BRYAN, GARNIER & CO

FOCUS

22nd November 2016

Orpea

More than ever a BUY

Healthcare

Fair Value EUR86 (price EUR72.98) **BUY**

Bloomberg	ORP FP
Reuters	ORP.PA
12-month High / Low (EUR)	80.6 / 65.8
Market capitalisation (EURm)	4,383
Enterprise Value (BG estimates EURm)	7,673
Avg. 6m daily volume ('000 shares)	94.70
Free Float	66.7%
3y EPS CAGR	21.7%
Gearing (12/15)	171%
Dividend yield (12/16e)	1.36%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	2,392	2,841	3,041	3,172
EBIT (EURm)	303.30	368.27	418.10	454.12
Basic EPS (EUR)	2.54	2.99	3.53	4.04
Diluted EPS (EUR)	2.12	2.84	3.34	3.82
EV/Sales	3.12x	2.70x	2.49x	2.35x
EV/EBITDA	18.7x	16.4x	14.4x	13.1x
EV/EBIT	24.6x	20.8x	18.1x	16.4x
P/E	34.4x	25.7x	21.9x	19.1x
ROCE	3.5	4.1	4.6	5.0

For a while, despite strong results, the stock has been under pressure and is suffering in particular from the potential impact of an interest rate upturn following the US presidential election on asset valuations and/or debt. In our view, this is an irrational overreaction. Therefore, with top-line growth of at least 10% (o/w 5% organic) with margin improvements, we are confirming our recently upgraded FV.

- **Real estate valuation not at risk and not for sale:** At the end of June 2016, the group owned 37% of its real estate for a total value of c.EUR3.7bn and would be impacted by an interest rate increase. Nevertheless, this concern can be dismissed at least in the short term for two main reasons: 1) the valuation made by DTZ and JLL represents a cap rate of 6.3% which sounds really conservative, and 2) the group's real estate is not for sale, so the group valuation based on real estate is only theoretical and most of the time never retained.

- **Restated gearing and financial leverage at respectively 1.5x and 2.5x :** At the end of June 2016, net debt reached EUR3,226m, up from EUR3,014m at the end of 2015. Such a level is largely explained by Orpea's real estate strategy, real estate now representing 80% of net debt. Moreover, the financial ratios have significantly lower covenants of 2x for gearing and 5.5x for net debt/EBITDA. Finally, due to current debt coverage, mechanically, average interest will decrease to 2.9% in 2021e from 3.4% today.

- **Sustained growth results with good visibility:** Having built strong new platforms, Orpea now has the ability to replicate its business model in its other countries, i.e. based on lfl growth, bolt-on acquisitions. So, the group's organic growth should be maintained ahead of n+3 with a margin improvement after two years of decrease due to platform acquisitions.

- Our FV is based on a DCF with a WACC of 5.9%, long-term growth of 2.5% as of 2025 with an EBIT margin of 13.5% (i.e. an EBITDA margin of 18% vs. 18.5% in 2014 and 16.7% in 2015).

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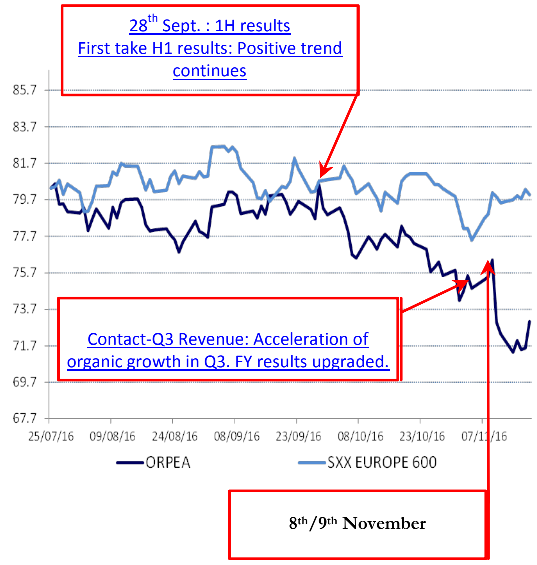
Orpea Major keys to Focus on
1. One Chart



For a while, the stock has been under pressure and particularly suffers from the potential impact of an interest rate upturn following the US presidential election on asset valuations and/or debt. In our view, an irrational overreaction for the following reasons:

