

## ARC Ratings affirms Réside Études's "BBB" ratings with stable outlook

<b><u>ISSUER</u></b>	<b><u>ISSUER RATING</u></b>
Réside Études Investissement S.A.	<b>BBB</b> Medium and Long Term (BBB, with stable outlook)
	<b><u>ISSUE RATING</u></b>
	<b>BBB</b> Medium and Long Term (BBB, with stable outlook)
<b><u>RATING DATE</u></b>	<b><u>NEXT REVIEW DATE</u></b>
12 July 2019	13 July 2020

ARC Ratings, S.A. (ARC Ratings) affirms the "BBB", 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 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 strengthening of the Group's ability to generate funds, proving its resilience in the context of losses arising from the launch of new residences, from the 5-star aparthotels and from the segment of residences for seniors. As expected, its greater EBITDA level allowed the improvement of debt coverage ratios, even in the context of significant investment. Benefiting from the positive fundamentals of the French market, the Group continues to implement its strategy of growth and investment, which, given the long-term nature of its activity, will lead to a temporary increase in its leverage. The Group forecasts successive improvements in its capacity to generate funds. It also expects improvement in its debt coverage ratios. These aspects support the rating stable outlook, which ARC Ratings will continue to monitor.

### **ISSUER PROFILE**

Réside Études Investissement S.A. is the holding of a French Group created in 1989 and headquartered in Paris. This Group initially focused mainly on assisted residences for students, but it has since diversified and ranks amongst the leaders in the three main assisted residence markets in France. The Group has demonstrated the ability to launch new residences annually (10 in 2018). It benefits from a national presence, particularly in large urban areas. Its long-term main activities are real estate management operation, real estate development and the creation of a property portfolio.

At the end of 2018, the accommodation units managed by the Group increased to 27,243 (worth nearly EUR 2.6 billion), of which: 57.9% for students; 28.9% in hotel or tourism residences (aparthotels from 2 to 5 stars, in most of the largest French cities); and 13.1% for non-disabled elderly people (seniors) near the centre of cities. This last segment shows the highest growth rate.

Its economic model allowed the transformation of a capital-intensive activity into a model less capital intensive. The large majority of accommodation units managed by the Group are held by investors, more than 20,300 private and institutional investors. The number of accommodation units held by the Group increased by more than 20% in 2018, representing around 6.5% of the total. The market value of these assets increased to EUR 206.4 million at the end of 2018 and is recorded as investment property.

In a favourable context for their activity, the Group's turnover rose by 22.1% in 2018 to EUR 463.9 million. More than 70% of which came from the real estate management operation, the most regular source of revenue.

### **RATING RATIONALE**

Résidé Études' key rating drivers are the following:

- Experienced Management Board - Résidé Études Investissement is controlled by an experienced management board that has been in this business for three decades. The shareholders' agreement allows share transfers among shareholders, hence ensuring the stability of the shareholder structure.
- The Strategy of the Company - The strategy of the Group continues to be mainly based on organic growth, presenting significant growth prospects, particularly in France. The positive results from the investment property activity, the development activity, the student residence segment (a segment in which it has been present for a longer period and which is more stable) and the aparthotels segment in the mid-range (that benefited from the tourism recovery in the country), can offset losses arising from the launching of new residences (as happened in recent years) and overcome losses in the 5-star aparthotels and in the segment of residences for seniors. The latest segment is the fastest growing, but is taking more time to reach their equilibrium. Noteworthy was the significant EBITDA increase, to more than EUR 30 million in 2018 compared with EUR 19.4 million in 2017, as well as, the cash flow position increase, to EUR 16.9 million (from EUR 10.2 million in 2017). These are the highest results achieved by the Group up to now.
- Business expansion forecasts - The Group's forecasts point to an increase of close to 13,300 accommodation units under operation and management to reach circa of 40,000 in 2023, mainly in France. More than 45% of the increase is related to residences for seniors. In addition, the Group intends to strengthen its property portfolio, as in previous years, which functions as a reserve of value. It should also be noted that the Group has the capacity to pilot its activity and, if necessary, to adjust its investment strategy, as has occurred in the past.
- High demand for accommodation - There is a shortage of residential housing construction in France (with a population of 67.8 million), while at the same time, its population continues to grow (with an increased number of seniors aged over 65), it continues to receive international students and to be a hub of international business. Investment in assisted residences benefits from the tax status of the furnished rental which continues to stimulate 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 conservative 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. 21% of total debt, equivalent to EUR 68.2 million, had a short-term maturity at the end of 2018, including the outstanding amount of the first bond loan which will be refinanced by a bond loan being prepared. In the context of significant investment and development activity expansion, the Group's net financial debt increased by 6.8%, to EUR 272.7 million. The EBITDA improvement allowed to decrease the net financial debt / EBITDA to 8.9 times, from 13.2 times in 2017. The coverage ratio of net interest costs by EBITDA also improve to 3.7 times, from 2.6 times. The Group benefits from a large pool of banks to finance its operations and reached a greater diversification of source of funds in 2018. The ongoing financial operations will increase this diversification and boost the cash and deposits. In the future, the Group forecasts a further improvement of the debt service coverage ratios.

