

NEW YORK UNIVERSITY
STERN SCHOOL OF BUSINESS

The Financial Services Industry FINC-GB 2334 30, Spring 2023

Professor Daniel A. Abut

Goals for this course

The financial services industry, which touches all of our lives, has been going through a continuous and profound transformation since the deregulation process that began in the early 1970s. This evolution has accelerated in recent years, as more and more pressure has been brought to bear by various stakeholders who have divergent goals and agendas: investors, clients, employees, regulators/politicians and the public at large. Overlaying all of this change has been rapid technological advancement that has had a direct impact on how the financial services industry distributes/delivers its products and services, meets expected equity returns and manages its inherent underlying risks.

Moreover, public criticism and scrutiny over the financial services industry has increased since the 2008 global financial crisis. Despite this, however, there is no denying that financial services companies in general (and banks in particular) continue to be the lifeblood that makes economies function, by connecting savers with producers, depositors with borrowers, and investors with businesses. As such, financial services firms remain among the most significant companies in any economy, and among the largest market-capitalization issuers in many equity markets around the world.

This course is an advanced finance elective, which provides a broad overview of the financial services industry and the forces that are continuing to transform it worldwide. In particular, this course introduces an easy-to-use analytical framework, which is broadly relied upon by financial services sell-side analysts and professional investors, to capture, understand and explain how financial services companies operate, how they are managed, how they create (and often destroy) value for their stakeholders, how they assess the pros and cons of every decision they make, how they handle the trade-offs involved in making those decisions, and how they are viewed, judged and ultimately valued by outsiders looking in.

After completing this course, students will have learned how to read and interpret financial statements produced by financial services companies, how to calculate ratios and metrics to monitor and assess a financial services company's health and performance over time, what growth strategies work, which ones often lead to trouble and why, and how to value financial services companies in good times, bad times, and after a systemic crisis. Drawing lessons from real life examples and cases, students will learn what mistakes the management team of financial services companies tends to repeat time and again, and how to spot problems in the financial services industry before they become full blown.

About the instructor

Daniel A. Abut currently divides his time between consulting, teaching and philanthropic endeavors. He is the founder and Chief Executive Officer of DATABANC LLC, an

advisory and consulting business that he started in 2017, whose clients are managements of financial services companies and investors specialized in the financial services industry. He has also served as Independent Board Member for Mexico's Banregio since 2018, and as Independent Member of the Investments Committee for Peru's Credicorp in 2018-2019. Until he retired from Wall Street in 2016, Professor Abut was an accomplished senior sell-side equity research analyst, who, between 1997 and 2015, consistently ranked in the top positions in some of the most prestigious investor polls (such as *Institutional Investor*, *Greenwich* and *Reuters*) for his coverage of banks and financials in Latin America. His 25-year Wall Street career was developed at three of the most respected firms in the investment banking business worldwide: JPMorgan (from 1991 to 1996), Goldman Sachs (from 1996 to 2006) and Citigroup (from 2006 to 2016). He joined JPMorgan in 1991, as an Associate in the Latin America Corporate Finance Division, and worked on a number of projects in mergers and acquisitions (including the privatization of the second-largest Mexican bank at the time), debt financing (including the largest Eurobond ever placed for a Latin American issuer at the time), and equity financing (including IPOs for some of the largest Peruvian and Colombian banks at the time). He was promoted to Vice President in 1995, and moved to the Latin America Equity Research Division, to cover some of the most important banks in the region. He joined Goldman Sachs in 1996, as a Vice President in the Latin America Equity Research Division, responsible for the coverage of 15 banks and financials in Latin America. He was promoted to Managing Director and Director of Latin America Equity Research in 2000, and to Global Bank Strategist in 2003. He joined Citigroup in 2006, as Managing Director and Senior Latin American Financials Analyst, where he led a team that covered 30 banks and financials in Brazil, Mexico, Chile, Colombia, Peru and Argentina. Prior to beginning his Wall Street career, Professor Abut obtained a Masters of Science in Management (with concentration in International Finance) from the MIT Sloan School of Management (1989-1991), where he was granted the "Miriam Sherburne" Merit Award for outstanding academic achievement; and a BA in Accounting (*Contador Público Nacional*) from Universidad Nacional de Rosario in Argentina (1981-1985). In between (1986-1989) he worked as a Financial Advisor for a brokerage boutique that his family owned in Rosario, Argentina.

