

Deteriorating Credits

Red Flags & Lessons Learned

A three-day workshop for experienced credit risk managers and fixed income investors. The training will provide a systematic approach to identifying early warning signals which can be applied to companies in different sectors.

TARGET AUDIENCE

Experienced credit risk managers and fixed income investors. The majority of Fitch Training programmes are offered at an intermediate and advanced level. There are no specific prerequisite courses to attend our programmes, however some topic knowledge may be required. Please refer to the target audience to see what level of prior knowledge is required for a specific course.

COURSE OBJECTIVES

The aim of this three-day corporate credit class is to hone the analytic skills needed to detect and respond to problems facing a corporate client and propose effective solutions that both meet the commercial needs of the business and protect the lender's interests. Specifically, participants will be equipped to:

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

CONTENT

ANALYTIC OVERVIEW

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

Warning signals

- Symptoms of a company's deteriorating credit standing: financial, non-financial and market indicators
- Credit migration and its impact on pricing during turbulent times
- Weakened vs. problem credits: call to action for both types of companies.

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 due to key macro-economic, sector and/or company specific factors.

CROSSING THE THRESHOLD: TRIGGERS FOR ACTION

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

Cash shortfalls and liquidity problems

- Defining liquidity
- Alternative ways to assess sufficient liquidity: identifying short-term sources and uses of cash, payment readiness
- Liquidity crunch: refinancing challenges
- Lender's conundrum: relying on "committed" bank facilities as sole source of liquidity.

Covenant breaches

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

ANALYSING THE PROBLEM

This section requires participants to apply the frameworks and tools of credit analysis to assess the seriousness of a company's problems, the actions being taken to address them and the chances of success, in terms of both short-term crisis management and medium-term business changes.

Sector indicators

- Understanding the criteria for success for the sector: why certain business models succeed / fail
- Identifying and quantifying key sector cash-flow drivers: sales growth, operating profit margins, working capital and capex needs
- Monitoring criteria: articulating key events that could change the outlook for the sector.

Management & Shareholders

- Companies in crisis: attributable to poor strategy or operational inefficiencies or over leveraging?
- 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: when is the level of transparency insufficient to continue bank support?

Business risk and commercial viability

- Assessing corporate strategy in light of the sector drivers: concluding on the short and medium-term outlook
- Uncovering key weaknesses: declining volumes against fixed cost base, volatile commodity prices, financially impaired customers, price competition, CAPEX requirements etc.
- Determining the changes needed to enable the company to address both sector challenges and company specific strategic and operational 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 and assessing the probability of a negative outcome
- Cash burn: ability to stem cash outflows as performance deteriorates
- Assessing management responses: revised corporate strategy, timeframe to execution and benefits
- Evaluating management's ability to implement: resources and capabilities
- Practical limitations and alternatives: Plan B?
- Determining when survival is unlikely: lenders options and timeframe for action.

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 etc.), 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 ACTIONS

This section is integrated throughout the workshop; the aim is to identify and assess the alternatives available to the lenders, taking into consideration: the extent of the problem, management's responses, overall commitment and exposure, and the interest of the various stakeholders.

Loan structure & the lender's right to act

- Determining the strengths and weaknesses of facility structures in protecting lenders when performance deteriorates
- Purpose: who is the borrower? In which legal entity are the assets and the cash-flows?
- Ranking: concerns surrounding maintaining seniority, structural subordination and multiple tranches of debt
- What protection has been negotiated? Identifying strong and weak forms of protection
- Monitoring credit indicators: deciding when a deteriorating credit needs to be watch-listed
- Evaluating exit options ahead of covenant breaches or other events of default
- When covenants are not breached: circumstances in which the bank can strengthen its position
- When covenants are breached: rationale for waiver or covenant amendments
- Negotiating meaningful terms and conditions / covenant packages.

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 of holding company debt / ownership requirements
- Requiring support from other stakeholders
- Access to equity capital: most probable sources and willingness to act.

Learning Paths



CONTACT US

Worldwide: +44 20 3530 2330

E: enquiry@fitchtraining.com

US: 212 612 7799

Web: www.fitchtraining.com

Ref: 8

ASIA: +65 6796 7248

Fax: +44 20 3530 2325