

# Corporate Credit Analysis

A four-day case study based workshop for bankers, fund managers and finance professionals seeking to build their analytic skills. Participants will learn a structured and systematic approach to evaluate the creditworthiness of a company and the relative attractiveness of the risk ~ return profile.

## TARGET AUDIENCE

Fixed income professionals, corporate bankers and analysts, corporate risk underwriters and other finance professionals working in credit risk management and credit products areas, including relationship management and debt origination.

Participants should have a firm grasp of accounting and be familiar with basic credit concepts before attending this programme. The two day Introduction to Corporate Financial Statements is designed as a preparation for those with limited accounting and banking experience.

## COURSE OBJECTIVES

The overall goal of this 4 day programme is to enhance existing analytic skills, using a structured and systematic approach to evaluate the credit standing of a company and the relative attractiveness of the risk-return profile of the investing / lending proposition.

Participants are encouraged to be focused, practical and concise in developing and articulating credit judgement.

Participants will be equipped to:

- Apply a 4-step model to assess the creditworthiness of a borrower: purpose, payback, risks and structure
- Evaluate the performance of a company based on qualitative and quantitative frameworks and tools (e.g. ratios and cash-flow measures)
- Use appropriate market indicators, where available (e.g. ratings, equity indicators, bond and CDS spreads) to understand refinancing risk and the market view on a credit
- Identify the key factors that drive a company's future performance and evaluate the likely impact on its credit standing
- Use a cash-flow approach to ascertain a company's ability to service/refinance its debt as it comes due
- Review debt structures to assess to what extent they meet the commercial needs of the borrower and protect the lender's interests.

## CONTENT

The analytic tools and frameworks for credit analysis are taught and demonstrated through a wide variety of live examples, up to date case studies and exercises. The course is highly interactive, practical and challenging. Case studies and exercises are drawn from a range of industries and regions.

## ANALYTIC OVERVIEW

### Structured approach to analysis

*Aim:* Introduce and reinforce a structured approach to the analysis of a transaction, whereby participants evaluate the business needs (purpose of transaction) and focus the credit analysis (payback, risks and structure).

- Purpose: identifying the borrower and use of funds
- Payback: linking credit assessment to primary and secondary sources of repayment
- Risks to repayment: the need for sector and company analysis to evaluate debt servicing ability
- Structure: assessing the ability of the debt to meet the commercial needs of a company while protecting lenders' interest.
- Exercise:* Identifying the true purpose of borrowing, the source(s) of repayment, the risk to the main sources of repayment and the expected structure of the debt, using several corporate borrowers (e.g. retailer, office equipment manufacturer)

### Market indicators of credit risk

- Aim: Appreciate how various market perspectives and indicators can be used as early warning signals of credit migration / increased refinancing risk
- Credit Ratings: rating trend and outlook
- Debt market: bond spreads vs. rating curves and CDS pricing
- Equity signals: share price movements and key multiples.

## RISKS TO REPAYMENT

*Aim:* Distinguish the key vulnerabilities of the operating environment on a company and evaluate the company's business risk and commercial performance by understanding its business model and competitive strategy and the impact on current and future creditworthiness.

*An illustration case study* will be used to highlight each section of the credit risk assessment. The case study chosen will reflect the market and region of the location of the course.

### Macro considerations

*Aim:* Identification of those macro drivers which significantly influence company specific cash-flow profiles.

### Operating environment

- Fundamental macro economic variables, influence of social issues, government intervention and regulation, political and sovereign risk issues.

### Sector

- Sector structure, competitive forces and effect of industry growth drivers on company performance
- Key sector drivers influencing cash-flow profiles for all operators in the industry: sales growth, operating profit margins, working capital requirements and capital expenditure
- Critical success factors needed to be addressed in order to sustain a competitive advantage in the future
- Exercise* in statement logic: asset configurations, funding structures and earnings of companies in different sectors
- Illustration case study:* concluding on key sector risks and critical success factors.

### Management and shareholders

*Aim:* Evaluation of the strengths and weaknesses of management and the influence of company ownership.

- Evaluating and measuring management's performance
- Corporate aims and goals: their effect on the company's future
- Evaluating the shareholder structure, support and influence
- Illustration case study:* identify management strengths and weaknesses and shareholder structure / support.

### Business risk

- Aim: Assessment of a company's business strategy in order to understand the asset investment needs and commercial viability of a company and their effect on the quality and stability of cash-flows.