Who should take this course?

This course should prove particularly useful for students seeking career opportunities at:

- Global investment banks, whether as bankers helping financial institutions or as sell-side research analysts covering banks and financials.
- Commercial and retail banks, whether as mid-level or senior level managements.
- Investment management companies, whether as buy-side analysts or portfolio managers investing in publicly-traded banks and financial services companies.
- Private equity firms, as investors in privately-held banks/financials or new start-ups.
- Consulting firms that provide services to banks and financial services companies.
- Government entities that regulate and supervise the financial services industry, such as Central Banks and Banking Superintendencies.

Grading

Final grades for this course will be calculated as follows: 40% will be determined by the grades that students obtain in an in-class, individual case write-up, which will take place at the mid-point of the course; 40% will be determined by the grades that students get in the final exam, which will be given at the end of the course; and 20% will be determined by the grades that students receive as a function of their participation in class, both during lectures as well as case discussions.

40% – In-class, individual case write-up.

40% – Final exam.

20% – Class participation.

All students are expected to abide by the NYU Stern Honor Code.

Students with disabilities

Students whose class performance may be affected due to a disability should notify the professor early in the semester so arrangements can be made, in consultation with the Henry and Lucy Moses Center for Students with Disabilities, to accommodate their needs.

Please see www.nyu.edu/csd for more information.

Schedule of classes

Thursday, February 9, 2023 – Lecture: Overview of the financial services industry.

The landscape for financial services continues to evolve.

- Banks: commercial/retail banks, investment banks, universal banks, global banks.
- Consumer finance companies and micro-lenders.
- Asset managers and private wealth managers.
- Hedge funds.
- Private equity firms.
- Fintech.

Introduction of our framework to analyze/value financial services companies.

- A financial services firm seen from the “inside”: (1) products, services; (2) customers, markets; (3) funding, capital; (4) personnel, systems, technology, distribution; (5) management.
- A financial services firm seen from the “outside”: (1) volumes and margins, net interest income, asset quality, fee-based income, market-related income; (2)

client growth, market share; (3) leverage, liquidity, capitalization; (4) operating expenses, efficiency; (5) net income, profitability.

- A financial services company's simplified balance sheet and income statement.

Thursday, February 16, 2023 – Lecture: Asset quality in the financial services industry.

The “life cycle” of a loan.

Key ratios and metrics to measure and monitor asset quality in the financial services industry – how to calculate them and how to interpret them.

Factors that influence asset quality – the economy and the normal business cycle, the loan portfolio/business mix, volume growth and level of risk-taking.

From normal credit cycles, to company-specific asset quality problems, to a full-blown, systemic, credit quality-driven banking crisis – lessons from the past.

Thursday, February 23, 2023 – Case discussion: Asset quality in the financial services industry.

Case: “United Bank of India – Present Fiasco and Future Plans”, Debasish Maitra and Pradip Banerjee, Ivey Business School, Western University, London, Ontario, Canada, January 22, 2016.

Topics that this case will allow us to discuss:

- Government-controlled banks vs. private-sector banks, and the significant differences in their operating performance.
- Macro/external and micro/internal factors that play a meaningful role in determining asset quality in a financial services company.
- Barriers of defense against credit quality issues: from balance sheet strength to income statement strength – from loan loss reserves and capital to profitability. The credit quality vicious cycle.

Thursday, March 2, 2023 – Lecture: Leverage, liquidity and capitalization in the financial services industry.

The Dupont leverage/profitability analysis.

Key ratios and metrics to measure and monitor leverage, liquidity and capitalization in the financial services industry – how to calculate them and how to interpret them.

Tier 1 capital, common equity Tier 1 (CET1) capital, Tier 2 capital.

From Basel I, to Basel II, to Basel III.

