Analysis of sdb

This report aims to provide an analysis of a proposed investment in Sheen Development Bank (SAD) by Unabridged in 2002 and assess whether the P/B ratio of 1. 6 for Unabridged to pay for its 18% stake in SAD is appropriate. The analysis of Newbie's acquisition of Sad's stocks Is based on several aspects of Sad's asset quality, earnings capability and capital adequacy. According to price-to-book ratio of SOB's Industry peers and some acquisition precedents by foreign Investors, Unabridged made a correct decision that It paid 1. Times book value of Sad's stake on basis of SOB's performance. This Is because of Sad's high P/B ratio and low ROE Indicating that SOB's share price was overvalued; therefore, Unabridged acquisition of Sad's stocks was appropriate with a P/B ratio of 1. 6. Finally, this report provide a reasonable recommendation for Investors to make a correct occultation decision In terms of real profitability of occultation targets. Table of contents: Four Chinese banks had begun to accept investments from foreign banks or financial investors since 1999.

As a listed bank with huge developing potentials, SAD was snagged by government officers and encumbered by massive low-quality loans which resulted in high Naps, an under-capitalized balance sheet and disappointing profitability. In order to bring to SAD the best management practices and expertise in banking, the Sheen government was primarily seeking long-term foreign strategic investors. Therefore, SAD decided to sell its four Joint shareholders' 18% non-traceable legal person stake of SAD.

At the same time, Newbie's successful experience in South Korean bank and its strong expertise in financial institution significantly enhanced the quality of its loan portfolio and its operating performance. Then, Unabridged was actively acquiring Sad's 18% stake in order to improve Sad's bad performance. This report will analyze how Sad's ratios in its balance sheet influence Newbie's acquisition decision as to Sad's price-to-book ratio. The paper also Justifies that Unabridged pays 18% Sad's shares with a reasonable P/B ratio. 3. 0 Main Body 3. Asset quality Difficulties in cash flows in a bank are always caused by a high NAP ratio. NAP ratio is a crucial tool to assess a banks performance, which is calculated as net non- reforming loans divided by total gross loans. Banks often report their NAP ratio as a measure of the quality of their outstanding loans. The higher the NAP ratio, the more possibility such returns will be lost and vice versa. As is shown in the Appendix 2, the NAP ratio decreased from 22. 7% to 1 1. 6% during the period from 2000 to 2002 Compared with Sad's industry peers, Sad's NAP ratio is higher than the average amount of its peers.

The NAP ratio of SAD was only below Bosom's, but far higher than other Joint-stock banks in 2002. Sad's NAP ratio was 1 1. 6% in 2002, to some extents, this ratio means that Sad's cash flows were falling into much more troubles and difficulties than other Joint-stock banks. On the other hand, Loan Loss Reserves by Gross Loans determines the quality of loans of a bank. LARK is a percentage that reflects accumulated provision expenses and gives an indication of the management's expectation of future loan losses. The higher the ratio, the more suspicious the loans are and vice versa.

The LARK ratio of SAD declined from 7. 1% to 3. 9% from 2000 to 2002, which was approximately the them. Although the LARK ratio of SAD decreased by nearly 3% during these three ears, Sad's loan loss reserves increased almost 100 million. By comparison with its industry peers, Sad's LARK/NAP was largely lower than the average level. Hence, Sad's high NAP ratio led to a low asset quality in 2002. 3. 2 Earnings capability Obviously, Sad's net interest margin declined by 1% from 2000 to 2002; compared with its industry peers, Sad's net interest margin was 0. % higher than the average ratio of other five Joint-stock banks in 2002. This indicates that Sad's ability of making profits is stronger than the average level. Meanwhile, Sad's non-interest income level ND operating expense were above the average level in 2002. Nevertheless, Sad's ROAR was 0. 9% in 2000 and was only 0. 3% in 2002. This ratio was merely half of the average ROAR of other five Joint-stock banks in 2002 indicating that Sad's profitability of the assets was relatively weak as well as its ROAR at the same time. Sad's ROAR was only one-third of the average ROAR of five Joint-stock banks.

Therefore, Sad's performance was not good compared with its industry peers; the reason of Sad's bad performance is that an increasing assets generating low net income. 3. 3 Capital adequacy In commercial banking, capital adequacy ratio (CAR) is used to monitor a banks situation of capitalization by regulators and managers. CAR is calculated as the sum of tier 1 capital (equity and retained earnings) and tier 2 capital (subordinated debt and reserves) and dividing it by its risk-weighted assets. Sad's CAR decreased from 10. 6% in December 2001 to 9. % in December in 2002, but still above the Chinese regulatory floor of 8%. It is particularly worth mentioning here that Sob's CAR was 0. 7% higher than the average CAR of other five Joint-stock banks in 2002. Not all the mime the CAR is good if high; a high CAR means that a banks large amount ofmoneyis stuck in provisions or risk management, and there would be fewer money left for investment or for the continuation of some activities. Therefore, from the situation of Sob's declining CAR, SAD suffered in substantial loan quality troubles caused by its poor credit management. . 4 Price-to-book ratio It would be appropriate for Unabridged to pay 1. 6 times book value to get 18% stocks of SAD. There were some precedent that foreign banks and financial investors acquired domestic banks' minority-stake from 1999 to 2001. For example, AFC acquired Bank of Shanghai 5% stake at a price-to-book ratio of 1. 5 in September of 1999; and acquired 15% stake of Nanjing City Commercial Bank at a price-to-book ratio of 1. 2 in November 2001. Even if Newbie's acquisition of Sad's stake at the price-to-book ratio of 1. Is higher than If's; however, it was still lower than the average ratio of other three domestic listed banks. Significantly, the price-to-book ratio of SAD was around 5. 5 to 5. 9 from 2002 to 2003; and at the same, the other three banks average price-to-book ratio was 3. 1 to 2. 2. Hence, the appropriate ululation range should be below 2. 2 for Newbie's acquisition. As we can calculate that the ROE of SAD was decreasing from 12. 07% to 9. 02% from 2000 to 2002. P/B provides a valuable reality inspection for investors seeking growth at a reasonable price.

Large differences between P/B and ROE, a key growth indicator could sometimes send up a red flag on companies. As a result. Sad's low ROE and high P/B ratio indicate that Sad's shares were overvalued at that time. If a company's ROE is Unabridged pays 1. 6 times book value that is far lower than Sad's price-to-book ratio, it would be an appropriate decision. . 0 Conclusion By way of conclusion, this report introduces the background of

Chinese banks' stocks acquired by foreign financial investors and analyzes lots of ratios in Sad's balance sheet.

The report also proves that Unabridged paying 1. 6 times book value through assessing Sad's asset quality, earning capability, capital adequacy and comparing its industry peers' P/B ratio and analyzing the relationship between P/B ratio and ROE ratio is appropriate. In addition, this report provides a considerable recommendation for investors to acknowledge a banks real performance. 5. 0 Recommendations However, much attention should be paid to comparing a banks key ratios analysis before acquisition its stocks for foreign investors.