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Equity valuation of microfinance institutions

Master's Thesis

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Executive Summary

Despite the growth of equity investments in MFIs (microfinance institutions), the majority of them are private placements. For MFI private equity investors, properly valuing their investments remains as a challenging task. Literature discussing MFI equity valuation methodologies is limited and so is the access to information regarding MFI private equity transactions. Thus, the paper aims to suggest some appropriate methods to value MFI equities and at the same time, to provide a toolkit for equity valuation of MFIs. In the process of examining main methods for valuing MFIs, the paper especially takes into account the aspect of MFIs as deposit-taking financial institutions, one part that previous literature rarely covered. In the literature review part, the paper summarizes all literature to date that discussed MFI valuation methodologies, along with some valuation practice disclosed by MFI equity investors. When it comes to choosing a proper MFI equity valuation method, the paper proposes that the maturity of the MFIs should be the first criterion and other perspectives including existence of deposits, use of market-to-market accounting, investor perspective and information availability should also be considered. As of present value models, the paper recommends the use of a FCFE model (free cash flow to equity model) for valuing MFIs in rapid growth stage and RI model (residual income model) for valuing mature MFIs. As of method of multiples, method of P/Revenue is recommended for start-up MFIs, while method of P/E is recommended for MFIs with positive earnings and method of P/BV is recommended for mature MFIs. Next, the paper summarizes all available price multiple data of MFI equity transaction, including data found in literature and data collected through two series of equity valuation surveys, one collected by CGAP between 2009 and 2012, and the other one collected from FIEC members in 2017. The new data set collected in 2017 is described in detail so as to provide a more recent industry valuation benchmark for MFI investors. Finally, based on data collected from FIEC members, the paper implements two multiple linear regression models. The regression results show that transaction size and region type Asia have significant positive effects on P/BV and ROE has negative effect on P/E, while other independent variables do not show significant relationships with the two dependent variables. Meanwhile, some observations on quality of the newly collected data are included as a contribution to better collection of microfinance equity transaction data in the future.