Korian (NR/NR) We recommend to stay away due to the high social risk; U/w reco on the bonds

Company: Korian (Core+)

Sector: Healthcare

Credit View	Transparency	Liquidity	Bond Recovery	ESG score
Stable-to-Negative	3/5	2 years	1st: 25%	E : 88/100 S : 44/100 G : 75/100

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Key Figures	2019	2020	2021
Revenue (€m)	3,613	3,874	4,311
EBITDAR	945	938	1,074
EBITDAR margin	26.1%	24.2%	24.9%
Net debt (€m)	2,517	2,840	3,229
Corporate leverage	3.1x	3.0x	3.1x

Korian, a leading provider of care services for elderly people in Europe

Korian is the largest nursing home operator in Europe, with 65k beds. On top of its core business, it operates specialized clinics and mental health facilities. The group is also developing alternatives to nursing homes, like home care services. The group is mainly present in France (49% of total sales), with also a significant footprint in Germany, Belgium and Italy.

Korian has been listed on the Paris Stock Exchange since 2006, with a current market capitalization of €1.1bn.

Strong financial track-record

The nursing home industry is supported by positive underlying trends. Indeed, demand is growing and there is low volatility, driven by an ageing European population and rising rates of both chronic and cognitive diseases. For Korian, this translated into a strong financial track record over the period 2015-21, marked by stable, good operating margins and satisfactory cash generation (before growth and real estate investments), although the onset of the Covid pandemic led to lower occupancy rates and some exceptional costs. Since 2022, the group has also had to cope with rising input cost inflation, implying some pressure on margins.

Social risk is rising, questions about the sustainability of the current margins

In 2022, a media storm shed light on the operating inefficiencies and wrongdoings of the nursing home industry in France. Compared to its peer Orpea, we estimate that Korian has better managed the crisis, notably because it took several measures to anticipate this development. Nevertheless, we suspect that Korian faces similar structural issues in its nursing homes (to Orpea), in the view of the numerous controversies. Accordingly, Korian and the industry are exposed to harsher sanitary and healthcare standards, which may significantly impact their operating profitability and business model.

Real estate is another concern in the view of rising interest rates

Property valuations started to correct in most European markets in 2022 amid expanding yields. On this basis, we raise concerns about a decline of the value of Korian's real estate portfolio and thus an increase of the loan-to-value ratio (55% at end-June 2022) related to real estate debt. We also bear in mind Orpea's recent difficulty to execute its real estate disposal at the targeted price. Compared to Orpea, potential real estate revaluation is likely to be easier to handle for Korian, since its ownership rate is much lower.

High adjusted net leverage and the notes offer very low protection to bondholders

Adjusted for leases and hybrid instruments (which are accounted for as equity), we calculate a high adjusted net leverage of 7.4x at the end of June 2022. Also negative, the group has a bunch of debt maturities to address in 2023 and 2024. Last but not least, Korian 2.25% bonds due 2028 are unsecured, and its associated bond indenture is very light.

We recommend to U/w Korian bonds as we do not feel comfortable with the high social risk

As a consequence of the turmoil in the nursing home industry, Korian 2.25% bonds due 2028 fell to a very low level around 70pts. The bonds currently provide a yield-to-worst of 9% and a Z-spread in excess of 600bps. We estimate there could be further price downside, in the event of new controversies, the implementation of harsher sanitary standards in nursing homes, or significant depreciation of the group's real estate portfolio.

We recommend to U/w Korian bonds, due to the high social risk

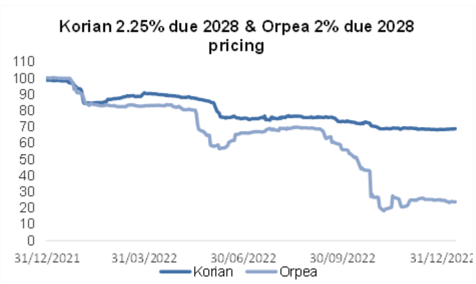
Along with the revelations of the operating inefficiencies in the nursing homes industry, Korian 2.25% social bonds due 2028 collapsed to a very low level in 2022. The bonds are now trading around 70pts, and offer a yield-to-worst of approximately 9% and a Z-spread above 600bps. For the record, the group and its bonds are not rated by the major rating agencies. However, at such a level, we can consider that Korian notes are trading like bonds in the B-rating class.

In the Healthcare HY universe, the closest peer to Korian is Orpea. However, Orpea's HY bonds do not provide a relevant comparison, since they are trading at a distressed level following the company's announcement of the opening of a conciliation procedure with financial creditors to restructure its debt. Excluding Orpea, we do not see other relevant peers in the HY universe.

