

Emerging Markets Corporate Credit

A four-day case study based workshop for finance professionals, fund managers and bankers offering a structured approach to evaluate the creditworthiness of a company operating in fast developing emerging markets

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 experience in accounting and financial statement analysis.

COURSE OBJECTIVES

The overall goal of this four day workshop is to enhance existing analytic skills, using a structured and systematic approach to evaluate the credit standing of a company and the attractiveness of the risk ~ return profile of a transaction. Participants are encouraged to become more time efficient, focused and concise in articulating credit judgement.

Specifically participants will be equipped to:

- Apply a 4-step model to assess the creditworthiness of a borrower in a developing financial market: 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) ,
- Identify the key drivers that drive a company's future performance and evaluate the key challenges of emerging markets credits: e.g. generating cash flow in growth markets and refinancing in volatile conditions.
- 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
- 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

This workshop makes extensive use of case studies, live examples and exercises to ensure that the training is highly interactive, practical, topical and challenging. Case studies are drawn from a range of industries and emerging markets (primarily BRIC, Latin American, and Asia) in order to provide participants with the opportunity to practise the application of the analytic frameworks and tools in context. The emphasis is on developing critical judgement; participants are required to be focused, practical and realistic in their approach.

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 developing regions, and include at least a few from the BRIC countries. The emphasis is on developing critical judgement; participants are encouraged to be focused, practical and realistic in their approach.

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. Compare and contrast the analytic techniques appropriate for mature and developing markets. 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 cash flow profiles for companies operating in developing markets.

Operating environment

- Sovereign risk,** systemic risk and sources and sustainability of economic growth
- Exercise:** Identify countries in different stages of development and levels of perceived sovereign risk
- Key macro vulnerabilities of developing markets:** volatility of foreign exchange and commodities, risk of high inflation, government intervention and general political risk

Sector

- Sector structure,** competitive forces and effect of industry growth drivers on company performance.
- Key sector drivers** influencing company specific cash-flow profiles: sales growth, (including effect of inflation, foreign exchange and commodity fluctuations) 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

Application: Analysis of operating environment and sector of

Illustration case study

Management and shareholders

Aim: Evaluation of the strengths and weaknesses of management and the influence of company ownership, within the challenging environment of emerging markets where transparency and corporate governance can be lacking.

- Evaluating and measuring managements' performance
- Corporate aims and goals: their effect on the company's future
- Evaluating the shareholder structure, support and influence
- Application to the illustration case study

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, within the challenging environment of emerging markets where disclosure can be poor.

Business strategy

- A company's markets, products, services and competitive position as well as corporate actions underpinning its growth strategy
- Application to the illustration case study

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. Effect of foreign exchange and commodity price fluctuations on profitability
- 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)
- Application to the illustration case study using peer analysis and benchmarks to assess and compare performance and 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 asset efficiency. Key ratios and cash flow industry benchmarks
- Impact of increasing asset investment need on cash flow for high growth companies : the risk of overtrading
- *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
- Application to the illustration case study using peer analysis and benchmarks to assess and compare asset management and effect on cash flow generation.

Forecasting and sensitising key cash-flow drivers

Assessing forecasts of operating performance and asset investment requirements: checking for reasonableness and consistency. Application to the illustration case study or separate company focussing on FX and commodity price fluctuations

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 available in developing financial markets: trade, bank debt, capital markets, governmental or development bank 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 in maturing financial markets

- 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 location and availability of financial reports. Some examples: beverage producers, steel manufacturing, chemical producers, pharmaceutical wholesalers, retailers, oil E&P, mining, oil refinery and distribution
- 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
- Application of to the 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 available in emerging financial markets.

- Debt profile: matching debt profiles and amortisation to repayment sources
- Ranking: different ways to achieve seniority or pari passu ranking versus 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.

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, food or beverage processing, energy trading, telecommunications, food retail, steel manufacturing, textile industry, packaging.

