PN-ACC-122

Basics of Credit Analysis

Participant Guide

June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Basics of Credit Analysis

Unit 1: Introduction

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Purpose

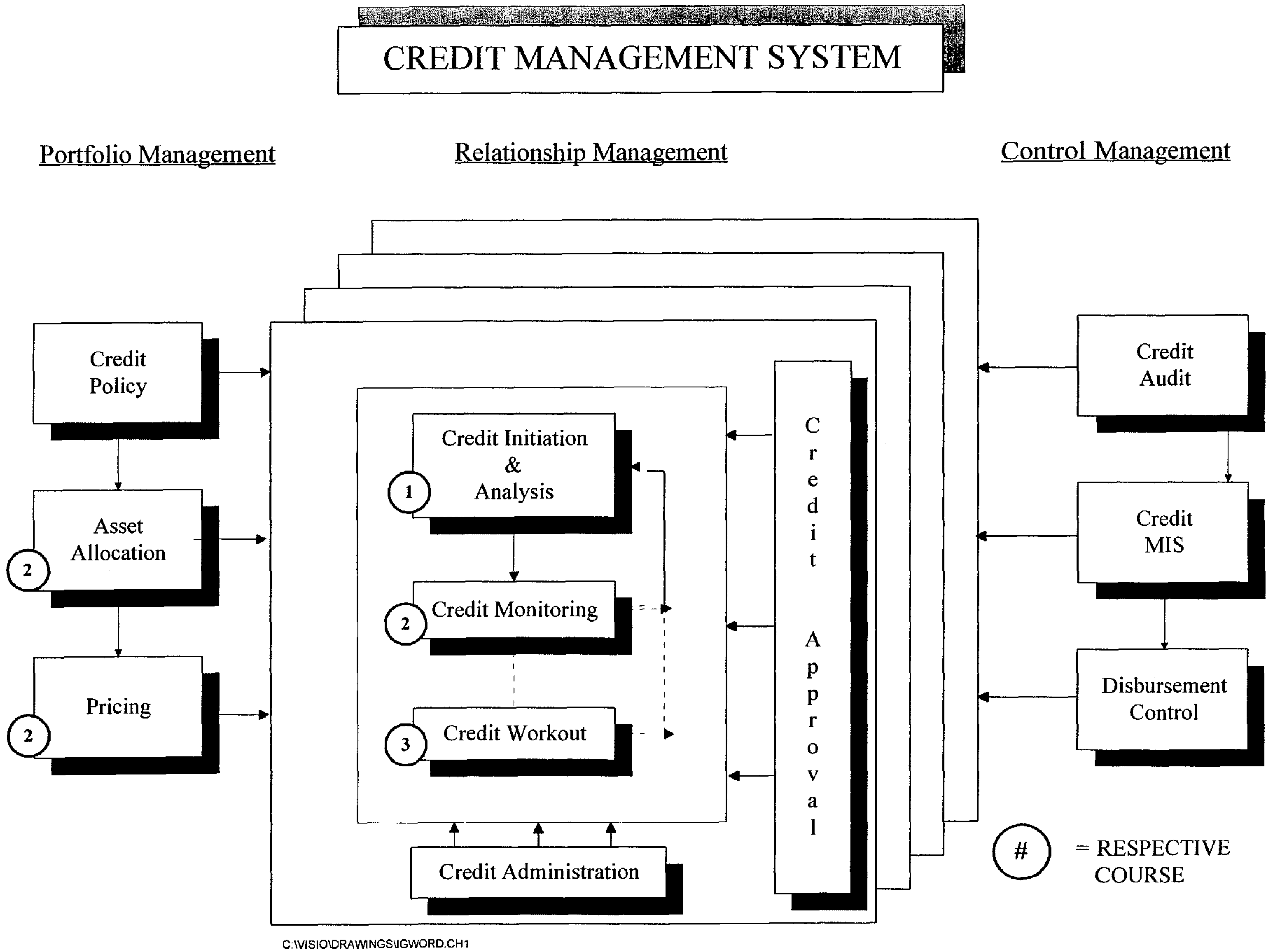
- The course delivers fundamental skills for an inspection officer to initiate, analyze, and recommend commercial credit extension.

- The course is a foundation-building course and will provide general principles related to credit extension, applicable to most markets.

Objectives

At the end of this course, you will be able to prepare a logical, well-documented and supported credit analysis package, using participant materials from this course as a guide.

NOTES


CREDIT MANAGEMENT SYSTEM
Portfolio Management
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Basics of Credit Analysis

Unit 1 Introduction

Unit 2 Financial Intermediation

Unit 3 Key Accounting Concepts

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Basics of Credit Analysis

Unit 2: Financial Intermediation

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June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

Purpose of Unit

Ensure all participants have the same understanding of financial intermediation in banking, because financial intermediation is the key banking function.

Objectives

At the end of this unit, participants will be able to:

1. Define financial intermediation within banking.
2. Describe financial intermediation's critical role in a market economy versus in a directed economy.
3. Describe the linkage of financial intermediation with credit management.
4. Give real-life examples of effective and ineffective intermediation.

Definitions

<u>Financial Intermediation in Banking</u> -

Efficient mobilization of finance resources and allocation of bank credit.

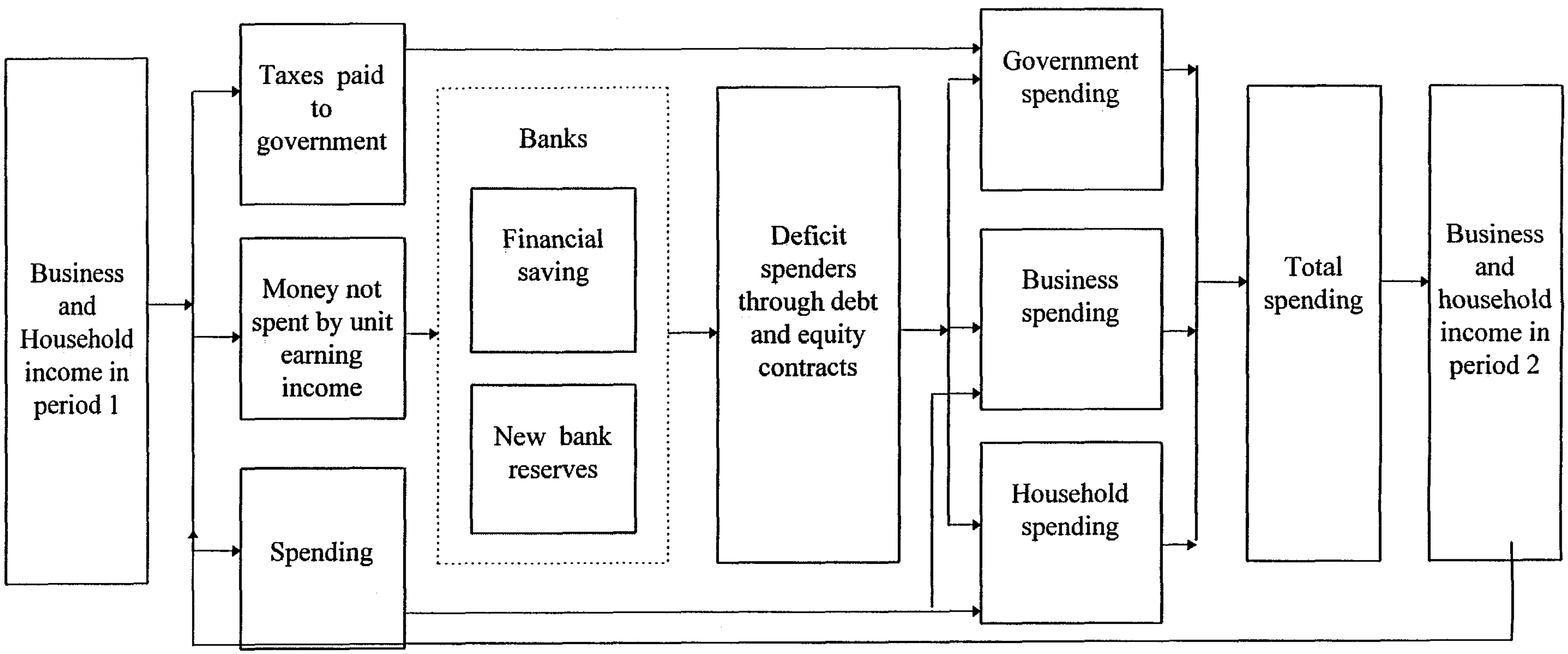
Results in:

- Gathering and managing deposits with safety
- Relending deposits on sound basis

Allocation of Resources

Should be viable activities in productive sector, resulting in improvement of real economy which contributes to growth in productive sector.

Financial Flows in the U. S. Economy



Directed Credit Programs

- When using a central plan:

  - Most funds go to directed credit, government decides—in case of Russia, defense build-up

