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SME PROBLEM LOAN MANAGEMENT TRAINING MANUAL

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FINANCIAL SECTOR PROGRAM

SME PROBLEM LOAN MANAGEMENT TRAINING MANUAL

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CONTENTS

ACRONYMS

A/E	Accrued Expense
AEDOH	Accrued Expenses Days on Hand
AGPTO	Average Gross Plant Turnover
ALEV	Asset Leverage
ANPTO	Average Net Plant Turnover
A/P	Accounts Payable
APDOH	Accounts Payable Days on Hand
A/R	Accounts Receivable
ARDOH	Accounts Receivable Days on Hand
ATO	Asset Turnover
CAPEX	Capital Expenditures
CPLTD	Current Portion of Long Term Debt / Current Maturities
CGS	Cost of Good Sold
DEP	Depreciation Expense
DOH	Days on Hand
FIFO	First In First Out
FG	Finished Goods
INV	Inventory/ Stock
INVDOH	Inventory/Stock Days on Hand
LIFO	Last in First Out
MS	Marketable Securities (Certificate of Deposits etc)
NPAT	Net Profit After Tax
NPAUI	Net Profit After Unusual Items
NPBT	Net Profit Before Tax
NPE	Net Plant Expenditure
NRV	Net Realizable Value
RM	Raw Materials
ROA	Return on Assets
ROE	Return on Equity
ROS	Return on Sales
SG& A	Sales and General Administrative Expenses
WC	Working Capital
WI	Working Investment
WIP	Work In Progress (Process)

FINANCIAL RATIO TEACHING AID

Financial Ratio Calculations

Ratios	**Calculations**
ROE	NPAT/Net Worth
ROS	NPAT/Sales
ATO	Sales/ Total Assets
ALEV	Total Assets/Net Worth

Profitability	**Calculations**
Sales	Self Explanatory
% Change	($Sales_1$ –$Sales_0$) / $Sales_0$
CGS/ Sales	Self Explanatory
Gross Profit Margin	Gross Profit/ Sales
SG&A / Sales	Self Explanatory
Operating Profit/Sales	Self Explanatory

Asset Efficiency	**Calculations**
WI	(A/R + INV) – (A/P + A/E)
% Change WI	(WI_1-WI_0 / WI_0
WI / Sales	Self Explanatory
ARDOH	(Net A/R /Sales) x 365
INVDOH	(INV / CGS) X 365
APDOH	(A/P /CGS) X 365
AEDOH	(A/E / CGS) X 365
AGPTO	Sales/ ((Gross $Plant_0$ + Gross $Plant_1$) /2)
ANPTO	Sales / ((Net $Plant_0$ + Net $Plant_1$) /2)
DEP/AGP	Self Explanatory

Liquidity & Leverage	**Calculations**
Current Ratio	Current Assets / Current Liabilities
Working Capital	Current Assets – Current Liabilities
Quick Ratio	(Cash + Marketable Securities + A/R) /Current Liabilities
Coverage Ratio	Current Assets / Total Liabilities
Tangible Leverage	(Total Liabilities-Gray Area) / Net Worth-Intangibles)
LTD/ CPLTD	Self Explanatory

DIRECT CASH FLOW STATEMENT TEACHING AID

The Direct Cash Flow Statement is organized in four sections: the Operating, Investing, and Financing and Debt Servicing section. It is organized in this manner to assist the user in focusing attention on the company's ability to generate or utilize cash. The following is a brief description of the various sections of the Direct Cash Flow Statement.

Operating Section: captures cash inflows and outflows related to revenues, income and expenses included in the income statement.

Investing Section: captures cash inflows and outflows related to investing activities. These cash inflows and outflows are related to the acquisition and disposal of assets used in the production of goods and services.

Financing Section: captures the cash receipts and disbursements related to financing activities. Financing activities includes obtaining resources from owners, investors, and creditors; and providing the owners, investors and creditors a return on their funds.

Debt / Equity Servicing Section: captures the cash outflow relating to debt and equity obligations.

MECHANICS FOR CONSTRUCTING A DIRECT CASH FLOW STATEMENT

1. Net Sales: Amount taken directly from the income statement.
2. Changes in Accounts Receivable: Accounts receivable$_0$ – accounts receivable$_1$.
3. **Cash from Sales: Sum of line 1 + 2.**
4. Cost of Goods Sold (less non-cash expenses): Amounts taken from financial statements.
5. Change In Inventory: Inventory$_0$ - Inventory$_1$.
6. Change in Accounts Payable: Accounts payable$_1$ – Accounts payable$_0$.
7. Cash Production Cost: Sum of lines 4 + 5 + 6.
8. **Gross Cash Profits: Sum of line 3 +7.**
9. SG&A Expense (less non-cash expenses): Amount taken form financial statements.
10. Change in Prepaid Expenses: Prepaid expense$_0$ – prepaid expense$_1$.
11. Change in Accrued Expenses: Accrued expense$_1$ – accrued expense$_0$.
12. Cash Operating Expenses: Sum lines 9 +10 + 11.
13. **Cash after Operations: Sum of lines 8 + 12.**
14. Miscellaneous Cash Income (Expenses): Amounts taken from the income statement.
15. Income Tax Provision: Amount taken from the income statement.
16. Change in Deferred Taxes: Deferred taxes$_1$ – deferred taxes$_0$.
17. Change In Taxes Payable: Taxes payable$_1$ –taxes payable$_0$.
18. Change In Other Current Assets: Other current assets$_0$ – other current assets$_1$.
19. Change in Other Non-current Assets: Other non-current assets$_0$ – Other non-current assets$_1$.
20. Change In Other Current Liabilities: Other current liabilities$_1$ – Other current liabilities$_0$.
21. Change In Other Non-current Liabilities: Other non-current liabilities$_1$ – other non-current liabilities$_0$.
22. Taxes Paid and Other Income (Expenses): Sum of lines 14 + 15 + 16 + 17 + 18 + 19 + 20 + 21.
23. **Net Cash after Operations: Sum of lines 13 + 22.**
24. Interest (Existing Debt): Amount taken from income statement.
25. Interest (New Debt Need): Amount taken from financial statements.
26. Change in Interest Payable: Interest Payable$_1$ – interest payable$_0$.
27. Dividends: Amount taken from income statement.
28. Change in Dividends Payable: Dividend Payable$_1$ – Dividend Payable$_0$.
29. Current Portion of Long-term Debt: CPLTD$_0$.
30. Total Financing Cost: Sum of lines 24 + 25 + 26 + 27 + 28 + 29.
31. **Cash before Long-term Uses: Sum of line 23 + 30.**
32. Capital Expenditures (NPE): NP$_0$ – NP$_1$ – DEP$_1$.
33. Change In Intangibles: Intangibles$_0$ – Intangibles$_1$.
34. Long-term Investments: Long-term investments$_0$ –Long-term investments$_1$.

35. **Financing Surplus/ Requirement): Sum of lines 31 + 32 + 33 + 34.**
36. Change in Short-term Debt: $STD_1 – STD_0$.
37. Change in Long-term Debt: $LTD_1 + CPLTD_1 – LTD_0$.
38. Change In Equity:
    Capital $Stock_1$ – Capital $Stock_0$
    Capital $Surplus_1$ – Capital $Surplus_0$
    Treasury $Stock_1$ – Treasury $Stock_0$
    + Unusual Gains; and
    -Unusual Losses.
39. **Total External Financing: Sum of lines 36 + 37 + 38.**
40. **Cash After Financing: Sum of lines 35 + 39.**
41. **Actual Change In Cash: Cash & $Equivalents_1$ – Cash & $Equivalents_0$**

Note: The above referenced subscripts indicate the balance year that the information is derived. This $Prepaid_0$ indicate prepaid expenses for the previous year, whereas, $Prepaid_1$ indicates the prepaid form the current year. Thus if you were calculating the 2001 cash flow statement information from the 2001 balance sheet would be denoted by the $subscript_1$, whereas information from the 2000 balance sheet would be denoted by $subscript_0$.

INTERPRETING THE DIRECT CASH FLOW CAPTIONS

Cash from Sales: Quantifies the cash collected from the selling activity by taking into account changes in accounts receivable. Remember, sales on the income statement include sales recognized not cash collected.

Cash Production Costs: This line sums the amount of cash paid by the company for the purchase of inventory, raw materials, labor, and other production items. The cash impact is quantified by adjusting for non-cash items and the effects of accrual accounting.

Gross Cash Profits: Indicates the cash effect of buying and selling goods.

Cash Operating Expenses: This line summarizes the cash outflow related to operations by adjusting for non cash items and the effects of accrual accounting.

Taxes Paid and Other Income (Expenses): This line summarizes the cash flow impact of other income and expenses; sundry current and non current balance sheet accounts; and entries related to taxes.

Cash After Operations: Highlights the cash effects of the operating cycle after accounting for overhead and other expenses.

Net Cash after Operations: This line reflects the cash effect of the operating cycle, after taxes and sundry accounts are accounted for.

Cash before Long term Uses: This line quantifies the cash effect of the operating cycle and financing payments on debt and equity, over which management has little discretion.

Financing Surplus/ Requirement: This line quantifies the total cash impact after all activities, including discretionary outlays for plant and investments. It indicates where there was a cash surplus or deficit after all activities were conducted.

Total External Financing: This section highlights the sources of financing used and the net affect of the financing activities of the company, e.g., new loans, payments on old loans, and the sale and repurchase of stock. Analyzing this section enables one to determine where the company has financed its needs appropriately.

Cash after Financing: This line highlights the cash position after non-discretionary, descritionary and financing activities are accounted for.

Actual Change in Cash: This line quantifies the amount by which cash increased or decreased between periods.

PRE COURSE ASSIGNMENT- PROBLEM LOANS

We realize that you are familiar with the various tools, techniques and concepts used in credit analysis. Even so, we would like you to complete the following pre-course assignment. The assignment involves calculating various financial ratios, as well as calculating and analyzing a Cash Flow Statement. Attached please find the following:

- Income Statement and Balance Sheet of the "Priority Group, Inc." for the years 20x2 through 20x5;
- Ratio Page Form
- Ratio Calculation Teaching Aid;
- Cash Flow Statement Form; and a
- Cash Flow Statement Teaching Aid.

Assignment:

- Calculate the ratios included on the Ratio Page for the years 20x4 and 20x5.
- Calculate the company's Cash Flow Statement for the years 20x4 and 20x5, and be prepared to answers the following questions:

    1. In 20x4 and 20x5, was Priority Group, Inc. able to pay interest and dividends with Net Cash after Operations?
    2. In 20x4 and 20x5, was Priority Group, Inc. able to pay maturing debt with Net Cash after Operations?
    3. What was the company's borrowing needs in 20x4 and 20x5?
    4. How did the company finance itself in 20x4 and 20x5?

Remember that the Cash Flow Statement must reconcile, i.e., "Cash after Financing" must exactly equal "Actual Change in Cash" in order for the statement to be calculated correctly. Also, the marketable securities (e.g., Certificate of Deposits) reflected on the company's books should be considered "cash" for the purpose of calculating the Cash Flow Statement, as well as for the financial ratios.

Please use the Ratio Page and Cash Flow Statement forms provided to record your results. You will note that the Ratios and Cash Flow Statement for 20x3 are also provided to assist you in completing the assignment. We recommend that you make copies of the Ratio Page and Cash Flow Statement forms prior to undertaking this assignment. If you need to make recalculations, having a "clean" copy will be very helpful.

Please complete the assignment above prior to arriving for the program. Your results will be discussed on the first day. If you have attempted the assignment, but were unable to complete it, please don't be discouraged—however, you must earnestly try to complete the assignment. We hope to address questions in the class.

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP – BALANCE SHEET ASSETS

Balance Sheet, December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Assets							
Cash	10,580	12,167	59,472	37,467			
Accounts Receivable (Net)	10,350	40,757	71,325	82,024			
Inventory/Stock	65,765	135,725	245,151	266,767			
Other Current Assets	1,667	1,848	2,051	2,185			
Total Current Assets	88,360	190,497	377,999	388,443			
Fixed Assets							
Property, Plant & Equipment	35,860	39,446	43,391	47,730			
Accumulated Depreciation	-19,153	-22,291	-25,743	-29,540			
Net Fixed Assets	16,707	17,155	17,648	18,190			
Investments							
Prepaid Expenses							
Other Non-Current Assets	5,721	6,292	6,923	7,371			
Intangibles	195	3,011	3,161	3,319			
Total Assets	112,743	216,955	405,731	417,323			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP – INCOME STATEMENT

Income Statement December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Net Sales	322,000	495,880	867,790	997,959			
Cost of Goods Sold	- 177,900	- 275,221	- 483,676	- 556,400			
Depreciation	-2,853	-3,138	-3,452	-3,797			
Gross Profit	141,247	217,521	380,662	437,762			
Selling & General Administrative	- 120,750	- 185,955	- 325,421	- 374,234			
Operating Income	20,497	31,566	55,241	63,528			
Interest Expense	-507	-5,684	-41,760	-31,547			
Miscellaneous Expense			1,910	648			
Miscellaneous Income							
Net Profit Before Taxes	19,990	25,882	15,391	32,629			
Income Tax Provision	-6,797	-8,800	-5,233	-11,094			
Net Profit After Taxes	13,193	17,082	10,158	21,535			
Unusual Items							
Net Profit After Unusual Items	13,193	17,082	10,158	21,535			
Dividends							
Change In Retained Earnings	13,193	17,082	10,158	21,535			
Adjustments To Equity							
Change In Net Worth	13,193	17,082	10,158	21,535			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP – RATIO SHEET

