GROUPE H E C

Générale de Santé case study

If you want to ask questions about the case to its author, please drop a message via the mailbox of www.vernimmen.net.

Yann Le Fur May 2006

You just attended the presentation of the annual results of the group Général de Santé. Right after the presentation, you hear a conversation between a financial analyst and an investor.

The analyst

This acquisition of group Hexagone is a major event for the firm. However, I would have preferred that Générale de Santé invest in a new industry. Private hospitals are a risky business, because hospital tariffs are set by unpredictable government decisions. Investing in a new industry would have allowed to reduce exposure to this risk. On this front, I still do not understand why the firm left the retirement home business a few years ago.

The investor

You know: I do not really think there are lots of synergies between private hospitals and retirement homes… In addition, if I want to invest in retirement homes, I just have to put Orpéa stocks in my portfolio!

Supprimé :

The analyst

You must be right: you are the investor after all. Anyway, I still think they are overpaying this acquisition approximately 10 times the EBITDA, while Générale de Santé is only worth approximately 8 times its EBITDA. I still don't see why the management could accept to pay such a price!

The investor

Maybe, but with just a little bit of synergies, the acquisition could well become cheap. I understand from the presentation I just saw that potential synergies are important.

The analyst

Yet, I still think the acquisition dilutes the EPS of GDS a lot. I still remember my corporate finance classes at HEC: even if this firm is rather well valued, its P/E of 18.8 in 2005 will never be high enough to compensate for current interest rates. If the company pays its debt back, it will just save on a 3% interest rate before tax.

The investor

Yes, but the firm will not invest its cash on the money market! It will invest it in Hexagone and the operation should boost the EPS, not dilute it. Moreover, the P/E should be increasing because of the new growth opportunities this merger creates for the group.
But I am more worried about the price of the equity issue. It seems to me that the discount is high with respect to the current market price.

The analyst

That is right, but you have a subscription right that should compensate for your dilution.

The investor

Correct, but what worries me is that apparently banks do not trust the stock price of Générale de Santé. If they did, they would have accepted to underwrite the transaction with a smaller discount.

The analyst

May be the Chief Financial Officer of GDS simply did not want to pay the fees demanded by banks to take such a risk. And let me repeat that investors should not care about the discount…

The investor

Yet, the stock price is likely to drop once the subscription right is taken out.

The analyst

Yes, mechanically so!

The investor

In my sense, that it is debtholders who are really to gain from the share issue. Indeed, the risk they bear is going to decrease!

The analyst

I don't believe so. The acquisition is going to be financed by 2/3 of equity, and 1/3 of debt, which is surprisingly close to the current capital structure of Générale de Santé (computed with market values, of course).

QUESTIONS

(Questions are repeated at the end of this document with sufficient space for you to answer)

Preliminary

1/ Do a quick financial analysis of Générale de Santé

2/ Do a quick stockmarket analysis

3/ Compute the EBITDA multiple (using the 2005 accounts and the last stockmarket capitalisation).

Investment analysis

4/ Do you think Générale de Santé should rather invest in its own industry, or diversify as the analyst suggests?

5/ Given that the firm is worth 430 million euros; what is the EBITDA multiple paid by GDS for Hexagone?

6/ How much should the annual amount of synergies be, to make sure that the acquisition is paid on the same multiple as Générale de Santé?

Share Issue Analysis

7/ The funds raised by the share issue will be used to pay back the temporary credit line put in place to acquire Hexagone. Under which conditions does the share issue dilute the EPS ? Compute the EPS dilution assuming that the credit line costs 3% before tax ? Do you think this is a correct way of reasoning here?

8/ What is the theoretical value of the subscription right? What should the stock price be once the subscription right has been given to shareholders?

9/ What is the dilution of control for those shareholders who exercise their subscription rights? What is the dilution of control for those shareholders who sell all of their subscription rights? What is the dilution for a shareholder who could not cash in or cash out anything in this transaction (using the cash from the disposal of some rights to exercise the remaining rights)

10/ What do you think of the decision taken by Efibanca and Dr Ligresti to subscribe the share issue?

11/ What is the signal linked to this equity offering?

