently plan to draw down cash, but its further expansion-and-renovation plans could potentially affect liquidity.

Debt burden

Pro forma debt service escalates through fiscal 2020 and levels off thereafter. This translated to, what we consider, high pro forma MADS of about 30% of fiscal 2018 operating revenue. While we view Village Tech's debt as very high, we understand officials do not currently plan to issue additional debt during the next few years.

While the strategic plan's phase three contemplates adding a permanent building structure to the existing campus, management indicates this phase will only occur upon the completion of successful fundraising, which it would use to pay a large portion of the project. We expect overall debt should decrease as operations expand. We think Village Tech's debt is strategic, but its increased debt has decreased financial resources.

Financial policies

Village Tech has formal investment-allocation, liquidity, and debt policies. It meets standard annual disclosure requirements. The financial-policies assessment reflects our opinion that while there could be some areas of risk, the organization's overall financial policies are not likely to negatively affect its ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure; we compare these policies with those of comparable providers.

Village Tech Schools, Texas Select Enterprise And Financial Statistics

	--Fiscal year-end Aug. 31--					Medians for 'BB' rated charter schools
	2019p	**2018**	**2017**	**2016**	**2015**	**2017**
Enrollment						
Total headcount	1,096	929	807	725	727	892
Total waitlist	648	228	211	469	591	MNR
Waitlist as % of enrollment	59.1	24.5	26.1	64.7	81.3	23.5

Village Tech Schools, Texas Select Enterprise And Financial Statistics (cont.)

	--Fiscal year-end Aug. 31--					Medians for 'BB' rated charter schools
	2019p	2018	2017	2016	2015	2017
Financial performance						
Total revenue ($000s)	N.A.	8,021	6,705	6,019	6,144	8,963
Total expenses ($000s)	N.A.	8,553	6,158	5,920	4,919	MNR
EBIDA ($000s)	N.A.	1,905	925	486	1,471	MNR
EBIDA margin (%)	N.A.	23.8	13.8	8.1	23.9	13.7
Excess revenue over expenses ($000s)	N.A.	(532)	547	99	1,225	MNR
Excess income margin (%)	N.A.	(6.6)	8.2	1.6	19.9	1.9
Operating lease expense	N.A.	721	646	612	N.A.	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.11	1.37	1.02	3.87	MNR
Lease-adjusted annual debt service burden (% of total revenue)	N.A.	29.4	17.1	18.0	6.2	MNR
Lease-adjusted annual debt service burden (% of total expenses)	N.A.	27.6	18.6	18.3	7.7	MNR
Maximum annual debt service (MADS) ($000s)	N.A.	2,443	N.A.	1,455	1,455	1,295
Lease-adjusted MADS coverage (x)	N.A.	1.07	N.A.	0.75	1.01	1.10
Lease-adjusted MADS burden (% of total revenue)	N.A.	30.5	N.A.	24.2	23.7	14.5
Lease-adjusted MADS burden (% of total expenses)	N.A.	28.6	N.A.	24.6	29.6	MNR
Pro forma MADS ($000s)	N.A.	2,443	2,443	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	1.07	0.64	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% of total revenue)	N.A.	30.5	36.4	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% of total expenses)	N.A.	28.6	39.7	N.A.	N.A.	MNR
Total revenue per student ($)	N.A.	8,634	8,309	8,302	8,451	MNR
Balance sheet metrics						
Days' cash on hand	N.A.	102.0	43.2	43.2	70.8	63.0
Total long-term debt ($000s)	N.A.	29,462	1,492	1,888	2,219	MNR
Unrestricted reserves to debt (%)	N.A.	9.0	46.7	35.5	41.8	10.3
Unrestricted net assets as % of expenses	N.A.	11.4	2.9	2.5	2.3	17.5
General fund balance ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Debt to capitalization (%)	N.A.	96.4	86.4	91.4	94.6	92.0
Debt per student ($)	N.A.	20,731	1,333	2,058	2,655	17,808
Pro forma metrics						
Pro forma unrestricted reserves ($000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma days' cash on hand	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma long-term debt ($000s)	N.A.	29,462	30,392	1,888	2,219	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR

Village Tech Schools, Texas Select Enterprise And Financial Statistics (cont.)

	--Fiscal year-end Aug. 31--					Medians for 'BB' rated charter schools
	2019p	**2018**	**2017**	**2016**	**2015**	**2017**
Pro forma debt to capitalization (%)	N.A.	98.0	99.0	93.0	95.0	MNR
Pro forma debt per student ($)	N.A.	31,714	37,660	2,604	3,052	MNR

p--Projected. N.A.--Not available. MNR--Median not reported. Operating lease expense--Annual amount paid in facilities/capital lease payments; excludes equipment/nonfacility lease payments and payments related to principal and interest on bonds. Net revenue available for debt service = EBIDA. Lease-adjusted MADS coverage = (Net revenue available for debt service + operating lease expense) / (MADS + operating lease expense).