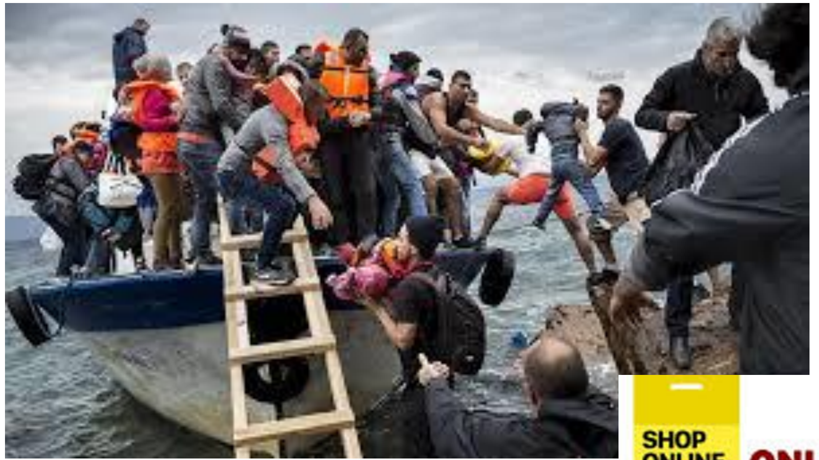
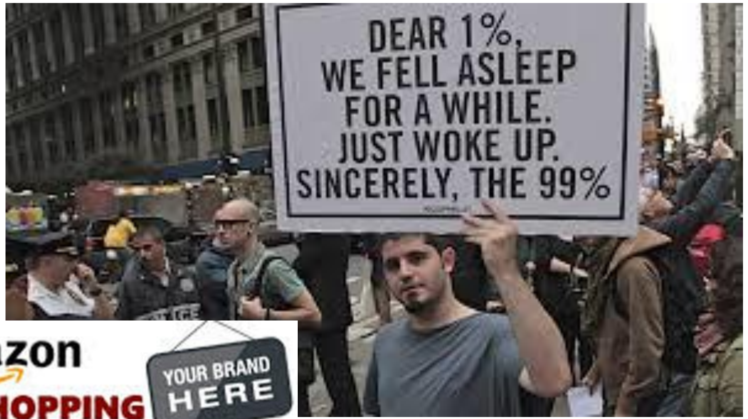
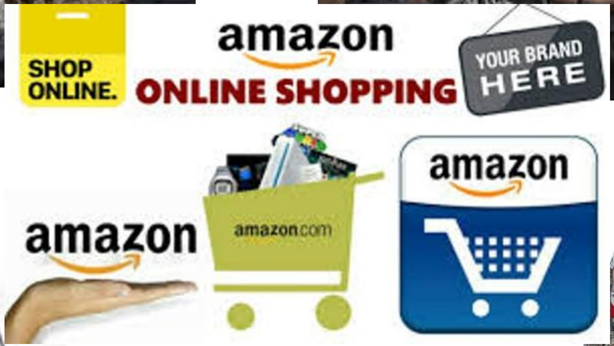
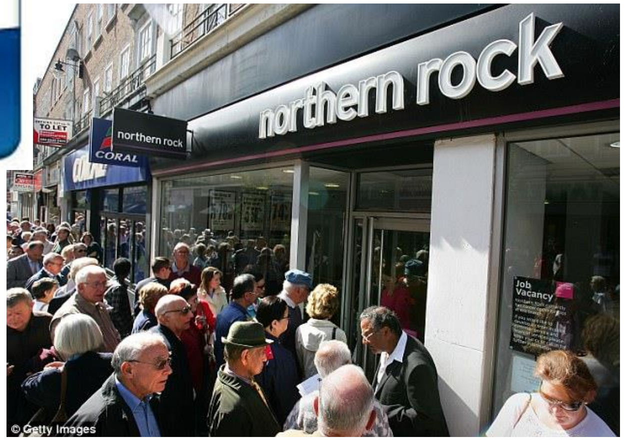
Part 1: Corporate Credit Analysis at a time of disruption:
The world is changing. And it's changing fast…









… and this level of disruption impacts all aspects of our society …

Our generation has seen change on a scale and at a speed which we've never seen before.

- ***Technological change***
- ***Political disruption***
- ***Major movement of people***
- ***Questioning institutions we used to revere***
- ***Social changes***

Starting with the onset of the Global Financial Crisis, we have reached a point when the scale and speed of changes is a revolution.