  - Few funds were lent for consumer goods

- Central plan delays reform of banking's key function

  - Raising deposits

  - Credit assessment

Exercise

1. Divide into groups of two or three.

2. Each person discusses a successful or failed intermediation.

3. Select one of the intermediations as an example to present to the whole group.

4. Discuss each intermediation.

Credit Creation

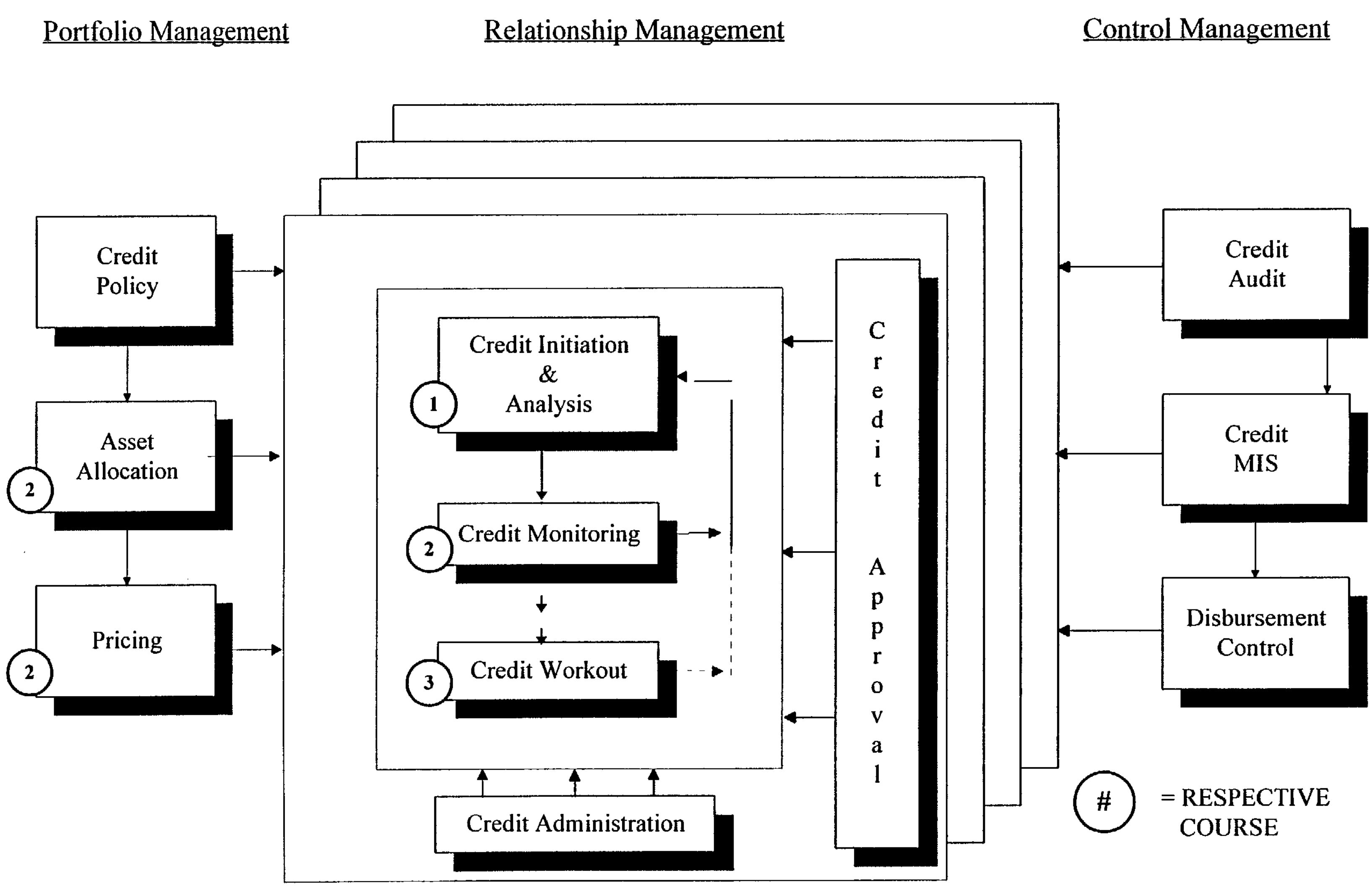
- Is one side of financial intermediation
- Is the focus of this course
- Is the key role of commercial bankers

Classical Banking Function

Leverages the capital structure of bank

- Little room for error
- Balance sheets show results
- Leverage at 8 or 10 to 1
- Small amount of bad assets makes a bank unprofitable

CREDIT MANAGEMENT SYSTEM



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Exercise

Part 1

1. Divide into groups of two or three.

2. Draw the credit management process used by your country's banks.

Part 2

Discuss your country's credit management process with the whole group.

Basics of Credit Analysis

Unit 3.1: Key Accounting Skills Overview

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Overview

This unit contains four sections.

- 3.1 Overview
- 3.2 Spreadsheet Development
- 3.3 Interpret Financial Ratios and Trends
- 3.4 Cash Flow Analysis and Projections

Objectives

At the end of this unit, you will be able to:

1. Identify the strengths and the weaknesses of the current credit analysis process.

2. Describe the underlying risks associated with the current situation.

3. Identify the basic financial and cash flow analysis requirements needed for all large lending customers to enable bank to identify and assess financial conditions and structure credit requirements.

Key Accounting Concepts

Key accounting concepts are used in analyzing credit in order to:

- Eliminate excessive, unquantified risks to the lending bank.

- Establish credit requirements based on actual cash flow.

- Enable banks to fully evaluate and understand their customers' creditworthiness.

- Enable banks to structure credit requirements based on accurate risk assessment.

Unacceptable Risks

Situations causing unacceptable risks for banks:

- No analysis of customer performance, liquidity, and leverage.
- Financial trends of customer's business not identified and interpreted.
- Amount of allowable credit not tied to company's cash flow.
- Facilities not structured to match business requirement and cash inflows and outflows.

Major Requirements

Banks should adopt these major requirements to identify and assess risks and evaluate and structure credit requirements.

- Develop a common format for organizing financial information to make analysis easier.

- Require a standard analysis for the key financial ratios and trends.

- Base credit on requirements directly related to actual business needs and cash flow projections.

- Structure facilities to protect the bank against key risks and to match likely cash inflows and outflows.

Suggested Responses to Discussion

1. Some weaknesses of the credit analysis process that is currently being practiced are:

   - Financial trends in the customer's business are not identified.

   - Many customers do not submit financial statements.

   - Many of the financials submitted are not audited.

   - The amount of credit allowed by the banks is not tied to the company's cash flow.

   - There are no standard analysis requirements for key financial risk areas and trends.

2. These statements describe a serious risk to banks under the current credit analysis process:

   - The banks do not know if the companies they loan to will be able to repay.

   - Business fluctuations and cash flow problems could cause companies to default on their loans.

Suggested Responses to Discussion, continued

3. These major requirements should be adopted by banks.

   - A common format should be developed and used to organize financial information about a company.

   - Banks should not attempt to base credit on requirements derived from business scenarios by management without first testing the scenarios through cash flow analysis.

- Facilities should be changed to protect the bank against key risks.

Basics of Credit Analysis

Unit 3.2: Spreadsheet Development

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Objectives

At the end of this unit, you will be able to:

1. Identify the reasons for using a standard spreadsheet format.

2. State the minimum amount of financial data required from all prospective and current borrowers to conduct ratio trend analysis and to analyze at least two years of cash flow generation.

3. Identify the recommended steps for completing financial spreadsheets.

4. Using the spreadsheet format and financial data provided, follow the recommended steps for completing financial spreadsheets.

Spreadsheets

Spreadsheets enable bank to:

1. Establish common definitions of financial ratios and key income statements, balance sheets, and cash flow items.

2. Facilitate the calculation of key ratios and cash flow analysis.

3. Identify and highlight critical information and ratios for analysis.

OH 3.2-2

Requirements

Suggested to have three years of:

- Financial data, sought from all prospective and current borrowers.

This data will allow for:

- Ratio trend analysis
- Cash flow generation analysis

Recommended Steps for Conducting Ratio & Cash Flow Trend Analysis

1 Collect and verify data.	⇒	**2** Spread profit and loss and balance sheet date.	⇒	**3** Reconcile net worth and fixed assets.	⇒	**4** Check whether ending balances are consistent with balance sheet.
8 Complete cash flows.	⇐	**7** Calculate ratios.	⇐	**6** Reconcile differences with customer.	⇐	**5** Check gross capital expend-itures with company data

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Five Key Components of Standard Financial Spreadsheets

1. Income statement
2. Balance sheet
3. Net worth and fixed asset reconciliation
4. Key ratios
5. Cash generation statement

Exercise to Complete a Spreadsheet

1. Fill out the spreadsheet. Follow the systematic process discussed in this unit.

2. With the instructor, review the information completed for each item.

Exercise

<u>Part 1</u>

1. Divide into two-person teams (if there is an odd number, there can be a team of three).

2. Have the participants complete reconciliation statement, i.e. net worth and fixed assets, for Meble Express.

<u>Part 2</u>

1. Exchange your work with another team.

2. Check each other's work, following the systematic process.

3. Each group will discuss their findings.

4. Discuss the process, emphasizing the advantages of using a spreadsheet and a systematic process for completing it.

CASE STUDY EXAMPLE:
Meble Express Ltd.

Introduction

Michal Szwed is a loan officer in the main Olsztyn branch of First City Bank. Two weeks before Mr. Szwed is scheduled to go on his vacation, he receives an urgent call from Marek Lutomski, a bank customer. Mr. Lutomski, founder-owner of Meble Express Ltd., asks to meet with the officer as soon as possible to discuss a loan request.

At the meeting on the following day, Mr. Lutomski presents his application for a short-term loan of 1,200 mlrd. zloties for additional working capital. Mr. Lutomski has just missed his first payment on a 3.798 mlrd. zloty unsecured loan from First City Bank; his company's bank account of two years has never exceeded 300 million zloties. He is, therefore, anxious to obtain more funds. In addition, Mr. Lutomski requests a long-term loan of $150,000 USD to purchase a warehouse for central storage of his rapidly growing inventory.

The loan officer compiles the following information from the meeting with Mr. Lutomski, from the bank's files and from the documents which the company president brought with him.

Management

Mr. Lutomski enjoys an excellent reputation as an honest and hardworking businessman and pillar of the community. He founded Meble Express in 1990 as an exposition store in Olstyn. He used his own money which he earned while working in the United States as a warehouse manager for five years. Prior to starting the company he had no experience in the furniture business.

According to the loan officer's notes, Mr. Lutomski appears to have a good understanding of the industry's distribution system. However, when it comes to financial management, he is limited to the concepts of "increasing sales" and the "positive net". Mr. Lutomski emphasized that the company's chief accountant is also focused on net profits.

Company Description

Meble Express Ltd. specializes in selling office furniture to small- and medium-sized companies. In 1991, Mr. Lutomski opened three new stores in Gdansk, Warsaw, and Bialystok. In 1992, a new store was opened in Lublin.

The company leases premises which are well-located in the center of each city. However, rents in these locations are comparatively high. Leasing agreements were signed for three to five years. The company had to spend a lot of money in renovations of the three stores to make them attractive for the customers.

Meble Express has three product lines: two from Poland and one from Germany. These include desks, chairs, computer desks, shelves, coffee tables and couches. Altogether, the company offers 85 different products, with a one-year warranty on all products sold. The products can be delivered to the warehouse within a day, if they are available; otherwise, delivery can take up to two weeks. Mr. Lutomski admitted that he sometimes has an enormous amount of inventory, "because getting the goods from suppliers takes a lot of time".

The company's stores are open 6 days a week, 10a.m. to 7p.m. There is one truck in both Warsaw and Olsztyn, which can usually deliver furniture within 24 hours. In every store there is a salaried salesperson in charge. Each of the stores has some rooms which are used as warehouses.

Nevertheless, Mr. Lutomski contends that he needs a centralized storage area for his growing inventory.

Market

Mr. Lutomski sells 90% of his furniture to small- and medium-sized firms (sales do not exceed $3 million). He attempted to sell to foreign companies and Polish banks. However, the owner concluded that it would require a lot of additional effort, such as hiring interior designers, which he was not prepared to undertake.

In the meeting with the loan officer, Mr. Lutomski indicated that he had not done formal market research. However, he is aware that companies in this country have much more money for consumption goods than consumers. He also sees a big potential in the fast growing private sector in Poland, even though many of these companies must carefully monitor their funds.

According to Mr. Lutomski, pricing of his company's Polish furniture is competitive, while German furniture is expensive.

Competition

Competition in this business has been very intense. There are dozens of retail furniture stores all over the country which vary in all aspects such as style, price, choice and quality. Most Western firms have found Polish distributors. Some Polish producers have their own distribution points, but most of them use other firms' services. Meble Express wants to focus on fast delivery, quality and price. The company has about eight competitors in each town, except for Warsaw. In the capital city, there are twenty competitors in the area where the firm operates (Srodmiescic and Mokotow).

According to Mr. Lutomski, Polish consumers expect to get a certain value for their money. Most of them buy Polish furniture, the style of which has greatly improved recently, because foreign products are very expensive. However, some customers do buy foreign furniture if their quality requirements are very high.

