S&P Global Ratings

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Little Scholars of Arkansas (LISA) Academy, Arkansas; Charter Schools

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ICR ser 2021		
Long Term Rating	BB+/Stable	New

Rating Action

S&P Global Ratings assigned its 'BB+' issuer credit rating (ICR) to Little Scholars of Arkansas (LISA) Academy, Ark. The outlook is stable.

An ICR reflects an 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 the obligation's nature and provision; standing in bankruptcy; or liquidation, statutory preferences, or legality and enforceability.

In fiscal year 2021, LISA Academy, via Little Scholars of Arkansas, LLC, a single-purpose entity, intends to enter into a loan agreement of approximately $15.041 million with the Equitable Facilities Fund (EFF) to provide financing for the acquisition of two of LISA Academy's existing leased facilities, as well as issuance costs. Based on current expectations, the EFF financing will be structured as a 35-year loan with level debt service payments and total proceeds of approximately $18.449 million, including a $1.352 million reoffering premium. Total pro forma debt is $46.294 million, which includes 2010 Q, Y, and Z bonds as well as 2018 A and B bonds, in addition to a $1.62 million bank note. The note payable has a fixed interest rate of 3.29% and matures in 2026. This loan could become accelerated in an event of default. We believe the school has sufficient liquidity to cover this contingency, as the school's unrestricted cash position of $7.56 million, as of year-end 2020, exceeds the bank note's balance. The outstanding pro forma debt is a general obligation (GO) of LISA Academy, secured by a pledge of all revenues of the network and mortgages on its owned facilities.

Following the COVID-19 outbreak, LISA Academy transitioned to online instruction. LISA Academy made additional investments over the summer to ensure that all families had access to Chromebooks or hotspots as necessary. After surveying families, LISA began the school year on time using a hybrid approach of 60% in person and 40% online. The school continues to monitor relevant health and safety guidelines and adjust plans as necessary.

Despite uncertainty regarding the duration and extent of the effect of the COVID-19 pandemic, funding in Arkansas continued without delay for fiscal 2020, with a modest increase in per-pupil funding for fiscal 2021. LISA Academy has been allocated approximately $687,000 in Coronavirus Aid, Relief, and Economic Security (CARES) Act funding for COVID-19-related expenses, with the funds functioning as a grant to schools to offset pandemic-related costs. We understand LISA Academy expects to receive additional funds from the recently passed Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act and will monitor details on amount and timing as they become available.

Credit overview

We assessed LISA Academy's enterprise profile as adequate, reflecting a good demand with consistent enrollment growth, very healthy waitlist of over 100% enrollment, a history of successful charter renewals, and a proactive management team, which offset transition risk associated with continued growth plans. We assessed its financial profile as vulnerable, with below 1x pro forma maximum annual debt service (MADS) coverage, sufficient liquidity, and a moderately high, but manageable, debt burden. We believe that, combined, these credit factors lead to an anchor rating of 'bb'. As our criteria indicate, the final rating can be within one notch of the anchor rating level. In our opinion, the final 'BB+' rating on LISA Academy better reflects the organization's sound market position, successful track record of growth, and unrestricted reserves in line with the 'BB+' rating level.

The rating also reflects our view of LISA Academy's:

- Growing enrollment and excellent demand, reflected by a waitlist that is over 55% of enrollment and good student retention;
- Sufficient unrestricted reserves with about 103 days' cash on hand as of fiscal 2020 year-end and steady liquidity expected for the near term; and
- History of successful charter renewals, with recent approval to open a K-12 grade campus in Rogers, Arkansas in the 2022-23 school year and increased enrollment cap by 950 students.

Offsetting credit factors, in our view, include LISA Academy's:

- Modest operating results, with weak pro forma lease-adjusted MADS coverage for the rating level, though our calculation is somewhat conservative as it incorporates future lease expenses without the benefit of the additional revenues expected growth will provide;
- Potential for additional financing or lease needs, given longer-term expansion discussions; and
- The inherent uncertainty associated with charter renewals, given that the final maturity on the bonds exceeds the length of the existing charter.

The stable outlook reflects our expectation that LISA Academy will build its operations to support sufficient MADS coverage, sustain liquidity, and a moderating debt burden, while successfully meeting enrollment growth projections over time.