Conclusion

12/ What would be the effect of the whole transaction (acquisition + share issue) on:

- The cost of equity
- The cost of debt
- The weighted average cost of capital

(please explain briefly each of your answers)

Appendix 1 – Financial elements

Balance Sheet			
(millions of euros)	**31/12/2003**	**31/12/2004**	**31/12/2005**
Intangible fixed assets	165	177	289
Tangible fixed assets	570	609	521
Financial fixed assets	28	55	86
Fixed Assets	**763**	**842**	**895**
Inventories	21	23	27
Trade receivables	211	221	245
Trade payables	-144	-148	-169
Other current liabilities	-162	-160	-114
Working capital	**-74**	**-65**	**-11**
Capital employed	**689**	**777**	**884**
Shareholders' Equity (Group share)	262	279	303
Minority interests	11	3	7
Total group equity	**273**	**282**	**310**
Medium and long term borrowing and liabilities	422	509	512
Current borrwing and liabilities	58	85	87
Cash and equivalents	64	98	24
Net Debt	**416**	**496**	**575**
Invested Capital	**689**	**777**	**884**

Income statement						
(millions of euros)	**2003**		**2004**		**2005**	
Sales	**1 132**		**1 250**		**1 436**	
Personal expenses	-559	*-49,4%*	-592	*-47,3%*	-648	*-45,1%*
Consumption of non finished goods	-202	*-17,9%*	-230	*-18,4%*	-265	*-18,4%*
Other operating products and charges	-141	*-12,5%*	-166	*-13,3%*	-202	*-14,1%*
Taxes	-58	*-5,1%*	-64	*-5,1%*	-74	*-5,2%*
Rents	-50	*-4,4%*	-58	*-4,6%*	-68	*-4,7%*
EBITDA	**122**	***10,7%***	**141**	***11,3%***	**179**	***12,5%***
Amortizations	-65	*-5,8%*	-69	*-5,5%*	-81	*-5,6%*
Other products and charges	4		-1		-6	
EBIT	**60**	***5,3%***	**72**	***5,7%***	**92**	***6,4%***
Cost of net debt	-24	*-2,1%*	-23	*-1,8%*	-25	*-1,7%*
other financial products and charges	2		1		1	
share of partnering firms	-1		-2		-1	
Corporate income tax	-18	*-1,6%*	-21	*-1,6%*	-25	*-1,7%*
Net earnings	**19**	*1,7%*	**28**	*2,2%*	**43**	*3,0%*
Minority interests	-3		0		-2	
Net earnings (group share)	**16**	***1,4%***	**27**	***2,2%***	**41**	***2,8%***

CASH FLOW STATEMENT			
(millions d'euros)	**2003**	**2004**	**2005**
Net Earnings	16	27	41
Amortization	65	69	81
cash flow	82	96	122
Change in OWC	10	-9	-54
Other	0	-10	-1
CASH FLOW FROM OPERATIONS	**92**	**77**	**67**
NET CASH FLOW FROM INVESTMENT	**-14**	**-147**	**-134**
Equity issue			
Dividends	-9	-10	-12
CHANGE IN NET DEBT	**69**	**-80**	**-80**

** Do not take it into account in your analysis*

RATIOS			
	2003	**2004**	**2005**
OWC in days of sales	-24	-19	-3
Operating margin after tax	3,4%	3,7%	4,2%
x			
Asset turnover	1,6	1,6	1,6
=			
Return on Capital Employed after tax	**5,7%**	**6,0%**	**6,8%**
Debt to Equity	1,5	1,8	1,9
Return on Equity	**6,0%**	**9,7%**	**13,2%**
Net DEbt / EBITDA	3,4	3,5	3,2

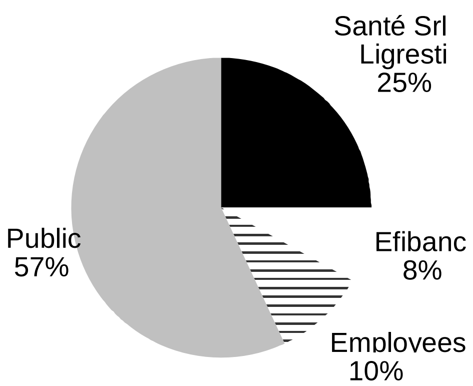
Note : Accounting statements do not include Hexagone, whose acquisition was finalized in January 2006

Appendix 2 – Stockmarket elements

	2003	2004	2005	2006(1)(2)	2007(2)
Stock Price					
Highest	12,3	15,3	32,0	29,8	
Lowest	8,4	10,0	15,1	22,1	
Last	10,3	15,5	28,9	26,5	
Shares outstanding (millions)	39,0	39,0	39,0	39,0	
Earnings per share	0,42	0,70	1,05	1,13	1,22
PER	24,6	22,1	27,5		
Dividend per share	0,25	0,30	0,35		
Dividend yield	2,4%	1,9%	1,2%		
Payout ratio	60%	43%	33%		
Stockmarket capitalization	404	603	1128	1034	
Shareholder's equity (share of group)	262	279	303		
Return on equity	6,0%	9,7%	13,2%		

(1)05/04/06, the day before the share issue announcement
(2)EPS are analysts' estimates

Ownership Structure



Appendix 3 – Press Release

GENERALE DE SANTE AND HEXAGONE HOSPITALISATION TO CONSTITUTE THE LARGEST PRIVATE HOSPITALIZATION GROUP IN THE GREATER PARIS AREA

Numerous geographic and operating complementarities

Paris, December 15, 2005 - Générale de Santé, Europe's leading private hospitalization group, and Hexagone Hospitalisation, France's second national private clinic network, have signed a memorandum of understanding by which Générale de Santé agrees to acquire part of the Hexagone Hospitalisation group. Under the provisions of the national antitrust law, however, the transaction remains subject to the approval of the Ministry of the Economy and Finance (DGCCRF).