- **« Real estate : Strategic asset with tangible value but not for sale. »:** For many years, Orpea's real estate strategy has been to remain the owner of a major portion of its real estate stock. The objective of this real estate policy is to: **control its operation** to provide the best quality service and maintain the flexibility to perform any work needed; **increase the group's net worth** through acquiring new and well located assets; **secure Orpea's profitability** in the medium and long term; **provide a source of financial security and flexibility** in the form of assets that are not volatile and easily saleable. At the end of June 2016, the group owned 37% of its real estate for a total value of c.EUR3.7bn (o/w around EUR250m for the common areas of a building) which would be impacted by an interest rate increase. Nevertheless, that concern can be dismissed at least in the short term for two main reasons: 1) the valuation made by DTZ and JLL represents **a cap rate of 6.3%** which sounds really conservative based on recent nursing home deals (in July, Primonial Reim bought assets based on a cap rate of 4.6%) and could be at risk only if interest rates rise significantly and rapidly, and 2) **the group's real estate is not for sale,** so the group's valuation based on real estate is only a theoretical exercise.

- **Restated gearing and financial leverage at respectively 1.5x (covenant 2x) and 2.5x (covenant 5.5x):** At the end of June 2016, net debt reached EUR3,226m, up from EUR3,014m at the end of 2015. Net debt is 80% of the real estate debt with an average interest rate of 3.4%. **Due to current debt coverage, mechanically, the average interest will decrease to reach at least 2.9% in 2021e**. Moreover, Orpea continues to optimise its financial resources with notably a new Schuldschein in July 2016 for EUR292m (maturity between five and seven years with a five-year maturity at 1.5% just after Brexit).

- **Other items - Regulatory changes in Germany: Definitely not an issue!** From scratch, the group has built up in the last two years a strong position in Germany (Orpea is n°3 with c.17,000 beds generating around 18% of consolidated revenue). With on-going public financing evolution in nursing homes to focus more on highly-dependent people (PSG II, PSG III), the increase in the minimum wage (+4% for the next two years) and changes in some Länder regulations (size, single room offer), the German market has given rise to some worries. **Again confirmed by the group, none of these measures should impact the margin** with over 86% single rooms, and only one hundred beds at risk and most employees over the minimum wage and benefiting from specific advantages and a training school.

2. Three Figures

10-12-22

Since early 2014, international expansion has been largely accelerated with strong new platforms. In fact, Orpea is now present in nine countries (ten including the first high-end nursing home in Nanjing, China) which represent new growth drivers for the results.

10 - **This is our revenue CAGR 2015-18e which is currently in line with medium-term revenue growth guidance**, o/w 5% organically (ADR 2%, volume 3%) based on the current pipeline and 5% from greenfields or bolt-on acquisitions. Remember that between 2010 and 2015, the average revenue growth per annum was 19.9% with organic growth of 7.3%. In the first 9m 2016, revenue was up 20.8%, o/w 5.9% organic after 6.3% in Q3.

12 – This is our EBIT CAGR 2015-18e. In fact, after the acquisition of new platforms especially in Germany, Austria and Poland that have weighed on profitability, the margin should improve again with **the implementation of "best practices"** (management of the occupancy rate, management of human resources bearing in mind that the cost of employees represents c. 50% of revenue).

22 – This is our net income CAGR 2015-18e. Strong leverage on net income, benefiting from **the decrease in cost of debt** with more debt on subsidiaries abroad (cost of debt in France is only 75% deductible) and a lower income tax rate. Such a trend will come from growth in the share of earnings from foreign subsidiaries where income tax rate is lower (tax rate in France is around 47% - IS of 33.3% + additional contribution + CVAE - compared with between 30%/40% in Belgium, Italy, 20%/30% in Spain, Austria or Switzerland and an even lower 20% in Germany, Poland or Czech Republic). **The group's current tax rate is 34% and will progressively lower to 30%.**

3. One Sentence

"Quality - the only guarantee of long-term profitability»

- As defined by Orpea, in a round-the-clock, 7 days-a-week service business caring for people with diminishing autonomy, Quality also means dealing with imperfection and constantly requires adjustments, improvements and rethinking. The group has over 100 staff dedicated to quality.

- In each country, Orpea's positioning is to provide the highest quality standard in terms of care and accommodation – "**Technical**" aspects of care tailored to each country: adjustment of reference procedures, traceability and controls – **Adaptation of the Quality programme** to regional and national cultures – **Quality**: a crucial criterion in acquisitions.

