Extract / Examples
Draft

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Company valuation with focus on banking valuation

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Why do we need (bank) valuation?

2010

- TBIF Financial Services B.V. (investment group Kardan) sold 84% of **VAB Bank**. Multiplier of transaction was equal to 1-1.1
- Platinum Bank bought **Home Credit Bank**. Multiplier is assessed on the level of 1-1.1
- System Capital Management group bought 100% of **Bank Rennaissance Credit**. Multiplier – 1.1-1.2
- Bank of Georgia sold 80% of **BG Bank** to private investors. Multiplier was equal to 0,82

Four international groups left Ukrainian banking market in 2010

2011

- Nikolay Lagun sold 30% of **Delta Bank** to Cargill Financial Services Corporation
- Redestribution of share capital in **Bank "Ukrainian Capital"**: The Ukrainian-Swiss Joint Stock Insurance Company sold 43,29% to Vladimir Gavriliuk who previously owned 31.16%.

M&A activity had been restarted in CEE region, but not in Ukraine.

Source: http://www.kreditprombank.com/upload/content/385; http://www.mergermarket.com

Section 1

Fair value and income valuation approach

Let's have a look on the different kinds of value

Market value (Tax and general; objective/standalone basis)	Market value (Price/M&A)
Fair value (Accounting)	Fair value (Legal issues)
Economic value	Value in use (Accounting) *or* Investment Value (particular investor's subjective view)

There are different valuation methods within two common approaches that are used for determining the value of a company

Income approach

„Gross value“ (Enterprise Value)

DCF methods:
- ⇨WACC-approach
- ⇨APV-approach

„Net value“ (Equity Value)

DCF methods:
- ⇨Equity-approach

⇨**Discounted dividends**

Market approach (Multiples)

„Gross value“ (Enterprise Value)

- ⇨EBIT multiple
- ⇨EBITDA-multiple
- ⇨Sales-Multiple

„Net value“ (Equity Value)

- ⇨**Price-Book-Multiple**
- ⇨Price-Earnings-Multiple

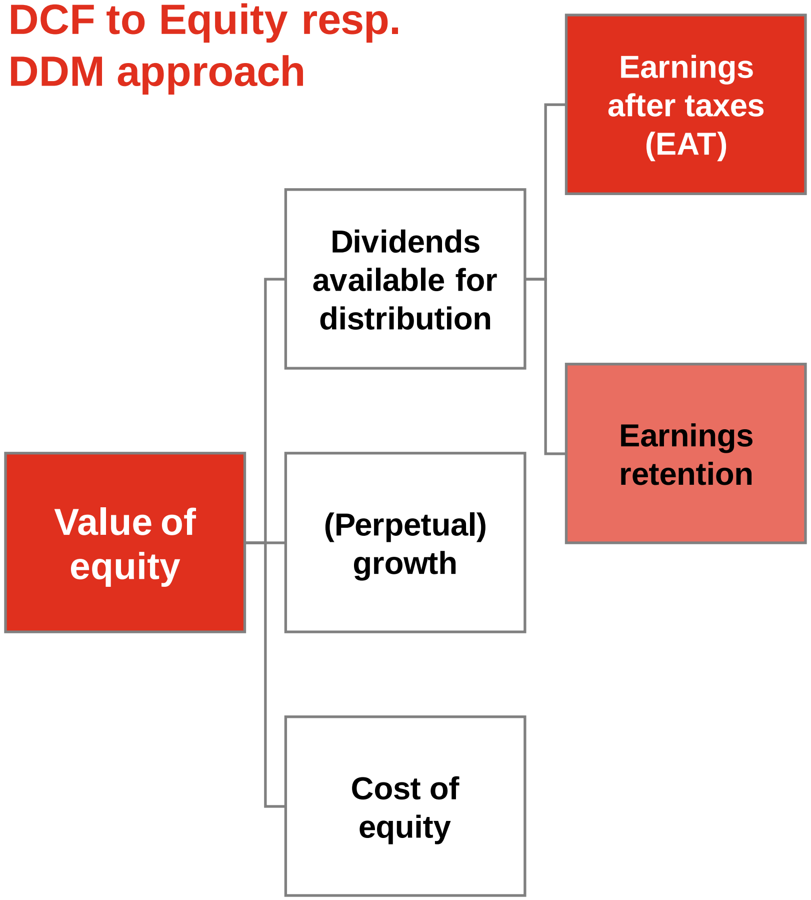
Bank valuation rises some further questions (1/2)

Bank valuation methodology has to consider the special nature of the business model:

- Liability side of the balance sheet not only represents the funding of a bank's business activities but is also an integral part of a bank's operations (e.g. customers' savings accounts). Leverage is considered very high compared with companies operating in other industries.
- Given that deposits are part of their business activities, interest expenses are included in the operating cash flow.
- The application of the enterprise DCF method would require determining the market value of the bank's debt as well as a weighted average of the cost of debt.

Bank valuation rises some further questions (2/2)

DCF to Equity resp. DDM approach



- However, given that the management of liabilities forms an integral part of a bank's operations, this approach is not feasible.
- Additional equity required from outside the bank may form part of the valuation as negative flows to equity.

Thus, only Equity methods are applied.

Section 2

The discount rate

According to CAPM, Cost of Equity contains a risk free rate and a risk premium

$$r_E = r_{rf} + \beta_{Stock,Index} \times MRP_{Index}$$

Risk free rate determined by AAA rated countries

Comparable company or peer group companies

Market portfolio: Reflects the investment opportunity of the investor (e.g. local vs. global)

General comments

- CAPM widely accepted in theory and practice (although empirical power has been challenged)
- Interest rate / cost of capital is always related to a certain currency, e.g. UAH risk free interest rate ≠ EUR risk free interest rate or USD risk free interest rate ≠ EUR risk free interest rate in general
- In the long run any difference should be explained by the differential in expected inflation rate.