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
FACT SHEET							
ROE	**22.90%**	**22.8%**					
ROS	**4.10%**	**3.4%**					
ATO	**2.86**	**2.29**					
ALEV	**1.95**	**2.9**					
Profitability							
SALES	**322,000**	**495,880**					
% CHANGE	**NA**	**54%**					
CGS/SALES	**55.2%**	**55.5%**					
GROSS PROFIT MARGIN	**43.9%**	**43.9%**					
SG&A/SALES	**37.5%**	**37.5%**					
OPER PROFIT MARGIN	**6.4%**	**6.4%**					
Asset Efficiency							
WORKING INVESTMENT	**58,493**	**149,220**					
% CHANGE	**NA**	**155.1%**					
WI/SALES	**18.2%**	**30.1%**					
ARDOH	**12**	**30**					
INVDOH	**135**	**180**					
APDOH	**36**	**36**					
AE DOH	**0**	**0**					
AGPTO	**NA**	**13.2**					
ANPTO	**NA**	**29.3**					
DEP/SGP	**NA**	**8.3**					
Liquidity & Leverage							
CURRENT RATIO	**2.89**	**1.46**					
WORKING CAPITAL	**57,812**	**60,438**					
QUICK RATIO	**0.69**	**0.41**					
COVERAGE RATIO	**1.61**	**1.34**					
TANGIBLE LEVERAGE	**0.99**	**1.98**					
LTD/CPLTD	**9.64**	**4.1**					

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP – CASH FLOW STATEMENT

Cash Flow Statement
December 31

		20X2	20X3	20X4	20X5	20X6	20X7	20X8
1	Net Sales		495,880					
2	Chng. In A/R		-30,407					
3	Cash From Sales		465,473					
4	Cost of Goods Sold (less non-cash expenses)		-275,221					
5	Chng. In Inventory		-69,960					
6	Chng. In Accounts Payable		9,640					
7	Cash Production Cost		-335,541					
8.	Gross Cash Profits		129,932					
9	SG&A (less non-cash expenses)		-185,955					
10	Chng. In Prepaid Expenses							
11	Chng In Accrued Expenses							
12	Cash Operating Expenses		-185,955					
13	Cash After Operations		-56,023					
14	Miscellaneous Cash Income (Expense)							
15	Income Tax Provision		-8,800					
16	Chng In Deferred Taxes							
17	Chng In Taxes Payable		373					
18	Chng In Other Current Assets		-183					
19	Chng In Other Non-current Assets		-571					
20	Chng In Other Current Liabilities		985					
21	Chng In Other Non-current Liabilities							
22	Taxes Paid and Other Income (Expenses)		-8,196					
23	Net Cash After Operations		-64,219					
24	Interest Expense (Existing Debt)		-5,684					
25	Interest Expense (New Debt Need- NDN)							
26	Chng. In Interest Payable							
27	Dividends							
28	Chng. In Dividends Payable							
29	CPLTD		-2,240					
30	Total Financing Payments		-7,924					
31	Cash Before Long-Term Uses		-72,143					
32	Capital Expenditures (NPE)		-3,586					
33	Chng, In Intangibles		-1,056					
34	Chng. in Long-Term Investments							
35	Financing Surplus / Requirement		-76,785					
36	Chng, In Short-Term Debt		88,513					
37	Chng. In Long-Term Debt		-10,141					
38	Chng. In Equity							
39	Total External Financing		78,372					
40	Cash After Financing		1,587					
41	Actual Change in Cash		1,587					

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP
ANSWER SHEET – BALANCE SHEET ASSETS

Balance Sheet,

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Assets							
Cash	10,580	12,167	59,472	37,467			
Accounts Receivable (Net)	10,350	40,757	71,325	82,024			
Inventory/Stock	65,765	135,725	245,151	266,767			
Other Current Assets	1,667	1,848	2,051	2,185			
Total Current Assets	88,360	190,497	377,999	388,443			
Fixed Assets							
Property, Plant & Equipment	35,860	39,446	43,391	47,730			
Accumulated Depreciation	-19,153	-22,291	-25,743	-29,540			
Net Fixed Assets	16,707	17,155	17,648	18,190			
Investments							
Prepaid Expenses							
Other Non-Current Assets	5,721	6,292	6,923	7,371			
Intangibles	195	3,011	3,161	3,319			
Total Assets	112,743	216,955	405,731	417,323			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP
ANSWER SHEET – BALANCE SHEET LIABILITIES

Balance Sheet

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Liabilities							
CPLTD	2,240	2,240	20,454	38,669			
Notes Payable - Bank		88,513					
Accounts Payable	17,622	27,262	39,754	48,780			
Accrued Expenses							
Interest Payable							
Dividends Payable							
Taxes Payable	690	1,063	1,860	2,138			
Other Current Liabilities	9,996	10,981	12,063	13,269			
Total Current Liabilities	30,548	130,059	74,131	102,856			
Long-Term Debt	21,601	9,220	243,766	205,098			
Deferred Taxes							
Other Non-Current Liabilities	2,900	2,900	2,900	2,900			
Total Liabilities	55,049	142,179	320,797	310,854			
Stockholders' Equity							
Common Stock	1,000	1,000	1,000	1,000			
Capital Surplus	13,500	13,500	13,500	13,500			
Retained Earnings	43,194	60,276	70,434	91,969			
Total Stockholders Equity	57,694	74,776	84,934	106,469			
Total Liabilities & Equity	112,743	216,955	405,731	417,323			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP
ANSWER SHEET – INCOME STATEMENT

Income Statement December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Net Sales	322,000	495,880	867,790	997,959			
Cost of Goods Sold	-177,900	-275,221	-483,676	-556,400			
Depreciation	-2,853	-3,138	-3,452	-3,797			
Gross Profit	141,247	217,521	380,662	437,762			
Selling & General Administrative	-120,750	-185,955	-325,421	-374,234			
Operating Income	20,497	31,566	55,241	63,528			
Interest Expense	-507	-5,684	-41,760	-31,547			
Miscellaneous Expense			1,910	648			
Miscellaneous Income							
Net Profit Before Taxes	19,990	25,882	15,391	32,629			
Income Tax Provision	-6,797	-8,800	-5,233	-11,094			
Net Profit After Taxes	13,193	17,082	10,158	21,535			
Unusual Items							
Net Profit After Unusual Items	13,193	17,082	10,158	21,535			
Dividends							
Change In Retained Earnings	13,193	17,082	10,158	21,535			
Adjustments To Equity							
Change In Net Worth	13,193	17,082	10,158	21,535			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP
ANSWER SHEET – RATIO SHEET

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
FACT SHEET							
ROE	22.90%	22.8%	12.0%	20.2%			
ROS	4.10%	3.4%	1.2%	2.2%			
ATO	2.86	2.29	2.14	2.39			
ALEV	1.95	2.9	4.78	3.92			
Profitability							
SALES	322,000	495,880	867,790	997,959			
% CHANGE	NA	54%	75.0%	15.0%			
CGS/SALES	55.2%	55.5%	55.7%	55.8%			
GROSS PROFIT MARGIN	43.9%	43.9%	43.9%	43.9%			
SG&A/SALES	37.5%	37.5%	37.5%	37.5%			
OPER PROFIT MARGIN	6.4%	6.4%	6.4%	6.4%			
Asset Efficiency							
WORKING INVESTMENT	58,493	149,220	276,722	300,011			
% CHANGE	NA	155.1%	85.4%	8.4%			
WI/SALES	18.2%	30.1%	31.9%	30.1%			
ARDOH	12	30	30	30			
INVDOH	135	180	185	175			
APDOH	36	36	30	32			
AE DOH	0	0	0	0			
AGPTO	NA	13.2	21	21.9			
ANPTO	NA	29.3	49.9	55.7			
DEP/SGP	NA	8.3%	8.3%	8.3%			
Liquidity & Leverage							
CURRENT RATIO	2.89	1.46	5.1	3.78			
WORKING CAPITAL	57,812	60,438	303,868	285,587			
QUICK RATIO	0.69	0.41	1.76	1.16			
COVERAGE RATIO	1.61	1.34	1.18	1.25			
TANGIBLE LEVERAGE	0.99	1.98	3.93	3.01			
LTD/CPLTD	9.64	4.1	11.9	5.3			

FINANCIALS FOR PRE-COURSE CASE PRIORITY GROUP ANSWER – CASH FLOW STATEMENT

Cash Flow Statement

December 31	20X2	20X3	20X4	20X5	20X6	20X7	20X8
1 Net Sales		495,880	867,790	997,959			
2 Chng. In A/R		-30,407	-30,568	-10,699			
3 Cash From Sales		465,473	837,222	987,260			
4 Cost of Goods Sold (less non-cash expenses)		-275,221	-483,676	-556,400			
5 Chng. In Inventory		-69,960	-109,426	-21,616			
6 Chng. In Accounts Payable		9,640	12,492	9,026			
7 Cash Production Cost		-335,541	-580,610	-568,990			
8. Gross Cash Profits		129,932	256,612	418,270			
9 SG&A (less non-cash expenses)		-185,955	-325,421	-374,234			
10 Chng. In Prepaid Expenses							
11 Chng In Accrued Expenses							
12 Cash Operating Expenses		-185,955	-325,421	374,234			
13 Cash After Operations		-56,023	-68,809	44,036			
14 Miscellaneous Cash Income (Expense)			1,909	648			
15 Income Tax Provision		-8,800	-5,233	-11,094			
16 Chng In Deferred Taxes							
17 Chng In Taxes Payable		373	797	278			
18 Chng In Other Current Assets		-183	-203	-134			
19 Chng In Other Non-current Assets		-571	-631	-448			
20 Chng In Other Current Liabilities		985	1,082	1,206			
21 Chng In Other Non-current Liabilities							
22 Taxes Paid and Other Income (Expenses)		-8,196	-2,278	-9,544			
23 Net Cash After Operations		-64,219	-71,087	34,492			

24	Interest Expense (Existing Debt)		**-5,684**	**-41,760**	**-31,547**			
25	Interest Expense (New Debt Need- NDN)							
26	Chng. In Interest Payable							
27	Dividends							
28	Chng. In Dividends Payable							
29	CPLTD		**-2,240**	**-2,240**	**-20,454**			
30	Total Financing Payments		**-7,924**	**-44,000**	**-52,001**			
31	Cash Before Long-Term Uses		**-72,143**	**-115,087**	**-17,509**			
32	Capital Expenditures (NPE)		**-3,586**	**-3,945**	**-4,339**			
33	Chng, In Intangibles		**-1,056**	**-150**	**-158**			
34	Chng. in Long-Term Investments							
35	Financing Surplus / Requirement		**-76,785**	**-119,182**	**-22,006**			
36	Chng, In Short-Term Debt		**88,513**	**-88,513**				
37	Chng. In Long-Term Debt		**-10,141**	**255,000**	**1**			
38	Chng. In Equity							
39	Total External Financing		**78,372**	**166,487**	**1**			
40	Cash After Financing		**1,587**	**47,305**	**-22,005**			
41	Actual Change in Cash		**1,587**	**47,305**	**-22,005**			

IDENTIFYING THE CAUSE OF THE PROBLEM LOAN CASES

Attached is the background information on the following three (3) building supplies companies:
Brown's Building Supplies, Inc.

Black and Sons Plumbing Company

Yellow Contractor's, Inc.

The background information includes historical financial information (balance sheets, income statements, cash flow statements and financial ratios) for the time period covering 20x2 to 20x8, as well as a brief memo prepared by the respective lending officers of The Lending Institution (TLI).

The President of TLI has engaged you to assist the TLI lending officers in identifying and detecting the financial causes of the problem loans by reviewing the financial information. The accountable lending officers were caught totally unawares when the companies advised them that they were unable to make their loan payments, as planned.

Assignment:

Review the information provided and prepare yourself to answer the following questions:

During the time period under review, were the companies able to:
1. Pay interest and dividends from cash generated internally?
2. Pay interest debt obligations with cash generated internally?
3. What were the annual financing needs or surplus of the respective companies?
4. How did the companies finance their operations?
5. Were the operations of the above referenced companies financed appropriately
6. What caused the financial problems for the respective companies and when did the problem(s) first occur?

BLACK AND SONS PLUMBING COMPANY

Memo to:	File
From:	Lending Officer
Company:	Black and Sons Plumbing Company
Re:	Briefing on the Relationship
Date:	Today

Background Information

The credit relationship with Black and Sons Plumbing began in 20x2 when TLI provided the company a 250,000 ten year loan, with a one year grace period on principal payments. The purpose of the loan was to refinance a balloon payment due to the Other Lending Institution (TOLI) and to finance the purchase of two fork lifts and two delivery trucks.

Prior to 20x2 TOLI made available to the company, a 120,000 working capital line of credit. TOLI, has continued to make the line of credit available to the company and in 20x7 increased the line of credit to 230,000 due to the company's growing need for working capital financing.

Since 20x2 the demand for the company's product has been extremely strong; however, in recent years the growth in sales has exhibited a declining pattern. In 20x5 TLI provided the company a second term loan in the amount of 300,000 (interest rate 12.5%, p.a.). The loan, which has a tenor of nine years, did not include a grace period on principal payments.

Since the beginning of the relationship there has been a growing demand for the company's product and the management team has been extremely forthcoming.

