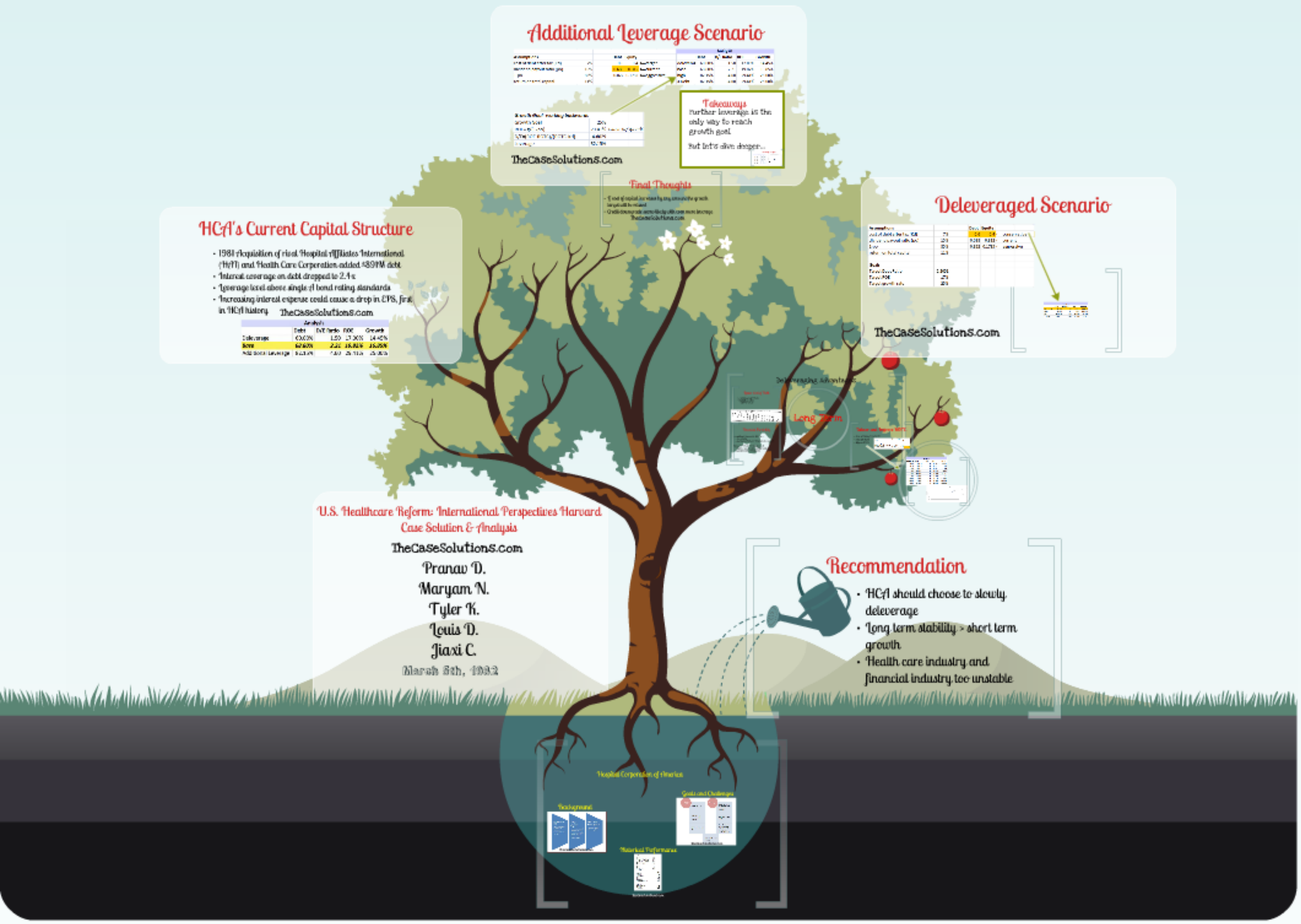
Additional Leverage Scenario
Takeaways
Further leverage is the only way to reach growth goal
But let's dive deeper...
TheCaseSolutions.com
Final Thoughts
HCA's Current Capital Structure
1981 Acquisition of rival Hospital Affiliates International (HAI) and Health Care Corporation added $891M debt
Interest coverage on debt dropped to 2.4x
Leverage level above single A bond rating standards
Increasing interest expense could cause a drop in EPS, first in HCA history
TheCaseSolutions.com
Deleveraged Scenario
TheCaseSolutions.com
Long Term
U.S. Healthcare Reform: International Perspectives Harvard Case Solution & Analysis
TheCaseSolutions.com
Pranav D.
Maryam N.
Tyler K.
Louis D.
Jiaxi C.
March 8th, 1982
Recommendation
HCA should choose to slowly deleverage
Long term stability > short term growth
Health care industry and financial industry too unstable
Hospital Corporation of America
Background
Goals and Challenges
Historical Performance

U.S. Healthcare Reform: International Perspectives Harvard Case Solution & Analysis

TheCaseSolutions.com

Pranav D.

