ARC Ratings affirms "BBB+" ratings of Réside Études

ISSUER	ISSUER RATING
Réside Études Investissement S.A	BBB+ Medium and Long Term (BBB+, with stable outlook)
RATING DATE	**ISSUES RATING**
5 October 2015	BBB+ Medium and Long Term (BBB+, with stable outlook)

ARC Ratings, S.A. (ARC Ratings) affirms the “BBB+” rating, with stable outlook, assigned to the medium and long-term financial commitments of Réside Études Investissement S.A. (Réside Études) and to a bond loan in the maximum nominal amount of EUR 50 million. These rating actions are based on the company’s stronger cash flow generation even in the context of newly started operations of a higher number of residences benefiting from a large base of residences in cruise speed and from the results of development and investment property activities, an improvement in debt structure including the new investments financing debt of a long maturity (which lead to a temporary decline in debt coverage ratios), and forecasts of business expansion in promising markets, in France, which will improve the Group's capital structure.

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 the assisted residence for students (hence its name), it has since diversified and currently ranks among leaders in the three main assisted residence markets in France: for students; hotel or tourism residences (mainly city residences directed to a business clientele); and for non-disabled elderly people (since 2007, that has experienced a major boom).

The Group’s main activities are the real estate management operation, the real estate development and the creation of a property portfolio (investment property). At the end of June 2015 the Group managed 21,867 accommodations units (with a value of around EUR 2.1 billion), of which: 60% for students; 33% in hotel or tourism residences (aparthotels from 2 to 5 starts, in the majority of large French cities); and 6.1% for non-disabled elderly people (seniors) near the centre of cities. Its economic model allowed transforming a capital intensive activity into a model less capital intensive, it only owned six per cent of this total (in the value of EUR 122.0 million, as investment property), while the large majority of accommodation units is held by investors (nearly 20,000 private investors) and managed by the Group. The consolidated turnover amounted to EUR 316 million in 2014 (+1.0%) of which around 75% came from the real estate management operation.

Réside Études Investissement continues to be entirely controlled by its Management: Mr. Philippe Nicolet, as President and founder, holding 75.4% of the share capital; Mr. Christian Verlaine and Mr. Robert Vergès, each hold 8.7%. The remaining shareholding is distributed amongst remaining senior staff and treasury shares.

RATING RATIONALE

Réside Études' key rating drivers are the following:

- Experienced Management Board – Réside Études Investissement is controlled by an experienced management board that has been in this business for over twenty years. Additionally, the shareholders' agreement allows the transfers among shareholders, hence ensuring the stability of the shareholder structure.
- The Strategy of the Company – The strategy of the Group is based on organic growth. The positive results, such as the student residence segment, and the results of development and investment property activities can offset losses arising from the launching of new residences, as happened in 2014. In addition, the Group has shown resilience and capacity to absorb losses from activities that are shut down. In 2014, in a context of entry into operation of 11 news residences the consolidated EBITDA amounted to EUR 22.8 million and the net profit to EUR 5.0 million.
- Business expansion forecasts - the Group's forecasts point to an increase of accommodation units under management to 25,050 in 2019 (+14.6% compared to June 2015, namely for seniors), through organic growth in France, and the reinforcement of investment property; note that the Group has the capacity to pilot its activity and, if necessary, to adjust the real state development of new plans and investments planned for own property.
- High demand for accommodation - there is a shortage of residential housing construction in France at the same time the country has no population growth problem and continues to receive international students (a double digit growth in number of international students last year) and to be a hub of international business. Tax on revenues from assisted residences has long benefited from tax advantages, which boosted this market.
- Conservative Dividend Distribution - the strategy of the Group and dividend distribution remains conservative, with approximately EUR 1.2 million a year. This allows the Group to strengthen its equity/assets ratio. In 2014 this ratio increase to 22.3% (1.2 points percentage points (pp) year-on-year). The group foresees the maintenance of this strategy, which will help to improve this ratio significantly.
- Debt Structure – note that most of the Group's debt is contracted in the medium and long term to finance investment property; this debt is preferably contracted at a fixed interest rate, and, if not, the Group seeks customised solutions to cap or hedge the interest rates; short term debt fall to 10.9% (of total) at the end of 2014 (-1.7 pp year-on-year) and corresponds mainly to banks overdrafts to finance the real estate development (which will be repaid when the development plans will be delivered); The Group benefice from a large pool of banks to finance its operations, which should be extended; the net debt increase EUR 17.1 million in 2014, to EUR 135.3 million, in a context of investment of EUR 15.0 million in fixed assets, and the net working capital requirements variation was of EUR 12.5 million (due primarily the acquisition of two lands for future residences); in those circumstances there was a temporary decline in debt coverage ratios: the net financial debt / EBITDA ratio increase to 5.9 times in 2014, from 5.1 times, and the coverage ratio of borrowing costs by EBITDA decrease to 2.9 times, from 4.1 times. Furthermore, ultimately, the Group could dispose of part of its own property and operating assets 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 in an amount of 10%; these evolutions and the taxation (taxes on income and consumption) have an impact on the household disposable income (which grew by 1.1% in 2014); a decline in the household disposable income will affect occupancy rates in residences and the gap between rents received from tenants and rents paid to investors; however the perspectives point to a recovery of the economy (+1.2% in this year and +1.5% in 2016) supported by an accommodative external environment, with a slowdown in fiscal consolidation (the general government balance will decline to -3.4% in 2016, that compare favourably with -4,0% in 2014), although unemployment is projected to decline only slowly; thus, the prospects point to the government will not reform the lodging aids system (note that a large number of students who are clients of Groupe Réside Études are eligible to these aids; note that the Group gives high importance to maintaining, over time, the quality of the residences under management and offers a greater number of services in the face of competition.