In spite of the resilient nature of the industry and Korian's strong financial track record, we are initiating coverage with an U/w recommendation on Korian 2.25% notes due 2028 as we do not feel comfortable with the group's high social risks. We estimate there could be further price downside for Korian bonds, in the event of new social controversies, the implementation of harsher sanitary standards in nursing homes, or significant depreciation of the group's real estate portfolio. We also view negatively the fact that the bonds are unsecured and that the associated bond indenture is very light. For a switch in the B healthcare universe, we highlight that we have an O/w recommendation on F.I.S. 5.625% notes due 2027 which offer a ytw 11% and Z+800bps (click here to see our latest comment on F.I.S)

HY comps	Security	o/s (€m)	Next call	Price 12Jan23	YTW	YTM	Z-Sprd	Bond ratings		SR reco
Korian	KORIFP 2 ¼ 10/15/28	300	Non-call	70	9,1	9,1	635	NR	NR	U/w
Peers to Korian										
Orpea	ORPFP 2 ⅝ 03/10/25	400	Non-call	24	Distressed level			NR	NR	N.a
Orpea	ORPFP 0 ⅜ 05/17/27	500	Non-call	33	Distressed level			NR	NR	N.a
Orpea	ORPFP 2 04/01/28	500	Non-call	24	Distressed level			NR	NR	N.a
CHYE Healthcare HY					6,6		425			
CHYE BB rating class					5,9		355			
CHYE B rating class					8,3		595			

Sources: Spread Research, Bloomberg, CHYE



Sources: Spread Research, Bloomberg

Key credit drivers

(+) Growing operating environment on the back of ageing populations and increasing dependency rates among elderly people.

(+) Korian is the leading nursing home operator in France and in Europe.

(+) Korian has been diversifying its revenue mix by acquiring smaller companies to build leading market positions in Germany, Italy and Belgium. A few years ago, it entered into new countries (Spain and the Netherlands) and scaled up its size in new business segments, notably mental health clinics.

(+) The group has been active in the development of alternatives for less dependent elderly people, such as assisted living facilities and home care networks. These new activities are likely to feed sales growth in the coming years as they match the demands of elderly people and local governments.

(+) Operating margins and earnings were preserved in spite of the recent market headwinds, proving the stability of the business model.

(+) Occupancy rates in nursing homes have recovered pretty well, after the Covid-19 pandemic.

(+) The group generated stable positive free cashflow over the last three years, before growth CapEx, real estate investments, and M&A.

(-) High social risk, along with the raising awareness in France regarding mistreatment of elderly residents. The nursing home industry and Korian is exposed to harsher sanitary and care standards.

(-) Korian is involved in major social controversies, in which it is accused of serious deficiencies in its operating processes.

(-) We estimate that the annual passthrough of higher input costs is likely to be only partial, leading to a negative impact on margins.

(-) Recurrent cash outflows to fund business growth and real estate investment, entailing an increase of the group's net debt.

(-) Korian's capital structure is relatively complex, due to the various layers of financial debt.

(-) Understanding Korian's financial results is rather difficult, due to the recurrent M&A activity, the group's high real estate debt and assets, and rather complex debt structure.

(-) Current liquidity profile (as of end-June 2022) will be insufficient to address financial debt falling due in 2024.

(-) In the view of rising interest rates, we rise concerns about a potential decline of Korian's real estate portfolio and thus an increase of Korian's loan-to-value ratio.

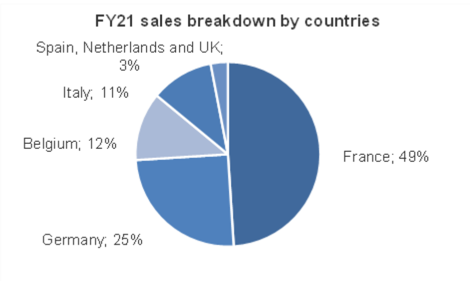
(-) Our adjusted net leverage (adjusted net debt/EBITDAR) was high at 7.4x as of end-June 2022.

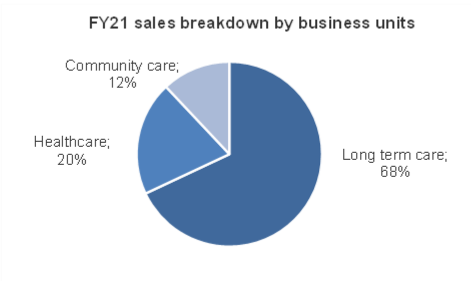
(-) The covenant package is very light.

Company profile

Founded in 2003 and based in Paris, Korian is the largest nursing home operator in Europe and in particular France, with 65k beds in around 700 facilities across 7 European countries (France, Germany, Italy, Belgium, Netherlands, Spain, and the UK). Alongside the core nursing home business, the group operates specialized clinics, dedicated to medical rehabilitation and mental health, with around 10k beds in almost 170 facilities. The group is also developing alternatives to nursing homes, including home care and assisted living facilities.

