Accounting STRATEGY SELECTION in the Acquisition & Integration of SHENZHEN Development Bank by Ping An

Guangdong University of Finance and Economics

Prepare by NewBee team

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I. Background

Currently, China has opened mixed operating policy, which makes it possible to form integrated financial company. Meanwhile, the file ‘CSRC [2010] No.147’ demanded the integration of SDB with PAB within 1 year.

II. Rationale

1. PA Strategy
   - Obtain a nation-wide banking licenses
   - Boot the balance of the insurance, banking and investment business

2. The possibility of merger
   NEWBRIDGE intended to sell its shares of SDB.

3. Synergy effect
   The integration will combine advantages, exerting the synergy effect.

4. The combination of International management
   They share the management skills, which can improve management efficiency.

III. Financial analysis

Ping An group

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit growth rate%</td>
<td>24</td>
<td>26</td>
<td>18</td>
<td>35</td>
<td>33</td>
<td></td>
</tr>
<tr>
<td>Bank income /total income%</td>
<td>3.13</td>
<td>7.59</td>
<td>11.52</td>
<td>11.70</td>
<td>11.86</td>
<td></td>
</tr>
<tr>
<td>Customers(million)</td>
<td>53</td>
<td>60</td>
<td>70</td>
<td>80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE%</td>
<td>18.50</td>
<td>17.30</td>
<td>16.00</td>
<td>13.80</td>
<td>16.40</td>
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</table>

- Banking contributed more in revenue, from 3% to about 10%.
- The synergy in cross-selling brings larger revenue and rapid increase in net profit.
- With expense increase, the growth speed in profit failed to match the asset. So the profitability (ROE) goes down until 2013.
- Due to the integration, there is notable growth in customers from most cities in China.

In conclusion, developing banking is good for risk diversification, minimizing the fluctuation of ROI and improving overall performance.

Ping An Bank

Probability

1. Trade financing, the conventional business of SDB, will develop further after the completion of transaction. It keeps stable ascension. The reason for the growth rate of 40% from 2008 to 2010, is that SDB focus on project ‘1+N’. After acquisition, the reason for the rate over 20% lies in the expansion of customer and further improvement in cash management.

2. Core business—micro finance, retail banking and credit card business have healthy development. Supported by the product policy and marketing promotion, the growth rate of micro financial business reached 16% in 2012 and 56% in 2013. As for retail banking, individual loans and advances are outstanding, increase about 50% after acquisition. And the issue of credit card grew rapidly, especially in 2011 and 2012, reached 58% and 69% respectively.

3. Cross-selling has great impact on cost income ratio and bank commission income growth rate. The cost income ratio decreased...
with the increase in efficiency. With expansion in customers, financing product creativity and services quality, bank commission income increased.

**Security**

1. Non-performing loan ratio of PAB rose 0.3%-0.5%, excluding 2011, mainly due to the external market. Nevertheless, PAB stated that the risk is under control.

2. CAR of SDB was low before acquisition, with the non-public offering of shares and enhancement in capital accumulation, the CAR of SDB meet the criteria.

**Liquidity**

As for Deposit loan ratio, its decline indicated that liquidity of PAB improved. Meanwhile the total deposit and loan growth rate of PAB rose while the bank industry is facing recessions in loaning and depositing.

According to the former analysis, we figure that this transaction matches the long-term strategy of PA group, which exerts synergy effect and promote the mixed operation of financial group. However, how to better integrate is still the challenge.

**The assessment of growth rate**

PAB adopted income capitalization method with 3-stage model in the valuation.

\[
P = \sum_{n=1}^{s} \frac{R_n}{(1 + r)^n} + \sum_{n=1}^{k} \frac{R_n}{(1 + r)^n} + r \frac{R_{n+1}}{(1 + r)^n}
\]

R1 was prudent, and R2 was overestimated (Its operation income cash flow growing at 9.6%, which is 20% higher than the project 8% growth rate of the national economy), R3 remains stable.

**IV Impact of ‘valuation appreciation’ in the transaction**

**Corporate strategy**

The overestimated growth rate enhanced the pricing of PAB, which could let SDB issue more directional additional shares. The more shareholdings, the more power to control SDB.

