

Bank & Financial Institution Modeling: – Certification Quiz Questions

Module 6 – Bank Buyout Model

21. If a private equity firm acquires 100% of a commercial bank using 100% Equity, which of the following statements are TRUE?

This question has 3 correct answers and 1 incorrect answer. You must select ALL THREE correct answers and no incorrect answers to earn a point for this question.

- a. Most likely, the PE firm has joined with other firms in a “club deal” so that no single firm owns more than 20 – 25% of the bank.
- b. A Returns Attribution Analysis for such a deal will be more similar to one for a growth equity deal rather than one for a traditional leveraged buyout.
- c. The PE firm’s success or failure depends heavily on its ability to change this bank’s Targeted CET 1 Ratio and Dividend Payout Ratio.
- d. The PE firm likely sees opportunities to boost this bank’s ROTCE, which should, in theory, also boost its P / TBV multiple.

22. A private equity firm is considering a buyout of a regional bank. The bank's ROE is 15%, its Cost of Equity is 12%, and its Net Income Growth Rate is 2%, so its implied P / BV multiple is $(15\% - 2\%) / (12\% - 2\%) = 1.3x$.

The bank's Current Book Value is \$500 million, so its Implied Equity Value is \$650 million based on this 1.3x P / BV. To achieve a 25% IRR over 5 years, the PE firm must sell the bank for an Equity Value of approximately \$2 billion at the end of the period. The firm believes that the bank’s Book Value will increase to \$1 billion after 5 years, and the bank does not plan to issue any Dividends during the holding period.

So, the P / BV multiple will need to expand from 1.3x to 2.0x to make this 25% IRR feasible. What is the most PLAUSIBLE way to achieve this multiple expansion, given the numbers described here?

- a. Increase the bank's ROE to 22% by the end of the holding period.
- b. Increase the bank's Net Income Growth to 9% by the end of the holding period.
- c. Reduce the bank's Cost of Equity to 8.5% by the end of the holding period.
- d. None of the above – these all seem unrealistic, so the firm must rethink its assumptions, pay a lower price, or get more Book Value growth.