

Methods of Corporate Risk Analysis in JBIC

September 4, 2014

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Topics of this session

1. Corporate risk
2. Risk management process
3. Corporate risk analysis techniques
4. Credit rating

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1. Corporate risk

* What is a corporate entity?

- * Private companies, Japanese or foreign
- * Non-sovereign public corporations

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1. Corporate risk

* What risks do companies face?

Automotive

- demand volatility, competition, R&D, supply-chain management

Electric

- regulation, tariff, liberalization, fuel price, temperature

Steel

- product price, raw material procurement (iron ore, coal)

Airline

- demand volatility, fuel price, war, terrorism, exchange rate

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1. Corporate risk

- * What is a corporate risk?
 - * Corporate risk for JBIC
 - * Japanese corporate entities : credit risk
 - * Foreign corporate entities : credit risk and country risk
 - * What is credit risk?
 - * Risk associated with borrower's failure to meet its financial obligations caused by weakness or deterioration of its business result

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2. Risk management process

- * Who judges corporate risk?
 - * Loan departments and Credit Department
 - * Credit Department jointly approves or disapproves loans, financial offers, etc, for corporate governance.
- * Process for risk management
 - * Credit opinions & Credit rating
 - * Monitoring, self-assessment of loan assets, revising credit ratings during whole loan term

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3. Corporate risk analysis techniques

* What aspects should be analyzed in credit opinions?

Qualitative Analysis

- Business environment
- Management
- Assessment of company's business
- Business strategy
- Tolerance of external shocks
- Regulation and protection
- Support from shareholders (including government)
- Fund raising capacity
- Information disclosure level

Quantitative Analysis

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(1) Qualitative Analysis

1. Business environment

- * Position of the industry in macro economy
- * Market scale
- * Demand and supply balance of products
- * Growth potential of the sector
 - e.g. demand trend, possibility of substitute goods
- * Pricing mechanism and pricing trend
- * Raw material and fuel price
- * Market share & market position of the company

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(1) Qualitative Analysis

2. Management

- * Management team's ability and experience
- * Corporate governance
- * Relationship with a parent company or main shareholders
- * Listed or unlisted

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(1) Qualitative Analysis

3. Assessment of company's business

- * Characteristic of products and services
e.g. added value, market fluctuation, demand seasonality
- * Strength and competitiveness
e.g. technology, cost competitiveness, development capability
- * Amount of orders and its prospect
- * Capacity Utilization of facilities
- * Production and sales structure
- * Business conditions of primary customers
- * Management issues and measures

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(1) Qualitative Analysis

4. Business strategy

- * Recognition of current situations and prospects
- * Implementation and future feasibility
- * Plan for capital investments and fund raisings

5. Tolerance of external shocks

- * Macro economic fluctuation, market fluctuation (products & raw materials), exchange rate, interest rate, etc
- * Hedging strategy, diversification

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(1) Qualitative Analysis

6. Regulation and protection

- * Regulation of pricing mechanism & new market entry
- * Legal or institutional protection
- * Subsidiary, preferential treatment

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(1) Qualitative Analysis

7. Support from shareholders (including government)

- * Relationship with shareholders
 - Trading records, financial assistance (e.g. Capital increase, loan, parent guarantee)
- * Position of parent company's group management
- * Privatization in case of state-owned enterprise

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(1) Qualitative Analysis

8. Fund raising capacity

- * Sustainability of fund raising
- * Relationship with financial institutions
- * Conditions of previous loans and bonds
 - e.g. guarantees, collaterals, covenants

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(1) Qualitative Analysis

9. Information disclosure level

- * Accounting standard
 - Difference of local standards and IFRS
- * Audited or unaudited

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(2) Quantitative Analysis

- ◆ Financial information
 - * Income statement
 - * Balance sheet
 - * Cash flow statement
 - * Off-balance-sheet items
 - e.g. derivatives, pension liabilities
 - * Financial indicators
 - e.g. EBITDA, ROA, D/E ratio, Debt to operating CF
- ◆ Historical trends (at least 5 years)
- ◆ Financial statement forecasts and stress test

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(3) Information Source

- * Publicly available source
 - Web Site, Annual report, Rating report, Articles, etc.
- * Documents from customers
 - Financial Statements, etc.
- * Questionnaire
- * Interview with corporate people

- * We strongly request customers to submit financial statements audited by an audit firm.

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(4) Securities & Covenants

- * Securities
 - * Guarantee, collateral

- * Covenants (especially in case of unsecured Loan)
 - * Financial covenants
 - e.g. D/E ratio, Debt/EBITDA, Interest coverage ratio
 - * Negative pledge
 - * Asset disposal
 - * Cross default

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4. Credit rating

- * Credit rating = Evaluation of the degree of certainty of interest and principal payments against obligation
- * All corporate customers are rated to 18 classes.
 - * Except for financial institutions and project finances
 - * 18 classes (S, AA, A1, A2, A3, BBB1, BBB2, BBB3, BB1, BB2, BB3, B1, B2, B3, C, D, E, F)
- * Quantitative scoring model and Qualitative adjustment

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4. Credit rating

- * Quantitative scoring model
 - * Repayment source
 - * Operating profit, Operating CF, Net Assets
 - * Profitability
 - * EBITDA/ Gross Assets, EBITDA/Sales
 - * Financial structure
 - * Debt/(Debt+Net Assets)
 - * Solvency
 - * Operating CF/Debt

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4. Credit rating

- * Credit rating adjustment steps
 - * Sector Adjustment
 - * Country risk ceiling adjustment
 - * Factors exceeding the country risk ceiling
 - * Parent company support factor
 - * Other factors not counted in the model
- * Final credit ratings result in the range from AA to B3.

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4. Credit rating

- * S ~ B3: “Normal”
- * C: “Needs attention”
- * D: “Needs special attention and management”
- * E: “In danger of bankruptcy”:
- * F: “De facto bankrupt” and “Bankrupt”
- * From C to F, Quantitative scoring model are not used.
- * Basically new customers are rated over B3 (at least).

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