Financial Information

The loan officer noted that Mr. Lutomski has consistently provided all the financial information which he has at his disposition. (Refer to the Exhibits following the case.)

The company's assets include receivables, inventory and the loan by the owner to the managers and stockholders. The company pays 10% income tax and 7% turnover tax (separate from sales). Starting in July of this year the company is going to pay VAT.

No audit of financial statements was conducted.

After examining Mr. Lutomski's personal balance sheet, the loan officer finds out that his customer owns a house, worth $60,000 USD, with no mortgage, that is not a collateral to any loan. He also owns a 1992 Ford Escort worth $12,000 USD.

The Decision

Two weeks have passed and Mr. Szwed is scheduled to leave tomorrow for his vacation. He's under pressure from his boss and from Mr. Lutomski to make a decision on the loan request before leaving. The loan officer has scheduled a meeting with Mr. Lutomski for later today to discuss his decision.

MEBLE EXPRESS LTD.
Financial Data

ASSETS	PLZ MLD 31 Dec 91 12 Months	PLZ MLD 31 Dec 92 12 Months
Cash	345	15
Receivables for delivery, labor, services	1,457	5,346
receivables for delivery - after 90 days	*	679
Receivables - net	1,457	6,025
Finished goods	6,558	9,876
CURRENT ASSETS, TOTAL	8,360	15,916
Receivables from management/shareholders	1,200	1,200
OTHER ASSETS		
TOTAL ASSETS	9,560	17,116
LIABILITIES AND NET WORTH		
Short-term liabilities - bank	1,354	3,798
Payables	5,436	8,765
CURRENT LIABILITIES, TOTAL	6,790	12,563
SUPERIOR LIABILITIES, TOTAL	6,790	12,563
TOTAL LIABILITIES	6,790	12,563
NET WORTH		
Common stock	100	100
Goodwill capital	2,670	4,453
NET WORTH	2,770	4,553
LIABILITIES AND EQUITY, TOTAL	9,560	17,116
Net tangible assets	2,770	4,553
Working assets	1,570	3,353

INCOME STATEMENT

		PLZ MLD 31 Dec 92 12 Months
Income from sales	*	16,056
Cost of goods sold	*	12,487
GROSS PROFIT/INCOME	*	3,569
General and administrative costs	*	2,769
OPERATING COSTS	*	2,769
OPERATING PROFIT	*	800
Cost of interest - short-term loan	*	612
FINANCIAL COSTS, TOTAL	*	612
PROFIT BEFORE TAX & EXTRAORD.	*	188
Current income tax	*	75
PROFIT BEFORE EXTRAORD.	*	113
NET PROFIT	*	113
Issue surplus	*	1,783
CHANGE IN NET WORTH	*	1,896

POLISH FINANCIAL SPREADSHEETS

Company Name: Meble Express Ltd.						Currency: PLZ MLD		
Amounts in:								
Date (Day, Month, Yr):	1991		1992		1993		1993	
Balance Sheet								
DESCRIPTION	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%
					Straight Line		Sensitivity	
ASSETS								
Fixed Assets								
INTANGIBLE FIXED ASSETS								
Start-up expenses or organizational expenses								
of raising additional capital in a joint stock co.								
Development expenses								
Goodwill								
Other intangibles								
Prepayment for intangible fixed assets								
TANGIBLE FIXED ASSETS								
Freehold land								
Buildings and constructions								
Plant and machinery								
Vehicles								
Other [tangible] fixed assets								
Construction in process								
Prepayments for construction in process								
FINANCIAL FIXED ASSETS/[INVESTMENTS]								
Shares								
Securities								
Long-term loans - shareholders								
Other financial fixed assets/[investments]								
LONG-TERM DEBTORS								
OTHER								
Current Assets								
STOCK								
Raw materials								
Semi-finished goods and work-in-progress								
Finished products								
Goods for resale								
Stock prepayments								
Other								
DEBTORS AND CLAIMS								
Trade debtors								
Taxation, subsidy and social security debtors								
Interbranch/group debtors								
Other debtors								
Debtors taken to court								
TRADE [SHORT-TERM] SECURITIES								
Own shares for resale								
Other securities								
CASH [AND CASH EQUIVALENTS]								
Cash in hand								
Cash at bank								
Cash equivalents [bills of exchange,								
cheques, etc.								
PREPAYMENTS								
Prepaid expenses								
Other								
Other Assets								
TOTAL ASSETS								

POLISH FINANCIAL SPREADSHEETS

Company Name: Meble Express Ltd.					Currency: PLZ MLD			
Amounts in:								
Date (Day, Month, Yr):	31/12/91		31/12/92		Straight 31/12/93		Sensitivity 31/12/93	
Balance Sheet								
DESCRIPTION	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%
Liabilities and Equity								
Equity								
BASIC CAPITAL [FUND]								
CALLED UP BUT NOT YET CONTRIBUTED								
BASIC CAPITAL/CAPITAL RECEIVABLE								
[A NEGATIVE FIGURE]								
SUPPLEMENTARY CAPITAL [FUND]								
Share premium account								
Statutory capital								
Capital/[reserves] provided for by the								
articles or deed								
Capital from additional payments								
from shareholders								
REVALUATION RESERVE								
OTHER RESERVES/[RESERVE CAPITAL]								
PROFIT/LOSS AFTER TAXATION FOR THE								
FINANCIAL YEAR								
Provisions								
CIT or PIT provision								
Other provisions								
LIABILITIES								
Long-Term Creditors								
Long-term loans, bonds and other securities								
Long-term bank credits								
Other long-term creditors								
Other - bank								
Past due								
Short-Term Creditors and Special Funds								
SHORT-TERM CREDITORS								
Loans, bonds and securities								
Bank credits								
Advance payments received								
Trade creditors								
Bills of exchange payable								
Taxation, customs duty, social security								
Payroll creditors								
Interbranch/group creditors								
Other short-term creditors								
Special Funds								
Accruals and Deferred Income								
Accrued expenses								
Other liabilities								
Total Liabilities and Equity								

POLISH FINANCIAL SPREADSHEETS

Company Name: Meble Express Ltd. Currency: PLZ MLD

Amounts in:

Date (Day, Month, Yr): 31/12/92 Projected '93

Profit and Loss

DESCRIPTION	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%
Cost of operational activities								
Value of sold goods and materials								
Production cost of sold products								
Cost of sales								
General costs								
Total costs								
Social insurance contribution								
Sales profit								
Other operational costs								
Value of sold fixed assets								
Other operational costs								
Profit from operational activities								
Financial costs								
Deduction to revaluate fixed assets and short-term securities								
Interest to be paid								
Including subsidiary and associated entities								
Other								
Gross profit from operational acitivity								
Extraordinary losses								
Gross profit								
Obligatory appropriations of profit								
Corporate income tax								
Other obligatory charges								
Net profit								

POLISH FINANCIAL SPREADSHEETS

Company Name: Meble Express Ltd.				Currency: PLZ MLD		
Amounts in:						
Date (Day, Month, Yr):			Historic 31/12/92	Straight Project 1	Sensitivity Project 2	
Polish Cash Flow Statement - Direct Method						
	DESCRIPTION					
	Sales-Net	1				
	(Inc) Dec in Receivables	2				
		3				
Cash from Sales (1+2)		4				
		5				
	Cost of Sales (IS)	6				
	(Inc) Dec in Inventories	7				
	Inc (Dec) in Payables	8				
		9				
	Cash Production Costs (sum 5..9)	10				
Gross Cash Margin (4+10)		11				
		12				
	S,G&A Expense (IS)	13				
	(Inc) Dec in Prepaids	14				
	Inc (Dec) in Accruals	15				
	Inc (Dec) Other Assets	16				
	Cash Operating Expense (sum 12..16)	17				
Cash from Operations (11+17)		18				
		19				
	Miscellaneous Cash Income (IS)	20				
	Income Taxes Paid (IS)	21				
	Total (sum 19..21)	22				
		23				
Net Cash from Operations (18+22)		24				
		25				
	Interest Expense (IS)	26				
	Dividends Paid/Owner Withdrawals	27				
	Extraordinary Loss (IS)	28				
	Financing Costs (sum 25..28)	29				
Net Cash Income (24+29)		30				
		31				
	Current Portion Long-Term Debt	32				
		33				
	Total (31+32)	34				
Cash after Debt Amortization (30+34)		35				
	Capital Expenditures	36				
		37				
	Total (36+37)	38				
Financial Surplus (Requirements) (35+38)		39				
	Special Fund	40				
	Inc (Dec) Short-Term Debt	41				
	Inc (Dec) Long-Term Debt	42				
	Inc (Dec) Equity	43				
		44				
Total External Financing (sum 40..44)		45				
		46				
	Cash after Financing (45+39)	47				
	Actual Change in Cash					

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POLISH FINANCIAL SPREADSHEETS

Company Name: Meble Express Ltd.					Currency:	PLZ MLD		
Amounts in:								
Date (Day, Month, Yr):	1992		Straight 1993		Sensitivity 1993			
Net Worth Reconciliation								
DESCRIPTION	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%
Opening Net Worth								
Plus: Net Income								
Sale of Equity								
Total Additions								
Less: Dividends								
Total Deductions								
Increase (Dec.) Net Worth								
End Net Worth								
Fixed Asset Reconciliation								
Ending Fixed Assets								
Plus: Deprec. for Period								
Less: Opening Fixed Assets								
Equals: Net Capital Expenditures								
Plus: Sale of Assets								
Gross Capital Expenditures								
Key Ratios	**1990**		**1991**		**1992**			
PROFITABILITY								
Gross Margin								
Operating Profit Margin								
Net Profit Margin								
EFFICIENCY								
Inventory Days								
A/Rs Days								
A/Ps Days								
R.O.A.								
R.O.E.								
LEVERAGE								
Debt to Assets								
Debt to Net Worth								
Interest Cover								
LIQUIDITY								
Current Ratio								
Quick Ratio								

Basics of Credit Analysis

3.3: Interpreting Financial Ratios and Trends

Participant Guide
June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Objectives

At the end of this unit, participants will be able to:

1. Identify the definitions of key ratios.
2. Use the recommended formula to conduct ratio analysis for profitability.
3. Use the recommended formula to conduct ratio analysis for efficiency.
4. Use the recommended formula to conduct ratio analysis for leverage.
5. Use the recommended formula to conduct ratio analysis for liquidity.

Key Financial Ratios

- Profitability: represents the degree to which a business is able to produce sales greater than the cost of doing business.

- Efficiency: represents the effectiveness of the company's management of its resources and activities.

- Leverage: the difference between the funds supplied by the business owners and the financing supplied by creditors.

- Liquidity: the ability of the company's management to meet current obligations.

Key Financial Ratios ... Profitability

Definition of Profitability: Represents the degree to which a business is able to produce sales in excess of cost of daily business.