- Changes in taxation - namely rises in VAT Rates, as observed in 2014 in the intermediate rate from 7% to 10% applicable to furnished rented units; The Group was unable to pass up fully the three points from VAT on rents, as a result, the main activity of the Group was affected, mainly the student residences sector.
- Changes in investment decision-making factors - these changes will have an impact in demand for the acquisition of new assisted residence 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 is being long-lasting; note that the Group has a thorough insight of the relevant legal and tax frameworks; the Group presents large renovation rates of lease (around 96% in the oldest contrasts with more than 9 years) given that according to the contracts entered into with investors, the Group has the right to renew the leases, which cannot be refused except if investors support the cost of an indemnity (such as the market value of goodwill, which can cover 2 to 3 years of rents); we highlight that the Group benefits from never having missed a payment to investors.
- Changes in the law - possible changes would result in an increase in maintenance, refurbishment and operation costs of assisted residences; according to the Group, recently not observed such changes and are not expected in the future; in addition, 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 wanting to gain market share may be affecting return levels; note that the Group continue to be the second player in the assisted residence for students and in the urban hotel or tourism residences, and want to grow significantly on the assisted residence for non-disabled elderly people; 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 to generate revenues. Note that the Group's residences are well localized, has generally a higher quality service to competition, and it is prudent in the choice of land for new locations in order to optimise profitability in the future.

RECENT DEVELOPMENTS AND OUTLOOK

The Group's real estate management operation continued to grow through into on operation of new residences, mostly as a result of the real estate development activity. At the end of June 2015, globally, the Group held the management of 183 residences with services (without considering the impact of the existence of mixed residences for students and aparthotels), of which 93 for students, 72 aparthotels and 14 for seniors. In the second semester of 2015, Group Réside Études started the operation of three new residences, as forecast.

Revenues from real estate management operation reached EUR 238.5 million in 2014 (+9.2% year-on-year). Note that revenues from residences for students segment were quite stable in 2014, in amount of about EUR 94 million. In the first semester of 2015 revenues from real estate management operation amounted to EUR 117.0 million (+6.8% year-on-year). Note that an earnings before taxes associated to these revenues, except from residences for seniors, was higher than estimated, although still negative (in EUR 0.3 million, due the losses of Relais Spa which more than absorbed the gains from remaining activities). In addition, the management operation of residences for seniors also suffered losses of EUR 2.3 million, due to operational problems, which the Group will be able to solve.

The activity of the real estate development continues to growth in 2014 and in the first half of 2015. However, Group's sales in real estate development declined by 24% in 2014, to EUR 68.2 million, due the application of the equity method of consolidation co-promotion programs and greater proportion of co-promotion programs. The Group delivered 4 programmes in 2014 (and the second part of other residence) and one in the first semester of 2015, which generate profits respectively of EUR 7.5 million and of EUR 0.5 million. At the end of June 2015 the Group had 22 development plans undergoing marketing and construction (including 7 in co-promotion), of which 14 for seniors and 5 for students.

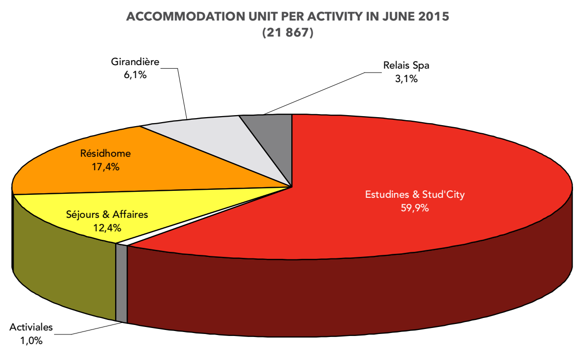
During the 2014 exercise the Group's property investment was widened mainly with the opened of 51 social accommodation units for students in residence «Estudines François Arago» (EUR 5.7 million) and the beginning of the major renovation of a building in Marseille (Republic Street), for conversion into a residence for non-disabled elderly people (EUR 4.2 million). The turnover from real estate property was increase (+14.4%) to EUR 10.4 million in 2014.