FINANCIAL INFORMATION ON BLACK AND SONS PLUMBING – BALANCE SHEET ASSETS

Black and Sons Plumbing
Balance Sheet,

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Assets							
Cash	29,440	33,856	37,918	41,141	46,695	52,299	56,221
Marketeable Securities	25,758	5,012	1,296	25,071	826	0	0
Accounts ReceivablesNet)/Debtors	165,833	190,708	205,492	222,958	253,058	283,425	296,664
Inventory/Stock	216,739	248,032	273,581	295,857	334,137	374,378	396,592
Other Current Assets	8,559	8,944	9,525	10,144	10,804	11,506	12,254
Total Current Assets	446,329	486,551	527,812	595,173	645,519	721,608	761,731
Fixed Assets							
Property, Plant & Equipment	309,425	346,555	388,142	426,956	469,652	516,617	568,279
Accumulated Depreciation	-75,674	-102,897	-133,387	-167,213	-204,423	-245,353	-290,376
Net Fixed Assets	233,751	243,659	254,755	259,743	265,229	271,264	277,903
Investments							
Prepaid Expenses							
Other Non-Current Assets	31,445	47,167	70,751	106,126	159,190	238,785	358,177
Intangibles	5,651	6,782	8,138	9,766	11,719	14,062	16,875
Total Assets	717,176	784,159	861,457	970,808	1,081,657	1,245,719	1,414,685

FINANCIAL INFORMATION ON BLACK AND SONS PLUMBING – BALANCE SHEET LIABILITIES

Balance Sheet

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Liabilities							
CPLTD	100,000	25,000	25,000	55,000	55,000	55,000	55,000
Notes Payable - Bank		124,488	188,562		100,000	228,742	205,028
Accounts Payable	101,523	116182	127157	133344	150597	189826	203962
Accrued Expenses							
Interest Payable							
Dividends Payable							
Taxes Payable							
Other Current Liabilities	33,212	35,703	39,273	43,200	47,520	52,272	57,500
Total Current Liabilities	234,735	301,372	379,992	231,544	353,117	525,840	521,489
Long-Term Debt	250,000	225,000	200,000	445,000	390,000	335,000	280,000
LTD-NDN							183,501
Deferred Taxes	5,231	5,859	6,562	7,218	7,940	8,734	9,607
Other Non-Current Liabilities	12,263	12,417	12,572	12,729	12,888	13,049	13,212
Total Liabilities	502,229	544,648	599,126	696,491	763,945	882,623	1,007,809
Stockholders' Equity							
Common Stock	4,125	4,125	4,125	4,125	4,125	4,125	4,125
Capital Surplus	20,625	20,625	20,625	20,625	20,625	20,625	20,625
Retained Earnings	190,196	214,761	237,580	249,566	292,962	338,337	382,126
Total Stockholders Equity	214,946	239,511	262,330	274,316	317,712	363,087	406,876
Total Liabilities & Equity	717,176	784,159	861,457	970,808	1,081,657	1,245,719	1,414,685

FINANCIAL INFORMATION ON BLACK AND SONS PLUMBING – INCOME STATEMENT

Income Statement December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Net Sales	1,532,454	1,762,322	1,973,801	2,141,574	2,430,686	2,722,369	2,926,546
Cost of Goods Sold	- 1,098,744	-1,257,384	-1,406,437	-1,520,956	-1,717,746	-1,924,620	-2,067,943
Depreciation	-18,305	-27,223	-30,490	-33,209	-37,209	-40,930	-45,023
Gross Profit	415,404	477,715	536,874	586,791	675,731	756,818	813,580
Selling & General Administrative	-353,997	-403,572	-452,000	-488,279	-546,904	-615,255	-658,473
Operating Income	61,408	74,143	84,873	98,512	128,826	141,563	155,107
Interest Expense	-12,425	-37,224	-50,377	-81,856	-63,125	-72,812	-77,751
Miscellaneous Expense	1,288	301	78	1,504	50	-1	-11,010
Miscellaneous Income							
Net Profit Before Taxes	50,271	37,220	34,574	18,160	65,751	68,751	66,346
Income Tax Provision	-17,092	-12,655	-11,755	-6,175	-22,355	-23,375	-22,558
Net Profit After Taxes	33,179	24,565	22,819	11,986	43,396	45,375	43,789
Unusual Items (bad debt)							

Net Profit After Unusual Items	33,179	24,565	22,819	11,986	43,396	45,375	43,789
Dividends							
Change In Retained Earnings							
Adjustments To Equity							
Change In Net Worth	33,179	24,565	22,819	11,986	43,396	45,375	43,789

FINANCIAL INFORMATION ON BLACK AND SONS PLUMBING – RATIO SHEET

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
FACT SHEET							
ROE	15.4%	10.3%	8.7%	4.4%	13.7%	12.5%	10.8%
ROS	2.2%	1.4%	1.2%	0.6%	1.8%	1.7%	1.5%
ATO	2.14	2.25	2.29	2.21	2.25	2.19	2.07
ALEV	3.34	3.27	3.28	3.54	3.4	3.43	3.48
Profitability							
SALES	1,532,454	1,762,322	1,973,801	2,141,574	2,430,686	2,722,369	2,926,546
% CHANGE	24.0%	15.0%	12.0%	8.5%	13.5%	12.0%	7.5%
CGS/SALES	71.7%	71.3%	71.3%	71.0%	70.7%	70.7%	70.7%
GROSS PROFIT MARGIN	27.1%	27.1%	27.2%	27.4%	27.8%	27.8%	27.8%
SG&A/SALES	23.1%	22.9%	22.9%	22.8%	22.5%	22.6%	22.5%
OPER PROFIT MARGIN	4.0%	4.2%	4.3%	4.6%	5.3%	5.2%	5.3%
Asset Efficiency							
WORKING INVESTMENT	281,049	322,559	351,915	385,471	436,598	467,977	489,294
% CHANGE	23.7%	14.8%	9.1%	950.0%	13.3%	7.2%	4.6%
WI/SALES	18.3%	18.3%	17.8%	18.0%	18.0%	17.2%	16.7%
ARDOH	39	39	38	38	38	38	37
INVDOH	72	72	71	71	71	71	70
APDOH	34	34	33	32	32	36	36
AE DOH	0	0	0	0	0	0	0
AGPTO	6.95	5.37	5.37	5.25	5.42	5.52	5.4
ANPTO	9.95	7.38	7.92	8.32	9.26	10.15	10.66
DEP/SGP	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%
Leverage/Liquidity							
CURRENT RATIO	1.9	1.61	1.39	2.57	1.83	1.37	1.46
WORKING CAPITAL	211,594	185,179	147,820	363,629	292,402	195,768	240,242
QUICK RATIO	0.83	0.75	0.64	1.14	0.85	0.64	0.68
COVERAGE RATIO	0.92	0.92	0.91	0.88	0.87	0.84	0.77
TANGIBLE LEVERAGE	2.32	2.26	2.28	2.56	2.43	2.47	2.53
LTD/CPLTD	3	9	8	8.1	7.1	6.1	8.4

FINANCIAL INFORMATION ON BLACK AND SONS PLUMBING – CASH FLOW STATEMENT

Mainline-Cash Flow Statement December 31	20X2	20X3	20X4	20X5	20X6	20X7	20X8
1 Net Sales	1,532,454	1,762,322	1,973,801	2,141,574	2,430,686	2,722,369	2,926,546
2 Chng. In A/R	-32,097	-24,875	-14,783	-17,467	-30,099	-30,367	-13,239
3 Cash From Sales	1,500,357	1,737,447	1,959,018	2,124,107	2,400,587	2,692,002	2,913,307
4 Cost of Goods Sold (less non-cash expenses)	-1,098,744	-1,257,384	-1,406,437	-1,520,956	-1,717,746	-1,924,620	-2,067,943
5 Chng. In Inventory	-41,078	-31,293	-25,549	-22,276	-38,280	-40,241	-22,214
6 Chng. In Accounts Payable	19,241	14,658	10,976	6,187	17,253	39,229	14,136
7 Cash Production Cost	-1,120,580	-1,274,019	-1,421,010	-1,537,046	-1,738,773	-1,925,633	-2,076,021
8. Gross Cash Profits	379,777	463,428	538,007	587,061	661,814	766,369	837,286
9 SG&A (less non-cash expenses)	-353,997	-403,572	-452,000	-488,279	-546,904	-615,255	-658,473
10 Chng. In Prepaid Expenses							
11 Chng In Accrued Expenses							
12 Cash Operating Expenses	-353,997	-403,572	-452,000	-488,279	-546,904	-615,255	-658,473
13 Cash After Operations	25,780	59,856	86,007	98,783	114,909	151,114	178,813
14 Miscellaneous Cash Income (Expense)							
15 Income Tax Provision	-17,092	-12,655	-11,755	-6,175	-22,355	-23,375	-22,558
16 Chng In Deferred Taxes	3,005	628	703	656	722	794	873
17 Chng In Taxes Payable							
18 Chng In Other Current Assets	-369	-385	-581	-619	-659	-702	-748
19 Chng In Other Non-current Assets	-1,497	-15,722	-23,584	-35,375	-53,063	-79,595	-119,392
20 Chng In Other Current Liabilities	2,317	2,491	3,570	3,927	4,320	4,752	5,227
21 Chng In Other Non-current Liabilities	151	153	155	157	159	161	163

22	Taxes Paid and Other Income (Expenses)	-13,484	-25,490	-31,492	-37,429	-70,877	-97,965	-136,434
23	Net Cash After Operations	12,295	34,366	54,515	61,354	44,032	53,149	42,379
24	Interest Expense (Existing Debt)	-12,425	-37,224	-50,377	-81,856	-63,125	-72,812	-77,751
25	Interest Expense (New Debt Need- NDN)	1,288	-1,130	-1,356	-1,628	-1,953	-2,344	-2,812
26	Chng. In Interest Payable							
27	Dividends							
28	Chng. In Dividends Payable							
29	CPLTD		-100,000	-25,000	-25,000	-55,000	-55,000	-55,000
30	Total Financing Payments	-11,137	-136,924	-75,299	-105,352	-118,075	-127,813	-143,761
31	Cash Before Long-Term Uses	1,158	-102,558	-20,784	-43,998	-74,043	-74,664	-101,381
32	Capital Expenditures (NPE)	-177,755	-37,131	-41,587	-38,814	-42,696	-46,965	-51,662
33	Chng, In Intangibles	-355	-1,130	-1,356	-1,628	-1,953	-2,344	-2,812
34	Chng. in Long-Term Investments							
35	Financing Surplus / Requirement	-176,951	-140,819	-63,727	-84,440	-118,692	-123,973	-155,855
36	Chng, In Short-Term Debt	-45,000	124,488	64,074	-188,562	100,000	128,742	-23,714
37	Chng. In Long-Term Debt	250,000			300,000		9	183,492
Bad Debt (expense) / Recovery								
38	Chng. In Equity							
39	Total External Financing	205,000	124,488	64,074	111,438	100,000	128,751	159,778
40	Cash After Financing	28,049	-16,331	347	26,998	-18,692	4,778	3,922
41	Actual Change in Cash	28,049	-16,331	347	26,998	-18,692	4,778	3,922

BROWN'S BUILDING SUPPLY

Memo to:	File
From:	Lending Officer
Company:	Brown's Building Supply
Re:	Briefing on the Relationship
Date:	Today

TLI initiated its relationship with Brown's Building Supplies, Inc. in 20x4 when it provided the company a 450,000 seven year term loan. The purpose of the loan was to finance a permanent increase in working investment, reflecting the increased demand for the company's products and services.

Prior to 20x4, Brown's Building Supplies had a credit relationship with the Other Lending Institution (TOLI) which provided the company the following two credit facilities:

Facility One: 90,000 four year term loan (interest rate of 12% p.a.) for the purchase of a delivery truck and store remodeling.

Facility Two: 175,000 line of credit (interest rate of 12% p.a.) to finance inventories (stocks) and accounts receivables (debts).

Between 20x2 and 20x8, the company's sales grew, on average, 10.8% p.a., as a result of the company's marketing efforts and the overall health of the market. The impressive sales growth in 20x4 (21%) largely reflected the inclusion of a new customer, Winter Drywall, Inc. Winter Drywall has won a large sub contract with Morris Developers, a speculative developer of low and moderate housing.

Since the beginning of the relationship there has been a growing demand for the company's product and the management has been extremely forthcoming.

FINANCIAL INFORMATION ON BROWN BUILDING SUPPLIES – BALANCE SHEET ASSETS

Browns Building Supply
Balance Sheet,

December 31	20x2		20x3		20x4		20x5		20x6		20x7		20x8
Assets													
Cash	34,684		37,978		45,954		51,009		55,753		60,492		66,904
Marketeable Securities	12,710		0		0		0		0		0		0
Accounts ReceivablesNet)/Debtors	184,188		201,686		542,990		365,695		399,704		433,679		479,649
Inventory/Stock	215,181		240,813		370,020		314,488		307,486		305,167		337,460
Other Current Assets	11,126		11,627		12,150		12,697		13,268		13,865		14,489
Total Current Assets	457,889		492,104		971,114		743,889		776,211		813,203		898,502
Fixed Assets													
Property, Plant & Equipment	191,712		214,717		240,483		269,341		301,662		337,861		378,405
Accumulated Depreciation	-89,639		-106,505		-125,396		-146,554		-170,250		-196,790		-226,516
Net Fixed Assets	102,073		108,212		115,087		122,787		131,412		141,071		151,889
Investments													
Prepaid Expenses													
Other Non-Current Assets	40,640		43,688		46,965		50,487		54,274		58,345		62,720
Intangibles	7,176		7,578		8,002		8,450		8,923		9,423		9,951
Total Assets	607,778	0	651,583	0	1,141,168	0	925,614	0	970,820	0	1,022,042	0	1,123,063

FINANCIAL INFORMATION ON BROWN BUILDING SUPPLIES – BALANCE SHEET LIABILITIES

Balance Sheet

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Liabilities							
CPLTD		22,500	22,500	86,786	86,786	64,286	64,286
Notes Payable - Bank	85,000	73,031	109,705	63,854	118,934	162,167	100,010
Accounts Payable	97,810	107,827	108,829	106,442	143,140	195,767	229,218
Accrued Expenses							
Interest Payable							
Dividends Payable							
Taxes Payable							
Other Current Liabilities	43,175	46,414	51,055	56,160	61,776	67,954	74,750
Total Current Liabilities	225,985	249,771	292,089	313,243	410,636	490,174	468,264
Long-Term Debt	90,000	67,500	495,000	408,214	321,428	257,142	342,856
Deferred Taxes	2,959	3,314	3,712	4,157	4,656	5,214	5,840
Other Non-Current Liabilities	15,942	16,142	16,344	16,548	16,755	16,964	17,176
Total Liabilities	334,886	336,727	807,145	742,162	753,475	769,494	834,136
Stockholders' Equity							
Common Stock	5,363	5,363	5,363	5,363	5,363	5,363	5,363
Capital Surplus	26,813	26,813	26,813	26,813	26,813	26,813	26,813
Retained Earnings	240,717	282,681	301,849	151,278	185,170	220,372	256,751
Total Stockholders Equity	272,892	314,856	334,024	183,453	217,345	252,547	288,926
Total Liabilities & Equity	607,778	651,583	1,141,168	925,614	970,820	1,022,042	1,123,063