Ratio	Calculation	Definition	Analysis
Operating Profit Margin	(Operating Profit/ Net Sales) x 100	• Represents the percentage of profits retained from each sales dollar	• Ratio should remain stable or increase over time • Understanding any changes requires a detailed breakdown of operating expenses
Net Profit Margin	(Net Profit/Net Sales) x 100	• Measures the business ability to generate profit from each sales dollar	• In general, this ratio should move in the same direction as the gross and operating profit margin • Variances require a closer look at non-operating expenses, for example: interest expenses

Key Financial Ratios ... Profitability, continued

Definition of Profitability: Represents the degree to which a business is able to produce sales in excess of cost of daily business.

Ratio	Calculation	Definition	Analysis
Direct Cost & Expense Ratios	(Cost of Goods Sold/Net Sales) x 100	• Indicates the percentage of each sales dollar used to fund the expenses	• Upward trends in any of these ratios may indicate reasons for declining profitability • Downward trends may indicate good cost control

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Key Financial Ratios ... Efficiency

Definition of Efficiency: Effectiveness of a company's management to manage its resources and activities.

Ratio	Calculation	Definition	Analysis
Inventory Days on Hand	(Inventory/Cost of Sold Goods) x 360 Days	• Indicates management's ability to efficiently manage inventory • Low ratio is good	• A large increase may indicate a deliberate management decision to make bulk purchase or a possible supply disruption

Key Financial Ratios ... Efficiency, continued

Definition of Efficiency: Effectiveness of a company's management to manage its resources and activities.

Ratio	Calculation	Definition	Analysis
Accounts Receivable Days on Hand	(Net Accounts Receivable/Net Sales) x 360 Days	• Indicates management's collection ability • Critical to cash flow	• Analyze receivable aging schedule and receivable concentrations • Poor receivable quality can significantly increase this ration and significantly impact cash flow

Key Financial Ratios ... Efficiency, continued

Definition of Efficiency: Effectiveness of a company's management to manage its resources and activities.

Ratio	Calculation	Definition	Analysis
Accounts Payable Days on Hand	(Accounts Payable/Cost of Goods) x 360 Days	• Measures trade creditors financing to company and management's paying habits	• Increasing days on hand may indicate cash flow problems • In general, a firm with cash flow problems leans on its trade creditors • If A/R days increases significantly, it may indicate a short-term solution to cash flow problems. • This is not a reliable source of cash above industry averages

Key Financial Ratios ... Efficiency, continued

Definition of Efficiency: Effectiveness of a company's management to manage its resources and activities.

Ratio	Calculation	Definition	Analysis
Return on Assets (ROA)	Net Profit before Taxes/Total Assets	• Measures return on investment represented by the business' assets	• Analyze as net profit before tax to eliminate effect of taxes
Return on Equity	Net Profit/ Tangible Net Worth	• Measures rate of return on owners' equity	• This measures management's ability to operate a profitable business • If return is good, company should be able to generate additional equity

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Key Financial Ratios ... Leverage

Definition of Leverage: Compares the funds supplied by business owners with financing supplied by creditors. Measures debt capacity and ability to meet obligations.

Ratio	Calculation	Definition	Analysis
Debts to Assets	Total Liabilities/ Total Assets	• Indicates the degree to which assets are funded by external creditors	• The lower the cushion, the greater the cushion against creditor losses in event of liquidation

Key Financial Ratios ... Leverage, continued

Definition of Leverage: Compares the funds supplied by business owners with financing supplied by creditors. Measures debt capacity and ability to meet obligations.

Ratio	**Calculation**	**Definition**	**Analysis**
Debt to Net Worth	Total Liabilities/ Net Worth	• Measures how many dollars of outside financing there are for each dollar of owners' equity	• This ratio indicates firm's ability to borrow more • High ratio equals high risk

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Key Financial Ratios ... Leverage, continued

Definition of Leverage: Compares the funds supplied by business owners with financing supplied by creditors. Measures debt capacity and ability to meet obligations.

Ratio	Calculation	Definition	Analysis
Interest Coverage	(Net Profit before Tax + Interest Expense)/Interest Expense	• Measures the degree to which earnings can decline without affecting the company's ability to meet annual interest costs	• This calculation does not include leased assets and obligations under lease contracts

Key Financial Ratio ... Liquidity

Definition of Liquidity: The ability of the company's management to meet current obligations

Ratio	Calculation	Definition	Analysis
Current Ratio	Current Assets/current liabilities	• Current asset dollars available to pay current obligations	• Must be aware of A/R and inventory quality, if either are poor, measure can be misleading

Basics of Credit Analysis

3.4: Cash Flow Analysis

Participant Guide
June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

Objectives

At the end of this unit, participants will be able to:

1. Identify the difference between cash versus accrual accounting.
2. Identify the correct definition of cash flow analysis.
3. Identify the correct techniques of cash flow analysis.
4. Outline how to project cash flow.
5. Identify how to make credit analysis decisions based on cash flow.
6. Construct a cash flow analysis and projection.
7. Make credit analysis decisions based on completed financial statements.

Key Financial Ratio ... Liquidity, continued

Definition of Liquidity: The ability of the company's management to meet current obligations

Ratio	Calculation	Definition	Analysis
Quick Ratio	Cash + Marketable Securities + NET A/Rs/ Current Liabilities	• A more accurate measure of current liquid assets available to pay current obligations	• Same analysis applies as above but need to be aware of quality of marketable securities

OH 3.3-13

Cash Flow Analysis

Cash flow analysis is an effective tool for:

- Testing preliminary assessments of financial strength
- Pulling together loan analysis process
- Indicating a different perspective on a company
- Helping banker look beyond accrual accounting

Calculate Cash Flow

Direct Method:

- Starts from top of income statement
- Cancels out the effect of accrual accounting to give actual inflows and outflows

Indirect Method:

- Starts at net income figure
- Focuses on balance sheet items

Cash Flow Summary Sheet

Polish Financial Spreadsheets							
Company Name:				Currency: PLZ MLD			
Amounts in:							
Date (Day, Month, Yr.):							
Polish Cash Flow Statement - Direct Method							
	DESCRIPTION						
	Sales-Net	1					
	(Inc) Dec in Receivables	2					
		3					
Cash from Sales (1+2)		4					
		5					
	Cost of Sales (IS) / Net of Depr. & Finc. Costs	6					
	(Inc) Dec in Inventories	7					
	(Inc) Dec in Payables	8					
	Other	9					
	Cash Production Costs (sum 5...9)	10					
Gross Cash Margin (4+10)		11					
		12					
	(Inc) Dec in Prepaids	13					
	Inc (Dec) in Accruals	14					
	Inc (Dec) Other Assets	15					
	Cash Operating Expense (sum 12..16)	16					
Cash from Operations (11+17)		17					
		18					
	Miscellaneous Cash Income (IS)	19					
	Income Taxes Paid (IS)	20					
	Total (sum 19..21)	21					
		22					
Net Cash from Operations (18+22)		23					
		24					
	Financial Expenses (IS)	25					
	Dividends Paid/Owner Withdrawls	26					
	Extraordinary Loss (IS)	27					
	Financing Costs (sum 25..28)	28					
Net Cash Income (24+29)		29					
		30					
	Current Portion Long-Term Debt	31					
		32					
	Total (31+32)	33					
Cash After Debt Amortization (30 +34)		34					
	Capital Expenditures	35					
	Intangibles	36					
	Total (36+37)	37					
Financial Surplus (Requirements) (35+38)		38					
	Other	39					
	Inc (Dec) Short-Term Debt	40					
	Inc (Dec) Long-Term Debt	41					
	Inc (Dec) Equity	42					
		43					
Total External Financing (sum 40..44)		44					
		45					
	Cash After Financing (45+39)	46					
	Actual Change in Cash	47					

OH 3.4-4

Analyze Cash From Sales

What is driving sales?

- Is company management the primary influence?

- Is industry changing and therefore affecting sales?

What is influencing accounts receivable turnover?

- Management doing good job with accounts receivable?

- Excessive credit?

- Potential bad debts significant?

Gross Cash Margin

What is influencing COGS?

- Discounts
- Raw material shortages
- Efficiency of production

What is influencing inventory?

- Inventory level
- Stockpiling

What is influencing accounts payable?

- Good payment terms?
- Suppliers no longer granting credit?

Cash From Operations

Is line 18 positive?

- If line 18 is positive, the company has been able to pay costs of operation cycle with internally generated funds.

Is management managing salaries and other key overhead expenses?

Is significant money being spent on research and development?

OH 3.4-7

Net Cash Operations

Has the company been able to pay all operating costs and income taxes from internal generated funds?

- If no, company cannot service interest internally at this time.

Is there a significant trend in taxes?

Net Cash Income

Is the company able to pay external financing without additional borrowing?

Is interest expense going way up?

- If yes, is it because interest rates are rising or because debt is significantly increasing?

If cash flow is positive, what can management do with it?

Cash After Debt Amortization

Is the company able to pay its debts from internally generated cash?

If CADA is positive, is it enough to pay for capital expenditures?

Is long-term debt on full amortization or does one large payment come due?

If CADA is negative, how long can trend be sustained?

Intangibles

- Beginning: Investment or intangibles
- Less: Amortization expense
- Equals: Expected investments or intangibles
- Less: Actual ending investments or intangibles
- Equals: Net change

Financing Surplus or Requirement

Has the company been able to meet all the financing requirements with internally generated cash?

How high have fixed asset and investment expenditures been? How were they paid? Do investments appear prudent?

How stable is the company's financing requirement? Can management control this requirement?

Total External Financing

How has the company financed itself?

- What are the key sources?
- Will the key sources be reliable in the future?

Has the company been able to meet commitments?

How will debt financing affect future interest costs?

Reliable Cash Flow Projections

Basic Requirements:

- Economic strategies
- Industry strategies
- Company strategies
- The company's management decisions
- Other factors affecting the company's finances

Projecting Cash Flow

Seven Key Steps:

1. Form key assumptions over key variables
2. Project the income statement, first approximation
3. Project balance sheet, first approximation
4. Project the cash flow summary, first approximation
5. Revise income statement and balance sheet
6. Revise cash flow summary
7. Analyze the projections

Form Key Assumptions

Form key assumptions over key variables because the fundamental element of good cash flow projections is a good set of assumptions.

If customer prepares projections, bank must:

- Identify customer's assumptions about sales, receivables, etc.
- Decide if customer's assumptions make sense
- Accept or modify customer's assumptions or create own

If bank accepts projections:

- Test
- Decide if range is acceptable

Approaches to Developing Assumptions

Two:

- Straight-line approach
  - Presumes history will repeat itself
- Synthesis approach
  - Scenarios of future events are developed

Straight-line Approach

Extends past trends into the future:

- For example, if sales have been growing regularly by 10 percent per year, the analyst could project an annual 10 percent sales growth in the future.