The key constraints on Réside Études' credit ratings are:

- Economic growth in France – On 3 June the International Monetary Fund (IMF) staff concluding Statement of the 2019 Article IV Mission. According to this statement, France's growth has slowed but remains resilient. 1.3% of growth is expected this year and a stabilization at around 1.5% in the medium term. The unemployment rate declined to 8.7% at end-March 2019, in part reflecting important labour-market and tax reforms implemented in recent years. But external risks have risen, and France's structural challenges persist: high public and private debt (public debt still close to 100% of GDP, while the fiscal deficit decrease to 2.5% of GDP last year), still high structural unemployment and sluggish productivity growth. Building on the government's agenda, reforms must continue to address these long-term challenges and bolster resilience to shocks. A potential decline in household disposable income (contrary to what occurred in 2015/2016 and in the second half of 2018) would affect occupancy rates in residences and the gap between rents received from tenants and rents paid to investors. It is worth noting that the sovereign ratings assigned to France remains strong: "AA/Stable" by Standard and Poor's, "AA/Stable" by Fitch Ratings and "Aa2/Positive" by Moody's Investors Service.
- Changes in taxation - Namely a rise in VAT Rates, as observed in 2014, applicable to furnished rented units. To the extent that the Group cannot full pass the potential VAT increase on to rents, this change can affect its profitability.
- Changes in investment decision-making factors - These changes can have an impact on demand for the acquisition of new accommodation units and on lease renewals. Taxation is one of the most important factors affecting investment. However, 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 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. The investors can hardly refuse except if support the cost of an indemnity which can cover 2 to 3 years of rents (which represents the market value of goodwill). It must be noted that the Group continues to give high importance to maintaining over time the quality of the residences and offer a larger number of services when compared with its competition. These factors help maintain higher occupancy rates.

- 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 affect return levels. The Group is the leader in the assisted residence for students and continues 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 take a significant position in this segment. It contributes to the improvement of the concept of residences for seniors by offering a quality product. 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 and grow faster in the activity of real estate management of residences, 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 helped to increase the main activity. In addition to the large private base of private investors, the Group wants to develop balanced marketing channels, by creating a durable relationship with the institutional investors. Note that the Group's residences are well localized and generally have a higher quality service than competition. In order to optimise profitability in the future, the Group is prudent in the choice of land for new locations and in the marketing phase.

## **DEVELOPMENTS AND OUTLOOK**

The Group's growth strategy led to the entry in operation of 10 new residences in 2018. In total, the Group holds the management of circa 180 residences with services.

It should be emphasized the Revenue Per Available Room improvement achieved by the Group in the globality of residences under management, particularly in the residences for senior segment. The exception occurred in the aparthotels residences under the brand Residhome in the first quarter of 2019. In this favourable context, revenues from real estate management operation increased to EUR 327.2 million in 2018 and close to EUR 68 million in the first quarter of 2019. The increase has been more significant in the residences for seniors.

The Group's marketing activity of the real estate development benefited from the high level of sales to private investors and institutional investors (block sales). The reservations rose by 26% in 2018, to EUR 293.4 million, while the value of notary deeds signed significantly increased by 70%, to EUR 317.6 million. Significant part of the notary deeds was related to residences for seniors, benefiting from the significant expansion of development in co-promotion. Due to the system of sale before completion ("Vente en État Futur d'Achèvement") the Group will receive the sale price in correlation with developments of the building works.

At the end of March 2019, the Group had 35 development plans undergoing marketing and construction (14 of which in co-promotion). More than three-quarters of the total are residences for seniors.

The Group updated its business plan for the period 2019-2023. Its growth strategy continues mainly in the French market, however already considered some expansion to neighbouring countries. The Group forecasts increase in its three business segments, mainly in residences for seniors, to reach circa 40,000 accommodation units. This will allow the Group to reach a more diversified and balanced mix of accommodation units in operation and management.

The Group intends to reinforce its property portfolio by approximately EUR 300 million, of which more than EUR 170 million of operational assets and EUR 88 million in investment property.

In the 2019-2023 period the total cash flow position is expected to reach EUR 164 million (or EUR 182 million considering also the net working capital requirements variation). In addition to its generation of funds, in order to finance the expansion of activity and to boost the cash and deposits, the Group forecasts the issuance of medium and term loans, in addition to the bank overdrafts related to the development activity. The most significant issuance of medium-and long-term debt is expected in the second half of 2019, being prepared:

- a bond loan, between EUR 30 million and EUR 50 million with a maturity of 6 or 7 years. The proceeds of this loan will be applied in the payment of the outstanding amount of EUR 18.5 million of the bond loan that matures in October 2019, and in the financing of its expansion strategy, namely in international markets;
- a syndicate long term loan in an amount of EUR 100 million, refinancing part of its investment property and operational assets. Circa of half of the proceeds will be applied in the payment of the debt.

Therefore, taking advantage of the large funding possibilities, the Group prepares to position itself at a higher level of debt, with the maximum forecast of EUR 447 million in 2023, and, at the same time, a higher cash level. The Group's net financial debt will gradually increase to more than EUR 400 million in 2023 (assuming the payment of EUR 30 million of the securitization of receivables in 2021, which may be renewed, and the renew of the bond loan that matures in February 2023). However, the Group expected an improvement of the net financial debt / EBITDA ratio to 7.5 times in 2020 (after a punctual 10.6 times forecasted for 2019, however below the 2017 figure), to below 6 times in 2022 and close to 5 times in 2023. Likewise, it is expected an improvement in the coverage of the net interest costs by EBITDA to 4.2 times in 2020 (after a decrease in 2019). In the following years, the Group forecasts a more comfortable coverage of net interest costs by EBITDA to 5 times in 2021 and close to 8 times in 2023.

In potentially less favourable conditions to develop the activities, the Group may slowdown the development of new plans and could also consider to sharply reduce its planned investments in investment property, which would have a positive impact on its cash position.

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