Thursday, March 9, 2023 – Case discussion: Leverage, liquidity and capitalization in the financial services industry.

Case: “Deutsche Bank and the Road to Basel III”, Yiorgios Allayannis, Gerry Yemen, Andrew Wicks and Matthew Dougherty, Darden School of Business, University of Virginia, Charlottesville, Virginia, USA, October 21, 2013.

Topics that this case will allow us to discuss:

- Investment banking vs. commercial banking vs. universal banking vs. global banking.
- How relying on exuberant asset growth and excessive leverage in order to enhance profitability can come back to bite you.
- Measures that can be taken when capitalization becomes an issue: from slowing growth to divesting assets, from restructuring businesses to lowering costs, from cutting the dividend to raising capital.

Thursday, March 23, 2023 – Lecture: Efficiency and profitability in the financial services industry.

Key ratios and metrics to measure and monitor efficiency and profitability in the financial services industry – how to calculate them and how to interpret them.

Factors that influence net interest income and the net interest margin (NIM) – loan mix/business mix, funding mix, level of interest rates, yield curve and direction of interest rates, asset quality.

Sources of fee-based income and market-related income. From transactional fees to investment banking/advisory fees.

The importance of scale for adequate efficiency and profitability.

Thursday, March 30, 2023 – In-class, individual case write-up.

Case: “Bank of America – Consumers Fight Back”, Russell Walker, Kellogg School of Management, Northwestern University, Evanston, Illinois, USA, March 25, 2016.

Thursday, April 6, 2023 – Lecture: Mergers and acquisitions (M&A) in the financial services industry.

The market’s general skepticism toward M&A in the financial services industry.

From cost synergy-driven intra-market transactions, to revenue synergy-driven intra-market transactions, to inter-market transactions.

The Herfindhal-Hirschman (HH) index used by regulators to assess the level of concentration/fragmentation in the financial services industry.

M&A deals in financial services that investors are more likely to view favorably. Strategic rationale. Execution challenges.

The EPS accretion/dilution analysis. The use of leverage in financial services M&A.

Thursday, April 13, 2023 – Case discussion: Mergers and acquisitions (M&A) in the financial services industry.

Case: “Bankinter – Growth Options During the Spanish Crisis”, Eric Duca and Lidija Lovreta, Ivey Business School, Western University, London, Ontario, Canada, November 12, 2015.

Topics that this case will allow us to discuss:

- The organic growth route vs. the M&A route: pros and cons.
- Intra-market transactions vs. inter-market transactions.
- Evaluating possible targets: strategic fit/rationale, execution challenges.

Thursday, April 20, 2023 – Lecture: Valuation of financial services companies.

The relationship between price-to-book (P/B) ratios and return on equity (ROE).

The relationship between price-to-earnings (P/E) ratios and earnings per share (EPS) growth.

The dividend yield.

The “*triangle of financial services valuation*” – profitability (short term and sustainable ROE), growth (short term and sustainable EPS growth) and quality (discount rate or cost of equity).

Using the CAPM model to calculate appropriate discount rates/cost of equity.

The concept of “fair” or “fully loaded” P/B ratios. The concept of “ex growth” or “floor” P/B ratios.

The concept of franchise value in financial services companies and how to capture it. Calculating price-to-deposits ratios and price-to-market share ratios.

Thursday, April 27, 2023 – Case discussion: Valuation of financial services companies.

Case: “Comerica Incorporated – The Valuation Dilemma”, Yiorgios Allayannis and Baijnath Ramraika, Darden School of Business, University of Virginia, Charlottesville, Virginia, USA, March 10, 2009.

Topics that this case will allow us to discuss:

- Asset-backed securities, mortgage-backed securities, and securitizations as a balance sheet management tool.

- The subprime crisis of 2008. What went wrong?
- Valuation is never assessed in a vacuum. Capturing the recent past and projecting the foreseeable future before any sensible valuation exercise can be performed. Back to the key performance metrics for a financial services company.
- Issues pertaining to valuing a financial services firm during turbulent/crisis times.

Thursday, May 4, 2023 – Final exam.