

# Case study: IPO of MEDICA

*Please send any questions on this case study to the author via the mail box on the web site  
[www.vernimmen.com](http://www.vernimmen.com)*

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*Although this case study is based on an actual deal, some facts and figures have been changed for teaching purposes.*

## **Presentation of Medica (excerpt from the IPO registration document)**

The Medica group, a key player in the care of temporarily or permanently dependent people, is mainly active in two sectors:

- the EHPAD sector, providing accommodation for the dependent elderly, commonly referred to as retirement homes, catering for permanently dependent people (107 homes with a capacity of 8,726 beds on December 31, 2008) and;
- the healthcare sector, mainly through SSR follow-up care units and establishments specialising in psychiatric care, providing accommodation for temporarily dependent people (37 healthcare establishments with capacity of 2,316 beds on December 31, 2008).

The Medica group operates mainly in France and has been active in Italy since 2005.

Starting out as a family-run business, the Medica group was acquired in 1999 by a subsidiary of the Caisse des Dépôts et Consignations, then in 2002 by equity capital funds, managed mainly by Bridgepoint and Alpinvest, and in 2006, by funds advised by BC Partners.

A management team, led by Jacques Baillet and Christine Jeandel, has been behind the development of the Medica group for the last 10 years.

With a total of 144 establishments and a capacity of 11,042 beds on December 31, 2008, the Medica group is the third largest operator in France in the dependency sector, given its presence on the EHPAD and SSR sectors, and the second largest French player in Italy.

The consolidated sales of the Medica group rose from €69.8m in 2000 (2,469 beds), to €481m on December 31 2009, with over 89% in France, working out at an annual growth rate in sales of 24%, driven by the combined effect of the development of the scope of the group and its active yield management strategy. Consolidated current operating income for the financial year ended December 31, 2009 was €64m.

## **Description of the initial public offering of Medica on Euronext Paris**

For its IPO planned for early 2010, Medica intends to carry out a capital increase for an amount of around €260m, the proceeds of which will be used to provide it with the resources for implementing its growth strategy, by paying off part of its existing debt, thus helping to improve its financial flexibility.

## Questions

1. Carry out a financial analysis of Medica



2. Among Medica's comparable peers listed in appendix 2, which, in your view, is the most comparable to Medica? Why?

Calculate the 2009 EBITDA multiple, the 2009 EBIT multiple and the 2009 P/E ratio for it.

3. Work out a valuation bracket for the Medica share, knowing that there are 14.2m issued shares.

4. Without redoing the calculations, look carefully at the discounted cash flows in appendix 3, taken from the four different brokers' notes. Which valuation(s) seem(s) to be free from any major methodological error? What are the mistakes made by the other analysts? Why have these errors occurred?

5. Select the cash flows valuation model that you consider to be the most relevant from appendix 3, and test the sensitivity of the value calculated to the Medica share price at:
- a variation of  $\pm 0.81\%$  of the cost of capital
  - a variation of  $\pm 0.25\%$  of the growth to infinity
  - a variation of  $\pm \text{€}7.6\text{m}$  of free cash flows in 2020

State your views.

You can download the valuation models for the Medica share on the [www.vernimmen.com](http://www.vernimmen.com), website, under quizz, cas.



6. On the basis of the various calculations that you have made, what sort of price bracket would you suggest for the Medica IPO in January 2010? Why?

7. What impact will the IPO have on Medica's balance sheet and on its income statement?

Would your answer be different if the IPO were to be carried out through the sale of existing shares, rather than a capital increase involving the issue of new shares? Why?

