REFeree’s review

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<th>Program:</th>
<th>Master in Corporate Finance</th>
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<td>Student:</td>
<td>Lai Yun</td>
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<td>Residual Earnings and Book Value in Equity Valuation on China Stock Market</td>
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Justification of the topic choice. Accuracy in defining the aim and objectives of the thesis. Justification of the topic choice; accuracy in defining the aim and tasks of the thesis; originality of the topic and the extent to which it was covered; alignment of the thesis’ topic, aim and objectives. 5

Structure and logic of the text flow. Logic of research; full scope of the thesis; alignment of thesis’ structural parts, i.e. theoretical and empirical parts. 5

Quality of analytical approach and quality of offered solution to the research objectives. Adequacy of objectives coverage; ability to formulate and convey the research problem; ability to offer options for its solution; application of the latest trends in relevant research are for the set objectives. 5

Quality of data gathering and description. Quality of selecting research tools and methods; data validity adequacy; adequacy of used data for chosen research tools and methods; completeness and relevance of the list of references. 5

Scientific aspect of the thesis. Independent scientific thinking in solving the set problem/objectives; the extent to which the student contributed to selecting and justifying the research model (conceptual and/or quantitative), developing methodology/approach to set objectives. 5

Practical/applied nature of research. Extent to which the theoretical background is related to the international or Russian managerial practice; development of applied recommendations; justification and interpretation of the empirical/applied results. 5

Quality of thesis layout. Layout fulfills the requirements of the Regulations for master thesis preparation and defense, correct layout of tables, figures, references. 5

Each item above is evaluated on the following scale, as applicable: 5 = the thesis meets all the requirements, 4 = the thesis meets almost all the requirements, 3 = a lot of the requirements are not met in the thesis, 2 = the thesis does not meet the requirements.

Additional comments:

The author’s choice of a topic to investigate is very timely due to resent regulatory relieves by Chinese government to allow invest in both mainland and Hong Kong markets and, thus, due to the potential increase in the demand by investors for Chinese markets. Moreover, the author analyzes a unique to Chinese markets trait, the significant price difference of dual listed companies, and how its behavior can be explained by the fundamental value.

The logic of the paper and its structure is strongly aligned with the questions stated in the introduction.

In order to find the best-suited model for the research the author applies four variants of fundamental value models. The justification of the models choice and parameters is elaborately tangled with the discussion of the results of the recent papers and the reference to the pioneering concepts and findings. Moreover, the author uses two statistic programs, EViews and Stata.

The full description of the data used is presented. The data is adjusted for outliers and the proper timing of market value data, before the first quarter results, is taken into account.

One of the strengths of the paper is the contribution to the research of the fundamental value models’ applicability and verification: the author has conducted one of few research about the fundamental value in China and has applied results to the dual-listed companies. In addition, the author scrupulously verifies the most relevant model for each stock exchange by analyzing more than one statistics and applying out-of- and in-sample testing, plus by consistently explaining the process of elimination and economic reasoning. Moreover, the paper stands out by the concise but insightful research of market price differences of dual
listed companies using a multifactor regression with the difference in the fundamental value as one of the variables.

The estimated significant models’ coefficients (and their break-down by industries) can be used by investors to calculate the intrinsic value of the investment in Chinese market with moderately high easiness. Given the presence of high language barriers, non transparent environment and restrictive accounting and reporting standards, the application of the results is applicable for the preliminary analysis of Chinese companies. For instance, the author provides the example of model application for recent IPOs.

The layout of the thesis fulfils the requirements.

Master thesis of Lai Yun meets the requirements of the Master in Corporate Finance program, and according to the reviewer’s opinion deserves an “excellent (A)” grade, thus the author can be given the desired degree.

Date: June 8, 2017

Referee: Master, Aleksandra Shmitt
Residual income valuation (also known as residual income model or residual income method) is an equity valuation method that is based on the idea that the residual income valuation model refers to the equity valuation model of measuring stock value through accounting net asset and residual income. Therefore, the market value per share is $32, and the book value per share is $24. Since the company’s market value is greater than its book value, the market expects a return of 18%. Andy is a new investor in the retail company. Therefore, he will buy 100 shares for $25 each, paying $2,500, expecting a return of 18% on the book value per share, which is $24 x 18% = $4.32 per share.

The BV of equity is a useful valuation tool to identify overvalued and undervalued stocks. Generally, investors base their investment decisions on the expected market return. However, the BV of equity indicates the value that the company returns to its shareholders. Summary Definition: Residual income reflects net income minus a deduction for the required return on common equity. While a firm may show positive earnings, the MVA = MV of debt and equity book value of supplied capital. Basic RI Model. Share Price0 = BVCE/Share0 + Σ RIt / (1 + rce)t. This approach starts with the current book value per share of equity today and discounts the expected value of future residual incomes. In theory a stock’s intrinsic value should exhibit a certain relationship among its ROE, its growth rate, and its cost of equity capital: Value0 = BVCE0 + [(ROE - rce)/(rce - g)] — BVCE0. This relationship can be used to derive the price to book ratio and firms that generate a positive residual income should be valued with a price to book ratio greater than 1.0.