Korian has been listed on the Paris Stock Exchange since November 2006, with a current market capitalization of €1.1bn. **The group employs around 60k employees and it generated sales of €4.3bn and IFRS 16 EBITDA of €1.0bn (23% margin) in 2021.**





Sources: Spread Research, Korian

Korian has three business units:

(i) **Long-term care**, representing the nursing homes, which is Korian's main business. These homes offer care and residential services for elderly people who are not able to stay at home due to their age or chronic diseases. Korian provides medical equipment and healthcare staff (doctors, nurses, caregivers; c. 50% of Korian personnel) to its residents. In France, the group's nursing homes revenue stems from i) the accommodation fee (70% of the full revenue) paid by residents, which varies widely depending on the quality of the facility and the geographic location, ii) the medical care fees (20%) paid by statutory health insurance system, and iii) dependence expenses including cleaning or laundry services (10%) paid either by the patient or the local department council (Sources: Orpea annual report 2020).

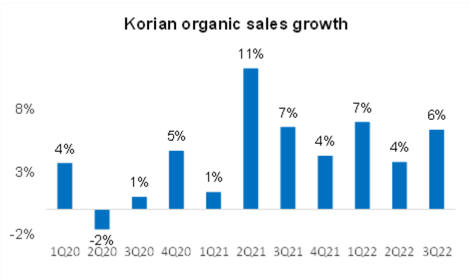
(ii) **Healthcare,** which offers care services to elderly people who need to recover from surgery or a chronic disease before returning to their homes or a long-term nursing home. On top of this, the group has been increasing its presence in the mental health end-market over the last three years through multiple acquisitions.

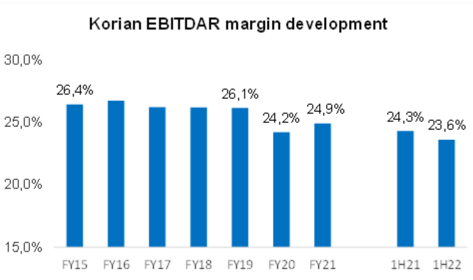
(iii) **Community care,** which is dedicated to people who are younger and more autonomous than residents in nursing homes. This business unit mainly includes home care through the network Petit-Fils (i.e. local agencies providing home care assistance) and assisted living facilities, which provide assistance services (cleaning, catering and laundry) and medical care if necessary. The aim of these alternatives is to respond to the wish of elderly people to stay at home as long as possible and to keep their autonomy, since they are seen as more humane and less traumatizing than a stay in a nursing home. They are also less costly than a stay in nursing home for both the patient and the authorities.

Business drivers

Recovery of occupancy rates, while there is moderate pressure on operating margins

Since the beginning of 2020, the industry has faced multiple operating difficulties, including i) the Covid-19 pandemic, which led to lower occupancy rates and exceptional costs, ii) inflationary pressures, and iii) major controversies regarding the treatment of the patients in nursing homes.





Sources: Spread Research, Korian

Occupancy rates hit low levels in 2020, as a result of higher mortality rates (than usual) and the freeze of nursing home entries. Along with the ramp-up of vaccination campaigns, occupancy rates significantly recovered in 2021 and 2022. **In 3Q22, occupancy rates in nursing homes reached 87% (+3% yoy), still running slightly behind pre-pandemic level of 90% on average**. In spite of low occupancy rates, Korian was able to report decent organic revenues growth of 2% in FY20 and high growth of 5.9% in FY21 and 5.3% in 1H22. Good organic growth was mainly supported by increasing prices (higher input costs passed on to clients), as well as higher volumes through higher outpatient activity in the clinics and the ramp-up of the community care business unit (i.e. home care and assisted living facilities activity).

EBITDAR margin stepped down to 24.2% in FY20 (vs. 26.1% in FY19), stemming from lower occupancy rates and increasing staff costs - up to €2.21bn or 57.1% of total sales in FY20 (vs. €2.01bn or 55.5% in FY19). In FY21, staff costs increased further to €2.53bn (58.8% of total sales), but EBITDAR margin slightly recovered to 24.9% thanks to better occupancy rates and reduced Covid-19-related costs. Regarding the increase in staff costs, management commented that it has been reinforcing its human resource structure and revised upwards its nursing staff ratio.