FINANCIAL INFORMATION ON BROWN BUILDING SUPPLIES – INCOME STATEMENT

Income Statement December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Net Sales	1,680,719	1,840,387	2,226,869	2,471,824	2,701,704	2,931,349	3,242,072
Cost of Goods Sold	- 1,190,016	- 1,311,893	- 1,588,908	- 1,765,971	- 1,935,039	- 2,101,619	- 2,324,019
Depreciation	-15,060	-16,867	-18,891	-21,158	-23,697	-26,540	-29,725
Gross Profit	475,643	511,628	619,069	684,695	742,969	803,190	888,328
Selling & General Administrative	-388,246	-421,449	-509,953	-568,520	-621,392	-680,073	-752,161
Operating Income	87,397	90,179	109,117	116,176	121,577	123,117	136,167
Interest Expense	-13,250	-26,597	-80,075	-79,162	-70,225	-69,781	-81,047
Miscellaneous Expense							
Miscellaneous Income	635						
Net Profit Before Taxes	74,783	63,582	29,042	37,014	51,352	53,336	55,120
Income Tax Provision	-25,426	-21,618	-9,874	-12,585	-17,460	-18,134	-18,741
Net Profit After Taxes	49,357	41,964	19,168	24,429	33,892	35,202	36,379
Unusual Items (bad debt)				-175,000			
Net Profit After Unusual Items	49,357	41,964	19,168	-150,571	33,892	35,202	36,379
Dividends							
Change In Retained Earnings							
Adjustments To Equity							
Change In Net Worth	49,357	41,964	19,168	-150,571	33,892	35,202	36,379

FINANCIAL INFORMATION ON BROWN BUILDING SUPPLIES – RATIO SHEET

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
FACT SHEET							
ROE	18.1%	13.3%	5.7%	13.3%	15.6%	13.9%	12.6%
ROS	2.9%	2.3%	0.9%	1.0%	1.3%	1.2%	1.1%
ATO	2.77	2.82	1.95	2.67	2.78	2.87	2.89
ALEV	2.23	2.07	3.42	5.05	4.47	4.05	3.89
Profitability							
SALES	1,680,719	1,840,387	2,226,869	2,471,824	2,701,704	2,931,349	2,072,324
% CHANGE	6.0%	9.5%	21.0%	11.0%	9.3%	8.5%	10.6%
CGS/SALES	70.8%	71.3%	71.4%	71.4%	71.6%	71.7%	71.7%
GROSS PROFIT MARGIN	28.3%	27.8%	27.8%	27.7%	27.5%	27.4%	27.4%
SG&A/SALES	23.1%	22.9%	22.9%	23.0%	23.0%	23.2%	23.2%
OPER PROFIT MARGIN	5.2%	4.9%	4.9%	4.7%	4.5%	4.2%	2.2%
Asset Efficiency							
WORKING INVESTMENT	301,560	334,673	804,180	573,740	564,050	543,078	587,891
% CHANGE	6.5%	11.0%	140.3%	-28.7%	-1.7%	-3.7%	8.3%
WI/SALES	17.9%	18.2%	36.1%	23.2%	20.9%	18.5%	18.1%
ARDOH	40	40	89	54	54	54	54
INVDOH	66	67	85	65	58	53	53
APDOH	30	30	25	22	27	34	36
AE DOH							
AGPTO	9.26	9.06	9.76	9.7	9.46	9.17	9.05
ANPTO	16.92	17.5	19.95	20.78	21.26	21.52	22.13
DEP/SGP	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%
Leverage/Liquidity							
CURRENT RATIO	2.03	1.97	3.32	2.37	1.89	1.66	1.92
WORKING CAPITAL	231,904	242,333	679,025	430,646	365,575	323,029	430,238
QUICK RATIO	0.97	0.96	2.02	1.33	1.11	1.01	1.17
COVERAGE RATIO	1.45	1.55	1.23	1.03	1.06	1.09	1.11
TANGIBLE LEVERAGE	1.19	1.03	2.41	4.12	3.51	3.07	2.91
LTD/CPLTD		3	22	4.7	3.7	4	5.3

FINANCIAL INFORMATION ON BROWN BUILDING SUPPLIES – CASH FLOW STATEMENT

Mainline-Cash Flow Statement
December 31

		20X2	20X3	20X4	20X5	20X6	20X7	20X8
1	Net Sales	1,680,719	1,840,387	2,226,869	2,471,824	2,701,704	2,931,394	3,242,072
2	Chng. In A/R	-12,606	-17,498	-341,304	177,952	-34,010	-33,975	-45,970
3	Cash From Sales	1,668,113	1,822,889	1,885,565	2,649,120	2,667,694	2,897,374	3,196,102
4	Cost of Goods Sold (less non-cash expenses)	-1,190,016	-1,311,893	-1,588,908	-1,765,971	-1,935,039	-2,101,619	-2,324,019
5	Chng. In Inventory	-9,488	-25,632	-129,207	5,532	7,002	2,319	-32,294
6	Chng. In Accounts Payable	3,519	10,017	1,003	-2,387	36,698	52,627	33,451
7	Cash Production Cost	-1,195,945	-1,327,508	-1,717,112	-1,712,827	-1,891,339	-2,046,673	-2,322,862
8.	Gross Cash Profits	472,168	495,382	168,453	936,293	776,356	850,701	873,240
9	SG&A (less non-cash expenses)	-388,246	-421,449	-509,953	-568,520	-621,392	-680,073	-752,161
10	Chng. In Prepaid Expenses							
11	Chng In Accrued Expenses							
12	Cash Operating Expenses	-388,246	-421,449	-509,953	-568,520	-621,392	-680,073	-752,161
13	Cash After Operations	83,922	73,933	-345,001	367,773	154,964	170,628	121,079
14	Miscellaneous Cash Income (Expense)							
15	Income Tax Provision	-25,426	-21,618	-9,874	-12,585	-17,460	-18,134	-18,741
16	Chng In Deferred Taxes	317	355	398	445	499	559	626
17	Chng In Taxes Payable							
18	Chng In Other Current Assets	-479	-501	-523	-547	-571	-597	-624
19	Chng In Other Non-current Assets	-2,835	-3,046	-3,277	-3,522	-3,787	-4,071	-4,376
20	Chng In Other Current Liabilities	3,012	3,238	4,641	5,105	5,616	6,178	5,795
21	Chng In Other Non-current Liabilities	197	199	202	204	207	209	212
22	Taxes Paid and Other Income (Expenses)	-25,215	-21,374	-8,433	-10,899	-15,496	-15,856	-16,108
23	Net Cash After Operations	58,707	52,559	-349,934	356,875	139,468	154,772	104,972
24	Interest Expense (Existing Debt)	-13,250	-26,597	-80,075	-79,162	-70,225	-69,781	-81,047
25	Interest Expense (New Debt Need- NDN)	635						
26	Chng. In Interest Payable							
27	Dividends							

28 Chng. In Dividends Payable							
29 CPLTD			-22,500	-22,500	-86,786	-86,786	-64,286
30 Total Financing Payments	-12,615	-26,597	-102,575	-101,662	-157,011	-156,567	-145,333
31 Cash Before Long-Term Uses	46,093	25,962	-452,508	255,213	-17,543	-1,794	-40,361
32 Capital Expenditures (NPE)	-20,541	-23,005	-25,766	-28,858	-32,321	-36,199	-40,543
33 Chng, In Intangibles	-381	-402	-424	-448	-473	-500	-528
34 Chng. in Long-Term Investments							
35 Financing Surplus / Requirement	25,172	2,555	-478,699	225,906	-50,337	-38,494	-81,432
36 Chng, In Short-Term Debt	85,000	-11,969	36,674	-45,851	55,080	43,233	-62,157
37 Chng. In Long-Term Debt	-95,623		450,000				150,000
Bad Debt (expense) / Recovery				-175,000			
38 Chng. In Equity							
39 Total External Financing	-10,623	-11,969	486,674	-220,851	55,080	43,233	87,843
40 Cash After Financing	14,549	-9,414	7,975	5,055	4,743	4,739	6,412
41 Actual Change in Cash	14,549	-9,414	7,975	5,055	4,743	4,739	6,412

YELLOW CONTRACTORS INC.

Memo to: File

From: Lending Officer

Company: Yellow Contractors Inc.

Re: Briefing on the Relationship

Date: Today

Background Information

TLI began its relationship with Yellow Contractors, Inc, in 20x3 when it provided the company a 175,000 nine year term loan. The purpose of the loan was to enable the company to refinance a portion of its short term debt and to finance a permanent increase I working investment, associated with the growth of the company’s business.

Prior to 20x3, Yellow Contractors Inc. had a credit relationship with the Other Lending Institutions (TOLI). TOLI provided the company a working capital line of credit to finance inventories (stock) and accounts receivables (debtors). Over the years TOLI increased the line of credit to its current amount of 150,000.

Since the beginning of the relationship, there has been a growing demand for the company’s product and the management team has been extremely forthcoming.

FINANCIAL INFORMATION ON YELLOW CONTRACTORS INC. – BALANCE SHEET ASSETS

YellowContractors Inc.
Balance Sheet,

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Assets							
Cash	10,705	12,311	13,788	14,781	16,038	17,962	20,657
Marketeable Securities	53,551	62,612	1,635	1,703	1,773	1,846	1,922
Accounts ReceivablesNet)/Debtors	45,802	115,879	125,851	130,697	144,093	161,384	185,592
Inventory/Stock	49,516	106,176	118,576	121,729	137,957	158,197	184,150
Other Current Assets	3,112	3,252	3,464	3,689	3,929	4,184	4,456
Total Current Assets	162,687	300,230	263,314	272,598	303,790	343,573	396,776
Fixed Assets							
Property, Plant & Equipment	62,244	69,713	78,776	84,054	89,686	95,695	102,106
Accumulated Depreciation	-25,431	-30,908	-37,070	-43,827	-51,037	-58,731	-66,939
Net Fixed Assets	36,813	38,806	41,706	40,227	38,648	36,964	35,167
Investments							
Prepaid Expenses							
Other Non-Current Assets	11,979	13,177	14,033	14,946	15,917	16,952	18,053
Intangibles	2,055	2,193	2,340	2,496	2,664	2,842	3,033
Total Assets	213,534	354,405	321,393	330,267	361,018	400,331	453,029

FINANCIAL INFORMATION ON YELLOW CONTRACTORS INC. – BALANCE SHEET LIABILITIES

Balance Sheet

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Liabilities							
CPLTD	0	19,444	19,444	19,444	19,444	19,444	19,444
Notes Payable - Bank	82,000	40,000	16,211	31,950	61,232	92,701	136,885
Accounts Payable	37,110	42,470	43,245	38,597	40,104	44,942	47,589
Accrued Expenses							
Interest Payable							
Dividends Payable							
Taxes Payable							
Other Current Liabilities	11,514	12,377	13,615	14,976	16,474	18,121	19,934
Total Current Liabilities	130,624	114,292	92,515	104,967	137,254	175,209	223,852
Long-Term Debt		155,556	136,112	116,668	97,224	77,780	58,336
LTD-NDN							
Deferred Taxes	1,747	1,957	2,211	2,359	2,517	2,686	2,866
Other Non-Current Liabilities	4,350	4,350	4,350	4,350	4,350	4,350	4,350
Total Liabilities	136,721	276,155	235,188	228,344	241,345	260,025	289,404
Stockholders' Equity							
Common Stock	1,500	1,500	1,500	1,500	1,500	1,500	1,500
Capital Surplus	7,500	7,500	7,500	7,500	7,500	7,500	7,500
Retained Earnings	67,812	69,251	77,205	92,922	110,673	131,306	154,625
Total Stockholders Equity	76,812	78,251	86,205	101,922	119,673	140,306	163,625
Total Liabilities & Equity	213,534	354,405	321,393	330,267	361,018	400,331	453,029

FINANCIAL INFORMATION ON YELLOW CONTRACTORS INC. – INCOME STATEMENT

Income Statement December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
Net Sales	557,256	640,844	717,746	769,423	834,824	935,003	1,075,254
Cost of Goods Sold	-401,630	-455,932	-509,179	-541,841	-585,515	-656,159	-755,222
Depreciation	-4,570	-5,476	-6,162	-6,757	-7,210	-7,693	-755,222
Gross Profit	151,056	179,436	202,404	220,825	242,099	271,151	311,824
Selling & General Administrative	128,726	146,753	164,364	175,429	192,010	213,181	245,158
Operating Income	22,330	32,683	38,041	45,396	50,089	57,970	66,666
Interest Expense	-15,730	-34,260	-26,087	-21,684	-23,300	-26,819	-31,449
Miscellaneous Expense							
Miscellaneous Income	3,213	3,757	98	102	106	111	115
Net Profit Before Taxes	9,813	2,180	12,052	23,814	26,895	31,262	35,332
Income Tax Provision	-3,336	-741	-4,098	-8,097	-9,144	-10,629	-12,013
Net Profit After Taxes	6,477	1,439	7,954	15,717	17,751	20,633	23,319
Unusual Items (bad debt)							
Net Profit After Unusual Items	6,477	1,439	7,954	15,717	17,751	20,633	23,319
Dividends							
Change In Retained Earnings							
Adjustments To Equity							
Change In Net Worth	6,477	1,439	7,954	15,717	17,751	20,633	23,319

FINANCIAL INFORMATION ON YELLOW CONTRACTORS INC. – RATIO SHEET

December 31	20x2	20x3	20x4	20x5	20x6	20x7	20x8
FACT SHEET							
ROE	8.4%	1.8%	9.2%	15.4%	14.8%	14.7%	14.3%
ROS	1.2%	0.2%	1.1%	2.0%	2.1%	2.2%	2.2%
ATO	2.61	1.81	2.23	2.33	2.31	2.34	2.37
ALEV	2.78	4.53	3.73	3.24	3.02	2.85	2.77
Profitability							
SALES	557,256	640,844	717,746	769,423	834,824	935,003	1,075,254
% CHANGE	24.0%	15.0%	12.0%	7.2%	8.5%	12.0%	15.0%
CGS/SALES	72.1%	71.1%	70.9%	70.4%	70.1%	70.2%	70.2%
GROSS PROFIT MARGIN	27.1%	28.0%	28.2%	28.7%	20.0%	29.0%	29.0%
SG&A/SALES	23.1%	22.9%	22.9%	22.8%	23.0%	22.8%	22.8%
OPER PROFIT MARGIN	4.0%	5.1%	5.3%	5.9%	6.0%	6.2%	6.2%
Asset Efficiency							
WORKING INVESTMENT	58,208	179,584	201,182	213,828	241,946	274,639	322,152
% CHANGE	-24.2%	208.5%	12.0%	6.3%	13.1%	13.5%	17.3%
WI/SALES	10.4%	28.0%	28.0%	27.8%	29.0%	29.4%	30.0%
ARDOH	30	66	64	62	63	63	63
INVDOH	45	85	85	82	86	88	89
APDOH	34	34	31	26	25	25	23
AE DOH	0	0	0	0	0	0	0
AGPTO	10	10	10	9	10	10	11
ANPTO	17	17	18	19	21	25	30
DEP/SGP	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%
Leverage/Liquidity							
CURRENT RATIO	1.25	2.63	2.85	2.6	2.21	1.96	1.77
WORKING CAPITAL	32,063	185,938	170,799	167,631	166,536	168,364	172,924
QUICK RATIO	0.43	1.12	1.51	1.39	1.17	1.02	0.92
COVERAGE RATIO	1.25	1.11	1.15	1.23	1.3	1.36	1.41
TANGIBLE LEVERAGE	1.75	3.55	2.73	2.23	2.00	1.84	1.76
LTD/CPLTD		8	7	6	5	4	3

