

Bank & Financial Institution Modeling: – Certification Quiz Questions

Module 5 – Bank Growth Equity Model

19. Which of the following statements BEST describes how the Returns Sources in a growth equity deal for a bank might differ from the Returns Sources for a traditional company?
- a. Unlike in a growth equity deal for a traditional company, Debt Repayment cannot be a Returns Source for a bank.
 - b. Dividends are a significant Returns Source in a bank growth equity deal, but they could not be in a deal for a traditional company.
 - c. Cash Generation boosts returns in traditional growth equity deals, but it makes no impact in bank deals because banks cannot freely distribute their Cash.
 - d. The Returns Sources are similar, but financial growth and multiple expansion are based on different metrics in bank growth equity deals.

20. You have built a growth equity model for a commercial bank that assumes an investment in 10% of the bank's equity and an exit in 3.5 years based on a range of P / TBV multiples.

In the Downside Case for this deal (screenshot shown below this question), the IRR and MoM Multiple are slightly below your firm's targets of 1.5x and 12%, respectively.

The Purchase P / TBV multiple was approximately 1.7x, which was a ~10% discount to the company's pre-transaction share price. What is the MOST PLAUSIBLE way to boost the MoM multiple and IRR in this deal?

Returns to Equity Investors:	Units:	Projected							
		1H 17	2H 17	1H 18	2H 18	1H 19	2H 19	1H 20	2H 20
Exit P / TBV Multiple:									
Upside	x		2.00 x	2.15 x	2.30 x	2.45 x	2.60 x	2.75 x	2.90 x
Base	x		1.80 x	1.90 x	2.00 x	2.10 x	2.20 x	2.30 x	2.40 x
Downside	x		1.70 x	1.60 x	1.50 x	1.40 x	1.50 x	1.60 x	1.70 x
Selected Exit P / TBV Multiple:	x		1.70 x	1.60 x	1.50 x	1.40 x	1.50 x	1.60 x	1.70 x
Tangible Book Value Upon Exit:	\$ B		\$ 62.8	\$ 63.6	\$ 64.4	\$ 65.2	\$ 66.1	\$ 67.0	\$ 68.0
Implied Equity Value Upon Exit:	\$ B		106.8	101.7	96.6	91.3	99.1	107.3	115.6
Net Income Growth:	%		2.1%	(10.4%)	(17.7%)	(3.8%)	16.0%	21.7%	19.1%
Return on Tangible Common Equity (ROTCE):	%		10.3%	8.5%	7.6%	7.9%	8.6%	9.4%	9.9%
Return on Equity (ROE):	%		9.2%	7.7%	6.9%	7.2%	7.8%	8.6%	9.2%
P / TBV Multiple Implied by ROTCE and NI Growth:	x		1.53 x	1.06 x	1.00 x	1.04 x	0.87 x	0.87 x	0.79 x
Cash Flows to Equity Investors:									
(-) Initial Equity Investment:	\$ B	(9.3)	-	-	-	-	-	-	-
(+) Portion of Dividends:	\$ B		0.1	0.2	0.2	0.2	0.2	0.3	0.3
(+) Proceeds from Sale of 10.0% Stake:	\$ B		-	-	-	-	-	-	11.6
Total Cash Flows to Equity Investors:	\$ B	(9.3)	0.1	0.2	0.2	0.2	0.2	0.3	11.8
Money-on-Money (MoM) Multiple:	x								1.4 x
Internal Rate of Return (IRR):	%								10.6%
Multiple for Sensitivities:	x	1.4 x							
IRR for Sensitivities:	%	10.6%							

- Negotiate a higher upfront discount to reduce the Purchase P / TBV multiple.
- Assume a lower Targeted CET 1 Ratio so that the bank can issue more in Dividends in each period.
- Assume a higher Exit P / TBV multiple since the company's financial metrics improve by the end of the period.
- Assume an Exit in Year 2 or 3 instead of waiting for 3.5 years.