CASE 30 QUESTIONS

ST. BENEDICT'S TEACHING HOSPITAL

Merger Analysis

1. Use the data contained in the case to estimate the postmerger cash flows for 2018 through 2022 assuming that Lafayette General Hospital is acquired by St. Benedict's Teaching Hospital. You have very limited data on which to base your forecasts. The key is to make supportable assumptions about the potential synergies that can be obtained from the merger. Also, any cost savings to St. Benedict's that result from the merger must be included in the analysis. (Hint: Use embedded interest expense in your forecast, but do not include any interest to fund the acquisition.)

2. Conceptually, what is the appropriate discount rate to apply to the cash flows? What is your actual numerical estimate? Do you have much confidence in it?

3. What is your estimate of Lafayette General's value to St. Benedict's using the DCF valuation technique? What are the strengths and weaknesses of this technique both in general and as applied in this situation?

4. A major concern in any DCF valuation is the accuracy of both the terminal (long-term) growth rate and discount rate estimates. How sensitive is the acquisition value to these estimates?

5. What is your estimate of Lafayette General's value using the market multiple valuation technique? What are the strengths and weaknesses of this technique both in general and as applied in this situation? (Remember that there are two bases for this approach—EBITDA and number of discharges.)

6. What is your final conclusion regarding the value of Lafayette General to St. Benedict's? How much should St. Benedict's initially offer for Lafayette General?

7. Assume that Hospital Associates of America (HAA) conducted a valuation of Lafayette General Hospital.
   a. Would HAA place a higher, lower, or about the same value on Lafayette General than would St. Benedict's? Justify your answer.
   b. Would the degree of interest exhibited by HAA in acquiring Lafayette General influence the amount of St. Benedict's initial offer?

8. How much external financing would St. Benedict's have to arrange to pay for the acquisition? (Hint: Consider the amount of excess cash on hand first. See exhibit 30.4 for guidance.) What types of securities and maturity structure should be specified in the financing plan?

9. Assume that the acquisition takes place.
   a. What organizational structure should be used for the combined enterprise?
   b. Should the medical staffs of the two hospitals be integrated (all physicians having privileges at both hospitals) or kept separate?

10. In your opinion, what are three key learning points from this case?