4. How does the Conference impact our Investment Case

Following another strong quarter (Q3 revenue released in early November was up 16.8% with an acceleration in organic growth at +6.3%), management's medium-term lfl guidance at around 5% per annum based on the current pipeline sounds definitely reasonable (pipeline representing c. 14% of the current network, o/w 82% under construction and 18% in refurbishment).

Moreover, having built strong new platforms, Orpea now has the ability to replicate its business model in its other countries, i.e. based on lfl growth and bolt-on acquisitions. So, the group's organic growth should be maintained ahead of n+3 with margin improvements after two years of decrease due to platform acquisitions.

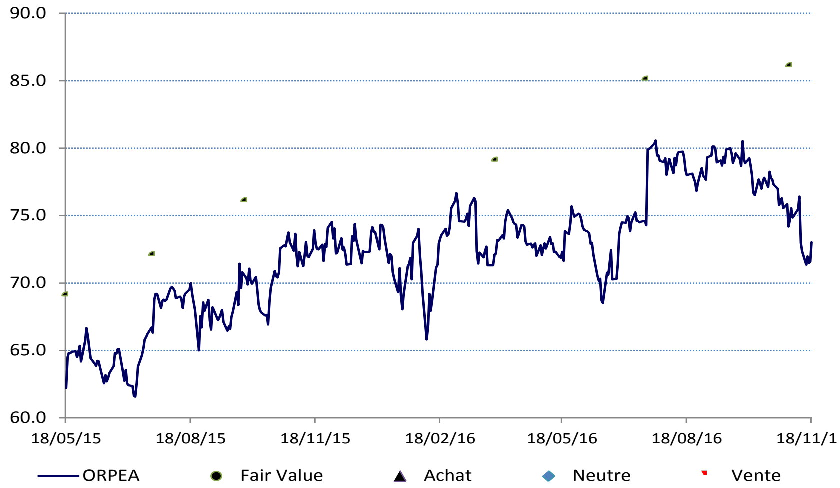
With strong visibility on such a results trend, **we are confirming our FV of EUR86**. At the current share price, the share is valued at 16.4x EV/EBITDA 2016e and 14.4x 2017e compared with EBITDA CAGR 2015-2018 of 12.4%. Based on our FV, EBITDA 2017e would be valued at 15.9x.

Next Catalysts

Investor days on 6th & 7th December (Switzerland)
FY revenue on 8th February, 2017

Price Chart and Rating History

Orpea

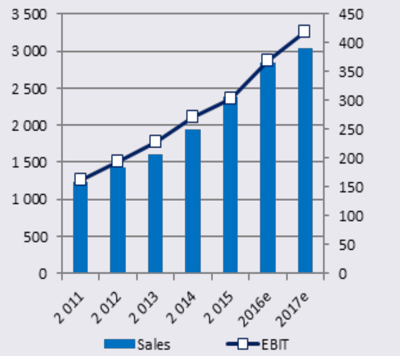


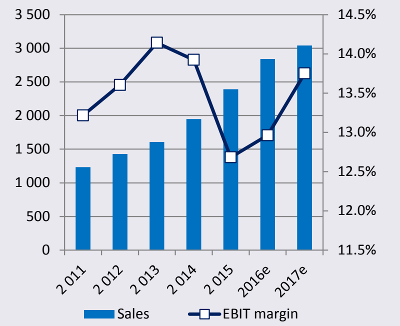
Ratings

Date	Ratings	Price
10/02/2015	BUY	EUR58,43
08/01/2015	Under review	EUR50,25
08/03/2011	BUY	EUR33,595

Target Price

Date	Target price
03/11/2016	EUR86
20/07/2016	EUR85
31/03/2016	EUR79
28/09/2015	EUR76
22/07/2015	EUR72
19/05/2015	EUR69
10/02/2015	EUR66
08/01/2015	Under review
16/05/2014	EUR59
12/12/2013	Under review
17/01/2013	EUR38
20/04/2012	EUR36
08/02/2012	EUR33
14/09/2011	EUR41
08/03/2011	EUR44