On 10 September 2015 ARC Ratings met with senior management of Réside Études to carry out an onsite review as part of the analytical process. In this meeting was analysed the evolution of the business, the ongoing measures to overcome some already identified management problems and their expansion strategy. In the next six months ARC will visit, on a sample base, the main residences under mangement by Group to confirm their conditions.

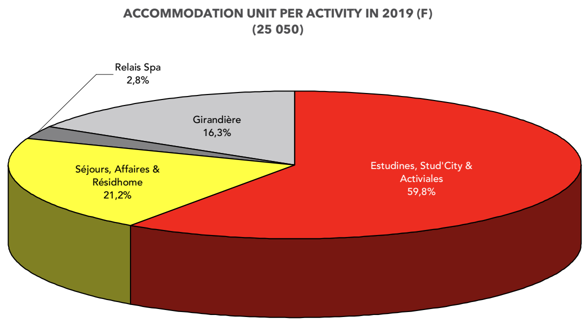
The Group managed to generate an EBITDA of EUR 22.8 million in 2014, of which 47% from the real estate management operation business. Financial results moved to EUR -7.4 million in 2014 (EUR -5.6 million in 2013), due to an increase in financial expenses. This evolution reflects namely the impact of an entire year of financial expenses from the bond loan issued in October 2013 and the interest from new loans to finance the reinforcement of the portfolio property. Although, the Group has suffered from unfavorable economic and fiscal environment, it has however managed to achieve a net profit of EUR 5.0 million in 2014 (EUR 7.8 million in 2013).

Compared to the business plan analysed in the previous Review Rating Report the Group presented a higher cash flow position of EUR 13.8 million (+57%) and a higher earnings before taxes, excluding discontinuing activities, (+14%). In a background of higher variation of net working capital requirements (NWCR), of a property investment activity of EUR 15.0 million and payments of dividends the Group’s net financial debt increased by EUR 17.1 million, to EUR 135.3 million at the end of 2014 (EUR 1.6 million above the estimated). The Group’s financial debts in the medium long term are quite stable, at EUR 151.6 million, and the equity / assets ratio improved (by 1.2 pp) to 22.3% in 2014.

Réside Études Group updated its business plan for the period 2015-2019, which considers: stock sales of buildings; reaching 25,050 accommodation units in operation and management at the end of 2019; an increase in property investment to EUR 186.0 million at that date; and an investment in exploration assets (EUR 9.6 million).



Source: Groupe Réside Études.



Source: Groupe Réside Études.

Compared to the previous business plan, the Group has higher cash flow position corrected by the NWCR variation (EUR +6.0 million) and higher investments in EUR 28.9 million. The combination of operational and investment activities and dividends will give rises in net financial debt until 2017 (mainly in 2015, by EUR 20.0 million). The Group expects net financial debt stabilization in 2018, at EUR 168.3 million, and a reverse in 2019 with a reduction by EUR 9.5 million (including the payment of the bond loan of EUR 44.0 million). It is somewhat less favorable than that provided in the previous business plan, since, by their nature, property investment needs time to be profitable.

As far as the capital structure is concerned, the base scenario continue leads to a sharp rise in equity, considering that it will retain about 90% of future net results; this should result in a continuous enhancement of the Group's capital base and in achieving an equity / assets ratio (deducted of short term net financial debt, cyclical resources and deferred tax liabilities) of approximately 46.2% at the end of 2019 (13.7 pp more as against end-2014). Moreover, the balance of medium and long term debt at the end of the year compared with the annual cash flow position suggests a quicker repayment of such debt, although at a lower pace than in previous business plan, down from 15.0 times in 2015 to 6.9 times in 2019 (against 11.8 times in 2014).

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ARC Ratings, S.A.

Rua Luciano Cordeiro, 123 – R/C Esq.
1050-139 Lisbon
PORTUGAL
Tel: +351 213 041 110
Fax: +351 213 041 111
E-mail: arcratings@arcratings.com
Site: www.arcratings.com

Key Contacts:

Isabel Fernandes	Emma-Jane Fulcher
Lead Analyst	CRO & Panel Chairperson
+351 213 041 110	+44 (0) 203 282 7594
isabel.fernandes@arcratings.com	emma.fulcher@arcratings.com