The agreement provides for the acquisition of 10 clinics, including one rehabilitation center, for a total consideration of nearly €430 million, including net debt. This amount values the acquired scope of Hexagone Hospitalisation at around 10 times the estimated EBITDA for 2005. The acquisition price also includes the real-estate freehold rights to 9 clinics. The financing of the transaction will consist of a bridge loan and a capital increase (planned for the first half of 2006, subject to market conditions).

Commenting on the transaction, Daniel Bour, Chairman of the Management Board of Générale de Santé, stated: "For our group, this deal is a major opportunity to develop our position in the greater Paris area. Indeed, the Hexagone Group, headed by its founder Dr. André Attia, makes an outstanding contribution to our business through the number, the quality, and the effectiveness of its clinics. With more than 35 years' experience in the business and with its management expertise evidenced by his group's excellent profitability, Dr André Attia could make a significant contribution to the expansion of Générale de Santé. In that respect, I hope the upcoming General Meeting of Shareholders will appoint him as new member of our Supervisory Board."

Dr. André Attia declared that: "Hexagone Hospitalisation's backing by a large player that shares the same values of healthcare quality and patient support is a guarantee for those men and women who have assisted me in building this group that our clinics' reputation for reliability will be maintained."

Hexagone Hospitalisation: a strategic opportunity for GDS

Hexagone Hospitalisation is a major player with excellent economic and financial performance, with profitability above sector's average. Hexagone is the second largest national private player after Générale de Santé.
The acquisition covers 10 clinics, including one sub-acute care center, most of which are located in the Paris area. The transaction brings a total capacity of 1,951 beds and patient spaces with a medical community of about 800 professional practitioners and nearly 1,900 medical staff.
Supported by a sustained investment policy, the Hexagone Hospitalisation assets being acquired have recorded excellent profitability: in 2004, its EBITDA reached 20.2% of pro forma sales of €183 million.

Growth potential driven by the development of strong complementarities

As a result of the acquisition, Générale de Santé will be able to provide patients in the Seine Saint-Denis, Seine-et-Marne, and Yvelines districts with a comprehensive healthcare offering, while representing a source of additional attractiveness for patients coming from neighboring districts such as the Val-de-Marne, Hauts-de-Seine and Paris.
After acquiring the Chiche Group in early 2005, Générale de Santé is now consolidating its position as the leading private network in Paris and the greater Paris area, with 35 clinics.

Numerous synergies available

Thanks to the geographic proximity of the clinics and their complementary skills and cultures, a rapid integration of the elements of Hexagone Hospitalisation being acquired into Générale de Santé's network is expected. The Group should be able to realize economies of scale and recurring synergies between the two entities. In particular, these would be based on the optimization of external purchases and services, as well as on the sharing of personnel costs and, in the medium term, on the growth potential resulting from the clinics' specialization in centers of excellence.

Structure, financing and timetable of the deal

This transaction should mainly be financed through a capital increase (of about €300m), primarily directed at Générale de Santé's shareholders and is expected to take place during the first half of 2006, subject to market conditions. Dr. Antonino Ligresti and Efibanca have already expressed their intentions to participate in the operation proportionally to their respective holdings (25% and 8%). For the financing of the balance, Générale de Santé should also be able to use the proceeds of the disposal of part of its real estate assets in the "HESTIA 1" plan.
A bridge loan, of a maximum amount of €450m, has already been obtained in order to be able to close the transaction in the course of January 2006, based on the current preliminary timetable. This would allow Générale de Santé to consolidate Hexagone Hospitalisation's business activity into its accounts as of January 1, 2006.
In order to present pro forma consolidated financial statements (i.e. including the elements of Hexagone Hospitalisation being acquired), Générale de Santé is postponing to March 23, 2006 the release of its 2005 earnings.

Antonino Ligresti, Chairman of the Supervisory Board of Générale de Santé, stated: "This acquisition will enable us to further display our expertise in quick integration of new businesses and our ability to offer healthcare services that complement the public system, while increasing the return on investment." As a significant shareholder, he added: "We are delighted by this significant operation that further evidences our commitment to accelerate growth in line with our business model, through a merger with an existing group in France. I am willing to support this new development in the Group's expansion by participating in a capital increase, if any."