### Business strategy

- A company's markets, products, services and competitive position as well as corporate actions underpinning its growth strategy
- Illustration case study:* how well positioned is the company and to what extent does it address sector's critical success factors.

## Earnings dynamics

- Strategic direction of the firm: sales and operating profitability, sources of operating cash-flow, trend and peer analysis
- Quality and stability of the income stream and the cost base of the firm
- Quantifying performance looking beyond EBITDA: defining, calculating and using operating cash-flow to analyze profitability. Key ratios and cash-flow benchmarks
- Ability to sustain profitability and cash-flow through economic cycles using peer analysis to bench-mark performance
- Different accounting conventions: looking beyond the numbers and uncovering misleading accounting practices
- *Exercise:* analysis of earning dynamics in specific company situations ( e.g. high volume -low margin business model or high FX and commodity exposures )
- *Illustration case study:* using peer analysis and benchmarks to assess and compare performance and current and future cash-flow generation.

## Asset management

- Using the asset conversion cycle to create expectations about balance sheet and asset efficiency
- Quantifying performance: general and industry specific ratio and cash-flow tools to analyse and benchmark asset efficiency
- *Exercise:* Identify 2 or 3 companies operating in the same industry ( e.g. brewing, airlines or retail) but with different business models using key asset management ratios
- *Illustration case study* using peer analysis and benchmarks to assess and compare asset management and effect on current and future cash-flow generation.
- Forecasting and sensitising key cash-flow drivers
- Assessing forecasts of operating performance and asset investment requirements: checking for reasonableness and consistency.
- *Case study:* robustness of future cash generation and key vulnerabilities

## Financial Risk

*Aim:* Assessment of the appropriateness of a company's funding structure given the operating environment, management and shareholder goals and overall business risk and evaluation of its debt service ability and refinance risk.

## Financial strategy

- Performance indicators, risk appetite of capital providers, cost of capital and availability of alternative funding sources.
- Using business risk to gauge an appropriate level of financial risk
  - Access to alternative sources of funding: trade, bank debt, capital markets, structured finance, equity etc.
  - Corporate treasury objectives: external rating maintenance, tenor matching, funding and liquidity and refinancing needs.

## Liquidity

Refinancing risk: payment readiness, contingency liquidity, and maturity profile of debt in the light of risk appetite and liquidity in current market conditions

- Determining financial flexibility: measuring liquidity: ratio and cash-flow tools
- Funding instruments used by companies that can increase the financial risk: e.g. Tenor and currency mismatch and concentration of refinancing risk in certain years
- *Exercise:* Assessment of payment readiness for companies in a variety of sectors (e.g. textiles manufacturing, food retail, tour operator)

## Solvency

Funding structure and a company's ability to service its existing and new debt from cash-flow.

- Solvency or degree of financial risk , taking into account on and off balance sheet obligations
- Debt servicing ability using cash-flow analysis
- *Exercise:* Assessment of degree of financial risk and debt servicing ability using several companies' cash-flow information and brief company descriptions. Companies are chosen depending on lregion and sectors, e.g . Some examples: car and aircraft manufacturers, beverage producers, steel manufacturing, chemical producers, pharmaceutical wholesalers, retailers, oil E&P, oil refinery and distribution, mining
- Rating medians to benchmark a company's financial standing.
- Future cash available for debt service using a simple debt capacity cash-flow model
- Quantifying refinancing risk: debt capacity vs. borrowing capacity
- *Illustration case study* using peer analysis and cash-flow forecast to assess overall financial risk, debt service capability and refinancing risks.

## STRUCTURE

*Aim:* Review the appropriateness of existing or new debt instruments.

- Debt profile: matching debt profiles and amortisation to repayment sources
- Ranking: different ways to achieve seniority or pari passu ranking vs. other capital providers
- Safeguards: the use of financial and non-financial covenants to mitigate risk
- Credit pricing: understanding investor's hurdle rates: compensating for expected and unexpected loss
- *Illustration case study:* conclusion on appropriateness of debt structure.

## GROUP CASE STUDY (STUDIES)

*Aim:* Practice the application of the framework and tools of credit analysis to a company and to make a concise and conclusive presentation to the group on the final day of the course.

- Preparation and presentation of a complete credit analysis and critique of a financing proposal in small groups of 2 to 5 participants
- Companies used for the group case studies vary per location of the course but some examples are: electronics manufacturing, food or beverage processing, energy trading, airlines, car manufacturing, telecommunications, food retail, steel manufacturing, office service industry, car hire services, packaging.

## Learning Paths