FINANCIAL INFORMATION ON YELLOW CONTRACTORS INC. – CASH FLOW STATEMENT

Mainline-Cash Flow Statement December 31	20X2	20X3	20X4	20X5	20X6	20X7	20X8
1 Net Sales	557,256	640,844	717,746	769,423	834,824	935,003	1,075,254
2 Chng. In A/R	2,830	-70,077	-9,973	-4,845	-13,396	-17,291	-24,208
3 Cash From Sales	560,086	570,768	707,773	764,578	821,428	917,712	1,051,046
4 Cost of Goods Sold (less non-cash expenses)	-401,630	-455,932	-509,179	-541,841	-585,515	-656,159	-755,222
5 Chng. In Inventory	8,556	-56,660	-12,400	-3,153	-16,228	-20,240	-25,953
6 Chng. In Accounts Payable	7,190	5,360	775	-4,648	1,507	4,839	2,647
7 Cash Production Cost	-385,884	-507,232	-520,804	-549,643	-600,237	-671,561	-778,527
8. Gross Cash Profits	174,202	63,536	186,969	214,935	221,191	246,151	272,519
9 SG&A (less non-cash expenses)	-128,726	-146,753	-164,364	-175,429	-192,010	-213,181	-245,158
10 Chng. In Prepaid Expenses							
11 Chng In Accrued Expenses							
12 Cash Operating Expenses	-128,726	-146,753	-164,364	-175,429	-192,010	-213,181	-245,158
13 Cash After Operations	45,475	-83,217	22,605	39,507	29,182	32,971	27,361
14 Miscellaneous Cash Income (Expense)							
15 Income Tax Provision	-3,336	-761	-4,098	-8,097	-9,144	-10,629	-12,013
16 Chng In Deferred Taxes	403	210	254	148	158	169	180
17 Chng In Taxes Payable							
18 Chng In Other Current Assets	-134	-140	-211	-225	-240	-255	-272
19 Chng In Other Non-current Assets	-1,089	-1,198	-856	-912	-971	-1,035	-1,102
20 Chng In Other Current Liabilities	803	864	1,238	1,361	1,498	1,647	1,812

21	Chng In Other Non-current Liabilities							
22	Taxes Paid and Other Income (Expenses)	-3,353	-1,006	-3,673	-7,724	-8,700	-10,103	-11,395
23	Net Cash After Operations	42,122	-84,223	18,932	31,783	20,482	22,868	15,966
24	Interest Expense (Existing Debt)	-15,730	-34,260	-26,087	-21,684	-23,300	-26,819	-31,449
25	Interest Expense (New Debt Need- NDN)	3,213	3,757	98	102	106	111	115
26	Chng. In Interest Payable							
27	Dividends							
28	Chng. In Dividends Payable							
29	CPLTD			-19,444	-19,444	-19,444	-19,444	-19,444
30	Total Financing Payments							
31	Cash Before Long-Term Uses	29,605	-114,727	-26,501	-9,244	-22,156	-23,285	-34,811
32	Capital Expenditures (NPE)	-14,364	-7,469	-9,063	-5,278	-5,632	-6,009	-6,412
33	Chng, In Intangibles	-129	-138	-147	-157	-167	-178	-190
34	Chng. in Long-Term Investments							
35	Financing Surplus / Requirement	15,112	-122,334	-35,711	-14,678	-27,955	-29,472	-41,413
36	Chng, In Short-Term Debt	2,000	-42,000	-23,789	15,739	29,282	31,469	44,184
37	Chng. In Long-Term Debt		175,000					
Bad Debt (expense) / Recovery								
38	Chng. In Equity							
39	Total External Financing	2,000	133,000	-23,789	15,739	29,282	31,469	44,184
40	Cash After Financing	17,112	10,666	-59,500	1,061	1,327	1,997	2,771
41	Actual Change in Cash	17,112	10,666	-59,500	1,061	1,327	1,997	2,771

GEIGER HAV SERVICE, INC.

Company:	**Geiger HAV Service, Inc.**
Annual Sales:	**116, 435, 000 (20X8)**
Total Assets:	**52,627, 000**
Service:	**Heating, Air Conditioning and Ventilation Repair (HAV)**
Established:	**20x0**

Background

You are a lender in the Workout Department of the First Fund, lending institution. The Workout Department is responsible for managing First Fund's portfolio of problem loans. Typically, loans that are transferred to the Workout Department involve large, highly sensitive relationships or have high external visibility. From time to time the Workout Department is asked to advise lenders on the best way of handling emerging problem situations. In these instances, the lender is generally either inexperienced in handling problem loans or over extended, and thus unable to appropriately manage and resolve the situations.

The Workout Department has been asked to advise on a borrower that could be embarrassing to First Fund. Your task is to assess the situation and develop a recommended plan of action to protect First Fund's position. You will present you recommendations to Anthony Jones, the Senior Lender. While reviewing the file you learn the following:

Geiger HAV Service Inc. founded in 20x0 by Justin Moore is one of a handful of independently owned and operated heating, air conditioning and ventilation repair companies in the market. Notwithstanding the recent entrance of franchise repair companies offering repair and maintenance of residential and commercial units, as well as the entrance of specialty repair companies exclusively handling either a single manufacturer's products or high-end technically sophisticated units, Justin Moore has been able to increase the market share of Geiger HAV's Service, Inc. Justin's technical skills, continuous ability to stay abreast of new procedures, ability to maintain professional relationships with customers and general perseverance have been key factors of the company's success. Many of Geiger HAV's customers consider the shop's location acceptable and accessible, the surroundings clean and the service timely and courteous. Geiger HAV is located on secondary road near an industry area.

As a child, Justin was always tinkering with machines. When most children were playing kid's games, Justin could either be found at the corner repair shop looking over the shoulder of a mechanic or opening an electric motor at the local dump. By the time Justin attended Kool University, a renowned HAV trade school which has been credited for training most of the top designers and mechanics that dominate the world of heating and air conditioning, Justin was considered to be quite exceptional.

The initial marketing strategy of Geiger HAV was to concentrate on promoting its services to manufacturers of heating, air conditioning and ventilation equipment. Although this type of business is less profitable than marketing directly to the public or end-users, because of the established rate schedule for parts and labor mandated by the manufacturers, it provides start-up companies with a predictable cash flow.

Geiger HAV Service's reputation for providing quality service in a timely and courteous manner grew by word of mouth. Its customer base expanded and became increasingly diverse. As a result, Geiger HAVs Service's reliance on the business generated by equipment manufacturers, as well as its concentration in related accounts receivable, gradually declined. As the proportion of manufacturer business declined, the operations became more profitable.

The building that houses the repair ship and office space was acquired by Geiger HAV Realty, a company wholly owned by Justin Moore in 20x4. Geiger HAV rented the shop for four or five years prior to the acquisition of the property by Geiger HAV Realty.

First Fund makes available to Geiger HAV Service, Inc. the following facilities:

> A 25,000 line of credit. The line of credit has been used to finance accounts receivable, inventory and the purchase of fixed assets. The loan officer estimates that between 7,000 and 10,000 of the line of credit was to finance the purchase of equipment.

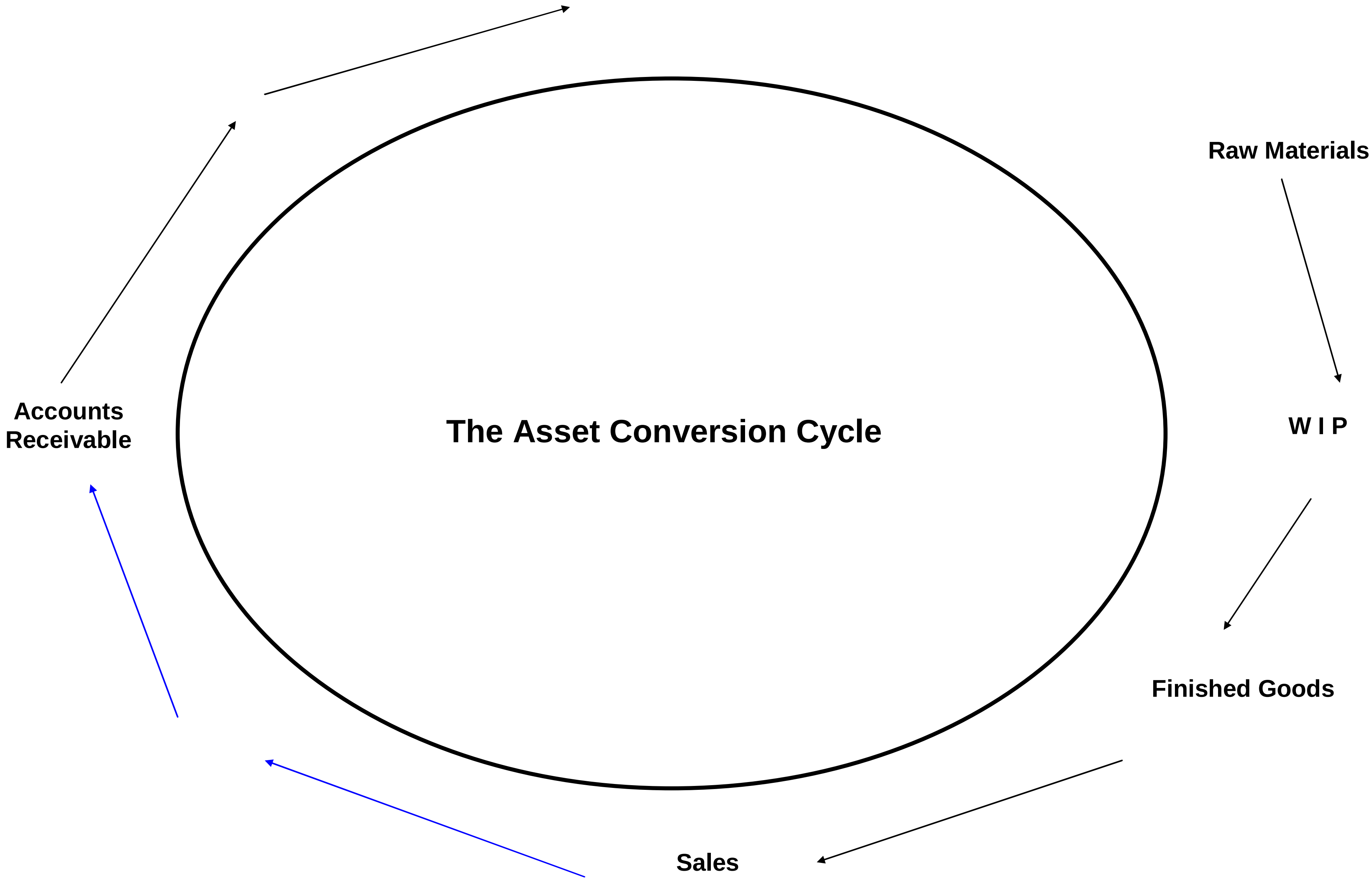
At a recent lunch, the junior loan officer of First Fund received an earful of surprising information. Justin, in an unusually animated manner, told the account officer the following:

