

# Deteriorating Credits: Early Warning Signals & Pre-emptive Action

A three-day workshop to provide a systematic approach to identifying early warning signals, understanding why certain companies suffer more than others, and developing effective responses to minimise future problems / loss to lenders.

## 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

To hone the analytic skills needed to detect and respond early to problems facing corporate clients and propose effective solutions. Specifically, participants will be equipped to:

- Identify early warning signals on a timely basis to enable them to interface effectively with a client, to discuss management's plans for dealing with the issues at hand
- Review covenant packages and funding structures, in context of operating performance, to determine the extent to which they provide effective triggers / protect the lender's interests
- Consider the practicality of solutions designed to stabilise the business and, assess alternative options in order to take effective action early and minimise future problems / losses.

## CONTENT

### ANALYTIC OVERVIEW

#### Early warning signals

- Symptoms of a company's deteriorating credit standing
- Credit migration and its impact on pricing during turbulent times
- Weakened versus problem credits: call to action for both.

#### Structured analytic approach

- Application of the four-step approach to credit to expose key early warning signals: purpose, payback, risks and structure
- Risks to repayment: current market conditions and their impact on risk assessment.

### TRIGGERS FOR ACTION

#### Cash shortfalls and liquidity problems

- Defining liquidity
- Alternative ways to assess sufficient liquidity
- Liquidity crunch: refinancing challenges
- Catch-22: relying on "committed" facilities as a source of liquidity.

#### Covenant breaches

- Characteristics of effective covenants
- Financial versus non-financial covenants: ability to quantify and assess
- Predictive qualities of existing covenant package
- Anticipating potential covenant breaches.

### ANALYSING THE PROBLEM

#### Sector indicators

- Understanding the criteria for success: success versus failure
- Identifying and quantifying key sector cash-flow drivers
- Monitoring key events that could change the sector outlook.

#### Business risk and commercial viability

- Assessing corporate strategy in light of the sector drivers
- Uncovering key weaknesses: declining volumes, fixed cost base, volatile commodity prices, CAPEX requirements etcetera
- Determining changes needed address sector challenges and

company specific issues

- Quantifying future performance: establishing and sensitising sustainable EBITDA levels and operating cash-flows
- Distance to breakeven: forecasting scenarios whereby the company is challenged to meet interest payments
- Cash burn: stemming cash outflows as performance deteriorates
- Assessing management responses: revised strategy, timeframe and benefits
- Evaluating management's ability to implement
- Practical limitations and alternatives: Plan B?
- Determining when survival is unlikely: options and time for action.

### ANALYSING THE PROBLEM

#### Management and Shareholders

- Companies in crisis: why?
- How to recognise weak management: identify key vulnerabilities
- Unravelling risks associated with complex group structures and dominant shareholders
- Ownership structure and its impact on shareholder support during turbulent times
- Companies with limited disclosure: ability to continue to support?

#### Financial risk and funding structure

- Quantifying liquidity and access to cash: payment readiness
- Creating liquidity: the potential for increasing debt, selling assets, alternative funding (sale and lease back etcetera.), equity injections
- Debt servicing: anticipating the problem and timeframe for action
- Debt capacity: estimating the quantum of debt that can be serviced through the downturn
- The need for new money to execute the business plan: debt, equity and other stakeholder perspectives.

### PRE-EMPTIVE ACTION

#### Loan structure and the lender's right to act

- Determining the strengths and weaknesses of debt structures
- Purpose: who is the borrower? Where are assets and cash-flows?
- Ranking: maintaining seniority, structural subordination and multiple tranches of debt
- Identifying strong and weak forms of protection
- Monitoring credit indicators
- Evaluating exit options ahead of covenant breaches or other events of default
- When covenants are not breached: circumstances in which lenders can strengthen their position
- When covenants are breached: rationale for waiver or covenant amendments
- Negotiating meaningful terms and conditions.

#### Courses of action: influencing management and financial strategy

- The potential to influence management strategy early
- Strategic options: sale of a business, reduction in dividend, change in management
- Evaluating the dividend policy in the light ownership requirements
- Requiring support from other stakeholders
- Access to equity: most probable sources and willingness to act.