- In the same way, the analyst would extend the trends to:

  - Cost of sales

  - Operating expenses

  - Balance sheet accounts

Synthesis Approach

- It can address change
- It can factor in what is known about
  - The future of the industry
  - The general state of the economy

Projection Assumptions Form

Income Statement	Historical -2	-1	0	Future +1	+2	+4
1. Sales %Δ						
2. Cost of sales %						
3. Interest rate %						
4. Tax rate %						
5. Extraordinary gains						
6. Extraordinary losses						
7. Other						
Balance Sheet						
1. A/R days						
2. Inventory days						
3. A/R days						
4. Fixed asset purchases						
5. Additional capital						
6. Other						

Project Income Statement, First Approximation

1. Estimate annual sales

   - Review historical growth of sales within company
   - Review industry trends and company's sales position within industry
   - Review company's sales management plans

2. Estimate the cost of goods sold or a similar measure in Central and Eastern Europe

   - Review the historical margins
   - Review the projected costs of key inputs
   - Review management's plans

Project Income Statement, First Approximation, continued

3. Estimate selling general, and administrative expenses

    - Review historical trends focused on margins

    - Review projected changes in staff and other operating expenses

4. Review future plans for fixed asset purchases

    - Depreciation is a key expense and must be factored in

Project Income Statement, First Approximation, continued

5. Estimate interest expenses on existing debt

   - Requires an assumption on future borrowing and how debt will be repaid

   - Easier to estimate after:

     - Major balance sheet accounts have been established

     - Capital investments have been estimated and changes in related liability and capital accounts have been made

Projection Assumptions Form

	Historical			Future		
Income Statement	-2	-1	0	+1	+2	+4
1. Sales %Δ						
2. Cost of sales %						
3. Interest rate %						
4. Tax rate %						
5. Extraordinary gains						
6. Extraordinary losses						
7. Other						
Balance Sheet						
1. A/R days						
2. Inventory days						
3. A/R days						
4. Fixed asset purchases						
5. Additional capital						
6. Other						

OH 3.4-24

Project Income Statement, First Approximation, continued

6. Estimate other income

   - May remain constant within a company unless there is a major change

7. Complete the income statement

   - This requires assumptions on income tax expense

Cash Flow Summary, First Approximation

1. Transfer information

    - Information must be transferred from the Income Statement Projection to the Cash Flow Summary

2. Estimate changes in accounts receivable

    - Projected A/R and the projected annual sales must be divided by 360 days.

    - Multiply number by the projected AR DOH

Cash Flow Summary, First Approximation, continued

3. Estimate inventory

   - Projected cash cost of goods sold is divided by 360 days to determine the cost for one day

   - Multiply this number by the projected inventory DOH for that year

   - Record the number

   - Calculate the difference

Cash Flow Summary, First Approximation, continued

4. Estimate accounts payable

    - Use the AP DOH method
    - Record number
    - Calculate difference

5. Estimate prepaid expenses

    - Not a material number
    - Similar number can be used from balance sheet

Cash Flow Summary,
First Approximation, continued

6. Estimate accrued expenses

    - Information sought from customer

    - If not done, percentage of AG&A method can be used.

7. Estimate change in other current and non-current accounts

    - Often remain the same

    - If so, no change is projected on balance sheet

    - If any accounts are material, can project as a percentage of SG&A or on basis of historical growth

Cash Flow Summary, First Approximation, continued

8. Estimate income taxes payable

   - Understand management's tax posture and existing tax laws

   - If no material information, same percentages should be kept

9. Estimate change in interest payable

   - Item will not significantly change unless the customer plans to significantly alter debt structure or interest rates show significant changes

Cash Flow Summary, First Approximation, continued

10. Estimate dividends, declared, or payable

    - Have firm understanding of profitability and owner financial demand and intentions

11. Estimate current portion of long-term debt

    - Have a firm understanding of the existing debt repayment schedules and the future debt payment schedules

12. Estimate net capital expenditures

    - Requires knowledge of the borrower's purchases and sales of net fixed assets

Cash Flow Summary, First Approximation, continued

13. Estimate long-term investments

    - Requires firm understanding of management's future plans

14. Estimated changes in short-term and long-term debt

    - If surplus of cash, number may be reflected as a short- or long-term debt requirement

    - Projected cash flow has financing requirement, short- or long-term debt needs should be changed accordingly

Cash Flow Summary, First Approximation, continued

15. Estimate the change in equity

    - Is additional equity anticipated from shareholders? If not, change is zero.

Revise Income Statement

Initial cash flow projections, the surplus or financing requirement is different from the amount need to pay out existing short-term debt.

- Due to first approximation of interest expense assumes the short-term debt will be paid out, the income statement needs to be revised based on a more reliable estimate of interest expenses.

Interest Expense Approximation Sheet

	Debt	
	Short	Long
Beginning Debt		
Plus: Ending Debt		
Divided by 2		
Equals Average Debt		
Times: Interest Rate		
Equals: Projected Interest Expense		

Total of short and long interest expense equals total interest expense.

Revise Cash Flow Summary

1. Recalculate:
   - Financing surplus or requirement
   - Change in cash

2. Reallocate the surplus or requirement

3. Project the balance sheet

Analyze Projection

Resolve:

- Is cash flow adequate to meet obligations without additional borrowing?
- How much debt can the company repay?
- Can capital expenditures be financed by internally generated cash?

Basics of Credit Analysis

Unit 4: Relationship Management

Participant Guide
June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Objectives

At the end participants will be able to:

1. Outline the issues and potential advantages of relationship management.

2. Describe the key actions of relationship managers.

Unit will cover:

- What relationship management is.
- How to organize a bank's lending function by relationship.
- Why relationship management is important.
- What the benefits of relationship management are.
- What the key actions of relationship management are.

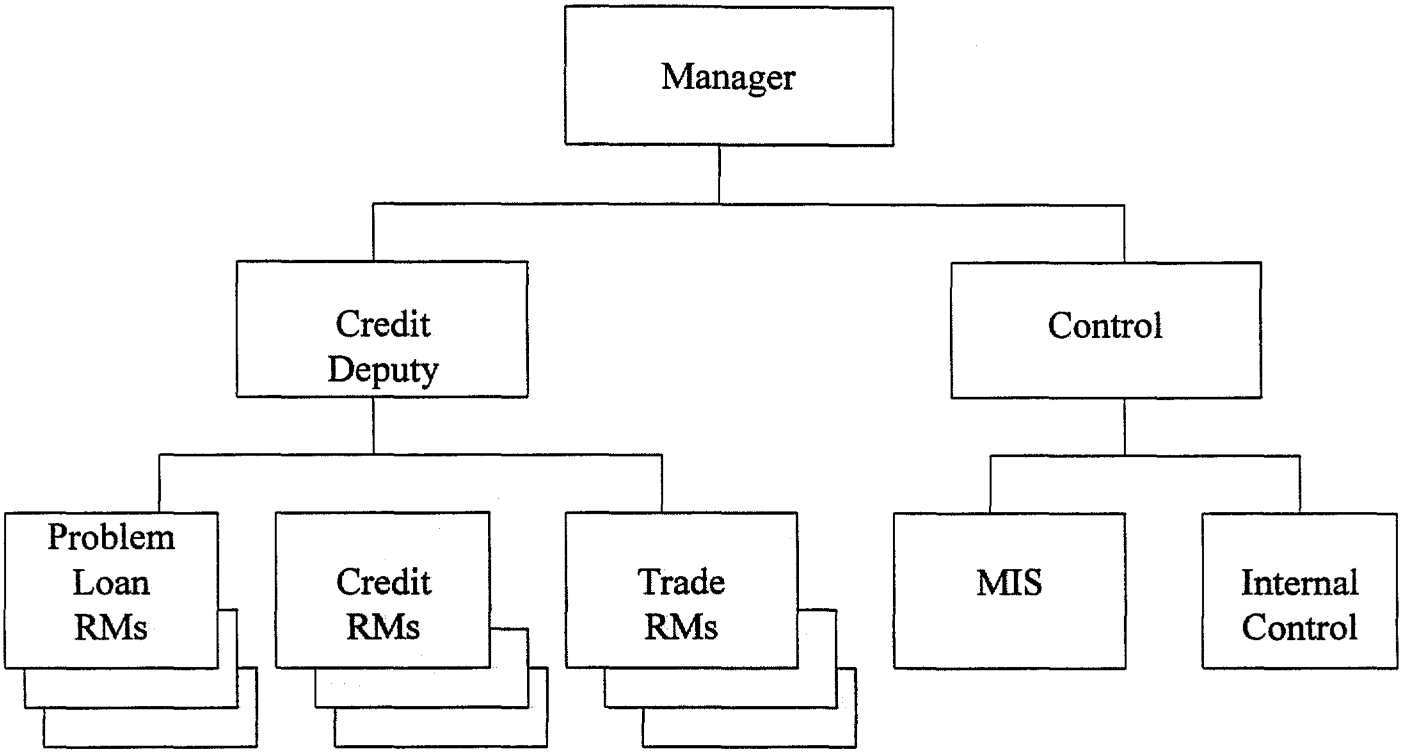
Relationship Management

- Requires delegated responsibilities for credit and marketing.
- Enhances analytical capabilities and application of good business judgment.
- Enhances technical specialties.

Banks Without Relationship Management

- Key responsibilities in question
- Managing customers is fragmented
- Results in:
  - Poor responsibility for results
  - Poor performance of critical function

Organizational Chart
Supporting Relationship Management



RMs = Relationship Managers

Key Actions of Relationship Managers

- Market to attractive customers within assigned industry sector
- Cross-sell full range of bank products
- Gather and verify credit data for full relationship
- Analyze customer creditworthiness
- Identify credit requirements
- Structure facilities profitably
- Monitor ongoing relationships

Assign relationship managers to specific industry sectors. Results in:

- Improved credit assessment capabilities and ongoing risk management capabilities. This:
  - Provides broad range of contacts
  - Facilitates development of expert knowledge to determine risk
  - Improves ability to assess value
  - Facilitates implementation of portfolio management guidelines

Assign relationship managers to specific industry sectors. Results in:

- Improved marketing and client services. This:
    - Provides knowledge to tailor selling of products and services
    - Improves ability to discern attractive prospects

Basics of Credit Analysis

Unit 5.1: Collect and Verify Data

Participant Guide
June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Overview of the Credit Analysis Process

- Section 5.1 - Collect and Verify Data
- Section 5.2 - Analyze Creditworthiness
- Section 5.3 - Determine Credit Requirements and Ability to Pay
- Section 5.4 - Structure Facilities
- Section 5.5 - Prepare Credit Analysis Package (CAP)

Objectives

At the end of this unit, you will be able to:

1. Define key process steps necessary to prepare a well-thought out credit analysis package.

2. Identify data to be gathered to facilitate analysis of creditworthiness.

Data Requirements

Data must be:

- Detailed
- Thorough
- Accurate
- Up-to-Date

Gathering good data may be difficult in Central and Eastern Europe.