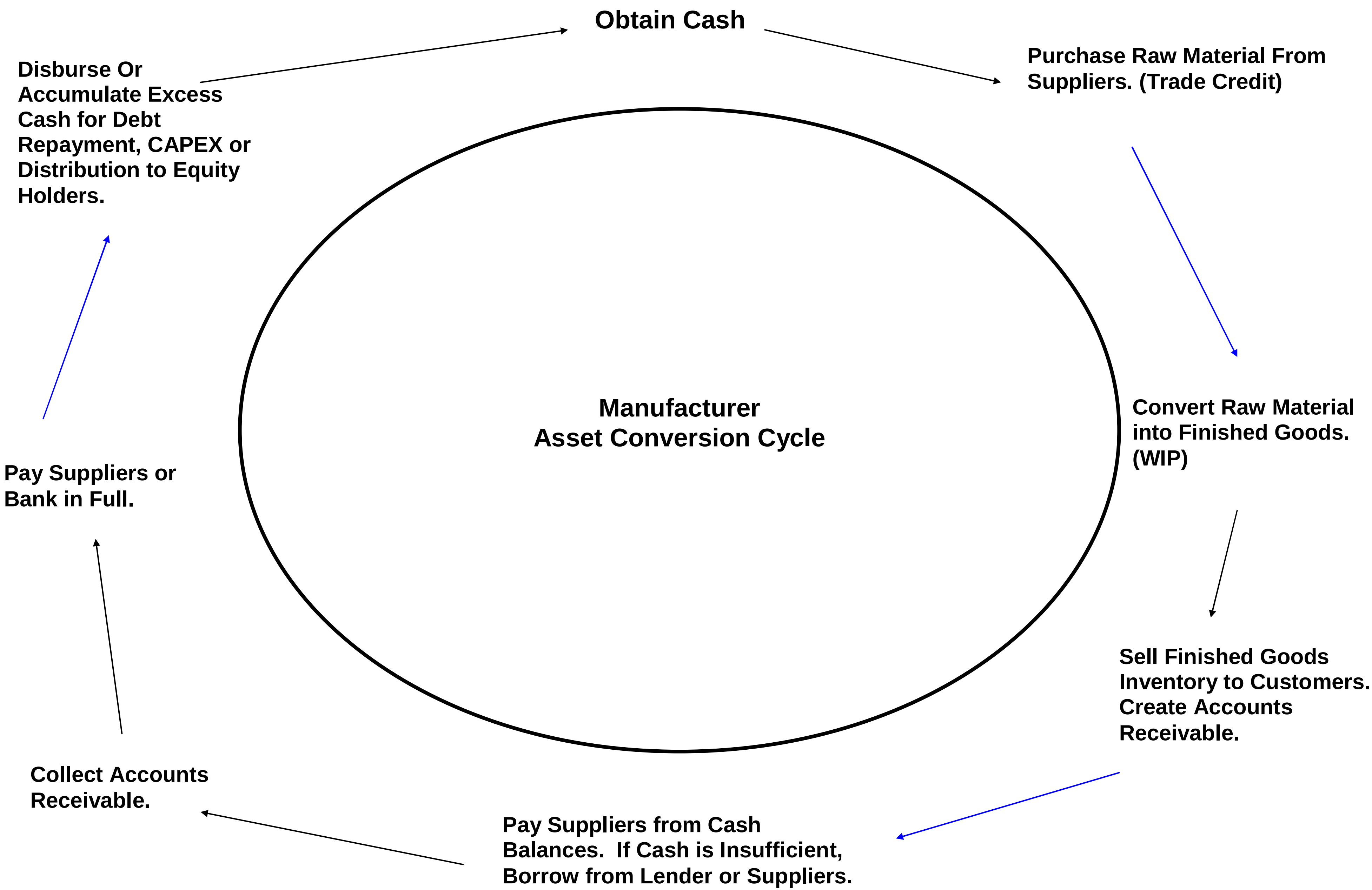
> Things have simply gotten too far out of line with Vera (spouse). I don't know how much more I can take. The annual dividends that are funding Vera's photographic business are inhibiting me from capitalizing the business like I should. The computer diagnostic equipment we are using will soon be a full generation old. Already some of my competitors can provide services quicker and at a lower cost than I can. I don't know how much longer I can go without investing in technology and not become obsolete. You know my reputation has always been based on my ability to stay current with technology. This has enabled me to provide my customers with the best possible service. Now it seems that every time I turn, Vera wants more money for the newest piece of photographic equipment. Did you know that the cost of professional photographic equipment approximates the cost of the diagnostic equipment I use at Geiger HAV? But there is one major difference that Vera doesn't seem to understand no matter how hard I try to explain. This photographic business or maybe I should say, this very expensive hobby of Vera's has not generated any money.
>
> Another thing, ever since Vera started hanging around these artistic types, there has been a real change in Vera's lifestyle. Things that we used to do just don't satisfy her anymore. More and more money goes toward expensive travel and clothing. Looking chic seem to be the most important thing to him these days. I don't know how much more I can take. The kids are grown. One day, I might simply drop by your office and hand you the keys as I head to the Caribbean. Did I tell you that I bought a little parcel of land there?

Assignment:

Develop your recommended action plan to protect First Fund's position and prepare your presentation to Anthony Jones. Presentation should identify the problem, list action plans both Internal and External, and additional information required. Please be prepared to defend your plan.

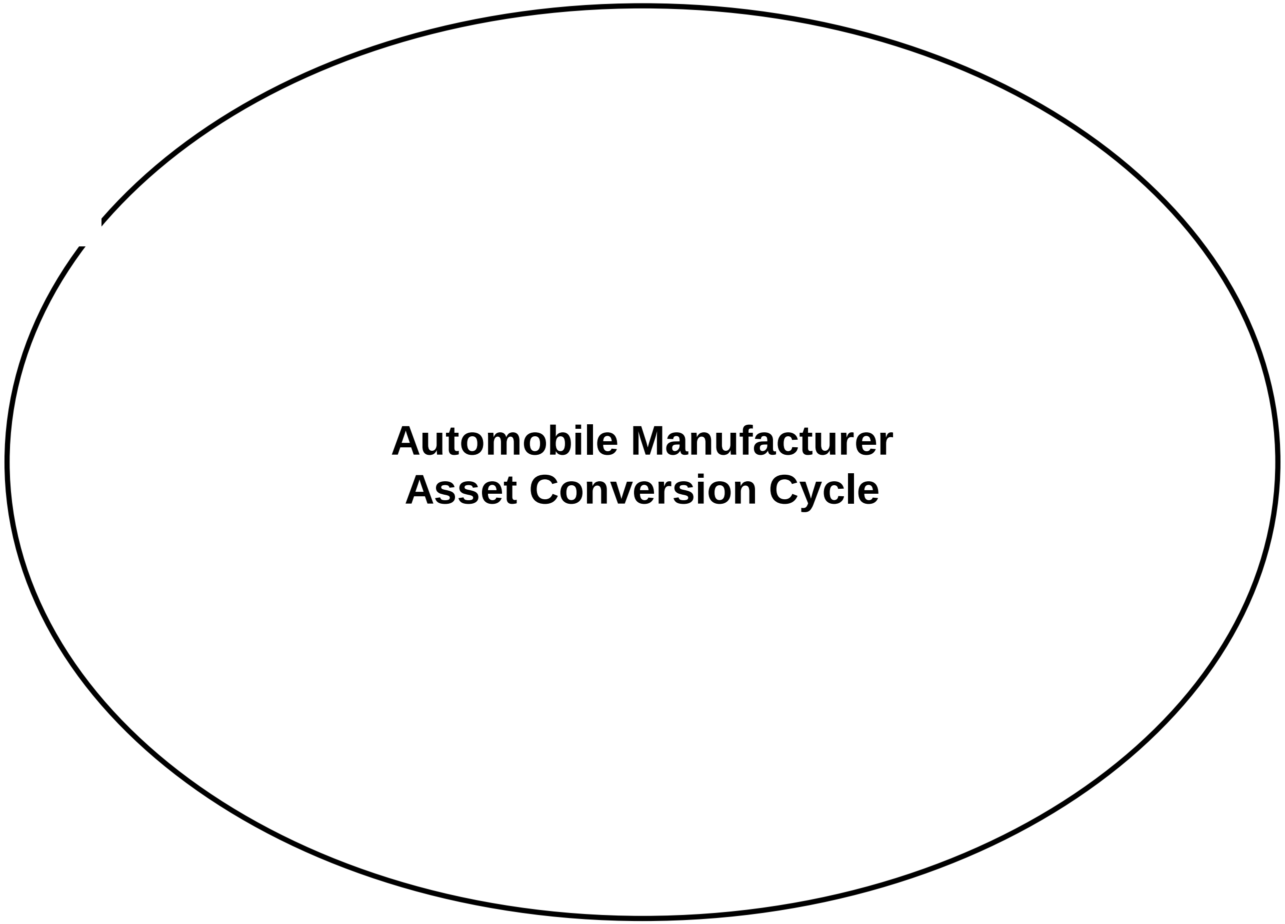
CONVERSION CYCLE




Obtain Cash
Purchase Raw Material From Suppliers. (Trade Credit)
Convert Raw Material into Finished Goods. (WIP)
Sell Finished Goods Inventory to Customers. Create Accounts Receivable.
Pay Suppliers from Cash Balances. If Cash is Insufficient, Borrow from Lender or Suppliers.
Collect Accounts Receivable.
Pay Suppliers or Bank in Full.
Disburse Or Accumulate Excess Cash for Debt Repayment, CAPEX or Distribution to Equity Holders.
Manufacturer
Asset Conversion Cycle

Retailer Stationary Products
Asset Conversion Cycle

Commodity Trader of Cocoa
Asset Conversion Cycle


Automobile Manufacturer
Asset Conversion Cycle

Four Components of the Asset Conversion Cycle ("ACC")

- ❑ Supply
- ❑ Production
- ❑ Demand
- ❑ Collection

Non-Financial Business Risks

- Business risks represent the key risks in a company's operation.
- Business risks are the events or series of events that can interrupt a company's asset conversion cycle.
- Business risks result in shrinkage in the stated book value of assets.
- Business risks must be identified and assessed in order to determine whether the risks are adequately mitigated.

Generic Non-Financial Business Risks In The Asset Conversion Cycle

Supply Risk
- Availability of raw material
- Price of raw material
- Number of suppliers
- Financial condition of major suppliers
- Availability of a substitute raw material
- Ability to deliver and/or receive raw material
- Spoilage
- Government regulations

Production Risk
- Management (skilled and experienced management mitigates risk)
- Labor (skilled labor and a good relationship with labor mitigate risk)
- Plant and Equipment (well equipped and maintained facilities mitigate risk)
- Government regulations (understanding and compliance mitigates risk)

Generic Non-Financial Business Risks In The Asset Conversion Cycle

Demand Risk
- Competition (having a competitive advantage in terms of product quality, pricing and/or selling terms mitigates risk)
- Prevailing economic environment (a healthy economic environment for the company's product mitigates risk)
- Spoilage (a short ACC, quick turnover or appropriate facilities mitigates risk)
- Government Regulation (lack of government regulation mitigates risk; however, the lack of government regulation could create other risks such as the inability to protect intellectual property)

Collection Risk
- Customer's credit quality (knowing customers and actively monitoring the financial condition of the customers, especially significant customers, mitigates risk)
- Customer concentration (a diverse customer base mitigates risk)
- Returns, Allowances, Charge-offs (active monitoring of conservative accounting systems and policies mitigates risk)
- Actively monitoring receivable aging schedule and delinquent accounts mitigates risk. Not providing credit eliminates collection risk, however eliminating credit terms impact product competitiveness

BUSINESS RISKS/MITIGANTS EXERCISE

You are a newly appointed lender. Two companies seeking financing have approached your institution. One company is a retailer of women's and children's clothing. The other is a manufacturer of gold jewelry.

Your assignment is to:
Indentify the business risks that each company faces and the steps each company's management should take to mitigate the identified risks.
Use the attached pages to list the business risks identified and the steps that management should take to mitigate the risks.

You have 15 minutes to complete the exercise.

Be prepared to discuss your response.

Retailer of Women's and Children's Clothing

	Risks	Mitigants
Supply		
Production		
Demand		
Collection		

Manufacturer of Gold Jewelry

	Risks	Mitigants
Supply		
Production		
Demand		
Collection		

WORKOUT DEPARTMENT EXERCISE

You have recently been assigned to manage the Workout Department of your financial institution. Due to the importance of the position, you will report directly to the President. If you are successful, it will catapult your career. However, if you are not successful, it will have a long lasting impact on your future.

Your lending institution has recently completed its first loan portfolio review and audit. The audit was conducted by a team of lenders working for the Community Development Group of Mainstream Lenders. The head of the Community Development Group sits on the board of your lending institution. During the audit, 25% of the loan portfolio was examined, representing 40% of the loans with outstanding balances of 15,000 and above. The audit plan has been designed so that each borrower will be reviewed and rated based on the recently established risk rating system developed by the financial institution with the past twelve months. The risk rating system classifies each borrower and not the credit facilities provided to the borrowers. Following are the definitions in the risk rating system of your credit institution.

Risk Rating System

Risk Rating 1: Exceptional degree of stability, substance and diversity. Strong fundamental balance sheet with continuous and significant cash flow demonstrated through out the business and industry cycles. Both size and market position gives the borrowers unquestionable access to financial markets.

Risk Rating 2: Comfortable asset and cash flow protection, but may be susceptible to cyclical changes. More concentration of business risk- by product or market- may be present. Borrower may have limited access to financial markets

Risk Rating 3: Acceptable cash flow and asset protection provide reasonable prospect of orderly payment. Nevertheless, risk elements are sufficiently pronounced to make future performance and the ability to attract alternative financing uncertain. Financial strength is below the level generally considered desirable for a new customer.

Risk Rating 4: Unfavorable industry or company specific risk factors represent a concern. Operating performance and financial strengths may be marginal and it is unlikely that the e obligor can attract alternative sources of financing. Considering all weaknesses and mitigating factors, there is an expectation that conditions will improve and the risk rating will be upgraded. Borrowers with a Risk Rating of 4 are considered to be on a watch list.

Risk Rating 5: Potential or emerging weaknesses create unacceptable business risk. Concerns center on the potential for a continuation of favorable economic, market or borrower-specific conditions or trends that may affect future debt service capacity. Defects in loan documentation, collateral control and financial information may also be a factor. Weaknesses are not pronounced and do not represent an imminent or serious threat to orderly repayment or asset protection. Nevertheless, greater than normal management attention is warranted to ensure a continuance of cash flow and asset value protection. Must possess potential for improvement and upgrading. These loan are classified “Special Mention”.

Risk Rating 6: Loans are inadequately protected by the current debt servicing ability of the borrower or by pledged collateral. Loans so classified have a well defined weakness or weaknesses that jeopardize the repayment of debt. These loans, classified “Substandard”, are characterized by the possibility that the lender will sustain some loss (of principal and / or interest), if the deficiencies are not corrected.

Risk Rating 7: Loans have all the weaknesses inherent in those classified as substandard, with the added characteristic that existing facts, conditions and values make the collection or repayment in full improbable, even though the extent of the probable loss cannot be qualified at this time. Although the possibility of loss is significant, there may be certain important and reasonably specific pending factors that work to the advantage and strengthening of the loan. Pending factors could include a merger, acquisition, liquidation proceeding, capital injections, additional collateral, new financing source or additional guaranties. In addition, this category represents loans or portions of loans that are determined to be uncollectible. Where there may be some long-term salvage or recovery potential, prospects are not sufficiently assured to support continuance as a bankable asset. These loans are classified “Doubtful or Loss”.

When the Workout Department is fully staffed it will consist of eight workout lending officers. Presently, only four lenders with diverse backgrounds have been assigned to the department. The management of the lending institution has assured you that your handpicked staff represents a cross section of the best and the brightest at your lending institution. Your responsibilities, Manager of the Workout Department include fully staffing the department.

Staff Profiles

Carlos Rentas
Most Recent Position: Not Applicable, New Hire

Carlos Rentas recently completed a business administration degree program at Central University. He majored in accounting and finance. Carlos has no work experience, but his family has significant political contacts and connections within influential business circles, Carlos’s father developed these connections while he was the Deputy Director of the State Economic Development Authority.

