SN VALUATION
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July 10, 2012

Economy/Market

Market is down 0.2%. Healthcare plan providers are up today. Denmark's deposit rate was cut, so bank depositors will get practically zero interest and banks will actually have to pay money since the interest rate is -0.2%. Eurozone depositors want to get out of the ECB 0% deposit rates into a more stable currency so they have been transferring funds to Swiss and Denmark. Denmark has currency pegged to the Euro so if people are buying Krones, then the government needs to also purchase Euros, so that Krones don't become so expensive relative to Euro. They probably have to print more money or sell other assets to buy Euros. Globally, US and UK unemployment rate is down. China lowering interest rates.

BYFC

Analyzing 10K for Broadway Financial, a bank in Los Angeles. Stock tanked 30% yesterday, probably over delisting concerns since they didn't report Q1 2012 earnings on time. They did report though on May 15th, but they received the notice from NASDAQ on the 25th. However, the company owns 3 buildings in Los Angeles. Market cap is only $1.5 MM, implying future liabilities are more than the real estate assets. Liquidation value right now. Income statement includes loss provision, which is deducted as an expense, but the cash is actually saved in a separate account to shore up losses to pay out to depositors. Somewhat like a depreciation, contra asset account. Loans need to be sold when deposits are pulled from the bank. Loans sold will show up in the investment section of cash flow and deposits pulled will be in the financing section.

Banks make money on the interest spread, so when valuing a finance firm, it's about the interest spread, the sum of future interest spreads plus the book value. The assets (loan) are really not assets since they have a counter entry as a liability (deposits). Operating expense is $16 MM, but they are averaging net interest spread of $17 MM, but the loss provision is eating up $4 MM, at least following GAAP, although it is not an actual outflow, so they are booking losses, which is eating away at their stockholder's equity, as retained earnings disappears. Loan operations don't have true assets, except buildings, office equipment, which are really purchased by the net interest spread. A lot of the safe investments that banks put a majority share of deposits are yielding near 0% returns, so the net interest spread is hurting the bank, but at the same time, the deposit payable is low too.

Int income - $25 MM	Gross loans - $342 MM – 6%	CDs - $215 MM – 2%
Int expense - $8 MM	RMBS - $19 MM - 3.35%	Other - $100 MM – 0.5%
Net int income - $17 MM	**Total Assets - $453 MM**	**Total Liabilities - $453 MM**
Provision for loss - $8 MM	Loss provision balance - $16 MM	
Non-int income - $0.7 MM		
Earnings before opex - $8.3		
Opex - $17 MM		
Loss - $8.7 MM		

We would like to expound on the loan loss provision, since it is a large "expense" on paper. A bank could take a large wash, and reserve a lot of the income during the period to shore up the loss provision, so that in the future, the loss provision expense could decrease, which would increase the reported earnings. During an economic recovery, we can see a reversal of the loan loss, which should decrease the provisions over time. Loan losses can materially affect the earnings trend, which is something that needs to be carefully reviewed, especially during weak economic periods like right now. A commercial bank's risky assets aren't necessarily investments in stocks, since they invest in safe bonds and MMFs, but rather the loans in the form of mortgages, commercial real estate loans, business loans, which could go bad. Yet, this is where the interest is the highest so they need to take the risk. Another big risk is a run on the deposits, which will force banks to sell loans at a discount, should other banks refuse to lend money, or purchase the bank's assets near market value.

Asset managers are similar to banks, in that the earnings are based off the assets managed, typically 50-100 bps. The earnings cover the operating expenses. Should the asset base shrink, the earnings will fall and most likely lead to a loss. Fund performance is a driver of asset growth so although the fund performance doesn't directly hit the books, it will encourage asset growth if performance is solid and shrink when the funds underperform. Thus, the AM will face a "run on the AM" via redemptions, which is why some funds are being listed publicly, to lock in the investment funds, so the PMs could take a long term view on investing, not worrying about redemption risk.