

# Warning Signals & Lessons Learned in Corporate Credit

A two-day workshop providing a systematic approach to identifying credit deterioration and determining a company's ability to improve performance or repair capital structure.

## TARGET AUDIENCE

Experienced credit risk managers, relationship managers, fixed income investors and other finance professionals looking to sharpen their analytic skills and apply them in context of an economic downturn.

## COURSE OBJECTIVES

The aim of this two-day corporate credit master class is to hone the analytic skills needed to appropriately identify and assess credit deterioration and determine a company's ability to improve performance or repair the existing capital structure. The focus will be on drawing upon lessons learned from the credit crisis to determine sustainable level of indebtedness, the robustness of deal structures, and what actions can be taken to limit loss to the bank. Current trends in the marketplace will be examined in order to highlight any potential risk trends.

**Specifically, participants will be equipped to:**

- Identify companies most susceptible to credit deterioration and the factors that will impact the likelihood of default or the need for distressed exchange of debt
- Review a company's funding structure in context of its sector and operating performance to determine whether the existing structure will effectively mitigate credit deterioration or the extent to which it has the potential to reduce lenders' recovery rates (e.g., risk of structural subordination, risk of deterioration in asset values, complications to the bankruptcy process, etc.)
- Appreciate the importance of safeguards to enable early intervention in deteriorating credits and the correlation between early intervention and ultimate recovery rates in distressed credits
- Consider the practicality of solutions designed to stabilize the business and assess alternative options available to minimize future problems / losses for investors.

## CONTENT

### ANALYTIC OVERVIEW

The goal of this section is to recognise early warning signals by applying a structured approach to evaluate the credit risk.

#### Early warning signals

- Symptoms of a deteriorating credit: financial, non-financial and market indicators
- Credit migration and its impact on pricing and market access during turbulent times
- Weakened versus problem credits
- Current market conditions: impact of the credit crunch and economic downturn, default and recovery rates

#### Structured analytic approach

- Application of the four-step approach to credit: exposing credits susceptible to deterioration (purpose, payback, risks and structure)
- Risks to repayment: current market conditions and their impact on risk assessment (macro economic, sector and/or company specific factors).

## CROSSING THE THRESHOLD: TRIGGERS FOR ACTION

This segment focuses on the most common events that trigger corporate distress and the need to take action.

### Cash shortfalls and liquidity problems

- Defining and assessing liquidity: identifying the most probable short term sources and uses of cash
- Quantifying the degree of refinancing risk and the potential challenges and costs of raising new capital
- Relying on existing "committed" bank facilities or cash as the sole source of liquidity

### Covenant breaches

- Characteristics of effective covenants
- Financial vs. non-financial covenants: ability to quantify and assess the degree of protection.

## THEMES OF DISTRESS

Aim: the themes of distress and the action taken by the companies and / or lenders are explored through discussion and many real life examples of actual or potential distress. The focus is on concluding upon lessons learned in order to avoid future problems.

### Macro - economic forces

- Economic cyclicalities in various markets and the sometimes disastrous effect on company performance
- Vulnerability to foreign exchange movements and the effect of sudden fluctuations
- Exposure to commodity price instability and the effect on profitability and cash flow
- Country exposure: Sovereign weakness, government intervention or cessation of government support

### Challenged business models

- Lack of sufficient scale in an increasing competitive environment
- Excessive growth with inability to finance externally - 'overtrading'
- Timing of expansion - capital expenditure at the height of the economic cycle resulting in overcapacity
- Higher operating leverage when competitors are leaner operators
- Dependency on a small numbers of customers and /or suppliers

### Disproportionate leverage

- Excessive leverage at the top of the economic cycle
- Debt servicing capability: anticipating the problem
- New money needed to restructure of recapitalise: equity and other stakeholder perspectives

### Refinancing risk

- Importance of maintenance of liquidity and payment readiness in turbulent financial markets
- Lender's conundrum: relying on "committed" bank facilities as sole source of liquidity
- Refinancing challenges: longer term debt, equity injection, alternative sources of funding

### **Poor loan structure and choice of financial instruments**

- Ineffective financial and non-financial covenants
- Potential covenant breaches and actions when breached
- Excessive off balance sheet obligations
- The use of hybrid financial instruments or complex derivatives is not understood by the client
- Debt denominated in a 'hard currency' while domestic currency weakens.

### **Management and ownership strategy and behaviour**

- Poor management decisions and risk management in the context of sector and macro economic environment
- Deficient financial disclosure or reporting
- Complex group structures and cross shareholdings
- Lack of corporate governance, control of executive management
- Failing of succession planning, management style
- Lack of integrity: behaviour, relationships, social responsibility
- Inability of shareholder to support during turbulent times.

### Learning Paths



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