Tanya Yellow
Most Recent Position: Assistant Branch Manager

Tanya Yellow responsibilities have included lending to retailers, wholesales, and restaurants. Tanya began her career as a messenger at the lending institution fifteen years ago. After receiving several promotions during her first six years, Tanya was given account responbilities. For the last nine years she has been an account officer in the South Central Branch where she has handled retailers and wholesalers, and the Northwestern Branch, where she was responsible for restaurants and start up companies. Tanya is of the old school and does not have much confidence in the new approach to lending, which includes credit analysis.

Tamara Chung
Most Recent Position: Branch Manager

Tamara Chung began working at the lending institution twelve years ago after graduating from Northern University where she majored in economics. Tamara started her career as an associate in the North Central Branch. During her career, she has worked in three of the seven branches of the lending institutions. Most of Tamara's lending experience is with small and midsize commercial companies.

Francine Elliot
Most Recent Position: Associate

Francine has worked at the lending institution for two years. Francine graduated two years ago from North Central University where she majored in international finance and management information systems. During her first year with the lending institution, she worked in the Loan Review Department where her responsibilities included reviewing credit applications, insuring that the required information was complete, and obtaining approval from the appropriate credit officers or loan committee. During the past twelve months, Francine has attended various training programs on such topics as credit analysis, portfolio management, trade finance, and asset liability management.

Attached is the initial problem loan portfolio to be managed by the workout Department. Your task is to recommend how the portfolio should be allocated among staff and how the work should be prioritized. A priority rating of one indicates a situation warranting immediate attention, whereas a priority rating of three indicates a situation requiring less immediate attention. A two rating indicates a situation requiring more immediate attention than a three rated situation, but less than a one rated situation. The President expects to receive your recommendations this afternoon. Please use the worksheets that have been provided.

Account	Company	Exposure Amount	Risk Rating	Industry/Sector
1	Acme Research Company	91,031	6	Assembler of Machine Tools
2	Advance Publication	32,776	5	Newspaper Publisher
3	Rose Group	55,870	5	Wholesaler of Food Products
4	Alice Medical Supply Dist.	75,000	6	Manufacturer of Textile Prod.

BREAKEVEN CALCULATION EXERCISE

Using the income statement information provided below, calculate the following information for the companies listed:

- Amount of Fixed Costs:
- Variable Costs ÷ Sales (VC ÷ Sales) %:
- Contribution Margin (CM %):
- Breakeven Sales (BES):

<u>Men & Boys Clothing Mfg.</u>		<u>Bakery</u>		<u>Computer Manufacturer</u>	
Sales	100	Sales	100	Sales	100
Cost of Goods Sold	(77)	Cost of Goods	(53)	Costs of Goods Sold	(52)
Depreciation	(1)	Depreciation	(3)	Depreciation	(2)
Gross Profit	22	Gross Profit	44	Gross Profit	46
Operating Expenses	(17)	Operating Expenses	(39)	Operating Expenses	(42)
Operating Profits	5	Operating Profits	5	Operating Profits	(4)
Other Expenses	(1)	Other Expenses	(1)	Other Expenses	(1)
Profit before Tax	4	Profit before Tax	4	Profit before Tax	3
<u>Breakeven Calculation</u>		<u>Breakeven Calculation</u>		<u>Breakeven Calculation</u>	
Fixed Costs(R)_______		Fixed Costs (R)_______		Fixed Costs (R)_______	
VC ÷ Sales (%)______		VC ÷ Sales (%)_______		VC ÷ Sales (%)_______	
CM (%)_________		CM (%)____________		CM (%)___________	
BES (R)_________		BES (R)____________		BES (R)___________	

BREAKEVEN CALCULATION EXERCISE

Using the income statement information provided below, calculate the following information for the companies listed:

- Rand Amount of Fixed Costs:
- Variable Costs ÷ Sales (VC ÷ Sales) %:
- Contribution Margin CM %:
- Breakeven Sales (BES): R

Men & Boys Clothing Mfg.		Bakery		Computer Manufacturer	
Sales	100	Sales	100	Sales	100
Cost of Goods Sold	(77)	Cost of Goods	(53)	Costs of Goods Sold	(52)
Depreciation	(1)	Depreciation	(3)	Depreciation	(2)
Gross Profit	22	Gross Profit	44	Gross Profit	46
Operating Expenses	(17)	Operating Expenses	(39)	Operating Expenses	(42)
Operating Profits	5	Operating Profits	5	Operating Profits	(4)
Other Expenses	(1)	Other Expenses	(1)	Other Expenses	(1)
Profit Before Tax	4	Profit Before Tax	4	Profit Before Tax	3
Breakeven Calculation		Breakeven Calculation		Breakeven Calculation	
Fixed Costs(R)	19	Fixed Costs (R)	43	Fixed Costs (R)	45
VC ÷ Sales (%)	77%	VC ÷ Sales (%)	53%	VC ÷ Sales (%)	52%
CM (%)	23%	CM (%)	47%	CM (%)	48%
BES (R)	82.6	BES (R)	91.4	BES (R)	93.7

BREAKEVEN CALCULATION EXERCISE - ANSWERS

Using the income statement information provided below, calculate the following information for the companies listed:

- Dollar Amount of Fixed Costs:
- Variable Costs ÷ Sales (VC ÷ Sales) %:
- Contribution Margin CM %:
- Breakeven Sales (BES): R

Men & Boys Clothing Mfg.		Bakery		Computer Manufacturer	
Sales	100	Sales	100	Sales	100
Cost of Goods Sold	(77)	Cost of Goods	(53)	Costs of Goods Sold	(52)
Depreciation	(1)	Depreciation	(3)	Depreciation	(2)
Gross Profit	22	Gross Profit	44	Gross Profit	46
Operating Expenses	(17)	Operating Expenses	(39)	Operating Expenses	(42)
Operating Profits	5	Operating Profits	5	Operating Profits	(4)
Other Expenses	(1)	Other Expenses	(1)	Other Expenses	(1)
Profit Before Tax	4	Profit Before Tax	4	Profit Before Tax	3
Breakeven Calculation		Breakeven Calculation		Breakeven Calculation	
Fixed Costs(R)	19	Fixed Costs (R)	43	Fixed Costs (R)	45
VC ÷ Sales (%)	77%	VC ÷ Sales (%)	53%	VC ÷ Sales (%)	52%
CM (%)	23%	CM (%)	47%	CM (%)	48%
BES (R)	82.6	BES (R)	91.4	BES (R)	93.7

MONTHLY CASH BUDGET EXERCISE

Temba's Ground Services, Inc.

You are a recently hired lender of the Western Mountain Loan Fund (WMLF). One of the companies assigned to your portfolio in Temba's Ground Services, Inc. (TGS). TGS, which began operating three years ago, provides a range of ground maintenance services to local commercial and residential customers. To reduce the impact of seasonal demand on the company's business, last year the company entered into the snow removal business. Though this decision has helped lessen the impact of seasonal demand patterns, it has not eliminated the affects of seasonality.

The management of WMLF has become frustrated by the apparent lack of management's understanding of the company's financing needs. During your first meeting with Ellen Hogan (WMLF loan committee member) you received an earful. She stated, "We are beginning to lose confidence in the company's management. They seem to be clueless. During each of the last four months, the company has requested additional short-term financing. The company simply doesn't seem able to organize a financial plan. I'll be happy when someone, anyone determines the company's financing needs, and designs an appropriate facility that could address the company's needs.

At your first meeting with TGS, you were given a partially completed monthly cash budget prepared by the company management. The budget (attached) contained information on the following cash inflows and outflows:

- Cash collection from accounts receivable;
- Purchase of inventory and / or supplies;
- Principal and interest payments on existing loans;
- Advertising and promotion; and
- Travel.

By asking Ms. Temba appropriate questions you obtained the following valuable information regarding the company cash inflows and outflows:

Long-term contracts

The company was recently awarded a five-year contract with the Lower County Museum and Art Gallery to provide ground services. The contract provides TGS a minimum monthly payment of R 70,000.

Wages Paid

Wages, which exclude amounts received by the owner, vary from month to month, depending on seasonal demand. During the year, the company employs one or two work crews. A work crew consists of a supervisor and four workers. Each supervisor is paid R 20,000 per month, while each worker is paid R 15,000 per month. Based on historical patterns, Ms. Temba believes the company will engage the following number of work crew, during the next twelve months:

Months	Work Crew	Months	Work Crew
January	1	July	2
February	1	August	2
March	1	September	2
April	1	October	1
May	2	November	1
June	2	December	1

Management has emphasized that the above wages do not include payroll expenses that equal 32.0% of the wages paid.

Rent

The company pays R20, 000 a month in rent.

Insurance

The company's annual insurance premium payment, amounting to R 54,000 is paid in January.

Owner's Withdrawal

Ms. Temba withdraws R75, 000 per month from the company. This amount included related taxes.

Other Assumptions

Incorporate the following assumptions in preparing the monthly cash budget.

- Interest charged on the short-term line of credit (new loans) is 9.0% per annum
- The company needs to maintain approximately R 50, 000 in available balances to cover operating expenses.

Assignment

Using the additional information provided above, complete the attached monthly cash budget and be prepared to answer the following three questions:

1. On a cumulative basis, is the company's cash flow sufficient to cover operating expenses?
2. How much short-term financing does TGS require to cover short-term needs, or how much (Rand amount) of the line of credit does the company need to operate?
3. In which month does the highpoint borrowing occur?

MONTHLY CASH BUDGET EXERCISE FORM

	January	February	March	April	May	June	July	August	September	October	November	December	Cumulative
1. CASH ON HAND (beginning of month)	175,000												
PLUS													
2. CASH RECEIPTS													
(a) Cash Sales													
(b) Collection from Accounts Receivables	60,000	60,000	75,000	90,000	95,000	130,000	450,000	450,000	550,000	550,000	20,000	180,000	
(c) Other Cash Income													
3. TOTAL CASH RECEIPTS (total 2 (a) through 2(c)													
4. TOTAL CASH AVAILABLE (before cash paid out)													
5. CASH PAID OUT													
(a) Purchases (inventory/stock)	7,500	7,500	10,000	12,500	19,000	25,000	30,000	30,000	30,000	12,500	12,500	12,500	20,900
(b) Wages (exclude owner's withdrawal)													
(c) Payroll Expenses (taxes, benefits, etc.)													
(d) Taxes (federal, state estimated, real estate, etc.)													
(e) Rent/Mortgage													
(f) Utilities	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	42,000
(g) Maintenance and Repairs													
(h) Other administrative (phone, supplies, and etc.)													
(i) Insurance	54,000												
(j) Interest Expense (existing loans)	2,110	2,040	1,960	1,890	1,810	1,740	1,660	1,590	1,510	1,440	1,360	1,290	20,400
(k) Loan Principal payment (existing loan)	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	90,000
(l) Legal and Accounting fees													
(m) Advertising and Promotion	2,000	2,000	3,000	3,000	4,500	6,000	7,500	8,000	5,000	5,000	2,000	2,000	50,000
(n) Travel	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	90,000
(o) Capital Expenditures					50,000						120,000		
(p) Owner's withdrawal/Salary (including tax payment)													
(q) Other													
6. TOTAL CASH PAID OUT (total 5 (a) through 5 (q)													
7. CASH SURPLUS (DEFICIT) (4 minus 6)													
8. BORROWINGS (new loans)													
9. LOAN PRINCIPAL PAYMENTS (new loans)													
10. TOTAL PRINCIPAL OUTSTANDING (new loans)													
11. INTEREST EXPENSE (new loans)													
12. CASH ON HAND (end of month)													
TOTAL CASH AVAILABLE/ TOTAL CASH PAID OUT													

MONTHLY CASH BUDGET EXERCISE FORM - ANSWER

	January	February	March	April	May	June	July	August	September	October	November	December	Cumulative
1. CASH ON HAND (beginning of month)	175,000	50,000	50,000	50,000	50,000	50,000	49,380	50,000	50,000	50,000	257,970	173,010	175,000
PLUS													
2. CASH RECEIPTS													
(a) Cash Sales	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	840,000
(b) Collection from Accounts Receivables	60,000	60,000	75,000	90,000	95,000	130,000	450,000	450,000	550,000	550,000	200,000	180,000	2,890,000
(c) Other Cash Income													0
3. TOTAL CASH RECEIPTS (total 2 (a) through 2(c)	130,000	130,000	145,000	160,000	165,000	200,000	520,000	520,000	620,000	620,000	270,000	250,000	3,730,000
4. TOTAL CASH AVAILABLE (before cash paid out) [1+3]	305,000	180,000	195,000	210,000	215,000	250,000	569,380	570,000	670,000	670,000	527,970	423,010	3,905,000
5. CASH PAID OUT													
(a) Purchases (inventory/stock)	7,500	7,500	10,000	12,500	19,000	25,000	30,000	30,000	30,000	12,500	12,500	12,500	209,000
(b) Wages (exclude owner's withdrawal)	80,000	80,000	80,000	80,000	160,000	160,000	160,000	160,000	160,000	80,000	80,000	80,000	1,360,000
(c) Payroll Expenses (taxes, benefits, etc.)	25,600	25,600	25,600	25,600	51,200	51,200	51,200	51,200	51,200	25,600	25,600	25,600	435,200
(d) Taxes (federal, state estimated, real estate, etc.)													
(e) Rent/Mortgage	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	240,000
(f) Utilities	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	42,000
(g) Maintenance and Repairs													
(h) Other administrative (phone, supplies, and etc.)													
(i) Insurance	54,000												54,000
(j) Interest Expense (existing loans)	2,110	2,040	1,960	1,890	1,810	1,740	1,660	1,590	1,510	1,440	1,360	1,290	20,400
(k) Loan Principal payment (existing loan)	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	90,000
(l) Legal and Accounting fees					12,500								12,500
(m) Advertising and Promotion	2,000	2,000	3,000	3,000	4,500	6,000	7,500	8,000	5,000	5,000	2,000	2,000	50,000
(n) Travel	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500	90,000
(o) Capital Expenditures					70,000						120,000		190,000
(p) Owner's withdrawal/Salary (including tax payment)	75,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000	900,000
(q) Other													0
6. TOTAL CASH PAID OUT (total 5 (a) through 5 (q)	284,710	230,640	234,060	236,490	432,510	357,440	363,860	364,290	361,210	238,040	354,960	234,890	3,693,100
7. CASH SURPLUS (DEFICIT) (4 minus 6)	20,290	-50,640	-39,060	-26,490	-217,510	-107,440	205,520	205,710	308,790	431,960	173,010	188,120	211,900
8. BORROWINGS (new loans)	29,820	100,870	90,380	78,440	270,078	161,700							732,370
9. LOAN PRINCIPAL PAYMENTS (new loans)	0						-150,590	- 151,920	-256,520	-173,340			-732,370
10. TOTAL PRINCIPAL OUTSTANDING (new loans)	29,820	131,070	221,450	299,890	570,670	732,370	581,780	429,860	173,340	0	0	0	
11. INTEREST EXPENSE (new loans)	110	600	1,320	1,960	3,260	4,890	4,930	3,790	2,260	650	0	0	23,780
12. CASH ON HAND (end of month)	50,000	50,000	50,000	50,000	50,000	49,380	50,000	50,000	50,000	257,970	173,010	188,120	188,120
TOTAL CASH AVAILABLE/ TOTAL CASH PAID OUT	1.07	0.78	0.83	0.89	0.5	0.7	1.56	1.56	1.85	2.81	1.49	1.80	1.06

HANDOUT 1 - MONITORING EXERCISE – WARNING SIGNS

- Discuss possible reasons for the issues mentioned below.
- Should you be concerned?
- What do you do in such a case?