LISA Academy opened in fall 2004 and served 163 middle school students (6th to 8th grade) in its first year. The school was established by a group of educators and university academicians who are passionate about the way children approach math and science. Since its founding, LISA Academy has placed an emphasis on its science, technology, engineering, and mathematics (STEM) college preparatory curriculum, intervention programs, student and teacher diversity, and STEM competitive teams. It currently operates seven schools, with total enrollment of 3,293 in the 2020-2021 school year. LISA Academy plans to open a hybrid school system for up to 1,050 students to enroll in kindergarten through 12th grade in fall 2021 and the Rogers campus for up to 950 students to enroll in kindergarten through 12th grade in fall 2022. The school is authorized by the Arkansas State Board of Education, with an enrollment cap of 4,382.

Environmental, social, and governance factors

We view the risks posed by COVID-19 to public health and safety as an elevated social risk for all charter schools under our environmental, social, and governance (ESG) factors. We believe the social risk is mitigated for LISA Academy because of its enrollment, and per-pupil funding has continued to grow despite the pandemic. Despite the elevated social risk, we believe the school's environmental and governance risks are in line with our view of the sector.

Stable Outlook

Downside scenario

We could consider a negative rating action should LISA Academy fail to meet its enrollment targets, MADS coverage weakens, or liquidity declines significantly from current levels. Though not currently planned, we would view any significant additional debt negatively. Any further potential unforeseen pressures from the pandemic that might cause material weakening of the school's demand, finances, or its trajectory may also result in a negative rating action.

Upside scenario

Although unlikely given management's plans to continue expanding over the medium term, we could consider a positive rating action if LISA Academy successfully executes its expansion plans with significantly improved lease-adjusted MADS coverage, along with continued growth in liquidity and a moderating debt burden.

Credit Opinion

Enterprise Profile

Economic fundamentals

LISA Academy operates from five separate campus locations in Little Rock, North Little Rock, Sherwood, and Springdale cities in Arkansas, with a majority of its students drawn from Pulaski County. The county's minor population size is significant, at about 120,000, but is projected to decline by approximately 3.5% over the next five years.

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, levels, and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the charter school sector represents a moderately high credit risk when compared with other industries and sectors.

Market position

We view LISA Academy's enrollment and demand profile as sound, supported by consistent enrollment growth in recent years, healthy waitlist solid student retention, and good academics compared with local public schools. Enrollment has grown by over 50%, from 2,218 students in fall 2017 to 3,293 for the 2020-2021 school year. Growth in recent years reflects the addition of grades at several school locations and the openings of the Springdale Campus in fall 2019 and Markham campus in fall 2020. LISA Academy's current strategy is to increase enrollment to just over 3,900 by fall 2024 by continuing to increase enrollment at its current campuses, in addition to the opening of a hybrid school in fall 2021, with capacity of up to 1,050 students and two additional campuses, Rogers-Bentonville Elementary and Rogers-Bentonville Middle School, in fall 2022. In our view, these growth expectations are reasonable, given LISA Academy's ability to historically meet or surpass enrollment targets, and its record of solid student retention.

LISA Academy operates from five separate campus locations in the Arkansas cities of Little Rock, North Little Rock, Sherwood, and Springdale. LISA Academy West schools (elementary, middle, and high school) are all located in Little Rock. LISA Academy North schools (elementary, middle, and high school) are located in North Little Rock and Sherwood, northeast of Little Rock and across the Arkansas River. The newest campus, LISA Springdale, is about 200 miles northwest of Little Rock. Currently, the LISA Academy North buildings are owned, while the remaining four locations are leased. The LISA Academy West High School and LISA Academy Springdale locations are currently leased from KLS Leasing, LLC; the EFF loan will finance the purchase of these two buildings. Once this financing is complete. LISA Academy will only have the remaining two campuses leased; however, it is planning on adding two new leases in fall 2022 with the opening of the Rogers-Bentonville locations. These leases have been included in our pro forma calculations. LISA Academy's current and planned facilities can fully support the network's expected enrollment growth.

Based on historical testing outcomes, overall academic performance tends to vary from campus to campus. LISA Academy North was the network's highest-performing campus, outperforming its host district and state in all but two grades in both English language arts (ELA) and math. LISA Academy West has overall outperformed the district and is improving to meet state proficiency rates. However, when compared with the subgroup of economically disadvantaged students, LISA Academy performs well relative to its neighboring schools, supporting the school's healthy demand. LISA Academy Springdale does not have annual testing data available, as the school launched in 2019-2020 and no state testing was performed in 2020. Overall performance has generally indicated improvement over time as students stay with LISA Academy and advance through the grades. Since its founding, LISA Academy has had an emphasis on STEM college preparatory curriculum, intervention programs, student and teacher diversity, and STEM competitive teams.