Appendix 4 – Financial Elements on Hexagone

Consolidated pro forma accounts for the ten clinics of Hexagone Group, prior to its acquisition on January 19, 2006

	2004	2005
Sales	183	202
Personal expenses	(82)	(87)
Purchase of non finished goods	(31)	(35)
Other operating products and charges	(19)	(23)
Taxes	(9)	(10)
Rents	(6)	(6)
EBITDA	**37**	**41**
Amortisation	(9)	(12)
EBIT	**26**	**29**
Net financial expenses	(2)	(1)
Other financial products and charges	-	-
Corporate income tax	(8)	(9)
Net earnings	**15**	**18**
Minority interests	-	-
Net earnings (Group share)	**15**	**19**

Appendix 5 – Summary of the share issue prospectus

Issuer : Générale de Santé

Context and purpose of the rights offering: On January 19, 2006, Générale de Santé acquired 10 clinics from the Hexagone Group for approximately € 430 million, including debt. The Company financed this acquisition with a € 450 million loan from Mediobanca-Banca Di Credito Finanziario S.p.A. This loan will be partially refinanced through the present capital increase. This capital increase is also intended to allow Générale de Santé to maintain financial flexibility for its industrial development.

New Shares offered: 14,635,584 new shares (the ''New Shares''), with a nominal value of € 0.75 per share, for a capital increase with a total nominal amount of € 10,976,688.

Dividends and voting rights: The New Shares will entitle their holders to receive any dividends approved by the Company for the 2005 fiscal year and, subject to approval at the annual shareholders' meeting, is expected to be paid in 2006 to the same extent as the Company's other outstanding ordinary shares. The New Shares will confer other rights of ordinary shares, including voting rights, on their holders from their date of issue.

Subscription price: € 20.50 per share, to be fully paid in cash at the time of subscription, of which € 0.75 represents the nominal value per share and represents € 19.75 the issue premium.

Percentage of capital and voting rights: Based on the Company's share capital of € 29,271,168 represented by 39,028,224 shares, the capital increase would represent 37.50% of the share capital and 37.55% of the Company's voting rights as of April 5, 2006.

Allocation of Rights: Each share held at the close of trading on April 7, 2006 will entitle the holder to receive one Right. Rights may also be purchased on Eurolist by Euronext during the Rights exercise period.

Subscription ratio: Eight Rights will entitle the holder to subscribe for three New Shares at the subscription price. Rights may be exercised in whole or part at the holder's discretion. The Company willonly issue a whole number of new shares, and no fractional shares will be issued. Subscriptions submitted for fractional New Shares will be rounded down to the nearest number of New Shares.
Holders may also subscribe for New Shares in excess of the number of shares that their Rights, including Rights they have purchased, entitle them to purchase, so long as such holders have exercised all of the Rights that they hold. To the extent New Shares are available as a result of unexercised Rights, holders will be allocated additional New Shares in proportion to the number of Rights they have exercised, and up to the number of additional New Shares for which they have subscribed. In case of a shortfall in the number of additional
New Shares available to satisfy the subscriptions in full, the 6 additional New Shares to be delivered will be allocated in proportion to the number of Rights, including Rights that are purchased, exercised by the holders of Rights, and the subscription price related to any New Shares not delivered will be returned to the account of the relevant holders without interest. See ''—Procedure for exercising Rights.''
Existing shareholders, or transferees of the Rights will have a priority right to subscribe for the New Shares.

Subscription by principal shareholders: Santé SARL and Efibanca S.p.A., which hold 9,757,363 and 3,121,951 ordinary shares representing about 25% and 8% of the Company's capital, respectively, have expressed their intention to subscribe for the capital increase, without reduction, up to the entire number of Rights attached to their shares. Générale de Santé is not aware of the intentions of other shareholders as to the exercise or sale of their Rights.

Indicative timetable for the capital increase:

April 5, 2006	AMF visa on the prospectus.
April 6, 2006	Transaction launch press release; Publication of the Euronext Paris notice.
April 7, 2006	Publication of a summary of the principal characteristics of the capital increase.
April 7, 2006	Publication of the legal notice of share capital increase in the *Bulletin d'Annonces légales obligatoires* (''*BALO*'').
April 10, 2006	Beginning of the subscription period—separation and commencement of the listing of the Rights.
April 24, 2006	End of the subscription period—end of the listing of the Rights.

May 8, 2006	Publication of the Euronext Paris S.A. admission notice for the New Shares indicating the final amount of the capital increase.
May 10, 2006	Issue, delivery and settlement of the New Shares; Admission of the New Shares for listing on Eurolist by Euronext.

Gross and Net proceeds: The gross proceeds from the share issue are estimated to be around 300m euros. Underwriting fees will be 9 million euros. These fees will be deducted from the issue premium As a consequence, the net proceeds from the issue will be around 291 million euros.

1/ Do a quick financial analysis of Générale de Santé

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3/ Compute the EBITDA multiple (using the 2005 accounts and the last stockmarket capitalisation).

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