## APPENDICES

1. Key financials for Medica
2. Financials for Medica's peers
3. Application of discounted cash flows (DCF) by analysts for valuing Medica

## APPENDIX 1:

### Key financials for Medica

#### Consolidated Income Statement

(Closing at December, 31st)

In € thousands	2007	2008	2009
Sales	384 700	448 814	480 727
- Cost of Sales	18 452	20 445	22 783
- Other external expenses	105 990	121 577	129 203
<b>= Value added</b>	<b>260 258</b>	<b>306 792</b>	<b>328 741</b>
- Staff costs	168 084	201 790	214 009
- Taxes	25 504	27 650	30 295
+ Other income (costs)	(4 318)	458	(1 520)
<b>= EBITDA</b>	<b>62 352</b>	<b>77 810</b>	<b>82 917</b>
- Amortisation and depreciation	15 072	17 227	18 830
<b>= EBIT</b>	<b>47 280</b>	<b>60 583</b>	<b>64 087</b>
+ Financial Income	(55 100)	(89 902)	(80 676)
+ Non recurring items	(1 828)	(2 908)	(7 195)
<b>= Pre Tax Income</b>	<b>(9 648)</b>	<b>(32 227)</b>	<b>(23 784)</b>
- Corporate income tax	(4 077)	(9 980)	(10 365)
+ Income from affiliates	-	(144)	(423)
- Goodwill impairments	-	-	(872)
<b>= Net Income</b>	<b>(5 571)</b>	<b>(22 391)</b>	<b>(12 970)</b>
- Minority interests	337	297	394
<b>= Net income (Group share)</b>	<b>(5 908)</b>	<b>(22 688)</b>	<b>(13 364)</b>

#### Consolidated Income Statement in %

(Closing at December, 31st)

As % of sales	2007	2008	2009
Sales	100%	100%	100%
- Cost of Sales	4.8%	4.6%	4.7%
- Other external expenses	27.6%	27.1%	26.9%
<b>= Value added</b>	<b>67.7%</b>	<b>68.4%</b>	<b>68.4%</b>
- Staff costs	43.7%	45.0%	44.5%
- Taxes	6.6%	6.2%	6.3%
+ Other income (costs)	-1.1%	0.1%	-0.3%
<b>= EBITDA</b>	<b>16.2%</b>	<b>17.3%</b>	<b>17.2%</b>
- Amortisation and depreciation	3.9%	3.8%	3.9%
<b>= EBIT</b>	<b>12.3%</b>	<b>13.5%</b>	<b>13.3%</b>
+ Financial Income	-14.3%	-20.0%	-16.8%
+ Non recurring items	-0.5%	-0.6%	-1.5%
<b>= Pre Tax Income</b>	<b>-2.5%</b>	<b>-7.2%</b>	<b>-4.9%</b>
- Corporate income tax	-1.1%	-2.2%	-2.2%
+ Income from affiliates	0.0%	0.0%	-0.1%
- Goodwill impairments	0.0%	0.0%	-0.2%
<b>= Net Income</b>	<b>-1.4%</b>	<b>-5.0%</b>	<b>-2.7%</b>
- Minority interests	0.1%	0.1%	0.1%
<b>= Net income (Group share)</b>	<b>-1.5%</b>	<b>-5.1%</b>	<b>-2.8%</b>

## Cash Flow Statement

In € thousands	2008	2009
Net income (Group share)	(22 688)	(13 364)
+ Amortisation and depreciation	17 227	18 830
+ Non cash items	690	(6 059)
<b>= Cash flow</b>	<b>(4 771)</b>	<b>(593)</b>
- Change in working capital	(14 619)	(10 439)
<b>= Cash Flow from Operating Activities (1)</b>	<b>9 848</b>	<b>9 846</b>
- Capital expenditure (tangible and intangible assets)	43 863	22 704
- Acquisition (disposal) of other fixed assets	50 361	25 157
<b>= Cash Flow from Investing Activities (2)</b>	<b>(94 224)</b>	<b>(47 861)</b>
<b>Free Cash Flow after financial expense (1)+(2)</b>	<b>(84 376)</b>	<b>(38 015)</b>
+ Proceeds from share issues	-	-
- Dividends paid	153	112
<b>= Increase (decrease) in net debt</b>	<b>(84 529)</b>	<b>(38 127)</b>