Data Verification

All data collected is verified against:

- Minimum external requirements
- Onsite physical verification standards

External Verification Standards

Person Responsible	Data	Source	Verification Standards
Relationship Manager	• Types of facilities & outstandings • Cash balances • Payment status • Pledging of security • General credit standing	• Banks through: -- Fax/telex -- Telephone -- Interview	• Select banks which provide credit • Obtain verification from at least 2 parties
Relationship Manager	• Terms of creditor, management and balance • Payment status • Payment history	• Suppliers through: -- Telephone -- Interview	• Select major suppliers which provide credit • Obtain verification from at least one • Recovery Officer
Relationship Manager	• Purchasing volumes • Purchasing terms • Payment status • Delivery terms	• Buyer through: -- Telephone -- Interview	• Select major buyers • Obtain verification from at least 1

OH 5.1-5

Person Responsible	Data	Source	Verification Standards
Administrative Officer	• Protect/service satisfaction • Market and competitive information • Company financial information • Product/service information	• Research	• As required
Professional Assessor (Coordinated by Relationship Officer)	• Inventory -- Number of units -- Market value -- Liquidation value • Fixed assets (Land, Building, Machinery & Equipment) -- Quality and market value -- Condition -- Capacity, utilization/ productivity • Production facilities (MFG.) -- Operating condition -- Technology	• Company's head office • Site visit	• Select professional assessor and professional site engineer from list of approved assessors • Obtain verification by professional prior to approving recovery strategy • Reassess collateral value semi-annually

OH 5.1-6

Person Responsible	Data	Source	Verification Standards
Professional Assessor, continued...	• Construction site • Efficiency • Cost effectiveness		
Relationship Manager	• Employee profile • Sales outlets/ warehouses • Sales/outputs	• Company's head office • Site visits	• Conduct site visit -- 2 sales outlets -- 1 warehouse • Conduct customer call to profile employees and verify sales figure:
Independent Accountants	• Financial information	• Company's books	• In cases of large loans where the bank is restructuring, accountants should be selected to verify financial information

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Foundations of Creditworthiness

- Industry Dynamics
- Financial Condition
- Management Quality
- Security Realization

ON-SITE VERIFICATION STANDARDS

Foundation	Data Required	Data Sources
Industry Dynamics	• Industry profile - 3 years - Size, growth - Concentrations - Cyclicality/seasonality - Explanation of trends • Industry outlook • Profiles of key competitors (top two) • Regulatory profile - current, recent, and expected changes. • Borrower's strategy and business plan	• Internal - Files - Research department - Other managers familiar with industry • Third parties - Ministries - Multilateral agencies - USAID, World Bank, EBRD - Other government organizations - Trade associations - Other banks - Other companies in industries • External - customer calls

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ON-SITE VERIFICATION STANDARDS

Foundation	Data Required	Data Sources
Industry Dynamics, continued...	• Key alliances: - With government - With private sector - With other influential players	• Library research and subscriptions
Financial Condition	• Company financials - 3 years - Profit and loss statements, balance sheets - Supplementary statements - reconciliation of net worth, fixed assets - Audited where possible • Creditor facilities - amounts and conditions of facilities of: - Banks - Suppliers	• Internal - Files - Other managers familiar with borrower • Borrower - In person calls - Site visits • Third parties - Credit Bureau - Creditors - banks and suppliers

ON-SITE VERIFICATION STANDARDS

Foundation	Data Required	Data Sources
Financial Condition, continued...	• Additional company financial data: - Related company financials - Inter-group accounts - Accounts receivable aging - Explanation of key accounts: investments, other assets/liabilities • Financial projections • Credit check - at least 2 banks	• Company supplied financials • Notes to financial statements • Company management information reports

ON-SITE VERIFICATION STANDARDS

Foundation	Data Required	Data Sources
Management Quality	• Background on all senior managers, including Board members - Education, experience - Skills • Management's track record - Performance - Information provided, meeting attended, other obligations - Standing with other creditors • Alliances with: - Government - Private sector - Other influential players	• Internal - Files - Other managers • Borrower - In person calls - Manager interviews - Site visits • Third party - Government officials familiar with managers - Private sector individuals - Credit bureau - Creditors - banks and suppliers

ON-SITE VERIFICATION STANDARDS

Foundation	Data Required	Data Sources
Security Realization	• Security documentation - Titles and deeds - Guarantees - Other documents • Legal opinion on executability • Physical verification • Assessed value • Database of similar cases - Liquidation value of security vs. assessed value - Time to realize value • Confirmation of bank's seniority	• Internal - Files - Interview with managers - Interview with lawyers - Case histories • Borrower - Site visits - Calls • Third parties - Assessors - Other lawyers - Creditors (concerning double pledging)

Basics of Credit Analysis

Unit 5.2: Analyze Creditworthiness

Participant Guide
June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Objective

At the end of this unit, you will be able to analyze the creditworthiness of the relationship.

Foundations of Creditworthiness

- Industry Dynamics
- Financial Condition
- Management Quality
- Security Realization

Industry Dynamics

Risk Area	Rationale
Industry Environment →	• Structural problems in an industry can affect overall risk of lending to an industry -- e.g., low returns, high costs, highly competitive, etc. • Environmental changes can have negative impact on lending -- e.g. trade impasses, FX deregulation, reduction in trade barriers, and other changes in government policy.
Company Position Within the Industry →	• Competitive dynamics can put some companies at a critical advantage or disadvantage. Competitive position is often heavily influenced by threat of new entrants, bargaining power of suppliers and customers, and threat of product substitution • Weakness in key areas required to succeed could affect overall risk of lending

Industry Environment

Components	Analysis	Problem Areas (Example)
Industry Cycle	• Determine market size and growth since the market economy began • Assess why market is growing/ declining • Assess rate of growth • Determine how the market is segmented in terms of: - Customers - Geography • Determine shares of leading competitors and degree of concentration • Assess other relevant factors - Cyclicality - Seasonality	• Shrinking market • Volatile market • Dominant competitors forcing out smaller ones • Key competitors have differentiated product with strong loyalties

Industry Environment, continued

Components	**Analysis**	**Problem Areas (Example)**
Industry Structure	• Evaluate industry characteristics and determine key features of each: - Nature of products - Barriers to entry/exit - Economies of scale - Substitutes - Capital requirements • Determine structural implications of industry characteristics - Distribution channels - Level of fixed costs and overcapacity	• Commodity like product leading to low profit margins • Low barriers to entry resulting in over capacity • Supply interruption • Over reliance on few, weak suppliers • Buyer concentration • Certain competitors have locked up key distribution channels

Industry Environment, continued

Components	Analysis	Problem Areas (Example)
Regulatory Factors	• Review regulations which govern industry • Review bodies that control regulations • Review recent changes and determine likelihood and nature of future changes • Understand company's ability to influence change	• Elimination of price controls leading to competition • Government controls key licenses required and expensive to obtain • New players allowed to enter market • Additional risk exposure from deregulation of FX markets • Price control on key inputs lifted • New burdensome regulations passed, for example: environmental laws

Company Position

Components	Analysis	Problem Areas (Example)
Competitive Position	• Identify key success factors--what a company must do well to succeed--based on industry environment analysis • Review product differentiation • Review company's performance against key competitors • Rank company's position	• Company disadvantaged in critical areas and not able to compete • Capital requirements are too high to change • Key distribution channels are closed off

FINANCIAL CONDITION SUMMARY

Borrower : Vyroba
Date Most Recent Financial Statements : February, 1992
Period Covered : 1992 - 1993
Audited : ☐ Yes ☒ No

Recovery Officer :
Date Completed : March 20, 1993
Number Years Information Analyzed: 4
Reliability of Financials:
☐ **Very Reliable** ☒ **Reliable** ☐ **Unreliable**

Overall Financial Condition **Level of Risk:** ER
Credit Problems:

- Increased leverage to finance recent plant expansion has adversely impacted performance, leverage, and liquidity
- Large concentration of receivables to slow paying customers has hurt liquidity

Summary Analysis of Key Risk Areas:

1. Profitability Level Of Risk: ER **% Net Income/Sales:** (4%)
Credit Problems/Comments:

- Profitability reporting is fairly reliable
- Rapidly rising administrative costs -- from 4% of sales to 8% over past 3 years
- Increasing interest expense associated with financing of plant expansion (4% - 8% of sales)
- High depreciation costs (2% - 4% of sales)

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Financial Condition, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Leverage	• Financial ratios - Debt/net worth - Debt/assets - Interest cover • Rate sensitivity	• Reconcile net worth • Evaluate capital structure • Assess creditor/share-holder support • Perform rate sensitivity analysis under varying rate scenarios • Evaluate	• Excess debt • Withdrawal of support • High cost borrowings/ bunching of payments • Overvalued equity • Over-sensitivity to interest rate swings

Financial Condition, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Liquidity, continued	• Lines of credit - Bankers - Suppliers - Shareholders	• Develop debt service profile • Review investment budget • Review intra-group accounts - Consolidating statements - Receivables and payables to related companies - Prices to related companies - Dividend payments - Owners' salaries/ payment	• Diversion of funds to associated companies/transfer funding

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Financial Condition, continued

Risk Area	Strength Measures	Analysis	Problem Areas(Example)
Liquidity	• Financial ratios: - Current - Quick - Inventory turnover - A/R days on hand - A/P days - Interest/ operating profit • Cash flow - Debt service - Sources funds analysis - Uses funds analysis	• Evaluate integrity of creditor support • Evaluate current asset quality and aging of receivables • Evaluate liquidity of investments • Assess shareholders' support - Willingness to guarantee - Willingness to inject additional capital • Review cost structure	• Poor quality current assets • Illiquid investments • Withdrawal of creditor support • Excess debt that drains available cash • Withdrawal of shareholder support • High cost borrowings/ bunching of payments • High payroll/material costs • Large investment costs

Financial Condition

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Profitability	• Financial ratios: - Return on assets - Return on sales - Return on equity - Operating profit/ sales • Profit and loss statement analysis • A/R's quality • Inventory quality • Fixed asset quality	• Complete financial spreads • Verify profitability information and determine accuracy • Perform trend analysis • Compare figures with other companies in industry • Perform site visits to assess inventory and fixed asset quality • Determine quality of A/Rs	• Declining revenue • Increasing costs - Payroll - Financing - Cost of goods - Depreciation • Insufficient profits to support growth • Insufficient scale--excess fixed costs • Poor quality receivables • Insufficient inventory to meet demand • Outdated production

Financial Condition

Risk Area		Rationale
Profitability	→	• Indicates operating success, growth potential and competitive position • Often numbers reported are inaccurate or manipulated
Liquidity	→	• Determines ability to meet obligations -- operating expenses, debt service, supplies, credit, etc.
Leverage	→	• Determines degree of financial risk and ability to absorb business risk • Is a sign of owners' commitment to the business • Excess leverage is often a key cause of business failure

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INDUSTRY DYNAMICS SUMMARY

2. Company Competitive Position Within Industry: **Overall Risk:** MR

a. Summary of Competitive Position:	Level of Risk	Comments/Credit Problems
Access to low cost wool and labor	LR	• Diversified sources of wool supply and good supply of labor
Efficient production	MR	• Older plant
Differentiated product	HR	• Follows market trend
Quality reputation	HR	• Inconsistent quality of product
Diverse range of buyers	LR	• Concentrated in large German buyers

b. Summary of Company's Potential for Change: **Level of risk:** MR — **Comments/Credit Problems**