**Step1** To own more than 51% shareholding of SDB, PAG should buy 1,495,000,000 shares. (Calculation is shown in the reference)

**Step2** PAG deliberately planned an overestimated growth rate to get a high valuation of PAB, which could have SDB issued more non-public offering shares.

**Step3** To match PAB’s valuation of ¥29,080,000,000, SDB should issue more 1,638,000,000 shares.

**Step4** PAG held 52.38% shareholding of SDB by giving subscription assets (¥26,390,000,000) plus consideration in cash (2,690,000,000).

Finally, PAG achieve its goal.

**Regulators**

First of all, SDB’s regulatory indicators ought to meet the criterion, for that SDB was the acquiring firm in law.

Secondly, aimed to improve Capital Adequacy Ratio and Capital Adequacy Ratio, PAB overestimated growth rate for a high valuation, which made SDB issue directional share.

Thirdly, due to the non-public offering shares, Equity capital and
Capital surplus was increased. So was the Core Capital.

At last, Core Capital Adequacy Ratio was improved.

<table>
<thead>
<tr>
<th>Equity capital</th>
<th>47.01%</th>
<th>Increased by non-publicly offering shares</th>
</tr>
</thead>
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<tr>
<td>Capital surplus</td>
<td>210.78%</td>
<td>Increased by non-publicly offering shares</td>
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### SDB Regulatory Criteria

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<tr>
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<tr>
<td>Core CAR</td>
<td>≥4%</td>
<td>≥8.5%</td>
</tr>
<tr>
<td>CAR</td>
<td>≥8%</td>
<td>≥10.5%</td>
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As is showed above, valuation appreciation enable SDB’s regulatory indicators to meet the criterion and the new regulation in 2011.

### V Accounting Strategy Selection

Before transaction, PA held 29.99% of the overall share capital of PAB, without material control right. So the corporate merger under the same control and the merger not under the same control are both available.

The corporate merger not under the same control was better, for group interest and improvement in the CAR of SDB (CAR underlying asset↗, FV(net asset)↗, CAR↗ due to goodwill).

### The impact of existence of the goodwill

PA controlled SDB and valuation was overestimated, the equity of minority shareholder in SDB suffered damage for their shares were diluted. However, without goodwill, capital surplus will decline. So does the CAR.

Goodwill = Cost of acquisition - FV of Net Identifiable Assets

\[
FV \text{ of consideration} = 29,080,475,600 \\
(17.75 \times 1,638,336,654) \\
Add \quad FV \text{ of NCI} = 1,950,237,000 \\
Less \quad FV \text{ of net asset of PAB} = (21,083,640,000) \\
The \text{ cash received} = (2,690,052,300) \\
GW \text{ at acquisition} = 7,257,020,300
\]

### Difference analysis

Goodwill in the case is ¥ 7,568,304,000, while the result is ¥ 7,257,020,300. The difference is ¥ 311,283,700, resulting from the FV of consideration. It was based on the FV of the closing price of Ping An Bank at acquisition date(¥ 17.94 per share), while ours is based on subscription share price(¥ 17.75 per share).
1. Financial Statement Analysis

I. Ping An Group

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II. SDB & New Ping An Bank

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</tr>
</thead>
<tbody>
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<td>Balance of trade finance growth rate%</td>
<td>41</td>
<td>43</td>
<td>28</td>
<td>28</td>
<td>29</td>
<td>20</td>
</tr>
<tr>
<td>Personal loans and advances growth rate%</td>
<td>-1</td>
<td>18</td>
<td>69</td>
<td>49</td>
<td>56</td>
<td>49</td>
</tr>
<tr>
<td>Number of credit card (‘000 pieces)</td>
<td>3640</td>
<td>4128.7</td>
<td>6510</td>
<td>11000</td>
<td>13810</td>
<td>16430</td>
</tr>
<tr>
<td>Cost income ratio%</td>
<td>41.76</td>
<td>40.84</td>
<td>39.99</td>
<td>39.41</td>
<td>40.77</td>
<td>36.33</td>
</tr>
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2. a. Corporate Strategy (Step1)

(29.99%×34.86+H/34.86+H) ≥51%, H≥1,495,000,000

b. Equitation

core capital ratio
= (net core capital / gross weighted risk assets) × 100%
capital ratio
= (net capital / gross weighted risk assets) × 100%