ARC Ratings downgrades to "BBB" the Réside Études ratings and change the outlook to stable

ISSUER	ISSUER RATING
Réside Études Investissement S.A.	BBB Medium and Long Term (BBB, with stable outlook)
RATING DATE	**ISSUE RATING**
17 August 2017	BBB Medium and Long Term (BBB, with stable outlook)

ARC Ratings, S.A. (ARC Ratings) downgrades to "BBB", with stable outlook, from "BBB+", with negative outlook, the 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 increased leverage of the Group, in the scope of a more pronounced growth of activity and strengthening of the property portfolio to achieve a higher level of fund generation. It should be highlighted the resilience demonstrated by the Group in the context of some segments of residences taking more time to reach their equilibrium than what was expected and the capacity to take decisions to improve the situation. The Group forecasts successive improvements in its capacity to generate funds (as well as in the debt coverage ratios, which experienced a fall in 2016) and in its financial structure in the long term, which supports the stable outlook.

ISSUER PROFILE

Réside Études Investissement S.A. is the holding of a Group created in 1989 and headquartered in Paris, France. This Group initially focused mainly on assisted residences for students, but it has since diversified and currently ranks amongst the 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 May 2017, the Group managed 24,273 accommodations units (worth approximately EUR 2.3 billion), of which: 57.8% for students; 31.8% in hotel or tourism residences (aparthotels from 2 to 5 stars, in most of the largest French cities); and 10.1% 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, reason being the large majority of accommodation units managed by the Group are held by investors (more than 20,000 private and institutional investors) and less than six per cent of the total (worth EUR 129.2 million at the end of 2016, as investment property) is owned by the Group itself.

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 twenty-eight 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 mainly based on organic growth. The positive results, such as the results of investment property activity, the development activity and the student residence segment (a segment in which it has been present for a longer period and which is more stable) can offset losses arising from the launching of new residences (as happened in recent years) and overcome losses in the 5-star aparthotels. However, the segment of residences for seniors (the latest which the Group has entered and fastest growing), as well as the 5-star aparthotels, are taking more time to reach their equilibrium. This aspect and the impact of some retraction in tourist demand in France, due to terrorism events, led to an EBITDA decrease, by 28.9%, to EUR 14.8 million in 2016. Nonetheless, the net profit, after minority interests, amounted to EUR 4.6 million in 2016 (-11.8% compared with 2015). It should be highlighted the capacity of the Group to perform a contract with one of the world leaders in the tourism sector, to reach the equilibrium of its largest 5-star aparthotel sooner, and to change the management of the segment of residences for seniors after assessing its recent performance.
- Business expansion forecasts - The Group's forecasts point to an increase of accommodation units under management to 35,429 at the end of 2021, through organic growth mainly in France. This increase will be equivalent to 11,867 accommodation units, of which approximately half are for seniors. In addition, the Group intends to strengthen its property portfolio, which functions as a reserve of value. Note that the Group has the capacity to pilot its activity and, if necessary, to adjust their investment strategy, as has occurred in the past.
- High demand for accommodation - There is a shortage of residential housing construction in France, while at the same time, the country has no population growth problems (although having an increased number of seniors aged more than 65) 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 - The dividend distribution policy remains conservative, with approximately EUR 1.2 million a year being distributed. The Group foresees the maintenance of this strategy.
- Debt Structure – Most of the Group's debt is contracted in the medium and long term (most at fixed interest rates) to finance the property portfolio. The debt contracted in the short term, corresponds mainly to bank overdrafts particularly to finance real estate development programs. Thus, the amount of this short-term debt is a function of the number of development plans and their construction and commercialisation phase. In February 2016, the Group was successful in improving its debt profile through a new bond loan, which also allowed attracting new resources to ensure its expansion. At the end of 2016, as a whole, the debt maturing in the short term stood at EUR 41.0 million (equivalent to 18.2% of total, close to 17.6% at the end of 2015). The Group benefits from a large pool of banks to finance its operations and is working to increase the diversification of sources of funds. In 2016, in the context of investment (EUR 23.2 million) and positive net working capital requirements (NWCR) variation (EUR 14.1 million), the net debt increased, by 20.3%, to EUR 200.2 million. In the current phase of investment and of some management challenges, the net financial debt / EBITDA ratio rose to 13.6 times, while the coverage ratio of net interest costs by EBITDA decreased to 1.8 times (compared respectively with 8.0 times and 3.2 times in 2015). It should be noted that the Group forecasts improvements in these ratios, and, ultimately, could dispose of part of its property portfolio if needed to fulfil its 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. In July 2017, the International Monetary Fund forecasts point to some recovery of growth rates to 1.5% in 2017 and to 1.7% in 2018 (closer to 1% in the previous two years). However, this organism considered that the government's ambitious reform program could go a long way in addressing France's longstanding economic challenges - persistent fiscal imbalances, high unemployment, and weak external competitiveness. These evolutions and the taxation (taxes on income and consumption) have an impact on household disposable income (which recovered 1.1% in 2015 and 1.7% in 2016). A potential decline in 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. The Group was unable to fully pass this VAT increase on rents, and as a result, the main activity of the Group was affected, mainly in the student residences sector.
- 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 are eligible investments for professional or non-professional furnished rental taxation, a 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 (close to 96% in the oldest leases contrasting with more than 9 years) and 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 (such as the market value of goodwill, which can cover 2 to 3 years of rents).
- Changes in the law - Possible changes that would result in an increase in maintenance, refurbishment and operation costs of assisted residences would be negative. 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. The Group is in the process of becoming the leader in the assisted residence for students and continue to be the second player in the urban hotel or tourism residences. In a moment of significant growth in the seniors' market, the Group intends to keep pace with this growth and hold an important position in this segment of the market. It should be highlighted that the Group is able to attract partners for the real estate development (co-promotion), allowing them 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 increased the main activity. Note that the Group's residences are well localized, have generally a higher quality service than 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.