The Charter Authorizing Panel of the Arkansas Department of Education provides academic and financial oversight as the school's charter authorizer. The department granted the school's initial charter in 2004. The charter was renewed in 2007 for five years and again in 2012 for five years. LISA Academy's charter was renewed in 2016 for a period of 13 years beginning in July 2017; at the time, this was the longest charter renewal ever granted by the Arkansas State Board of Education. Based on our discussion with the authorizer, the authorizer reports an excellent working relationship with LISA Academy and did not note any concerns with governance, academics, compliance, or finances. The statutory framework assessment reflects our opinion that, while there may be some areas of risk, the framework is not likely to impair LISA Academy's future ability to pay debt service, unless state funding is materially impaired and weakens financial metrics.

Management and governance

In our view, LISA Academy's senior leadership team is experienced, sophisticated, and knowledgeable, providing a solid foundation of oversight for the organization. We believe the school is led by a highly capable and dedicated

CEO/superintendent, with support provided by an active leadership team, including experienced individuals in key roles. In April 2020, management hired a new chief financial officer (CFO). The expertise and tenure of management has added to the success of the schools' operations and demand over time.

Additional oversight is provided by an active five-member independent board of trustees, and consists of individuals with diverse backgrounds in education, finance, medicine, and law. The board also represents individuals with solid presences in the local community, which we believe provides stability for the network's demand and operations. We understand that the organization expects to engage in continued strategic planning efforts to continue expanding, which may include discussion around adding members to the board as the network continues to grow. In our view, management has been prudent in terms of prior growth and facilities planning, and we expect any future expansion would be handled similarly.

Financial Profile

Financial performance

LISA Academy has had a history of modest operating surpluses in recent years. In fiscal 2020, the school reported a surplus of $1.12 million, or 3.9%. This translates to a relatively weak pro forma lease-adjusted MADS coverage of approximately 0.9x. Despite coverage being low for rating category medians, we recognize this is a very conservative calculation, as pro forma MADS includes future lease expenses for the two campuses opening in fall 2022 without the benefit of the corresponding enrollment. We expect that as the academy continues to execute its expansion plans, and gets students in seats, continued healthy operations will bolster current ratios and coverage will improve over time.

Fiscal 2021 performance is expected to be positive, with a surplus that is modest but better than previously anticipated. Management originally budgeted for a slight deficit, based on conservative funding expectations going into the fiscal year. However, with careful expense planning, coupled with support from the CARES Act and other grants, they are now expecting a surplus. We expect LISA Academy will maintain positive performance in the near term, with an overall operational profile consistent with the rating level as the organization grows into its current financing plans. Based on the state's initial budget proposal, we do not expect per-pupil funding to be pressured, but should funding be pressured over time, management has a history of budgeting conservatively and outperforming expectations, which speaks to its operational flexibility, should it be needed.

Liquidity and financial flexibility

We consider the academy's balance sheet to be a credit strength. The academy has historically maintained a good liquidity position for the rating level, though days' cash on hand dipped in fiscal 2020, to about 103 days' cash on hand from 126 days in fiscal 2019. This is largely due to an increase in expense base as the school has grown significantly over the last two years. The school added about $1 million to its unrestricted cash reserves in fiscal 2020, growing reserves to $7.562 million. LISA Academy's pro forma cash-to-debt metrics are good for the rating, at 27%, based on fiscal 2020 performance. The organization's current unrestricted reserves provide some cushion to weather uncertainty related to the pandemic and the potential for future funding cuts. Overall, we expect LISA Academy will maintain sufficient liquidity for the rating level.

Debt burden

Our view of the rating accounts for the academy's near-term debt plans. We understand that LISA Academy is in the process of acquiring a $17 million loan with the EFF. Post-issuance, LISA Academy will have $46,294 million in debt outstanding, with pro forma lease-adjusted MADS of about $4.6 million. Our rating reflects the assumption of the EFF loan closing in the near term. However, if these plans do not materialize, we would assess the effect on the credit profile accordingly.

LISA Academy's pro forma lease-adjusted MADS burden is what we consider elevated, at 16.0% of fiscal 2020 total revenues. The academy's pro forma debt per student is approximately $16,376 per student, based on fall 2020 enrollment; this is in line with similarly rated peers. The organization's pro forma debt-to-capitalization ratio is also relatively high, at 76.8%. We believe that the network has limited flexibility at the current rating for additional debt without a commensurate increase in revenue. We expect that management will continue to be prudent in its management of debt and expansion plans.

Benefits for certified employees are provided through the Arkansas Teachers Retirement System (ATRS). ATRS' Pension fund ratio was at 80.96% as of fiscal 2020, which we consider well-funded. The academy's contribution was $1.9 million in fiscal 2020. We do not believe the potential for increased contributions is likely to result in budget stress for LISA Academy during the outlook period, given that its total pension contribution translates to 6.9% of total expenses, which we view as currently manageable.

