# ARC Ratings affirms "BBB+" Réside Études ratings and changes the outlook to negative

| ISSUER | ISSUER RATING |
|---|---|
| Réside Études Investissement S.A. | BBB+ Medium and Long Term (Negative outlook) |
| **RATING DATE** | **ISSUES RATING** |
| 17 August 2016 | BBB+ Medium and Long Term (Negative outlook) |

ARC Ratings, S.A. (ARC Ratings) affirms the "BBB+" rating assigned to the medium and long-term financial commitments of Réside Études Investissement S.A. (Réside Études) and to a bond loan with an outstanding amount presently of EUR 18.5 million, after a partial repayment in advance on 18 February 2016. This rating action is based on the resilience and adjustment capacity demonstrated by the company in 2015 in an unfavourable context for the aparthotel activity and opening a considerable number of residences with impact on lower generation of funds. The new bond loan carried out on February 2016 improved the Group's debt profile and allowed to capture funds for a greater expansion of activity. However, the pursuit of a strategy of more substantial boost of the property portfolio will lead to greater leverage in the coming years and, given that investments need time to be profitable, a more gradual improvement in medium and long term debt coverage by the cash flow position, aspects that lead to ARC Ratings to revise the outlook to negative from stable.

## ISSUER PROFILE

Réside Études Investissement S.A. is the holding of a Group created in 1989 and headquartered in Paris, France. This Group initially mainly focused on assisted residence for students, it has since diversified and currently ranks amongst leaders in the three main assisted residence markets in France. Its long term main activities are the real estate management operation, the real estate development and the creation of a property portfolio. At the end of April 2016 the Group managed, in 187 residences, 22,854 accommodations units (around EUR 2.2 billion), of which: 60.6% for students; 31.6% in hotel or tourism residences (aparthotels from 2 to 5 starts, in the majority of large French cities); and 7.7% for non-disabled elderly people (seniors) near the centre of cities. It should be highlighted that its economic model allowed transforming a capital intensive activity into a model less capital intensive, reason being the large majority of accommodation units managed by the Group are held by private investors (more than 20,000) and less than six per cent of the total (EUR 125.3 million, as investment property) is owned by him.

## RATING RATIONALE

Réside Études' key rating drivers are the following:

- Experienced Management Board – The company is controlled by an experienced management board. The shareholders' agreement ensuring the stability of the shareholder structure.
- The Strategy of the Company – The positive results from the investment property activity, the development activity and the student residence segment (more stable) can offset losses arising from the launching of new residences

(12.6% of accommodation units managed entered into operation in 2014 and in 2015) and overcome losses from 2015 events with negative impact in the aparthotel business. In 2015 the consolidated EBITDA reached EUR 18.9 million and the net profit, after minority interests, amounted to EUR 5.2 million.

- Business expansion forecasts - The Group's forecasts point to an increase of accommodation units under management to 29,375 in 2020 (+36% compared to 2015, of which more than half for seniors), through organic growth mainly in France, and a significant increase in the property portfolio. Note that the Group has the capacity to pilot its activity and, if necessary, to adjust their investment strategy, as occurred in the past.
- High demand for accommodation - There is a shortage of residential housing construction in France at the same time the country has no population growth problems and continues to receive international students and to be a hub of international business. Tax on revenues from assisted residences has long benefited from tax advantages, which have boosted this market.
- Conservative Dividend Distribution - Approximately EUR 1.2 million a year being distributed. The Group foresees the maintenance of this strategy.
- Debt Structure – Note that most of the Group's debt is contracted in the medium and long term (at fixed interest rates) to finance the property portfolio. Short term debt rose punctually to 17.6% (of total) at the end of 2015 and corresponds mainly to banks overdrafts particularly to finance real estate development transactions. The Group benefits from a large pool of banks to finance its operations. The net debt increased by EUR 31.1 million in 2015, to EUR 166.5 million, in the context of investment (by EUR 26 million), and positive net working capital requirements (NWCR) variation by EUR 11.4 million. This framework led to a decline in 2015 debt coverage ratios, having the net financial debt / EBITDA ratio increased to 8.8 times from 5.9 times, while the coverage ratio of borrowing costs by EBITDA stood at 2.7 times (2.9 times in 2014). In February 2016 the Group was successful in improving its debt profile through a new bond loan (of EUR 50 million; annual interest rate of 4.5%; 7 years), which also allowed attracting new resources (of EUR 24.5 million) to ensure its expansion. Furthermore, ultimately, the Group could dispose of part of its property portfolio, if needed in order to fulfil their financial commitments.