As for 2022, management upgraded its organic revenues growth guidance to around 6% (vs. above 4% initially) and downgraded its pre-IFRS 16 margin guidance to stable against 2021 (vs. improvement). The main headwind has been related to input cost inflation, including wages, energy and catering. For energy, the estimated cost increase for FY22 (+€20m) is manageable thanks to hedging policies in place. However, for other expenses, such as catering, it implies some negative impact on margins due to the time lag effect, as it takes some time to pass through higher costs to patients. For example, in France, private nursing operators are free to set accommodation fees at admission, but then annual tariff indexation is regulated and determined by the French Ministry of Finance. **Since the average stay in nursing home is 2.5 years, we estimate that the annual passthrough of higher input costs will be only partial, and thus will provoke pressure on margins going forwards**. Based on this assumption, we anticipate that Korian's EBITAR margin will trend downwards in FY23, against FY22.

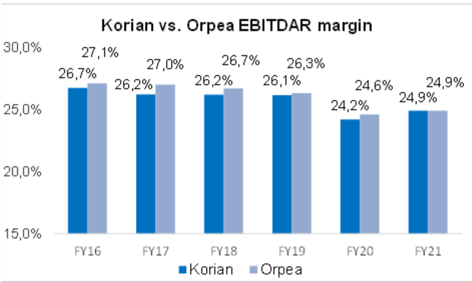
Social risk is raising serious questions about the sustainability of EBITDAR margins around 25%

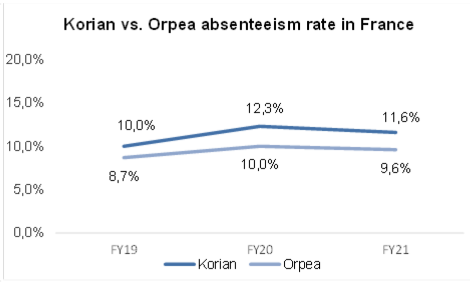
The publication of Victor Castanet's investigation within the book Les Fossoyeurs raised public awareness in France regarding the poor treatment of residents in for-profit nursing homes. In brief, the book accuses Orpea (i.e. the main peer of Korian) of favoring profitability in its nursing homes, through the rationing of food or hygiene products for example, over the well-being of its residents. It also includes allegations of misuse of public funds and wrongdoing in financial management. Although the accusations in the book mainly relate to Orpea, the media storm shed light on potential wrongdoings of other nursing homes operators, including Korian.

The fall-out from the book was exacerbated by the broadcast of a TV investigation in France last March, in which Korian was accused of mistreatment of elderly residents, misappropriation of public funds, insufficient staff ratio, as well as serious operating deficiencies in hiring processes and the distribution of medicines to patients. The group rejected most of the allegations, and notably underlined that the testimonies of wrongdoing mainly refer to 2016 or before, prior to the appointment of Sophie Boissard as CEO in January 2016. **Korian management argues that since then it has undertaken major changes to improve the quality of its operations**. In particular, the group is working on various initiatives, including the certification ISO 9001 of all nursing homes by 2023, reducing the absenteeism and accident rates, and increasing the share of employees on training courses. Furthermore, the group announced last February that it is starting a transformation to become a European, mission-led company in order to place ESG commitments at the heart of its strategy.

Even if we acknowledge Korian's initiatives to better manage social risks, **we believe that improving conditions for both patients and employees is contingent on further increasing staff ratios**, which would ultimately impact nursing home operators' margins. Korian has made some progress on this front, along with the staff ratio increasing to 7 to 10 patients (against 6 to 10 patients). However, we highlight that dependency rates of elderly people in nursing homes have significantly increased over recent years, requiring a higher staff ratio. Accordingly, we suspect that the recent increase in staff ratio will probably be insufficient to address the operating issues in Korian's nursing homes.

At this stage, it is difficult to assess the potential negative impact on margins, if Korian was required to reinforce further its workforce in order to meet stricter healthcare and sanitary standards. At constant perimeter, if the group was required to increase its staff by 10%, we calculate that the group's EBITDAR margin would be down by approximately 5% theoretically. Also, we believe that Orpea may be a good proxy to estimate the potential damage on margins, as both Orpea and Korian reported similar EBITDAR margins over the period 2016-21 (as seen in the graph below). **In its investor presentation for the restructuring plan, Orpea's fresh management was guiding for an EBITDAR margin of 20% in 2025, or 5% below 2021 level** and 6% below 2019 level.





Sources: Spread Research, Orpea and Korian
Notes: Orpea's absenteeism rate is based on the perimeter France + Benelux in FY19 and France + Benelux + UK-Ireland in FY20 & FY21 / Korian's absenteeism rate is based on the perimeter France

Underlying cash generation provides some comfort, but recurrent outflow for M&A and real estate has led to a substantial debt increase

Over the period 2019-21, Korian reported a stable operating free cashflow of around €230m per year (before development CapEx, M&A and real estate investments), reflecting the group's resilient business model and capacity to preserve good operating margins in spite of the industry headwinds. Along with new financial debt and also some equity injection (€400m in FY20), the cash generated was fully reinvested in the growth of the business, through development CapEx and M&A, and in real estate (in order to increase the company's ownership rate of operating buildings). All in all, **cash generated from operations was more than offset by recurrent outflows for the business growth and real estate investment, entailing a substantial increase of the group's net debt to €3.23bn at end-2021 (vs. €2.52bn at end-2019)**.