## Balance sheet

In € thousands	2007	2008	2009
Intangible fixed assets	571 633	614 541	630 445
+ Tangible fixed assets	260 684	294 951	294 325
+ Financial fixed assets	16 484	16 306	18 815
+ Other long term assets	872	561	12 385
<b>= Fixed Assets (1)</b>	<b>849 673</b>	<b>926 359</b>	<b>955 970</b>
Inventories	1 373	1 624	1 915
+ Accounts receivable	28 968	35 948	29 927
+ Other current assets	43 157	23 628	21 084
- Accounts payable	33 947	36 993	36 607
- Other current liabilities	78 455	77 730	80 281
<b>= Working capital (2)</b>	<b>(38 904)</b>	<b>(53 523)</b>	<b>(63 962)</b>
<b>Economic assets = (1)+(2)</b>	<b>810 769</b>	<b>872 836</b>	<b>892 008</b>
Shareholders' equity	161 085	138 396	122 252
+ Minority interests	5 899	6 126	3 315
<b>= Equity (3)</b>	<b>166 984</b>	<b>144 522</b>	<b>125 567</b>
Long term debt	666 494	721 146	411 456
<i>o/w convertible bonds</i>	92 547	90 391	-
+ Short term debt	3 158	31 142	393 531
<i>o/w convertible bonds</i>	-	-	100 217
- Cash & equivalents	25 867	23 974	38 546
<b>= Net Debt (4)</b>	<b>643 785</b>	<b>728 314</b>	<b>766 441</b>
<b>Capital employed = (3)+(4)</b>	<b>810 769</b>	<b>872 836</b>	<b>892 008</b>

**Working capital turnover**

	2007	2008	2009
Operating Working Capital/Sales (days)	-37d	-44d	-49d

**Profitability**

	2007	2008	2009
Operating profit after tax (33%) / Sales	8,2%	9,0%	8,9%
×			
Sales / Capital Employed (excluding financial assets)	0,5	0,5	0,6
<b>= After tax ROCE</b>	<b>4,0%</b>	<b>4,7%</b>	<b>4,9%</b>
<b>ROE, excluding non recurring items</b>	<b>-2,2%</b>	<b>-13,5%</b>	<b>-4,6%</b>
Gearing ratio (Net Debt / Equity)	386%	504%	610%

**Appendix 2:**  
**Financials for Medica's peers**

	<b>Medica</b>	<b>Orpéa</b>	<b>Korian</b>	<b>Le Noble Age</b>
2008 sales	€449m	€702m	€781m	€127m
Growth in volume	8.5 %	13.4 %	10.1 %	12.3 %
Market capitalisation	?	€1,227m	€627m	€133m
Value of net bank borrowings and financial debt, including minority interests	€769m	€1,194m	€542m	€82m
2009 EBITDA	€83m	€151m	€92m	€14m
2009 EBIT	€64m	€115m	€63m	€12m
2009 net profits	-€13m	€48m	€24m	€10m
2010 EBITDA	€93m	€175m	€105m	€18m
2010 EBIT	€73m	€137m	€73m	= €15m
2010 net profits	€25m	€66m	€28m	€11m

### Appendix 3:

## Application of discounted cash flows (DCF) by analysts for valuing Medica

### Discounting of free cash flows - Analyst 1.

Discounting of free cash flows - Analyst 1.										
Cash flows										
	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e
Sales	525	580	628	686	693	716	737	759	781	803
EBIT	73	82	90	99	104	104	107	110	114	117
- Theoretical tax at 34 %	(25)	(28)	(31)	(34)	(35)	(35)	(36)	(37)	(39)	(40)
+ Depreciation	29	20	21	21	21	22	22	23	24	24
- Capex	(39)	(35)	(35)	(30)	(28)	(26)	(27)	(28)	(29)	(30)
- Change in working capital	5	6	6	4	5	2	2	3	3	3
= Free cash flow	43	45	51	60	67	67	68	71	73	74
Cost of capital										
Risk free rate	3.40%									
Market premium	5.60%									
Beta of the stock	1.40									
Cost of equity	11.24%									
Perpetuity growth										
Perpetuity growth	2.5%									
Terminal cash flow 2020	76									
Computation of values										
Terminal value in 2019	868									
+ NPV of cash flows 2010-2019	342									
= Enterprise Value	1 210									
- Net debt and minorities	769									
= Equity value	441									
# shares	14.2									
Value of the share	31 €									