How we work is changing

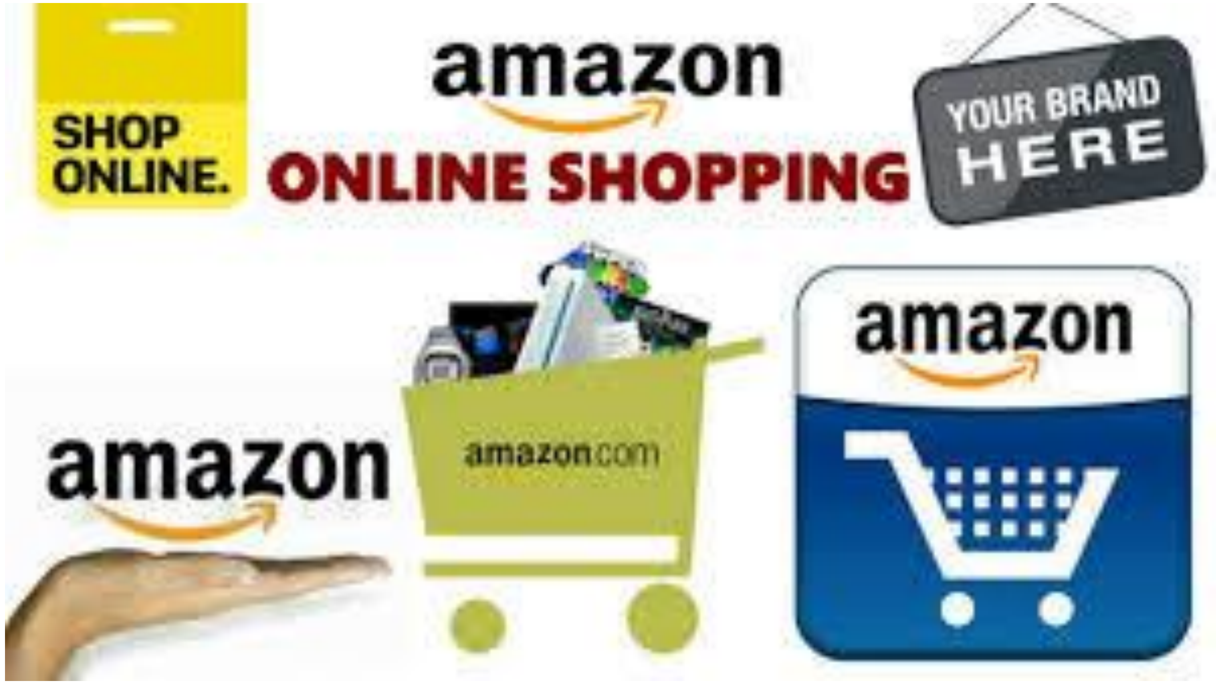
From this…

… to this

Where and how we shop is changing

From this…

… to this



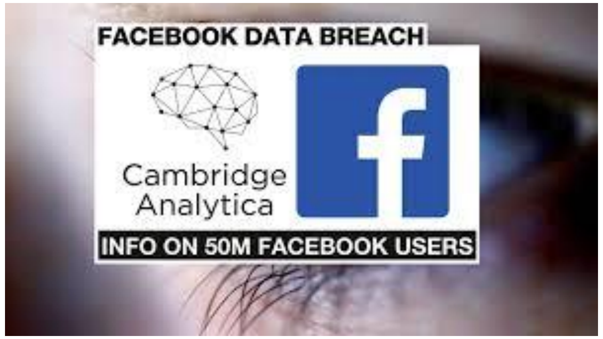
Our sources of electricity are changing

From this… *… to this*

What does this mean for businesses?

- In the business world, the institutions which will remain and prosper will be those which learn to **thrive** and **continuously innovate** in an environment of more than usual uncertainty.

- They will need to pay attention to **promoting ethical and socially acceptable values**, and realise the absolute necessity of maintaining a reputation as a responsible corporate citizen



What does this mean in terms of Corporate Credit Analysis?

The pace of change affecting businesses creates both opportunities and risks.

Traditional corporate credit analysis techniques were developed at a time where change was more gradual.

The techniques can still be used but **analysis has to become more rigorous** in a fast moving business environment, **with a greater emphasis on the evaluation of a company's business model and corporate culture and management's ability and flexibility to adapt to change.**

To effectively structure & price credit decisions, we need to consider & re-evaluate the issues in 6 key themes…

1. Business Environment

2. Financial Statements

3. Capital Structure

4. Forecasting

5. Documentation, pricing and ranking of creditors

6. Problem credits

Theme 1: What will be the impact of the business environment?

There will be a need to give more attention to evaluating a company's business model , corporate culture and management's ability to adapt to disruptive change.

Business Environment

- **Macroeconomic, political and regulatory issues**
- **Industry dynamics**
- **The financial markets**
- **Social, demographic, technological and environmental trends**
- **Operational Risks and risk assessment and management**
- **Management and Corporate Governance**

Theme 2: What is the company's financial performance?

More attention will need to be given to companies' cashflow, particularly in industries where there is a tendency to work on the basis of rapidly building revenues and assuming cash deficits will be met by additional financing.

Financial Statements

- **Accounting Policies**
- **Ratio Analysis**
- **Cash Flow Analysis**
- **Off Balance Sheet Finance**
- **Consolidation**

Theme 3: What is the company's capital structure ?

Companies should be operating with less aggressive capital structures. Mathematically, debt may be cheaper than equity as a source of capital but this needs to be viewed in the context of a less predictable business environment and therefore more equity may be needed to provide financial flexibility.

Financial Statements

- **Interest, currency and commodity price exposures and hedging policy**
- **Capital structure policy – debt vs equity**
- **Liquidity and access to finance**
- **Off Balance Sheet Finance - joint ventures and guarantees, use of Structured Finance, derivative exposure**

Theme 4: What does the future hold?

Forecasts will need to be more cautious, particularly in businesses where disruptive change is likely.

Forecasting

- **Key assumptions?**
- **Cash needs**
- **Key financial drivers**
- **Proposed capital structure**

Theme 5: Is pricing reflective of the risk and Intercreditor issues?

Debt pricing should reflect increased risk. It needs to be recognised that traditional forms of collateral such as Real Estate may not be available for asset light, service related businesses.

Documentation, pricing and ranking of creditors

- **Security and ranking of creditors**
- **Pricing (to reflect RAROC and indicators of a company's risk such as bonds and a company's share price performance)**
- **Covenants**

Theme 6: What happens if the company faces problems?

Given the changed business environment debt default rates may be higher and recovery rates lower than in previous business cycles

Problem credits

- **Reasons for problems**
- **Exposure to the company**
- **Intercreditor issues**
- **Restructuring options**
- **Potential losses given default**

What's next?

In the next presentation I will be highlighting some qualitative issues that need to considered as part of a corporate credit analysis.

In the meantime, should you wish to contact me, I can be contacted on malcolm@m-training.co.uk or check out my website at:

www.m-training.co.uk