For 2022, the group was guiding for an operating free cashflow of €300m, above the previous years' level, in spite of some softness on operating margins. In our view, this expected improvement in cash generation in FY22 will have been mainly driven by the growth of the top-line (from both increasing volumes and higher pricing) and a more limited working capital outflow (vs. €94m in FY21). Regarding interest paid, we do not estimate a significant increase in FY22 thanks to the hedging policy in place. FY22 is consequently expected to be another year in which operating free cashflow is insufficient to fully fund Korian's growth and real estate investments, leading to a likely further increase of Korian's reported net debt.

Here below is the group's cash generation track record over the period 2019-22, as reported by Korian (with SR estimates for FY22):

In € m	FY19	FY20	FY21	1H21	1H22	FY22e
Sales	3 613	3 874	4 311	2 107	2 224	4 569
Pre-IFRS16 EBITDA	**535**	**498**	**597**	**276**	**283**	**636**
Margin	14,8%	12,9%	13,9%	13,1%	12,7%	13,9%
Non cash & others	(39)	(23)	(20)	(11)	(36)	(50)
Working capital change	7	12	(94)	(140)	(45)	(45)
Taxes paid	(59)	(63)	(39)	(13)	(12)	(30)
Interest paid	(114)	(114)	(123)	(58)	(60)	(125)
Operating cashflow	330	310	321	54	131	386
Operating CapEx	(99)	(87)	(91)	(38)	(49)	(100)
Operating free cashflow	**231**	**223**	**230**	**16**	**81**	**286**
Development CapEx	(99)	(112)	(189)	(84)	(86)	(180)
M&A	(254)	(530)	(220)	(237)	(139)	(139)
Net free cashflow	**(123)**	**(419)**	**(180)**	**(304)**	**(143)**	**(32)**
Dividends paid	(33)	(10)	(36)	-	-	(37)
Real estate invesments/divestments	(279)	(560)	(474)	(242)	(166)	(166)
Increase in equity	-	391	-	-	-	-
Cash from partnerships and others	2	241	351	214	(42)	(42)
Others	-	34	(50)	(1)	(41)	(41)
Change in net debt	**(433)**	**(323)**	**(389)**	**(334)**	**(392)**	**(319)**
Reported net det, excluding leases	2 517	2 840	3 229	3 174	3 621	3 547
Reported net debt, including leases	6 163	6 552	7 014	6 896	7 383	7 332

Sources: Spread Research, Korian

Going forwards, we estimate that Korian's cash generation will be able to maintain an annual operating free cashflow (before growth investments) of between €200m and €300m, assuming no substantial deterioration of the group's operating margins. In this case, we believe that Korian will have enough financial headroom to pursue its growth strategy.

However, in our view, the group's operating earnings remain under the threat of input cost inflation as well as **harsher healthcare standards, such as staff ratios, which may ultimately impact Korian's margins and cash generation**. Assuming a significant decline of the EBITDAR margin to 20% (vs. approximately 25% historically), we estimate that Korian's operating free cashflow would remain slightly above breakeven. But this would leave minimal headroom for development CapEx and other growth initiatives, which are key to the group's business model. In that event either the growth plans would need to be pared back or Korian would need to secure additional funds.

Capital structure

Capital structure as of 30 June 2022	Maturity	Ccy	Drawn (EURm)	Undrawn (EURm)	Leverage	Coupon / Margin	issuer
Real estate debt	n.a	EUR	1 843		3,0x	n.a.	Subsidiaries
Real estate debt			**1 843**	**-**	**3,0x**		
Syndicated term loan	2024	EUR	500			n.a.	Korian S.A.
RCF	2025	EUR	-	500		n.a.	Korian S.A.
Corporate bank term loan and RCF			**500**	**500**	**0,8x**		
Bank overdraft	< 1 year	EUR	1			n.a.	n.a.
Convertible unsecured notes	2027	EUR	330	-		0,9%	Korian S.A.
Social unsecured notes	2028	EUR	300			2,3%	Korian S.A.
Shuldschein & private placement	2022-34	EUR	1 430			n.a.	n.a.
Private Placement	*2023*	*EUR*	*135*			*3,3%*	*Korian S.A.*
Schuldschein	*2023-26*	*EUR*	*450*			*n.a.*	*Korian S.A.*
Private Placement	*2025*	*EUR*	*16*			*3,7%*	*Korian S.A.*
Schuldschein	*2027-2030*	*EUR*	*380*			*n.a.*	*Korian S.A.*
Sustainability-linked Euro PP	*2028*	*EUR*	*230*			*3,4%*	*Korian S.A.*
Schuldschein	*2034*	*EUR*	*100*			*2,3%*	*Korian S.A.*
Schuldschein	*2035*	*EUR*	*49*			*n.a.*	*Korian S.A.*
Others financial liabilities	n.a.	EUR	102	-		n.a.	n.a.
Corporate financial debt			**2 162**	**-**	**5,0x**		
Total Reported Debt			**4 505**	**-**	**7,5x**		
Less cash in hand			(856)	-			
Less marketable securities			(28)				
Total Net Reported Debt, excluding leases			**3 621**	**-**	**6,0x**		
LTM reported EBITDA as of 30 June 2022					605		
Debt adjustments							
Equity component convertibles	2027	EUR	30			0,9%	Korian S.A.
ORDINANE hybrid	Undated	EUR	330			1,9%	Korian S.A.
Deeply subordinated green non-convertibles	Undated	GBP	225			4,1%	Korian S.A.
Leases		EUR	3 762				
Pensions		EUR	92				
Total Net Adjusted Debt			**8 060**	**-**	**7,4x**		
LTM adjusted EBITDAR as of 30 June 2022					1 084		