• Will focus on developing new products • However, no plan to address quality control problems	• Strategy does not fully address weaknesses

c. Company Influence:	Level of risk:	Comments/Credit Problems
• **Well connected with key government officials and private sector players**	LR	None

INDUSTRY DYNAMICS

Borrower: Vyroba Carpet

Industry: Carpet manufacturing and export

Recovery Officer:
Date Completed: March 20, 1993

Summary Overall Assessment: **Level of Risk** $\boxed{\text{MR}}$

Credit Problems:
- Signs of over supply and reputation for quality declining in key markets
- New competitors entering with higher quality products
- Company fairly well positioned, but faces quality control problem which could weaken future position

Summary Analysis of Key Risk Areas:

	Level of Risk	Comments/Credit Problems
1. Industry Environment:		
a. Industry cycle	MR	• Market growth slowing • Demand concentrated in Germany
b. Industry structure	MR	• Declining profit margins • Low barriers to entry, increasing competition
c. Regulatory factors	LR	• Proper government support
Overall:	MR	

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Company Position, continued

Components	Analysis	Problem Areas (Example)
Company Influence	• Review political affiliations • Review buyer and supplier loyalty • Review private affiliations • Assess implications for bank's position and company's performance	• Company poorly positioned to lobby for critical issues • Company aligned with unpopular or weak players • Little loyalty for buyer or suppliers

OH 5.2-9

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Company Position, continued

Components	Analysis	Problem Areas (Example)
Potential for Change	• Review company's strategy • Review depth and flexibility of management • Assess in terms of: - Degree to which it addresses weakness/strengths - Degree to which it is able to change with existing resources - Management's ability to execute.	• No strategy exists to address weakness/improve position • Strategy is not practical or achievable • Management lacks skills to change • Costs are too high to change

FINANCIAL CONDITION SUMMARY

2. Liquidity Level of Risk: $\boxed{\text{ER}}$
Credit Problems/Comments:

Net Operating Income/Debt Service: 0.75
Current Assets/Current Liabilities: 0.8

- Increased debt service associated with debt financing of new plant
- High receivable concentration
- Short term financing used to finance fixed assets

3. Leverage Level of Risk: $\boxed{\text{ER}}$
Credit Problems:

Debt/Tangible Net Worth: 5:1

- Large loan recently taken on to finance plant expansion
- Owners were unwilling to inject more capital

Management Quality

Risk Area	Explanation
Integrity →	• Forms the whole basis for a sound banking relationship • Lack of integrity leads to: - Inability to negotiate and reach sound agreements - Lack of confidence in application of bank funds • Integrity often deteriorates in difficult times
Competence →	• Incompetent management has little chance of competing or addressing and resolving credit problems if they occur • Poor management skills leads to credit problems and failures

Management Quality, continued

Risk Area		Explanation
Market Confidence	→	• Market confidence will influence management/bank power balance • If market confidence is strong, the company may be better off to survive a crisis • Poor market confidence can quickly cause liquidity problems as creditor support is withdrawn

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Integrity	• Honesty - Quality/reliability of information - Meeting commitments - Character and track record • Cooperativeness - Consistency and quality of communication with bank - Supportiveness - Willingness to negotiate and be flexible in difficult times	• Review credit files - Note missing information/ documentation - Frequency/nature of communication • Interview branch/ regional managers familiar with customer • Interview management - Test openness - Ask for references - Develop impressions • Interview private sector individuals familiar with management	• Quality/reliability of information - Failure to disclose - Misrepresentation - Inconsistent information - Changing auditors - Refusing audits • Meeting commitments - Failure to meet with bank - Failure to meet contractual obligations - Failure to provide documentation - Double pledging security

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Integrity, continued		• Gauge promises versus actions • Compare information with others	• Character - Obsessive tax avoidance - Involved in questionable activities - Poor reputation • Communication - Postponing meetings • Supportiveness - Will not provide information - Will not pledge security

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Management Quality, continued

Risk Area	**Strength Measures**	**Analysis**	**Problem Areas (Example)**
Competence	• Ability - Experience - Operating skills - Financial skills - Administrative skills - Management structure - Management depth • Skills - Decision-making track record - Ability to adapt	• Interview branch/ region bank manager • Interview management • Obtain key managers history and determine: - Education - Experience - Related skills • Review performance - Profits, growth, direction of trends - Compared with other companies	• Experience - Lack of relevant experience - Inability to manage • Skills - Insufficient technical skills • Management structure - Poor controls - Lack of key functions - Lack of depth

Management Quality, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Competence, continued		• Review organization chart - Determine span of control - Interview individuals familiar with management - Review risk profile —investments, debt/leverage • Compare impressions with other creditors	• Decision-making - Autocratic style - Lack of MIS/analysis - Unwilling to make difficult decisions (cost cutting, etc.) - High-risk investments
Market Confidence	• Market reputation • Length of management experience	• Interviews • Time in business • Group memberships	• Management disliked by competitors who may spread rumors • Out-of-favor politically • Poor reputation

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MANAGEMENT QUALITY SUMMARY

Borrower: Vyroba
General Manager: R.J. Tapa
Principal Shareholder: P.R. Pande

Recovery Officer:
Date Prepared: March 20, 1993
% Company Owned: 80%

Overall Management Quality Credit Problems/Comments: **Level of Risk:** $\boxed{\text{MR}}$

- Missing financial controller
- Competence questioned by recent decision to expand and increase leverage
- Otherwise, high integrity and favorable alliances

Summary Key Risk Areas:

1. Integrity Level of Risk: $\boxed{\text{LR}}$ **(Honesty, Cooperativeness)**

Credit Problems/Comments:

- Management quick to provide any information requested
- Consistently meet obligations
- Very cooperative and open

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MANAGEMENT QUALITY SUMMARY

2. Competence Level of Risk: **Credit Problems/Comments:**	$\boxed{}$	**(Ability -- Experience, Skills, Depth;** **Competence -- Decision-making, MIS Profile)**
3. Market confidence credit problems/ **comments**		**(Affiliations, Reputation)**

Security Realization

Risk Area		Explanation
Control	→	• Without proper documentation the bank has no claim on security • Without ability to execute claim, security cannot be realized
Net Liquidation Value	→	• Low liquidation values may not cover outstanding debts • High liquidation costs will reduce net amount received • Security quality may deteriorate over time • Money has time value

Security Realization

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Control	• Perfection - Legal rights - Documentation adequacy - Double pledged security - Fraud - Insurance policy • Executability - Ability to obtain favorable judgment - Ability to take possession - Length of legal process	• Verify documentation - Security perfection - Documentation completeness - Documentation integrity - Insurance policy and documentation • Assess customer's lobbying power with legal authorities, local potential buyers • Conduct site visit(s) to verify security existence	• Legal rights - Land title not pledged - Bank has second priority or is subordinated • Documentation adequacy - Lacking notary - Missing signatures - Incomplete documentation - Lacking stamp duty - Outdated, past due

Security Realization, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Control, continued		• Review recent trends in legal execution • Assess length of time to complete legal action	• Fraud - Criminal proceedings • Insurance does not cover exposure • Ability to obtain favorable judgment - Customer has strong lobbying power - Judge sympathetic towards customer

Security Realization, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Control, continued			• Ability to take possession - Missing security - Difficulty in evicting squatters - Security transferred - Security immobile • Length of legal process - Documentation - Lobbying conflicts - Slowness of due process

Security Realization, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Net Liquidation Value	• Liquidation value - Quality - Quantity • Time of sale - Market price dynamics - Opportunity cost - Technology replacement - Long legal process	• Use assessor to value security - Quality and quantity - Market demand • Review recent cases - Assessed value vs. sale value - Change in sale value - Time to sell	• Security is of poor quality or perishable • Quantity not sufficient to cover exposure

Security Realization, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Net Liquidation Value, continued		• Review economic conditions • Determine overall likely length of sale - Auction process - Auction success/ failure - Sale on secondary market • Select appropriate discount rate • Determine Net Liquidation Value	• Market Demand - No market for goods - Security highly specialized - Value too large--few can afford - Borrower has influence over potential buyer - Collusion against bank • Market price dynamics - Volatility - Inflation - Rapid depreciation

Security Realization, continued

Risk Area	Strength Measures	Analysis	Problem Areas (Example)
Net Liquidation Value, continued			• Opportunity cost--value increases/ decreases over time • Technology--security becomes obsolete • Legal process - Erodes security value - Market could change during process

SECURITY REALIZATION SUMMARY CONTROL

Borrower: Vyroba Carpets

Assessor: **Name:** M.L. Achrya
FDM: Engineer Experts

Recovery Officer:
Date Prepared: March 28, 1993
Date of Assessment: January 10, 1993

Security Realization Level of Risk $\boxed{\text{ER}}$

Security Coverage:

- **Control:** Security perfected and adequate executability
- **Net Liquidation Value (000's) :** Zls. 1,200
  (Primary + Secondary Security)
- **Exposure (000's) :** Zls. 2,500
- **% NPV/Exposure:** 48%
  (Security Cover)

Credit Problems:

- Reduced liquidation value of machinery due to uncertainty regarding carpet market
- Real estate market uncertainty and long lead time of sale reduces security value

Summary Key Areas:
Credit Problems/Comments:

Date Last Site Visit : February 10,1992
Date Security Doc. Checklist: December 20,1991

1. **Control Level of Risk:** $\boxed{\text{LR}}$

   a. **Perfection:**
   - All documentation perfected and in place
   - Bank has senior claim on all security

   b. **Executability:**
   - Customer not likely to lobby in case of liquidation
   - Security can be easily transferred
   - Potential for court delays in obtaining secondary security, but not expected to be excessive

SECURITY REALIZATION SUMMARY - NET LIQUIDATION VALUE

EXAMPLE

2. Net Liquidation Value	Level of Risk	ER	(Zls. 000)	Total
a. Assessed liquidation value	3,000	800	-	3,800
b. Liquidation Value Discount	50%	60%	-	N.A.
c. Time of Sale (Number of years)	2	3	-	N.A.
d. Discount Rate (%)	20%	20%	-	20%
e. Net Liquidation Value (a x b x (c+d))	960	240	-	1,200
f. Exposure (principle+interest)	-	-	-	2,500
g. % NPV/Exposure -- Security Cover (f/g)	-	-	-	48%

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OH 5.2-35

Industry Dynamics

Rating	Industry Environment Risk Areas	Company Position
Excessive and Unacceptable Risk	• Shrinking market; highly cyclical and concentrated • Severe structural problems • Unfavorable regulatory environment	• Company severely disadvantaged • No strategy • Alliances impair market position
High Risk	• No market growth, cyclical and concentrated • Unattractive structure • Worsening regulatory environment	• Weak against all KSFs • Poor strategy • Alliances weaken position
Moderate Risk	• Slowing growth, signs of increasing cyclicality • Emerging structural concerns • Neutral regulatory environment	• Slightly disadvantaged against KSFs • Strategy only partially addresses weaknesses • Neutral alliances
Low and Acceptable Risk	• Growing, attractive market • Attractive structure • Favorable regulatory environment; no expected change	• Well positioned • Practical, achievable strategy • Favorable alliances

