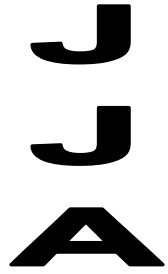


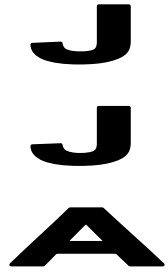
Commercial Credit Overview

Role of Financial Institutions and
Commercial Credit



Financial Institutions and Credit

- Financial Institutions
 - Core Business
 - Role in the Economy
- Institution Risk Management
 - Marketplace Factors Impacting Institution
 - Institution's Response to Marketplace Factors
- Commercial Credit and the Institution
 - Role and Activities
 - Role of Information



What We Do

- *Products:*
 - ➔ Money
 - ➔ Information
- *Delivery* ➔ *Commodity Activity*
- *Core Business* ➔ [*Prudent **RISK***]

What We Do

- *Exist To Fulfill Dreams*
- *Bank Product/Service → Money/Information*
 - *Convenience (Facilitate Payments)*
 - *Wealth Management*
 - *Build Wealth (Investments)*
 - *Protect Wealth (Insurance)*
 - *Credit (Replace Borrower's Cash Shortfall)*

Risk Generators

- Marketplace Factors Impacting the Institution
- Institution's Response to Marketplace Factors

Marketplace Factors

- External → No Control, But Can Manage if Aware of Issues (Opportunity/Threat)
 - Marketplace Driven by the “Dumbest Competitor”
 - Increasing Competition
 - Economy

Response to Marketplace

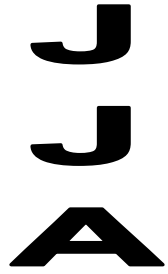
- Internal → Resources Available/Needed to Respond to Marketplace Factors (Strength/Weakness)
 - Process → What Needs to be Done to Manage Risk?
 - Systems → How Will Risks Be Managed?
 - People → Who Will Manage the Risks?

Role of Commercial Credit

- Two-edged Sword
 - Primary Source of Revenue Generation
 - Primary Source of Risk to Institution
- Role of Credit
 - Consumer=Individual (Compliance)
 - Commercial=Entity (Legal)

Credit Risk Overview

- ***Credit Risk = $P \times C$***
 - ***Probability*** → Events that will impact repayment
 - *Credit Action* → *Analysis*
 - *Activity* → *Identify Risks*
 - ***Consequences*** → Events Not Occurring as Expected
 - *Credit Action* → *Structure*
 - *Activity* → *Mitigate Risks Being Taken*

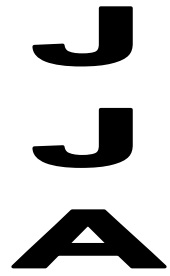


Commercial Credit Assessment

- *Commercial Credit* → Financing the Borrower's ***“Cash Shortfall” (CAUSE)***
- *Commercial Loan* → Finance a ***Self-liquidating Asset (REPAYMENT SOURCE)***
- *Properly Managed Credit ALIGNS the Cause with the Repayment Source*
- *Key focus is on “Getting the Cash Back!”*

How We Do It

- ***Credit → Financing the Borrower's Cash Shortfall***
 - Where/Why/What for ***Cause*** of Cash Shortfall
 - Events Necessary to Generate ***Cash for Repayment***
- General Approaches to Credit Decisions
 - ***Character*** → “How Long Have You Lived in the County?”
 - ***Collateral*** → “What’s It All Worth?”
 - ***Credit Scoring*** → “How Have You Been Behaving?”
 - ***Cash Flow*** → ***Borrower Behaviors!***



Behaviors → Cash Drivers

- (IS) Sales
- (BS) Inventory DOH
- (BS) Accounts Receivable DOH
- (BS) Accounts Payable DOH
- (IS) Gross Margin
- (IS) Operating Expense as % of Sales
- (BS) Capital Expenditures

Cash Outcomes

- *Uses (Cash Outflows)*
 - *Increase Assets* ➔
 - *Decrease Liabilities* ➔
 - *Decrease Equity* ➔
- *Sources (Cash Inflows)*
 - *Debt* ➔
 - *Equity* ➔

Credit Risk Assessment

- ***Financial Analysis → Quantitative Analysis***
 - *Involves “Numbers”*
 - *Obtain Multi-year Data → Perform Trending → Identify Change*
 - *Generates “Questions” → Start Point for Credit Analysis*
 - *Key Tool to Perform Credit Analysis*
- ***Credit Analysis → Qualitative Analysis***
 - *Involves “Events”*
 - *Generates “Explanation” of Reason/Impact of Change (“Risks”)*
 - *Used to Understand Issues Impacting Repayment (Borrower’s Response to Marketplace Factors Impacting Business)*
 - *Key Tool to ANTICIPATING THE FUTURE*
[GET THE CASH BACK!!!!]

Key Credit Concepts

- *No One Ever Makes a Loan Decision; Every Decision Is a **Portfolio Decision**.*
- *You aren't paid to make a loan; you are paid to manage credit risk!*
- *Focus of Analysis on “Anticipating the Future”*

Risk Assessment

*No One Ever Makes a
Loan Decision; Every
Decision Is a Portfolio
Decision.*

Portfolio Risk

- Results from Institution's Response to Marketplace in the Future *[SWOT]*
- Driven by Credit Policy
 - Communicates Institution's Business Plan for Credit Products
 - Sets Expectations for Personnel Behaviors
- Occurs at Several Levels

Risk Assessment

*You aren't paid to
make a loan; you are
paid to manage credit
risk!*

Credit Risk Management

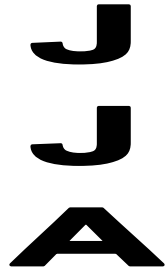
- Credit Risk = $P \times C$
 - Probability → *Identify Risks* → *Analysis*
 - Financial → Identity Change → Generates Questions
 - Credit → Explain Events → Anticipate the Future
 - Consequences → *Mitigate Risks* → *Structure*
 - Covenants
 - Collateral
 - Documentation
 - Pricing

Credit Risk Management

- Portfolio Management → What Risks Are We Willing to Take?
- Portfolio Acquisition → How Will We Manage the Risks Taken?
- Portfolio Maintenance → What Do We Do With It Now That We Got It?

Risk Assessment

*Focus of Analysis is
on “Anticipating the
Future”*



Credit Risk Management

- Yesterday's Loan Repaid With Today's Cash; Today's Loan Repaid With Tomorrow's Cash
- Must GET THE CASH BACK!
- Must Have/Understand Activities to Increase Likelihood of Repayment
 - Strategy → Credit Policy
 - Tactics → Credit Process
 - Action → Credit Practice

Role of Information

Organized *DATA* →

Becomes *INFORMATION* →

Creates *KNOWLEDGE* →

Generates *OPPORTUNITY!*

Action Needed

- Assess Your Current Situation
 - Current Marketplace Factors
 - Current Response to Factors
- Understand Desired Results for Institution
 - Future Marketplace Factors
 - Future Response to Factors