

Bank Valuation

A two-day intensive case study and computer modelling based workshop offering a structured approach to the analysis and valuation of bank equity. Key drivers, performance indicators, forecasts and stress tests are combined to address the challenges of bank valuation post credit crisis.

TARGET AUDIENCE

Targeted for equity analysts and investors, M&A and equity capital market professionals. The workshop is highly intensive and assumes participants will be familiar with financial terms, general accounting and valuation principles. For analysts who wish to refresh these skills, we recommend the workshop: Introduction to Bank Financial Statements. We also offer an advanced level workshop Advanced Bank Analysis: Evaluating Complex Financial Statements which could serve as a follow-on to Bank Valuation for very experienced analysts.

COURSE OBJECTIVES

The overall goal of this two day workshop is to give participants a structured approach to the valuation of a bank.

- Specifically, participants will be equipped to:
 - Identify and benchmark the key performance drivers for banks in order to identify strong and weak performers
 - Anticipate the economic, regulatory and strategic issues which will drive bank valuations and capital needs going forward
 - Forecast future performance and growth in order to value potential earnings and dividend flows
 - Use multiples, dividend methodologies and distributable profit to assess the current and future equity value of a bank
 - Recognise both the upside potential of bank performance and the risk of further stress on bank earnings and capital that could cause valuations to fall
 - Apply these techniques in a modelling case study to build a valuation assessment of a large international bank.

CONTENT ANALYTIC OVERVIEW

The goal of this section is to introduce a structured approach to the analysis of banks and to compare the key valuation parameters of the equity investor with the perspective of other key players in the market.

Valuation goals

- Shareholder perspective: equity performance indicators – share price, return vs. index, total shareholder return, beta, multiples, economic value added
- M&A opportunities: consolidating markets, distressed banks, growth opportunities
- Capital needs: growth pressures, regulatory changes, distressed recapitalisations
- Differing perspectives: shareholder vs. regulators, debt markets and rating agencies; regulatory and refinancing constraints on bank valuation.

Structured approach

- Value parameters: key parameters of value: franchise, true asset quality, market potential for growth, protected market position, future outlook, potential for diversification of activities, time frame for action etc.
- Value drivers: operating environment, management and franchise, financial fundamentals
- Structure: financing alternatives: ordinary vs. hybrid capital; key considerations: dilution regulatory and rating constraints.

VALUE DRIVERS I: OPERATING ENVIRONMENT

The goal of this section is to review the key macro economic and competitive factors which differentiate bank performance in different markets and understand the regulatory issues which will drive bank strategy and potentially constrain performance going forward.

Macro-economic and competitive factors

- Impact of interest rates, credit growth and other macro-economic variables on performance;
- Competitive and structural issues of the banking system: drivers of differential profitability in key markets.

Regulation and supervision

- Key regulations: implementation of liquidity, capital, lending limits and other guidelines in different markets
- Capital adequacy: key provisions of Basel II for risk weighted assets
- Impact of Basel III on capital adequacy, leverage and liquidity
- Other regulatory developments e.g. Frank Dodd bill in the US
- Hybrid capital; types of hybrid capital – historic and recent innovations e.g. reserve capital instruments, trust preferred securities, contingent convertibles etc; changing regulations
- Tier one core capital requirements: composition and adjustments to tier one and core tier one capital
- Impact of M&A on capital: positive and negative goodwill; impact of dilution on share price; impact of consolidation on risk weighted assets and capital ratios.

Case study: Using economic environmental assumptions to build growth forecasts for a multi-national bank.

VALUE DRIVERS II: MANAGEMENT AND FRANCHISE

The goal of this short section is to review management strategy and risk management challenges and the impact this has on capital allocation.

- Bank business models and sources of franchise
- Structured approach to the assessment of management: strategy, systems, skills and structure
- Risk management challenges: key risks in banks and the models and processes used to manage them; lessons learned from the credit crisis
- Economic capital models to manage risk and allocate capital.

VALUE DRIVERS III: FINANCIAL DRIVERS

The goal of this section is to review the key performance indicators of banks in order to forecast and sensitise future earnings, asset growth, funding sources and capitalisation.

Statement logic

- Relating the bank's businesses to its balance sheet and profit and loss
- Key assets and liabilities in the banks balance sheet and how these drive the income statement
- Review of key accounting principles: IFRS and GAAP standards
- Performance drivers; asset growth and quality
- Key risks in the loan portfolio
- Business drivers of growth, credit appetite, liquidity needs,
- Loan quality: portfolio analysis, impaired loans and reserve adequacy
- Reconciling loan loss provisions between IFRS and Basel 2/3
- Trading and investment portfolios: quality and purpose of securities and derivatives portfolios; realised and unrealised gains and losses; impact on earnings and capital
- Value at risk; Principles, limitations and need to supplement / stress test
- Fair value hierarchy and mark to model issues
- Impairment provisions; estimating potential requirements for provisions and write downs.
- *Illustration case study:* forecasting asset growth and impairment provisions.

Performance drivers: earnings

- Key drivers of earnings: income stability and diversity, growth potential, cost control
- Core income sources: benchmarking and forecasting net interest, fees, commissions and trading
- Expense management: forecasting and sensitising expenses; management targets and peer comparisons.

Illustration case studies: Using assumptions about costs, income and risks to build a forecast for a large international bank

Financial structure - liquidity

- Funding: stability and variety of funding sources, contingency funding
- Liquidity: assessing dependence on short-term wholesale funding, inter-bank market; key challenges of repo and CP funding; defining liquid asset needs
- Gap / asset and liability (ALM) management: managing re-pricing and refinancing risk
- Capital markets funding; use of securitisation, covered bonds and unsecured bond markets to source stable funding.

Financial Structure - Capital Adequacy

- Capital Adequacy for Basel II and III
- Impact of leverage ratios
- Stress Tests on capital.

Illustration case study: Building a funding strategy and assessing capital adequacy for a large international bank

VALUATION

The goal of this section is to review the application of key valuation tools used to value banks.

- Exit routes: Sale to strategic partners, trade sale, management sale. Financial investors, IPO, cash out
- Multiples valuation: price / earnings and price / book valuations
- Cost of equity: bank betas and risk premia
- Internal Rate of Return methodologies
- Multiple valuation techniques: Price / earnings, assets, alternative methodologies for non-banking divisions.
- Contribution valuations and payment in kind
- Dividend discount model: three-stage dividend discount model – key assumptions relating to growth phases and payout levels
- Distributable profit methodology: building an assumption about required capital retention into earnings forecasts
- Distressed bank valuations: valuing banks in distressed markets with negative earnings and / or equity.

Illustration case study: application of analytic tools to assess the fair value of a large international bank and comparison to its current market price.

Learning Paths