The key constraints on Réside Études' credit ratings are:

- Economic growth in France – In the recent past the French economy recorded low growth rates and unemployment rates to the order of 10%, albeit with a positive trend. On May 2016 the International Monetary Fund considered France's economy to be recovering, but major efforts are still needed to foster job creation and put public finances on a more sustainable footing. This organism's forecasts point to growth rates close to 1.5% in 2016 and to an average of 1.75% over the coming five years. These evolutions and the taxation (taxes on income and consumption) have an impact on the household disposable income (which strengthened growth to 1.4% in 2015, +0.3 pp year-on-year). A decline in the household disposable income would affect occupancy rates in residences and the gap between rents received from tenants and rents paid to investors. It must be noted that the Group continues to give high importance to maintaining over time the quality of the residences and offers a greater number of services in the face of competition, that help maintain better rates.
- Changes in taxation - Namely rise in VAT Rates, as observed in 2014, applicable to furnished rented units.
- Changes in investment decision-making factors - These changes will have an impact in demand for the acquisition of new accommodation units and lease renewals. Taxation is one of the most important factors affecting investment, but the Group's products as eligible investments for professional or non professional furnished rental taxation, statute that has been long-lasting. Note that the Group has a thorough insight of the relevant legal and tax frameworks. It should be emphasized that the Group maintains large renovation rates for leases (next to 96% in the

oldest leases contrasting with more than 9 years) benefits from never having missed a payment to investors. In addition, the contracts entered into with investors give the Group the right to renew the leases, which cannot be refused except if investors support the cost of an indemnity (which can cover 2 to 3 years of rents).

- Changes in the law - Possible changes would result in an increase in maintenance, refurbishment and operation costs of assisted residences. The establishment of a rent control system in large cities, although that does not apply to the residences under management by the Group could have an impact on rents in practice.
- Rising competition - The entrance of new market players and competition from existing players may be affecting return levels. It should be highlighted that the Group is able to attract partners for the real estate development (co-promotion), allowing him to share the risk of this phase and grow faster in the activity of real estate management, a long-term activity and a stable source of revenues. The marketing of accommodation units developed by third parties, which will be managed by the Group, also increase the main activity. Note that the Group's residences are well localized, have generally a higher quality service to competition, and the Group is prudent in the choice of land for new locations and in the marketing phase in order to optimise profitability in the future.

## RECENT DEVELOPMENTS AND OUTLOOK

The Group has seen a 5.5% growth in this portfolio under management in 2015. Revenues from real estate management operation increased by 7.7% in 2015 (to EUR 256.8 million) and by 5.7% in the first four months of 2016.

In the development activity, the Group delivered 6 programs in 2015 (with profits of EUR 8.2 million). At the end of April 2016 there was 28 development plans undergoing marketing and construction, mostly for seniors. The Group regularly monitored the development plans and controls their expected margins. At that date the Group are also marketing three development plans for third parties. Finally, two real estate programs, bought in Vente en État Futur d'Achèvement, for the Group's property investment are under construction.

The updated Group’s business plan for the period 2016-2020 points to a greater expansion in the three main activities, fueled by the new bond loan. The number of accommodation units in operation and management will increase towards a more diversified mix, where the units for students still the majority (benefiting from the Group's history in this business segment) and the units for seniors will account 20%. The Group forecasts into operation of 50 residences developed by him. The investment activities will reach EUR 224.7 million, including the reinforcement of the property portfolio by around EUR 170.0 million (of which EUR 113.9 million in investment property).

The Group’s expansion strategy points to reaching annually a positive and growing cash flow position (by EUR 115.7 million in the total). However, the significant investment activities, in addition to the expansion of development activity, will lead to the net financial debt increase, to EUR 291.0 million at the end of 2020. Despite retaining around 87% of future net results, some temporary decline in the equity / assets ratio (deducted of short term net financial debt, cyclical resources and deferred tax liabilities) is expect in 2016 and in 2017. For the following years the Group forecasts a recovery of its capital structure (to 33.4% at the end of 2020, slightly higher than in 2015). The balance of medium and long term debt at the end of the year compared with the annual cash flow position suggests an improvement over the period, down from 20.0 times in 2015 to 8.1 times in 2020. It should be noted that the Group has the ability to adjust the amount of investment, in the function of overall business performance, and consequently the amount of debt.

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