Financial policies

LISA Academy meets standard annual disclosure requirements. Audits are timely and sufficiently transparent, with no material or significant deficiencies in auditor findings. The network maintains an internal target of days' cash on hand for operating purposes and an informal approach to risk management, with insurance coverage for key areas. No investment policy exists, typical for its charter peers, but the network has no aggressive investments. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the network's overall financial policies are not likely to impair its future ability to pay debt service. Our analysis of financial policies includes a review of the network's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies with those of similar schools.

LISA Academy--Enterprise And Financial Statistics

	--Fiscal year ended --					Medians for 'BB' rated charter schools
	2021	**2020**	**2019**	**2018**	**2017**	**2019**
Enrollment						
Total headcount	3,293	2,827	2,218	2,158	N.A.	909
Total waiting list	3,381	1,563	2,068	N.A.	N.A.	MNR
Waiting list as % of enrollment	102.7	55.3	93.2	N.A.	N.A.	23.8
Financial performance						
Accounting standard	N.A.	FASB	FASB	FASB	FASB	N.A.
Total revenues ($000s)	N.A.	28,751	20,827	19,162	18,214	9,158
Total expenses ($000s)	N.A.	27,631	19,784	17,120	15,305	MNR

LISA Academy--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended --					Medians for 'BB' rated charter schools
	2021	2020	2019	2018	2017	2019
EBIDA ($000s)	N.A.	3,443	3,088	3,059	3,865	MNR
EBIDA margin (%)	N.A.	12.0	14.8	16.0	21.2	15.4
Excess revenues over expenses ($000s)	N.A.	1,120	1,043	2,042	2,909	MNR
Excess income margin (%)	N.A.	3.9	5.0	10.7	16.0	2.5
Operating lease expense ($000)	N.A.	908	927	1,379	776	MNR
Pension/OPEB adjustments ($000)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Lease-adjusted annual debt service ($000)	N.A.	2,570	2,354	1,903	1,314	MNR
Lease-adjusted annual debt service coverage (x)	N.A.	1.69	1.71	2.33	3.53	MNR
Lease-adjusted annual debt service burden (% total revenues)	N.A.	8.9	11.3	9.9	7.2	MNR
Lease-adjusted MADS ($000s)	N.A.	4,861	4,861	4,861	1,208	1,336
Lease-adjusted MADS coverage (x)	N.A.	0.90	0.83	0.91	3.84	1.20
Lease-adjusted MADS burden (% total revenues)	N.A.	16.9	23.3	25.4	6.6	12.8
Pro forma MADS ($000s)	N.A.	4,607	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS coverage (x)	N.A.	0.94	N.A.	N.A.	N.A.	MNR
Pro forma lease-adjusted MADS burden (% total revenues)	N.A.	16.0	N.A.	N.A.	N.A.	MNR
Total revenue per student ($)	N.A.	10,170.1	9,390.0	8,879.5	N.A.	MNR
Balance sheet metrics						
Unrestricted reserves ($000s)	N.A.	7,562.0	6,596.0	3,683.0	5,286.0	MNR
Days' cash on hand	N.A.	103.3	126.0	81.1	130.1	76.90
Total long-term debt ($000s)	N.A.	29,198	27,635	27,628	6,865	MNR
Unrestricted reserves to debt (%)	N.A.	26.5	24.5	13.7	80.7	10.7
Unrestricted net assets as % of expenses	N.A.	52.3	68.0	61.8	70.1	22.2
Debt to capitalization (%)	N.A.	67.6	68.0	72.9	39.8	91
Debt per student ($)	N.A.	10,328	12,459	12,803	N.A.	17,370
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 ($000s)	N.A.	46,294	27,635	27,628	6,865	MNR
Pro forma unrestricted reserves to debt (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma debt to capitalization (%)	N.A.	76.8	68.0	72.9	39.8	MNR
Pro forma debt per student ($)	N.A.	16,376	12,459	12,803	N.A.	MNR

N.A.--Not available. N/A--Not applicable. MNR--Median not reported. MADS--Maximum annual debt service. Operating lease expense--Annual amount paid in facilities/capital lease payments; excludes equipment/nonfacility lease payments and excludes payments related to principal and interest on bonds. Net revenue available for debt service = EBIDA + operating lease expense. Lease-adjusted MADS coverage = (net revenue available for debt service + operating lease expense) / (lease-adjusted MADS). Total expenses include pension and OPEB adjustments. Pension and OPEB adjustments = reconciling adjustments made to financial information to account for differences in GASB 68 and GASB 75.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020