### Discounting of free cash flows - Analyst 2.

Discounting of free cash flows - Analyst 2.										
Cash flows										
	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e
Sales	525	580	628	686	693	716	737	759	781	803
EBIT	73	82	90	99	104	104	107	110	114	117
- Theoretical tax at 34 %	(25)	(28)	(31)	(34)	(35)	(35)	(36)	(37)	(39)	(40)
+ Depreciation	29	20	21	21	21	22	22	23	24	24
- Capex	(39)	(35)	(35)	(30)	(28)	(26)	(27)	(28)	(29)	(30)
- Change in working capital	5	6	6	4	5	2	2	3	3	3
= Free cash flow	43	45	51	60	67	67	68	71	73	74
Cost of capital										
Risk free rate	3.40%									
Market premium	5.60%									
Beta of the stock	1.40									
Cost of equity	11.24%									
Cost of debt after tax	4.33%									
Debt / Enterprise Value	45%									
Cost of capital	8.13%									
Perpetuity growth										
Perpetuity growth	2.5%									
Terminal cash flow 2020	76									
Computation of values										
Terminal Value in 2019	1 347									
NPV of Terminal Value	616									
+ NPV of cash flows 2010-2019	397									
= Equity Value	1 014									
# shares	14.2									
Value of the share	71 €									

### Discounting of free cash flows - Analyst 3.

Cash flows										
	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e
Sales	525	580	628	686	693	716	737	759	781	803
Net income	15	33	51	69	75	85	90	95	100	105
+ Depreciation	29	20	21	21	21	22	22	23	24	24
- Capex	(39)	(35)	(35)	(30)	(28)	(26)	(27)	(28)	(29)	(30)
= Free cash flow	5	18	37	60	68	81	85	90	95	99
Cost of capital										
Risk free rate	3.40%									
Market premium	5.60%									
Beta of the stock	1.40									
Cost of equity	11.24%									
After tax cost of debt	4.33%									
Net debt / Enterprise value	45%									
Cost of capital	8.13%									
Perpetuity growth										
Perpetuity growth	2.5%									
Terminal cash flow 2020	101									
Computation of values										
Terminal value in 2019	1 802									
NPV of Terminal value	825									
+ NPV of cash flows 2010-2019	380									
= Enterprise Value	1 204									
- Net debt and minorities	769									
= Equity value	435									
# shares	14.2									
Value of the share	31 €									

### Discounting of free cash flows - Analyst 4.

Cash flows										
	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e
Sales	525	580	628	686	693	716	737	759	781	803
EBIT	73	82	90	99	104	104	107	110	114	117
- Theoretical tax at 34 %	(25)	(28)	(31)	(34)	(35)	(35)	(36)	(37)	(39)	(40)
+ Depreciation	29	20	21	21	21	22	22	23	24	24
- Capex	(39)	(35)	(35)	(30)	(28)	(26)	(27)	(28)	(29)	(30)
- Change in working capital	5	6	6	4	5	2	2	3	3	3
= Free cash flow	43	45	51	60	67	67	68	71	73	74
Cost of capital										
Risk free rate	3.40%									
Market premium	5.60%									
Beta of the stock	1.40									
Cost of equity	11.24%									
After tax cost of debt	4.33%									
Net debt / Enterprise value	45%									
Cost of capital	8.13%									
Perpetuity growth										
Perpetuity growth	2.5%									
Terminal cash flow 2020	76									
Computation of values										
Terminal value in 2019	1 347									
NPV of Terminal value	616									
+ NPV of cash flows 2010-2019	397									
= Enterprise Value	1 014									
- Net debt and minorities	769									
= Equity value	245									
# shares	14.2									
Value of the share	17 €									