Sources: Spread Research, Korian

Korian's capital structure is relatively complex, due to the various layers of financial debt including i) real estate debt of €1.84bn related to its €3.3bn owned real estate portfolio (entailing a LTV of 55%), ii) corporate bank debt including the €500m term loan and the undrawn €500m RCF, iii) other corporate debt mainly made up of unsecured bonds, Shuldschein and private placements totaling €2.2bn, iv) financial and operating leases for €3.8bn, and v) hybrid bonds recorded as equity in the financial statements. We did not find details about the ranking of the syndicated €500m term loan and the €500m RCF, but we suspect that they may rank ahead the unsecured bonds and other Shuldschein/private placements (in the event of a debt restructuring).

In its investor presentations, management usually reports a corporate net leverage ratio excluding real estate debt, which is calculated as follows: (reported net debt – real estate debt) / (pre-IFRS16 EBITDA - 5.8% real estate debt). **This corporate net leverage ratio stood at 3.6x at end-June 2022** (vs. 3.1x at end-2021 and 3.0x at end-2020), which is below the maintenance covenant ceiling of 4.5x under the syndicated term loan and the RCF.

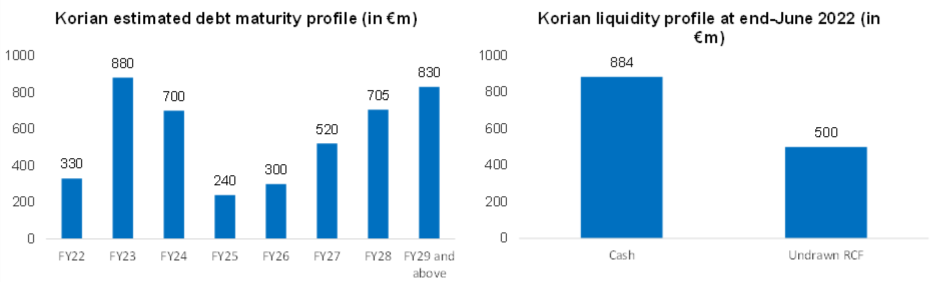
Including the real estate debt, Korian's reported net debt came out at €3.62bn at the end of June 2022. Based on the pre-IFRS 16 EBITDA of €605m, we calculate a reported net leverage ratio of 6.0x as of the end of the period.

In addition, we made several adjustments to the group's reported net debt of €3.62bn, mainly including the leases for €3.8bn and the hybrid instruments (which are accounted for as equity). **We made the choice to add these hybrid instruments to the group's financial debt, since they pay cash coupons and there is a strong incentive for Korian to call them** at the first reset date (due to the coupon step-up). For the record, the first reset dates for the €330m ORDINANE bonds and the £200m deeply subordinated hybrid notes are September 2026 and June 2024 respectively.

We also highlight the lack of information regarding the group's debt structure in the financial reports. In particular, the group provides only limited information about the amount outstanding in the multiple Shuldschein and private placements tranches.