The Beta is also one of the value drivers

Comparators and the corresponding betas used for valuation of Ukrainian bank

Example

Betas of comparable companies

Bank	Country	Beta
Raiffeisen bank Aval	Ukraine	1.25
Kazkommertsbank	Kazakhstan	0.95
Halyk Savings bank	Kazakhstan	1.64
Bank Moskovsky	Russia	0.65
Rosbank	Russia	0.56
Bank Vozrozhdeniye	Russia	0.87
Moscow Industrial bank	Russia	0.92
Median		**0.92**

Source: Bloomberg

- Quality of comparators is most important
- Apart from assessing the quality of comparators (e.g. through business descriptions), consider the following:
  - ✓ Size
  - ✓ Statistical significance of regression estimate
  - ✓ Evidence of distress (e.g. excessive gearing)
  - ✓ Number of observations

Section 3

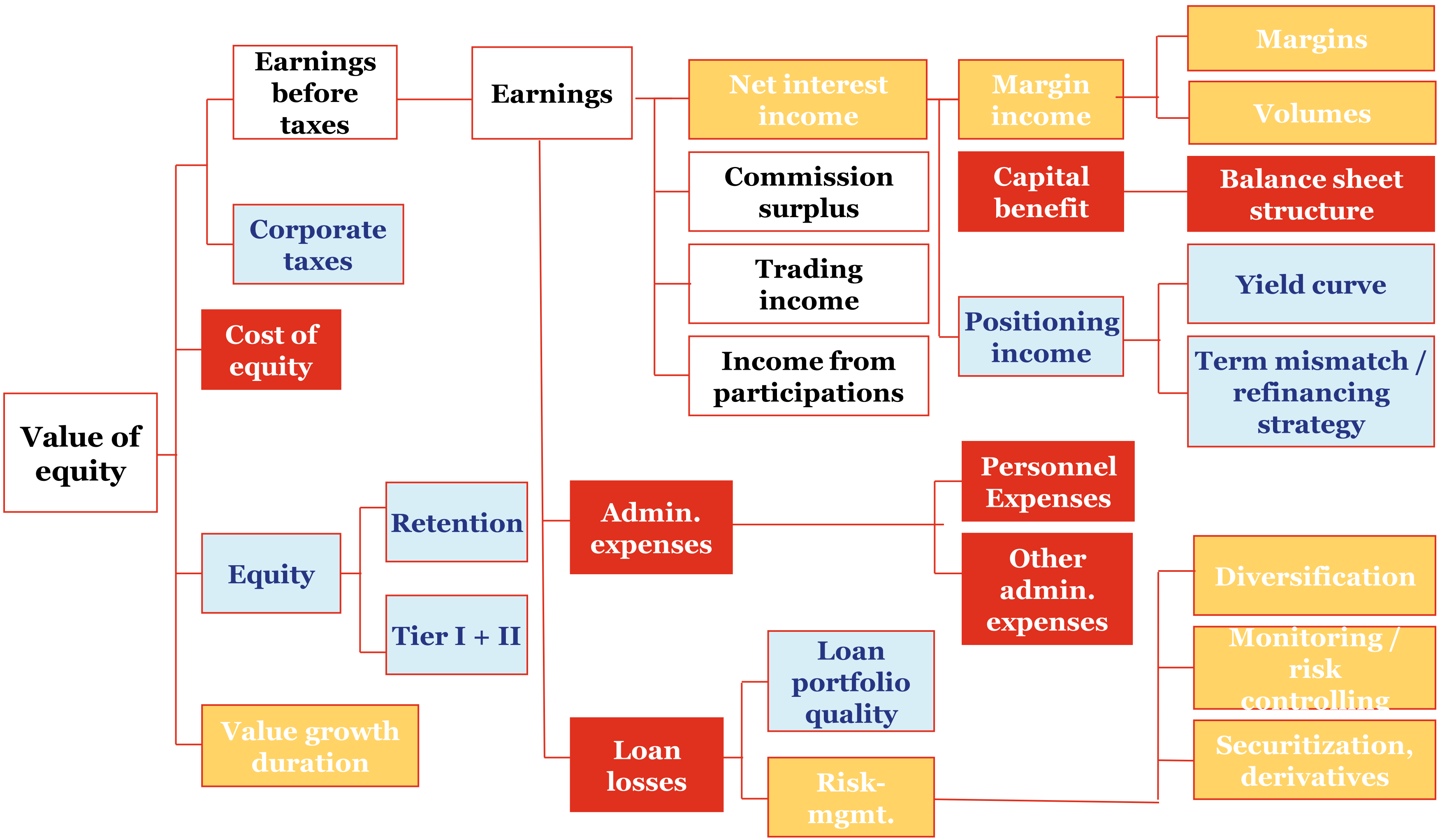
It's time to develop a valuation model

Note: Thinking about cash flows starts with the business involved, not with the accounting figures

Trying to understand the underlying business

1. Strategic issues
   - Competitive advantages: interdependencies
   - Value chain/Market "forces": basic needs
2. Value flexibility
   - Timing issues/Decisions on scale
   - Interactions/Technology/Innovation
   - Learning effects/Choice of scope

In the bank valuation there are different "value drivers"



Section 4

Q&A session

Thank you for attention!

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