1. New borrower has not made first payment – is now one week late.

2. Company's loan was for 10 new sewing machines. So far, money for only five machines was disbursed.

3. You receive the quarterly financial statements on a borrower and find out that Accounts receivable turnover period has doubled from previous statements – from 30 days to 60 days.

4. You have called 3 times to make appointment for a site visit, but can not reach the borrower.

5. Through the grapevine, you hear the owner and her husband are getting a divorce.

6. When you visit the company, you find out that one of the shareholders is out of the business.

7. You do a monitoring site visit and it appears that the company has much more inventory in stock than reported on the financial statement.

8. You gave the company a line of credit 8 months ago, his account balance is drawn all the time full amount.

HANDOUT 1 - MONITORING EXERCISE – WARNING SIGNS - ANSWERS

- Discuss possible reasons for the issues mentioned below.
- Should you be concerned?
- What do you do in such a case?

1. New borrower has not made first payment – is now one week late.

Client forgot. He is short of cash.
Client is a fraud.

Solution:
Call the client, Go and see the business.

2. Company's loan was for 10 new sewing machines. So far, money for only five machines was disbursed.

Client still waits for equipment delivery. Client is in trouble, shrinks his operations.

Solution:
Go and see if the 5 new machines are in use.

3. You receive the quarterly financial statements on a borrower and find out that Accounts receivable turnover period has doubled from previous statements – from 30 days to 60 days.

Client has problematic customer, cannot collect on time. Client gave better conditions to the customers.

Solution:
Ask the client for current accounts receivable list and aging schedule.

4. You have called 3 times to make appointment for a site visit, but can not reach the borrower.

Client on vacation. Client in trouble does not want to be reached.

Solution:
Do a surprise site visit.

5. Through the grapevine, you hear the owner and her husband are getting a divorce.

If the husband plays a role in the business, it can hurt it.

Solution:
Try to verify this information from some other source. Call the client to see, how she is doing. Check regularly the repayments to catch problem as soon as possible. Check the ownership of the collateral.

6. When you visit the company, you find out that one of the shareholders is out of the business.

Was there a fight? What is the reason for the shareholder exiting the business?

Solution:
Check to see who took over the shareholders responsibilities in the business? Is there going to be a payout in cash? How much, when, or over what time period? What is the plan for the future?

7. You have a monitoring site visit and it appears that the company has much more inventory in stock than reported on the financial statement.

Statements period do not need to correspond to the time of the site visit. Is it a seasonal business? Statements can be unrealistic to show lower profits and pay less tax. Could be improper and unreliable accounting.

Solution:
Check the inventory and its saleability. Warn the client to keep accounting in order.

8. You gave the company a line of credit 8 months ago, the company account balance is fully drawn.

Client could be using the short-term debt (for working capital) to cover long-term need (investment).

Solution:
Check the use of funds. Talk to the client and warn about the danger of using a short -term loan incorrectly.

HANDOUT 2 - MONITORING EXERCISE – DEFINITIONS

Measurement and Management of Delinquency

Find the correct definitions for the following terms

TERM	DEFINITION
1. Problem loan	A. The outstanding balance of all overdue loans divided into age categories by how many days the payment is overdue; typically <30 days, 30-60 days, 60-90 days, and 90+ days
2. Delinquent loan	B. The cumulative amount of loan loss provisions (recorded as an expense on the profit and loss) minus loan write-offs; generally recorded on the balance sheet as a negative asset.
3. Portfolio at risk	C. The rate of return on the portfolio, calculated by dividing interest & fee income by average portfolio outstanding.
4. Aging of portfolio outstanding	D. A loan on which the borrower fails to make a payment when it is due or to meet other terms and conditions of the promissory note.
5. Portfolio yield	E. The outstanding balance of all loans having an amount overdue. In distinction to arrears, this ratio includes the amount in arrears plus the remaining outstanding balance of the loan.
6. Loan loss reserve	F. A loan in which the condition of the business or the borrower's personal conditions have changed for the worse such that the borrower's ability or willingness to repay is threatened.

HANDOUT 2 - MONITORING EXERCISE – DEFINITIONS - ANSWERS

Measurement and Management of Delinquency

Find the correct definitions for the following terms

TERM	**DEFINITION**
1. Problem loan	A. The outstanding balance of all overdue loans divided into age categories by how many days the payment is overdue; typically <30 days, 30-60 days, 60-90 days, and 90+ days
2. Delinquent loan	B. The cumulative amount of loan loss provisions (recorded as an expense on the profit and loss) minus loan write-offs; generally recorded on the balance sheet as a negative asset.
3. Portfolio at risk	C. The rate of return on the portfolio, calculated by dividing interest & fee income by average portfolio outstanding.
4. Aging of portfolio outstanding	D. A loan on which the borrower fails to make a payment when it is due or to meet other terms and conditions of the promissory note.
5. Portfolio yield	E. The outstanding balance of all loans having an amount overdue. In distinction to arrears, this ratio includes the amount in arrears plus the remaining outstanding balance of the loan.
6. Loan loss reserve	F. A loan in which the condition of the business or the borrower's personal conditions have changed for the worse such that the borrower's ability or willingness to repay is threatened.

1—F; 2—D; 3—E; 4—A; 5—C; 6--B

HANDOUT 3 – PROBLEM LOAN EXERCISE – IMPACT

Financial impact of Problem Loan Exercise

You are assessing a loan with the following characteristics:

Loan amount: 50 million
Interest Rate: 20% per annum
Loan term: 12 months (regular monthly installments)

Assume that this becomes a problem loan. After making only 5 full payments, the borrower has fled the country. If the cost per loan for the bank is estimated at 50,000, please calculate the following:

1. Lost interest income:
2. Lost principal:
3. Net revenue per loan (when there are no delinquencies or defaults):
4. Number of new loans required to earn the lost principal and interest:

HANDOUT 3 – PROBLEM LOAN EXERCISE – IMPACT - ANSWERS

Financial impact of Problem Loan Exercise

You are assessing a loan with the following characteristics:

Loan amount: 50 million
Interest Rate: 20% per annum (simple interest)
Loan term: 12 months (regular monthly installments)

Assume that this becomes a problem loan. After making only 5 full payments, the borrower has fled the country. If the cost per loan for the bank is estimated at 5,000,000, the principal paid is 50,000,000/12*5= 20,833,333, and interest paid is 0.20* 50,000,000/12*5=4,166,667. Please calculate the following:

1. Lost interest income:

(50,000,000*.20)—4,166,667 = 5,833,333

2. Lost principal:

50,000,000—20,833,333 = 29,166,667

3. Net revenue per loan (when there are no delinquencies or defaults):

10,000,000 (total interest income) – 5,000,000 (cost of loan) = 5,000,000 (when there are no delinquencies or defaults)

4. Number of new loans required to earn the lost principal and interest:

(29,166,667 + 5,833,333) / 5,000,000 = 35,000,000 / 5,000,000 = 7 loans

HANDOUT 4 – PORTFOLIO MANAGEMENT EXERCISE – PRIORITIES

Discuss how you would prioritize the 10 actions that you need to complete and explain WHY.

1. Application returned incomplete, you have called 3 times to get updates.

2. Applicant needs help to completing the cash flow.

3. Loan is being disbursed today to begin reconstruction.

4. Client wants to know how much he has to pay to close out the loan today. He wants to take the loan at a different bank.

5. Loan disbursed 8 months ago and the client is 2 days late with a payment.

6. Client wants you to come try a new appetizer she is introducing at her restaurant. Your last visit was a year ago.

7. Application is complete but you just received a negative reference and the client is calling 3 times a day.

8. Cold call from an auto leasing company. Wants to know about loan products.

9. Friend of the branch manager who wants to borrow money to begin a small casino.

10. A former client requests a second loan for expanding his business to a second location.

HANDOUT 4 – PORTFOLIO MANAGEMENT EXERCISE – PRIORITIES - ANSWERS

Discuss how you would prioritize the 10 actions that you need to complete and explain WHY.

1. Application returned incomplete, you have called 3 times to get updates. **(9)**
2. Applicant needs help to completing the cash flow. **(6)**
3. Loan is being disbursed today to begin reconstruction. **(5)**
4. Client wants to know how much he has to pay to close out the loan today. He wants to take the loan at a different bank. **(2)**
5. Loan disbursed 8 months ago and the client is 2 days late with a payment. **(1)**
6. Client wants you to come try a new appetizer she is introducing at her restaurant. Your last visit was a year ago. **(3)**
7. Application is complete but you just received a negative reference and the client is calling 3 times a day. **(8)**
8. Cold call from an auto leasing company. Wants to know about loan products. **(7)**
9. Friend of the branch manager who wants to borrow money to begin a small casino. **(10)**
10. A former client requests a second loan for expanding his business to a second location. **(4)**

PROBLEM LOAN MANAGEMENT TEST

1. Please define creditworthiness.

2. A problem loan is a loan to a company that is not being repaid as agreed or to a company that has financial problems.

   True ___________ False___________

3. Workout is the term which is used to describe the uncooperative and forced agreement between the borrower and lender to establish a framework for repayment of indebtedness.

   True___________ False ____________

4. The slash and burn approach of immediately liquidating assets is often the best way of producing the maximum loan recovery.

   True___________ False _______________

5. Please complete the following sentence: Business risks results in the shrinkage in the

   a. Liabilities of the company
   b. Expense of the company
   c. Equity of the company
   d. Sales/ Revenues of the company
   e. Book value of the assets of the company

6. Which company will have the shortest ACC between a trading company of copper ore or a manufacturer of copper products?

7. Optimally, covenants should be used to ____________.
   a. Punish a company for not meeting its projections
   b. Provide an early warning to the lender of potential problem
   c. Inform the lender that the borrower has violated the agreement
   d. Indicate that the company is nearing bankruptcy
   e. All of the above

8. Covenants should be set based on which set of projection scenarios?
   a. Best case
   b. Most likely case
   c. Worse case

9. In conducting sensitivity analysis on projection, the best case scenario should come from the lender after careful review and discussion with the borrower.
   a. True
   b. False

10. Credit Risk is defined as the risk that a loan will either not be paid or will not be paid on time.
    a. True
    b. False

11. In the credit process, what element of the process is critical for keeping the loan on track following disbursement?
    a. Evaluation
    b. Loan approval
    c. Loan Workout
    d. Monitoring
    e. All of the above

12. Return on Equity is defined as:
    a. NPAT / Liabilities
    b. NW / NPAT
    c. NPAT / Sales
    d. NPAT/ Total Assets-Liabilities
    e. NPAT / Dividends

13. ROS (Return on Sales) measures a company's?
    a. Asset management
    b. Liability management
    c. Efficiency
    d. Leverage
    e. Profitability

14. Working Investment is __________.
    a. Current Assets – Current Liabilities
    b. Current Assets -- Total Liabilities
    c. Cash + Account Receivables – Current Liabilities
    d. (Accounts Receivable + Inventory) – (Accounts Payable + Accrued Expenses}
    e. Total Assets – Total Liabilities

15. What kind of lending facility would you use to structure the financing of a delivery truck by a commodity company?
    a. Line of credit
    b. Letter of Credit
    c. Term loan
    d. Short term note payable
    e. None of the above

16. What is the best way of detecting a problem loan, circle all that apply.
    a. Discussion with the borrower
    b. Annual report
    c. Quarterly report
    d. Suppliers to the borrower
    e. Rumor heard on the grape vine

17. Problem loans can be caused by which three general factors?

18. Please name the three stages of cash crisis.

19. The primary objective of the game plan is to obtain the maximum recovery warranted by the situation. For who is the game plan developed?
    a. Borrower
    b. Suppliers
    c. Customer
    d. Lender
    e. No one in particular

20. The breakeven point is the point where sales equal expenses resulting in 0 profits.

    True ____________ False ____________

21. As a lender assessing a problem loan what area will be the primary focus of your analysis?
    a. Profits
    b. Sales
    c. Cost of Goods Sold
    d. Cash Flow
    e. Working Capital

22. On the cash flow statement, net cash from operations represents the cash flow generated from the core operations of the borrowers business.

    True ____________ False ______________

23. Name at least four (4) key preliminary loan restructuring considerations for the lender.

24. In South Africa, it is easier to perfect a mortgage on immovable property than a lien on moveable property.

    True _____________ False _____________________

25. You can have a lien on very high quality assets of a borrower, but it won't do you any good unless:
    a. The lien is perfected properly.
    b. The lien specifies which assets comprise the collateral.
    c. The relationship manager monitors the borrower and the collateral carefully.
    d. The borrower is trustworthy.
    e. All of the above.