Company description

Orpea is one of the European leaders in Dependency care. It operates long-term care facilities (nursing homes) and clinics (post acute and rehabilitation clinics, psychiatric care clinics). Created in 1989 by the current Chairman Dr Jean Claude Marian who still owns 7% of the capital, Orpea had 2015 sales of c. EUR2.4bn, 8.4 times the level reported in 2005. The group's high growth is driven by an ambitious and uninterrupted acquisitions policy in place since its flotation in 2002. Today, the group's new strategic priorities include an international development, a solid operating profitability, a strict financial discipline and a lasting policy of shareholders

Simplified Profit & Loss Account (EURm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenues	1,608	1,949	2,392	2,841	3,041	3,172
Change (%)	*12.5%*	*21.2%*	*22.7%*	*18.8%*	*7.0%*	*4.3%*
Adjusted EBITDA	298	350	400	468	528	568
EBIT	227	271	303	368	418	454
Change (%)	*17.0%*	*19.3%*	*11.8%*	*21.4%*	*13.5%*	*8.6%*
Financial results	(95.5)	(99.2)	(96.8)	(111)	(115)	(105)
Pre-Tax profits	173	210	228	257	303	349
Exceptionals	NM	NM	NM	NM	NM	NM
Tax	(61.0)	(75.3)	(77.3)	(86.1)	(100.0)	(115)
Minority interests	(0.14)	0.0	0.0	0.0	0.0	0.0
Net profit	114	136	153	174	206	237
Restated net profit	114	154	153	174	206	237
Change (%)	*17.3%*	*35.1%*	*-0.3%*	*13.4%*	*18.5%*	*15.0%*
Cash Flow Statement (EURm)						
Operating cash flows	229	260	301	391	437	463
Change in working capital	20.9	30.3	13.0	(2.6)	(1.2)	(0.76)
Capex, net	(235)	(587)	(1,014)	(366)	(136)	(139)
Financial investments, net	125	489	642	(459)	(190)	(305)
Dividends	(31.8)	(38.8)	(44.5)	(54.2)	(59.9)	(70.4)
Other	NM	NM	NM	NM	NM	NM
Net debt	1,952	2,209	3,087	3,289	3,190	3,060
Free Cash flow	15.7	(297)	(700)	22.5	300	323
Balance Sheet (EURm)						
Tangible fixed assets	1,993	2,198	3,009	3,153	3,151	3,149
Intangibles assets	1,838	2,221	2,593	2,717	2,715	2,714
Cash & equivalents	468	622	519	27.7	78.3	25.4
current assets	738	957	1,002	601	692	666
Other assets	NM	NM	NM	NM	NM	NM
Total assets	5,452	6,286	7,371	7,085	7,183	7,096
L & ST Debt	2,210	2,831	3,606	3,317	3,269	3,086
Others liabilities	NM	NM	NM	NM	NM	NM
Shareholders' funds	1,413	1,498	1,810	1,683	1,683	1,683
Total Liabilities	3,828	4,588	5,361	5,402	5,500	5,413
Capital employed	4,282	4,860	6,052	6,343	6,341	6,338
Financial Ratios						
Operating margin	14.14	13.92	12.68	12.96	13.75	14.32
Tax rate	(35.27)	(35.90)	(33.87)	(33.50)	(33.00)	(33.00)
Net margin	7.08	7.89	6.41	6.12	6.78	7.47
ROE (after tax)	8.06	9.09	8.47	10.33	12.24	14.08
ROCE (after tax)	3.72	3.91	3.51	4.06	4.62	5.02
Gearing	138	147	171	195	190	182
Pay out ratio	27.92	28.47	29.03	31.20	29.05	29.73
Number of shares, diluted	55.48	55.57	60.27	60.27	60.27	60.27
Data per Share (EUR)						
EPS	2.15	2.45	2.54	2.99	3.53	4.04
Restated EPS	2.08	2.08	2.12	2.84	3.34	3.82
% change	*16.2%*	*0.0%*	*1.9%*	*33.8%*	*17.6%*	*14.4%*
BVPS	NM	NM	NM	NM	NM	NM
Operating cash flows	4.14	4.68	4.99	6.49	7.26	7.68
FCF	0.28	(5.34)	(11.62)	0.37	4.98	5.36
Net dividend	0.70	0.80	0.90	0.99	1.17	1.34

Source: Company Data; Bryan, Garnier & Co ests.

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY — Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL — Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL — Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56,1% NEUTRAL ratings 32,5% SELL ratings 11,5%

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