Good cash position but high amount of debt to be refinanced in 2023 and 2024

In its investor presentations, the group published a graph showing the maturity profile of its financial debt over the period 2022 to 2028 and beyond. Unfortunately, the group does not provide the exact figure of debt due every year, but we can easily guess a rough amount as displayed in the graph below:



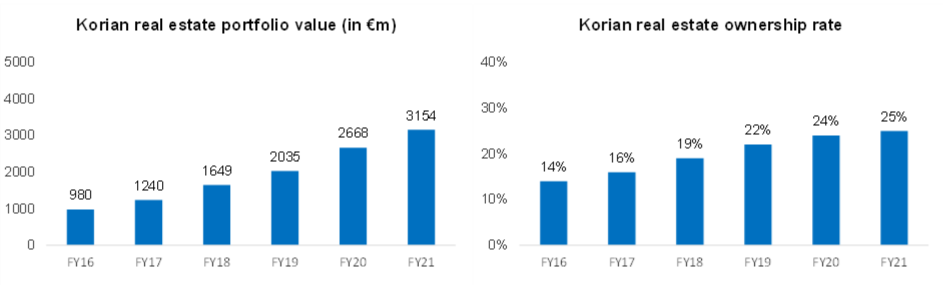
Sources: Spread Research, Korian

Current liquidity (at end-June 2022) will be adequate to address debt maturities falling in 2023 (which we estimate at €880m), but it will be insufficient for the financial debt due 2024. A large share of the debt which matured in 2022 and will mature in 2023 relates to real estate debt, which should be relatively easily refinanced as long as Korian maintains a sustainable loan-to-value ratio. The remaining part of the debt for the two years involved Shuldschein and private placements. As for 2024, Korian will have to refinance its €500m syndicated term loans, as well as real estate debt and private placements totaling €200m.

All in all, we believe that the Korian's current liquidity profile does not leave large headroom, in light of the high social risk and rising interest rate environment. Also, we outline that the €500m undrawn RCF is subject to a maintenance corporate net leverage ratio covenant of 4.5x (vs. 3.6x at end-June 2022).

Real estate may become another concern in view of rising interest rates

Over the last six years, **Korian has invested heavily in its real estate assets, leading to a substantial increase of the ownership ratio, to 25% at end-2021 against 14% at end-2016**. The main rationale behind these investments was to benefit from attractive yields compared to the past very low interest rates. This strategy also provides better control over its operating facilities, notably for the restructuring or reallocation of the nursing homes.



Sources: Spread Research, Korian

Based on the independent valuation of Cushman & Wakefield, the group's real estate portfolio is estimated at €3.15bn at the end of 2021 assuming a capitalization rate of 5.3%. For the group's real estate debt, this implies a LTV ratio of 55%. At the end of June 2022, the value of Korian's portfolio was revised up to €3.33bn, thanks to further real estate investments (still based on a capitalization rate of 5.3%).

In the view of the rise in interest rates in 2022, and the prospect of more to come, we would raise concerns about a potential decline of Korian's real estate portfolio and thus an increase of the loan-to-value ratio. We notably **bear in mind Orpea's difficulties and challenges it has encountered to execute its real estate disposal at the targeted price**, which prompted Orpea to renegotiate its debt with creditors in October. Also noteworthy, Orpea recently indicated that its independent appraisers have revised upwards its capitalization rate to 5.5% (from 5.3% previously), leading to an additional impairment of €0.3m on Orpea's real estate portfolio.

Although Korian's management was confident about the valuation of the company's real estate portfolio in its last investor presentation in late October, we remain guarded. As outlined in our last real estate report (click here to see the document), **property valuations have started to correct in most European markets with an acceleration in the trend in the second half of 2022 amid expanding yields**. We expect this trend to continue in 2023 as governments further raise their interest rates. It is true that raising rents may mitigate to some extent the negative revaluation of properties, but this lever may be limited given the potential challenges to maintain good operating margins for nursing homes.

ESG score of 67/100 is somewhat misleading, in the view of the high social risk

Based on our ESG methodology, we calculate a rather good ESG score of 67/100 for Korian, which is above our global average of 63/100. However, **this ESG score should not blind investors to the group's high social risks and major controversies in the nursing home industry**, which may lead to harsher sanitary and healthcare requirements. Note that within the total our low social score is compensated for by rather high environmental and governance scores.

Environmental: The company's E score came in at 88/100, mainly thanks to the presence of an environmental policy with quantitative targets to reduce environmental footprint, and the group's low exposure to environmental issues. Also, Korian's low level of gas emissions and energy consumption support its good environmental score.

Social: Korian's social score stands at a weak 44/100, as a result of the major social controversies regarding mistreatment of elderly residents, and very low social metrics. In particular, the turnover rate in excess of 20% and the high frequency of workplace accidents reflect social issues in the company. We also highlight the group's high absenteeism rate of 13.9% in both 2021 and 2020, against 8.3% in 2019. In France, Korian's absenteeism rate was 11.6% in 2021, which is quite in line with its main peer Orpea. As said above, we believe that Korian is exposed to the risk of tougher sanitary standards, which may ultimately impact its operating margins and cash generation.

Note that our social score is somewhat boosted by the essential nature of Korian's business activity and the absence of a presence in countries with human right issues.

