Financial Analysis and Valuation of Komercni Banka

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MSc in Finance Capstone Project

Academic Year | 2019-2020

Introduction

The aim of this capstone project is to perform financial analysis of Komercni Banka, analysis on their economic environment and based on the different assumptions to conclude if the bank share prices are fairly priced on the market or the bank is undervalued.

The most challenging part of the project was to make the projections of different aspects of the bank, its loan, deposit portfolio, interest income and expense. To come up with real numbers on bank growth and projections I took on consideration the overall GDP growth, since the any company cannot grow in size more than the overall GDP growth, also I researched on what different analysts suggest about the bank and came up with the final model about bank projections and valuation.

Special thanks to Concorde Securities, without which I would not have the opportunity to search about bank analysis and valuation.

Building the Model

Banks in compression to other companies are subject to many regulations, in order to reduce different risks, while building the model the most important thing is to check if we are meeting these requirements and our projections meet all the requirements, such as Common equity tier 1, which for European banks must be at least 14.1%. While building our assumption and projections we should always check if we meet this requirement.

To build the model for my bank and to do the projections I took in consideration the overall market situation since the banks are directly affect with what's going on in the market, also based on bank annual report and future projections that bank presented on it, projections I build the projections for bank loans and deposits, then came up with projections on interest income and expense and bank net income.

I used Divided Discount Model and Relative Valuation Assumptions to check if the bank is overvalued or undervalued, the reason why to use DDM for banks and other financial institutions is because Free cash flow, which is a main component that is used to value the bank by Discount Cash Flow Model, does not have a significant meaning because changes in in working capital can be massive due to the balance sheet -centric nature of the business. Also, capital expenditures are very low since they are not directly re-investing in their business.

Banking Industry Challenges

Increase in Fintech Competition

As with other businesses, digitalization is all over in banking industry too. Banks nowadays do not have to compete only with each other but with digital banks too. Modern FinTech choices counting Revolut, PayPal, TransferWise, Improvement, and numerous others offer many banking services such as offering credit or debit cards and customers do not have to pay any fees generally. Numerous of the most up to date FinTech companies, frequently mobile-only "neo-banks," from all over the globe and it's a risk for traditional banking industry and also in our case for Komecni Banka too since the bank its located in a very urban and developed country means that the bank its highly exposed to fintech competition.

Investing in mobile first-banking

Retail Banking has shift to a mobile-first business, since customers are more and more relying on technology, studies shows that most of the customers use mobile banking and the statistics show that the number is increasing each year. Banks have to prepare for this to have an up to date mobile application and to be invest in their mobile application and other digital ways since they might face some risks, since customers are shifting more and more towards digital banking.

Regulatory Compliance

Banking Industry is one of most regulated sectors of the industry, regulatory compliance has become one of the most challenging part of the banking industry due to the increase in the regulatory fees relative to their income and earnings. There a lot of requirement that banks have to comply such us Dod Frank, risk-weighted capital requirements and many more.

Macroeconomic Environment in Czech Republic

The Czech macro trends, the trends in the banking sector, and the challenges the industry may face in the future are important aspects to check.
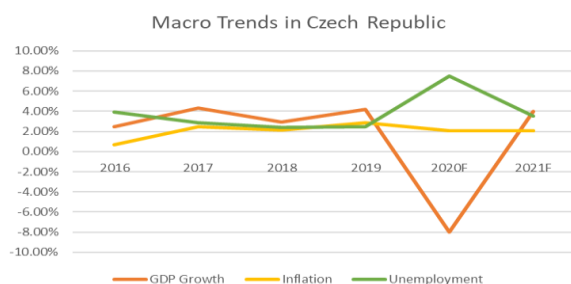
Source: CNB

Czech economy has been stable during the recent years and has been one of the most fastest growing economies across Central Europe. The Central Bank of Czech Republic expects GDP -

8%, this due to recent situation of coronavirus, and in 2021 CNB expects GDP growth to be 4%.e CNB expects the coronavirus epidemic to cause a downturn in economic activity, which in turn will affect loan portfolios of each individual bank.

Due to this crisis CNB allowed banks to postpone loan installments, in order to help clients who's their income was disrupted due to the recent crisis.

CNB lower the countercyclical capital buffer rate on bank from 1.75% to 1%. This decision means that banks will need less capital for every loan provided to the domestic economy, this in turn would give more leeway firms and individuals whose income where disrupted by recent crises.

Key Learning Outcomes

To come up with predictions and finding I had to read and analyze the company annual reports and other analysis about the banks, on this way I learnt many things about banking industry specifically and how financial services companies are organized, how they work, the way that they are build and how they function. Also building models for bank valuation it was one of the things that I learnt throughout the project, how to make analysis on banks financial statements and how to build a valuation model about it.

Also making prediction is another thing that I managed to learn throughout the project, since the most important part when performing a company valuation is to come up with predictions I had to deal a lot with it, and had to decide about the growth of the bank overall.

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