Financial Condition

Rating	Performance	Liquidity	Leverage
Excessive Risk & Unacceptable Risk	• Negative ratios, declining trend • Increasing cost ratio, declining revenue ratios	• Debt/Service below 1 • Current ratios below 0.75 • Declining trend • Well below industry average	• Debt/Tangible Net Worth >5 • Owners not willing to inject equity • Large amount of short term debt supporting fixed assets
High Risk	• Profit ratios probably negative • Flat trend • Cost ratios high, but not increasing	• Debt/Service well below 1 • Current ratios below 0.75 - 1 • Flat trend • Below industry	• Debt/Tangible Net Worth 3 - 5 • Owners not willing to inject equity • Short-term debt financing fixed assets
Medium Risk	• Profit ratios positive, but declining • Costs increasing • Below industry average	• Debt/Service above 1.5 • Current ratios above 1 • Declining trend • Below industry average	• Debt/Tangible Net Worth 2-3 • Owners willing to provide limited support • Short-term debt financing fixed working capital
Low Risk & Acceptable Risk	• Positive ratios, well above industry average • Flat increasing trend	• Debt/Service above 2 • Strong current ratio • Above industry average	• Debt/Tangible Net Worth below 2 • Strong owner support • Appropriate capital structure

Management Quality

Rating	Integrity	Competence	Market Reputation
Excessive & Unacceptable Risk	• Never meets commitments • Poor quality, unreliable information • Refuses to support relationship	• No relevant experience/ skills • No vision • No depth • Inappropriate organization structure • Aggressive risk taker	• Allied against current administration • Poor reputation causing loss of credit
High Risk	• Rarely meets commitments • Information is of low quality, low reliability • Weak relationship support	• Limited experience/skills • Limited vision • Limited depth • Poor structure • Risk taker	• Recent problems diminishing reputation
Medium Risk	• Generally meets commitments • Reasonable quality information, generally reliable • Supports relationship	• Moderate experience/skills • Moderate depth • Some vision • Adequate structure • Risk neutral	• Neutral reputation
Low & Acceptable Risk	• Always meets commitments • Quality, reliable information • Strong relationship support	• Experience/skilled • Visionary • Deep management team • Good structure • Risk adverse	• Strong reputation

Security Realization

Rating	Control	Net Liquidation Value
Excessive Risk & Unacceptable Risk	• Security not perfected • Executability severely impaired	• Security cover below 50%
High Risk	• Perfection is weak • Executability complex	• Security cover 50% - 75%
Medium Risk	• Perfection adequate • Potential executability issues	• Security cover 75% - 100%
Low Risk & Acceptable Risk	• Strong perfection • No executability complications	• Security cover above 100%

Unit 5.2

Mini-Case Materials
(Participants' Handouts)

SUMMARY RISK ASSESSMENT FORM

I. Overall Position Evaluation

Borrower: ______________________________

Credit Inspector: ______________________________

Date Prepared: ______________________________

Summary Overall Position:

Level Risk:

List most salient credit points and indicate symptoms in each foundation and trace cause/effect relationships.

Credit Foundation:	**Industry Dynamics**	**Financial Condition**	**Management Quality**	**Security Realization**
Level Risk:				
Credit Problems:				

INDUSTRY DYNAMICS SUMMARY

a) Industry Environment	Comments	Level of Risk
- Industry Cycle-------------------		
- Industry Structure-------------		
- Regulatory Factors-------------		
b) Company Position		
- Competitive Position----------		
- Potential For Change----------		
- Company Influence-----------		

Summary	
Risk Ratings	Low, Acceptable, Moderate, High, Excessive, Unacceptable

Meble Express, Ltd.
Instructor Guide

FINANCIAL CONDITION SUMMARY

Credit Inspector: ______________________

Date Completed: ______________________

Date of Most Recent Financial Statements: ______________

Period Covered: ______________________

Number of Years Information Analyzed: _______

Audited: ☐ Yes ☐ No

Reliability of Financials: ☐ Very Reliable ☐ Reliable ☐ Unreliable

Overall Financial Condition:

Level of Risk:

Key Credit Issues:

Summary Analysis of Key Risk Areas:

1. **Profitability Level of Risk:** ☐ **Credit Problems/Comments:** **% Net Income/Sales:**

2. **Liquidity Level of Risk:** ☐ **Comments:**

3. **Leverage Level of Risk:** ☐ **Debt/Equity:**

Risk Ratings — Low, Acceptable, Moderate, High, Excessive, Unacceptable

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MANAGEMENT QUALITY SUMMARY

a) Integrity	Comments	Level of Risk
- Honesty		
- Cooperativeness		
b) Competence		
- Knowledge		
- Skills		
- Attitude		
c) Market Confidence		
- Reputation		
- Support		
Summary		
Risk Ratings	Low, Acceptable, Moderate, High, Excessive, Unacceptable	

SECURITY REALIZATION SUMMARY

Meble Express, Ltd. - Instructor Guide

	Comments	Level of Risk
1. Control - Documentation - Executability		

2. Net Liquidation Value Level of Risk: ☐

Total

a. Category of Security

b. Assessed liquidation value

c. Liquidation Value Discount

d. Time of Sale
(Number of years)

e. Discount Rate (%)
(1 year fixed deposit rate+4%)

f. Discount factor
(1/(1+e) d

g. Net Liquidation Value (NLV)
(b x c x f)

h. Exposure (principle+interest)

i. % NLV/Exposure -- Security Cover (g/h)

Basics of Credit Analysis

Unit 5.3: Determine Credit Requirements and Ability to Pay

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June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Objective

At the end of this unit, participants will be able to describe the key steps in determining credit requirements necessary to structure a facility to enhance repayment ability.

Ratings of Foundations of Creditworthiness

- If no foundation of creditworthiness is rated four or worse, specific credit requirements are determined by developing cash flow projections.

- If a credit is rated four or worse, normally no proposal is made.

Cash Flow Projection Steps

Step 1
Develop Realistic Cash Flow Assumptions

↓

Step 2
Project Major Inflows

↓

Step 3
Project Major Outflows

↓

Step 4
Review Outcome and Determine Credit Requirements

Cash Flow Sensitivity Analysis Steps

Step 1:	Analyze historical cash flow
Step 2:	Review industry dynamics and their effects on cash flow
Step 3:	Identify key variables and quantify their effect on cash flow
Step 4:	Test critical variables
Step 5:	Discuss findings with company and gauge their ability to react to sensitive items
Step 6:	Develop most likely and worst case scenarios after meeting with management
Step 7:	Gauge the company's ability to make repayments of loan as requested against most likely and worst case scenarios

Basics of Credit Analysis

Unit 5.4: Structure Facilities

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June 30, 1995

USAID/Barents Group/Titus Austin, Inc.

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Objective

At the end of this unit, you will be able to define key parameters required to structure facilities.

Structural Parameters

- Amount
- Repayment Schedule
- Monitoring Requirements
- Security
- Documentation
- Pricing

Amount of Credit Required

- Includes funded and unfunded facilities

- Must be confirmed by projections showing need for the amount proposed

- A reasonable cushion should be included, e.g. 10%

Associated Analysis

- Credit requirements analysis

- Cash flow analysis and projections

OH 5.4-3

Repayment Schedule

- Sensitivity analysis showing worst case need should be included.

- Shows that company can repay facilities proposed.

Associated Analysis

- Ability to repay and acceptable debt reduction based on cash flow projections (see prior unit.)

Monitoring Requirements

- Reporting Requirements, for example:
  - Financial statement presentations and due dates
  - Covenants

Associated Analysis

- Assessment of each foundation and requirements to control
  - Industry dynamics
  - Financial condition
  - Management quality
  - Security realization

Security

- Value of security to be provided
- Necessary documentation for security
- Value of bank guarantees
- Necessary documentation for guarantees

Associated Analysis

- Security and guarantee realization
- Available security and guarantees

OH 5.4-6

Documentation

- Requirements to best control security and borrower through covenants

Associated Analysis

- Requirements to best control security and borrower through covenants, e.g.
  - How should land title be secured?

Pricing

- Pricing analysis

Associated Analysis

- Pricing analysis
    - Base rate
    - Risk premiums
    - Profit margins

OH 5.4-8

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Exercise

"I recommend that the Tosea Component Company increase their line of credit by 600,000. The additional money is required to purchase land to build a new factory. Our relationship has been good, and I recommend approval."

Documentation

- Requirements to best control security and borrower through covenants

Associated Analysis

- Requirements to best control security and borrower through covenants, e.g.

  - How should land title be secured?

Pricing

- Pricing analysis

Associated Analysis

- Pricing analysis
  - Base rate
  - Risk premiums
  - Profit margins

Exercise

"I recommend that the Tosea Component Company increase their line of credit by 600,000. The additional money is required to purchase land to build a new factory. Our relationship has been good, and I recommend approval."

Basics of Credit Analysis

Unit 5.5: Prepare Credit Approval Package (CAP)

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Objective

At the end of this unit, participants will be able to:

1. Using a form, summarize credit discussions in a credit approval package.

Credit Approval Steps

1. Purpose of Credit Request

   - Reason for request
   - Brief description of borrower
   - History of relationship

2. Summary Risk Assessment Form

   - Summary of each credit foundation
   - Overall risk
   - What could go wrong

Credit Approval Steps, continued

3. Credit Requirements

   - Summary of borrower requirements, based on cash flow

   - Sensitivity analysis based on projections

4. Credit Recommendations

   - Facility amount

   - Key reasons for approval

   - Structural parameters

Key Supporting Documents

- Credit Request Summary Form
- Basic information report
- Financial spreadsheets
- Projection forms
- Security documentation checklist
- Other relevant documents

Basics of Credit Analysis

Unit 6: Summary

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Unit Purpose and Objective

- Discuss how to apply the key elements of the credit analysis module on the job.

Objective

At the end of this unit, participants will be able to summarize the general principles related to credit analysis.

Key Elements

- Credit creation is fundamental to the role and visibility of commercial bank intermediation.

- Credit analysis is the fundamental process step that determines the success or failure of credit creation.

- Credit analysis has four key objectives:

  - Identify sound prospective customers.

  - Fully understand customers' creditworthiness.

  - Structure facilities to contain risks and meet targets.

Key Elements, continued

- To achieve these objectives, a standard credit analysis process should be followed:

  - Actively screen prospective customers to identify most creditworthy.

  - Gather necessary data to analyze risks.

  - Analyze customer risks.

  - Structure facilities to maximize return and minimize losses.

- Propose a well supported credit analysis package.

Key Elements, continued

- Fundamental to understanding customer risks is analyzing the four foundations of creditworthiness:
  - Industry
  - Financial Condition
  - Management Quality
  - Security Realization

Exercise

Part 1

- List five key principles you want to remember from the course and apply on the job.

Part 2

- Divide into small groups of three to four.

- Discuss the key principles you want to discuss.

- Finalize a list of at least three principles the group would want to apply on the job.

Part 3

- Each small group presents two items from the list.

Basics of Credit Analysis

Unit 5.2: Analyze Creditworthiness

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