DEVELOPMENTS AND OUTLOOK

In 2016 the favourable conditions on the bond markets in France and the confidence placed by investors in the Group enabled it to improve its debt profile and to attract new resources (EUR 24.5 million) to ensure a higher level of development of the activity. Being a long-term activity, that need time to be profitable, it is expected that the positive impact on the capacity to generate funds will take a couple of years to be reached.

In a growth environment, the Group has strengthened its management team, namely in the segment of residences for seniors, to better monitor the expansion of activity. The first five months of 2017 Group's data indicate a year-on year 9.1% revenue increase from real estate management operation, in the three business segments, benefiting from the improvement in the occupancy rate (namely in aparthotels) and from the increase in the number of accommodation units (by approximately 6%). Likewise, the marketing activity of the real estate development expanded by about 25%.

At the end of May 2017, the Group had 36 development plans undergoing marketing and construction (approximately 64% for seniors), which allow to anticipate a significant growth in the management operation business in the future. The Group benefits from a large pool of banks to finance its operations. The greater dynamism of the programs promoted by the Group, in spite of the practice of receiving the sale price in instalments from the investors according to the development phase of the building works, lead to the need to contract short-term debt.

The Group's strategy of substantially boost the property portfolio is in progress, which will lead to greater leverage in the coming years. It should be noted the large maturity of this debt.

The updated Group's business plan for the period 2017-2021 points to expansion in the three main activities, and in their profitability, taking advantage of the good prospects for the growth of the residences markets. The Group intends to create a durable relationship with institutional investors as a way to secure a more diversified funding basis. The number of accommodation units in operation and management will significantly increase towards a more diversified mix, where the units for students still account for 52.7% of total (benefiting from the Group's history in this business segment) and the units for seniors will account for 21.2% in 2021. Compared to the previous business plan, in the five-year period, the cash flow position (corrected by the NWCR variation) will be higher by one third, despite considering that in accumulated terms the management of residences for seniors (which is in a fast growth phase) will need to be supported by the other more mature segments of residences under management and by the other profitable Group's activities. In order to enhance the generation of funds from 2020 onwards, the net financial debt will assume higher values, with a maximum forecast of EUR 326.8 million in 2019. Despite the increase of the net financial debt, the Group expects improvements in the debt coverage ratios by the EBITDA, more significant from 2018 onwards.

It should be noted, that in the function of overall business performance, the Group has the ability to adjust the amount of investment, as well as, to slowdown the development of new plans and reduce the NWCR associated, to reduce the net debt. Finally, and ultimately, the Group could dispose of part of its investment property and operation assets. Globally, the book value at these assets exceeded the respective debt in an amount of more than EUR 80 million at the end of 2016, particularly regarding the eight student's social residences (EUR 25.2 million) and the Paris Opéra aparthotel (EUR 16.3 million).

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