

ICBC SOFT SIDE OF CREDIT

Learn essential concepts for effective commercial credit supervision

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WORKSHOP PURPOSE AND COMMERCIAL CREDIT FOUNDATIONS

- Structured Credit Framework
 - Workshop provides a repeatable framework to evaluate risk and structure transactions in all commercial lending environments.
- Core Pillars of Commercial Credit
 - Comprehensive review of the Five Cs of credit and their role throughout loan lifecycle from prospecting to monitoring.
 - Conditions, Character, Capital, Capacity, Collateral
- Qualitative and Quantitative Analysis
 - Emphasis on combining financial data with borrower intent and business context for comprehensive credit judgment.
- Risk Management and Relationship Building
 - Focus on consistency, documentation, and understanding macroeconomic and industry influences for sustainable lending.

COMMERCIAL LOAN INTERVIEW PROCESS AND INITIAL ASSESSMENT

- Initial Assessment and Goals

- Begin by understanding borrower's goals, motivations, and risk profile before reviewing financials.

- Site Visit Importance

- Conduct physical tour to observe operations, equipment condition, and asset validation early in process.

- Financial Review and Documentation

- Review financial trends, leverage, liquidity, and request comprehensive documents to ensure thorough analysis.

- Consideration of Economic Context

- Account for industry and economic conditions that may impact financial results and credit risk.

COMMERCIAL LOAN INTERVIEW PROCESS AND INITIAL ASSESSMENT

- Initial Assessment and Goals

- Begin by understanding borrower's goals, motivations, and risk profile.
 - The initial aspect of the lending process must be a complete understanding of the borrowers, guarantors and related interests
 - What is their appetite for risk
 - Short and long term plans
 - Who is driving the bus
 - How do they make decisions (ownership percentages, operating agreements 50/50)
 - Evaluation of related interests
 - Evaluation of expertise and experience

COMMERCIAL LOAN INTERVIEW PROCESS AND INITIAL ASSESSMENT

•Initial Assessment and Goals

- How to review the financial profile of the borrower and guarantors.
 - Review the provided financial statements line by line
 - Ask if there have been any changes since the date of the financial statement
 - Ask questions about current status and contemplated endeavors
 - Keep in mind you are looking for possible risk elevation situations, assets or liabilities contingent and direct
 - Make sure all borrowers, guarantors and related interests are examined

THE CULMINATION OF THIS PROCESS SHOULD IDENTIFY ALL DOCUMENTATION NEEDED TO PROPERLY UNDERWRITE THE LOAN

IDENTIFYING ELEVATED RISK AND RELATED INTERESTS

Hidden Risks from Related Interests

Lenders must examine affiliated companies and personal investments for potential hidden financial exposure and distress.

Evaluating Management Risk Appetite

Assessing borrower's willingness to take risks helps predict aggressive growth, leverage, or acquisitions behavior.

Identifying Concentration and Regulatory Risks

Risks may arise from customer concentration, supplier dependency, and industry-specific regulatory exposures.

Risk Mitigation Strategies

Early risk identification enables the Bank to proactively address the risk change to determine remedial measures or contemplate a viable exit strategy.

CONDITIONS: ECONOMIC, INDUSTRY, AND MANAGEMENT ENVIRONMENT

- Macroeconomic Influences

- Interest rates, inflation, and commodity price volatility impact borrower performance and risk levels.

- Industry Competition

- Competitive pressures and barriers to entry shape pricing power and long-term viability in cyclic markets.

- Management Depth and Succession

- Strong management teams and effective succession planning reduce operational risks and ensure business continuity.

- Regulatory and Environmental Factors

- Regulations, environmental concerns, and technology shifts influence risk profiles and credit assessments.

CAPITAL: STRUCTURE, SOURCES, AND ADEQUACY

LENDER OR PARTNER?

Understanding Capital Sources

- Internal capital sources
- External capital sources
- What is not a capital resource

Assessing Capital Adequacy

- Adequacy of capital is a function of the bigger picture of the borrower, guarantors and related interests

Impact of Capital Transactions

- Capital extractions like distributions or acquisitions can weaken financial position if not structured properly.

Importance of Strong Capital Position

- Strong capital aligns borrower-lender incentives and ensures resilience during financial stress.

CAPACITY: CASH FLOW, REPAYMENT, AND STRESS TESTING

- Repayment Capacity Analysis

- Evaluate borrower's ability to repay debt using historical data and future cash flow projections under reasonable assumptions.

- Financial Metrics and Risk

- Analyze profitability, leverage, liquidity, and concentration risk to identify potential financial vulnerabilities in the borrower's profile.

- Stress Testing Cash Flow

- Simulate adverse scenarios like price declines or cost increases to assess resilience and ensure adequate margin of safety

PREDICTING THE FUTURE WITH DATA FROM THE PAST!

CHARACTER: MANAGEMENT INTEGRITY AND CREDIT CULTURE

- Importance of Character

- Character reflects borrower's integrity, reliability, and commitment essential for credit judgment.

- Evaluating Management Behavior

- Reviewing borrower's history with creditors and transparency reveals management discipline and reliability.

- Impact on Credit Decisions

- Strong character improves confidence and influences credit outcomes, especially during financial stress.

COLLATERAL: SUPPORT, STRUCTURE, AND VALUATION

- Collateral's Supporting Role

- Collateral provides secondary repayment sources and strengthens borrower commitment beyond cash flow.

- Marketability and Valuation

- Lenders assess collateral marketability and rely on accurate valuations to ensure realistic coverage in volatile markets.

- Physical Inspection Importance

- Physical inspection verifies collateral existence and condition, reducing reliance on paper documentation.

- Balanced Credit Underwriting

- Effective collateral analysis balances protection with prudent underwriting and does not replace credit fundamentals.

COLLATERAL: SUPPORT, STRUCTURE, AND VALUATION

Collateral valuation considerations

- Quality of comps
- Proximity of comps
- Component valuation
- Appraisal approaches utilized
 - Cost approach
 - Sales comparison approach
 - Income approach

Business value versus real estate value (Value in use)

CAP rates

COLLATERAL: SUPPORT, STRUCTURE, AND VALUATION

Collateral valuation considerations

- Economic conditions and their impact on value

Chattel collateral value in liquidation

- Initial and periodic inspection
- Blanket liens
- Purchase money how to perfect

Collateral that needs to eat and can die

COLLATERAL: SUPPORT, STRUCTURE, AND VALUATION

Loan Structure does it matter

Loan Covenants meaningful or window dressing

- Quarterly financials
- Quarterly A/R aging
- Annual financials

Lending is substituting current cash needed for cash to be received over a future time frame

- Match the term to the cash flow stream
- Match the term to the collateral replacement period

You are structuring your workout plan at inception consider this is in your structure