Governance: Korian's G score came in at 75/100, stemming from a good composition of the board of directors, the separation of the CEO and chairman positions, and the very limited related party transactions. On the negative side, we incorporate some governance controversies related to the above social controversies, since they raise concerns about the quality of internal control.

Bonds covenant

2.25% social bonds due 2028

In October 2021, Korian issued €300m 2.25% social bonds due 2028. Due to the characteristics of the bonds, the proceeds are earmarked to finance eligible social projects, including i) construction or development of nursing homes, ii) refurbishment of existing facilities, iii) investing in infrastructure and services for medical care and clinics, and iv) proximity and community services, housing solutions, and digital technologies.

As part of the social bonds' issuance, Korian's social financing framework was backed by a second-party opinion released by S&P. In its report, S&P considers that Korian's overall use of proceeds commitments as strong. It has also a positive view on the group's disclosure practices and management of proceeds.

Covenant package

We consider that the covenant package is light and in line with the bond indentures of investment grade issuers. For example, there are no restrictions regarding debt incurrence or restricted payments.

Issuer: Korian

Governing law: The notes are governed by French law.

Ranking and security: The notes will rank unsecured and unsubordinated. They will rank pari passu with other present or future unsecured and unsubordinated obligations of the issuer.

Early redemption at the option of the issuer:

Prior to the maturity of the bonds, the issuer will have the option to repay in part or in full through the make-whole provision. Also, there is typically a residual maturity call option, which allows the issuer to redeem the notes @ 100 three months before the maturity date.

Change of control: Put at 100 at the option of bondholders in the event of a change of control.

Negative pledge: The issuer is not allowed to create or permit any pledge, lien or other security interest upon the whole or any part of its assets, unless the issuer's obligations under the notes are equally secured.

Spread Research's Definitions

Investment recommendation criteria

Buy: recommendation to buy the bond to maximize exposure as we have a strong positive conviction about the issuer in terms of credit fundamentals and our assessment of relative value.

Overweight («OW»): overweight exposure as we have a positive credit opinion based on improving financial/operational profile, and/or cheap valuation.

Underweight («UW»): underweight exposure as we have a negative credit opinion based on weakening financial/operational profile, and/or rich valuation.

Sell: recommendation to sell the bond as we have a strong negative conviction mainly based on deteriorating credit fundamentals, negative event risks and/or over-valuation.

The time horizon for Spread Research's recommendations is 3-6 months.

Key credit indicators

Credit View: Spread Research's broad opinion of an issuer from a credit perspective, which may be based on qualitative and quantitative aspects, and suggests a degree of comfort regarding an investment in the issuer's debt aside from any relative value analysis. Our scale includes 'Positive', 'Stable-to-Positive', 'Stable-to-Negative', 'Negative'.

Transparency Index: Spread Research measures the degree of transparency of an issuer on a scale of '0' to '5'. It is based on the quality of an issuer's financial information and the level of disclosures made available to investors, management's accessibility and track record.

Index of Liquidity: Liquidity is Spread Research's measure of how long an issuer can finance its operations assuming that access to both equity and debt capital markets is closed. It is measured on a scale of '0' to '3' years. We assume that the firm cannot refinance its debt and draws on its unused facilities from day one. Using our projection of free cash flows for the next three years, we estimate whether the firm has sufficient cash available to meet its scheduled debt repayments due within 1 year, 2 years or 3 years. A negative number or a small positive number indicates that the firm faces a liquidity problem by that time or that a refinancing of its credit lines is required. Whenever bank debt covenants are available, our liquidity index is adjusted for the probability of a bank debt covenant breach.

Bond recovery: We normally estimate recovery prospects for bondholders using the greater of two values: a) the liquidation value, which derives from the net asset book value, with discretionary discounts applied to book values from the company's consolidated financial statements, or b) the going concern value, which derives from a multiple of our estimated distressed EBITDA. We take into account the different debt-ranking levels, if any. Our score displays the 10%-rounded average of our recovery computation.

ESG Index: Spread Research measures the risks attached to Environmental, Social and Governance metrics of an issuer on a scale of '0' to '100'. Our methodology uses both qualitative and quantitative indicators and is refined into 3 versions, suitable for industrial, distribution, and services companies. It is based on a weighted mix of 35 ESG criteria assessing topics such as an issuer's level of controversies, exposure to regulatory changes, greenhouse gas emissions, energy consumption, working conditions, Board and Audit committee, and relationships with auditors. It is risked-based and is focused on credit analysis, which means that it is not suitable for purely socially responsible investment purposes.

Disclaimer

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Our recommendation is general, it is not tailor-made to the individual financial situation, experience or knowhow of the subscribers. It is neither tailor-made to the risk level or loss potential that the subscriber is willing to take or incur. Our recommendation is only general and based on our analysis of the company that is the subject

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