Maryam N.

Tyler K.

Louis D.

Jiaxi C.

March 5th, 1982

Background

Established in 1968

- One of the premier management companies
- Flourished during the 70's

Federal Healthcare Programs

- Medicare/Medicaid created in 1965
- Consistent cash flow helped Hospital management industry thrive

Early 1980's

- Period marked by contractionary monetary policy
- Spending Cuts

Goals and Challenges

Financial Goals

- Sustain 17% ROE
- Achieve 25% Annual Nominal Growth
- Maintain 60% Debt Ratio

Challenges

- Federal spending cuts for mandated healthcare programs
- Debt Ratio risen to 68.8 %
- Use of leverage concerns rating agencies. Have threatened to lower bond rating

Reevaluate Capital Structure

mance

Historical Performance

Hospital Corp of America

1981 ROE	23.7%	
1981 Ratio of Market to book value	2.806	
Growth in hospitals, 1976-1981	30.1%	
Growth in net income, 1976-1981	32.4%	
1981 Revenues/ bed	$ 48.26	
1981 Net Income/bed	$ 2.23	
P/E ratio	18.5	
EPS	2.23	
Market Price/Share	41.255	
Book value/share	14.7	
		1981
Selcted Ratios		
Current Ratio		1.4
Net Profit Margin		4.6
ROA		6.9
ROE		23.7
Asset Turnover		1.5
Total debt/Total Capital (%)		68.6
Hospital Data		
Hospitals in Operation		349
Bed Capacity		49886
Occupancy Rate		68%

HCA's Current Capital Structure

- 1981 Acquisition of rival Hospital Affiliates International (HAI) and Health Care Corporation added $891M debt
- Interest coverage on debt dropped to 2.4x
- Leverage level above single A bond rating standards
- Increasing interest expense could cause a drop in EPS, first in HCA history

Analysis				
	Debt	D/E Ratio	ROE	Growth
Deleverage	60.00%	1.50	17.00%	14.45%
Base	***68.80%***	***2.21***	***19.82%***	***16.85%***
Additional Leverage	82.15%	4.60	29.41%	25.00%

Additional Leverage Scenario

Assumptions		Debt	Equity	
cost of debt after tax (Kd)	7%	0.6	0.4	<==target
dividend payout ratio (po)	15%	0.688	0.312	<==current
1-po	85%	0.822	0.1785	<==aggressive
return on total capital	11%			

Analysis				
	Debt	D/E Ratio	ROE	Growth
deleverag	60.00%	1.50	17.00%	14.45%
base	68.80%	2.21	19.82%	16.85%
high	82.15%	4.60	29.41%	25.00%
X Debt	82.15%	4.60	29.41%	25.00%

Growth Goal- working backwards		
Growth Goal	25%	
ROE= g/(1-po)	29.41%	*<-ROE w/ g=25%*
D/E=(ROE-ROTC)/(ROTC-Kd)	4.6029	
Leverage	82.15%	

TheCaseSolutions.com

Takeaways

Further leverage is the only way to reach growth goal

But let's dive deeper...

Final Thoughts

- If cost of capital increases by any amount the growth target will be missed
- Credit downgrade seems likely with even more leverage

.com

Final Thoughts

- If cost of capital increases by any amount the growth target will be missed
- Credit downgrade seems likely with even more leverage

Deleveraged Scenario

Assumptions			Debt	Equity	
cost of debt after tax (Kd)	7%		0.6	0.4	<==conservative
dividend payout ratio (po)	15%		0.688	0.312	<==current
1-po	85%		0.822	0.1785	<==aggressive
return on total capital	11%				
Goals					
Target Debt Ratio	2.2051				
Target ROE	17%				
Target growth rate	25%				

Analysis				
	Debt	D/E Ratio	ROE	Growth
deleverage	60.00%	1.5	17.00%	14.45%
base	68.80%	2.21	19.82%	16.85%
high	82.15%	4.60	29.41%	25.00%
X Debt	82.15%	4.60	29.41%	25.00%