CREDIT EVALUATION AND MANAGEMENT

26th OCTOBER - 13th NOVEMBER 1987

MONDAY 26th October

Introduction Review of Past Experience The Need for Credit Analysis	DISCUSSION GROUP CASE STUDY
Lending Framework Review of Balance Sheet Profit and Loss Fundsflow	
Understanding Operations Reflected in Financial Statements Need for Spread Sheets - Introduction to new form	PRACTICE SPREAD SHEET COMPLETION

TUESDAY 27th October

Understanding Cashflow Use of existing financials to interpret cashflow Introduction to Analysis Form Need to investigate Asset and Liability Flows	PRACTICE FORM COMPLETION

WEDNESDAY 28th October

Evaluation of Financial Statements - Cash Management Operational Non Operational - Profit ability/Operating leverage - Asset Management	SPECIMEN EVALUATION CASE

THURSDAY 29th October

Evaluation continued - Equity Sufficiency - Structural Liquidity - Gearing - Repayment Capability	SPECIMEN EVALUATION CASE

FRIDAY 30th October

Evaluation of Financial Statements	CASE STUDY PART 1

MONDAY 2nd November

Transaction Analysis Framework

- Updating the information
- Understanding the purpose and facility structuring
- Profit and cashflow projections

Interview Technique — CASE STUDY 1 PART 2

TUESDAY 3rd November

CASE STUDY 1 CONTINUED

Credit Line Proposal
Report Writing for Financial Analysis

WEDNESDAY 4th November

Interview
Analysis
Write-up — CASE STUDY 2

THURSDAY 5th November

CASE STUDY 2 CONTINUED

FRIDAY 6th November

Interview
Analysis
Write-up — CASE STUDY 3

MONDAY 9th November

CASE STUDY 3 CONTINUED

Interview
Analysis — CASE STUDY 4
Write-up

TUESDAY 10th November

CASE STUDY 4 CONTINUED

Interview
Analysis — CASE STUDY 5
Write-up

WEDNESDAY 11th November

Control in Current Asset Financing and Monitoring	CASE STUDY 5 CONTINUED

THURSDAY 12th November

	CASE STUDY 6

FRIDAY 13th November

Conclusion	CASE STUDY 6 CONTINUED

RODUCTION TO THE USE OF RATIOS IN CREDIT ASSESSMENT

The provision of a ratio is an arithmetical exercise which in itself does not yield a basis for credit assessment, either in the observance of a single ratio, or of a combination of ratios. The traditional credit assessment factors (volume factors) of capital resources, profits, liquidity, repayment and security will continue to provide the main bases for credit assessment, with ratios regarded as informative supplements.

A ratio, when seen as part of a series, is an indicator of trend for the business itself or, when seen in conjunction with the ratio for its own particular industry is an indicator of the business's efficiency vis-a-vis its competitors. For such indicators to be of use, ratios need to be presented in a standard format which is capable of consistent interpretation. In the interests of uniformity of preparation and interpretation the ratios are shown in the form of percentages, e.g. 200% rather than 2:I and 350% rather than 3.5:I.

An improvement or deterioration in any particular ratio cannot, per se, be interpreted as being a portent of good or evil, but should be heeded as an indication that it should be studied in conjunction with other ratios, volume factors and the special nature (if any) of the business under consideration.

Ratios I - 9 outlined in the following pages are those considered to give the most useful supplementary information for decision-taking in credit assessment, monitoring and trigger situations. No attempt has been made to establish a "model" ratio as this must vary in each individual case. Statistics on pages I6-I9 outline factors which are not ratios but which constitute basic information for a lender.

Plus and Minus signs accompanying the ratios in the second and third year ratio columns indicate a variance with the previous year. A plus sign should indicate an improved position from a lending banker's point of view, a minus sign a deterioration. It will still be necessary however to consider all variations by closer examination of each ratio and the causes for the change.

It must be stressed that the following ratios are calculated by the computer from the actual balance sheet and profit and loss account figures as per the "print out" and ignore completely Contingent Liabilities, Leasing commitments and Reservation of Title. Where these items are significant, due regard should be given to the ability of the customer to provide for these commitments.

RATIO 1

OVERALL PROFITABILITY

$$\frac{\text{PRE-TAX PROFITS}}{\text{NET CAPITAL RESOURCES}}$$

A lender must, at all times, look to profitability as either:-

(a) a source of repayment of his lending, or

(b) a safety factor justifying the continuity of his lending.

An investor's or a business man's interpretation of a return on capital may be the maximisation of profitability in relation to the minimum utilisation of capital resources, but it will be seen that it behoves the lender to add a rider that those capital resources (and/or borrowings) must be capable of increase should the necessity arise.

"Pre-tax profits" is defined as net earnings after all charges but before tax, dividend and appropriations.

"Net capital resources" is defined as share capital, reserves, profit and loss account and that part of deferred taxation which is not considered to be an imminent liability, but after deduction of goodwill and other intangibles.

This ratio:-

(1) measures the return on capital and therefore the historical efficiency of the company's management;

(2) shows the volatility of a company's record;

(3) indicates the efficiency of that particular company against the industrial average where this is known;

(4) provides an indication as to whether profitability is keeping pace with inflation;

(5) indicates in conjunction with ratios 3 and 9 certain situations involving high gearing wherein a lender could be justified in backing a company beyond the normal gearing ratio in the knowledge of a profit level that will service and repay the borrowing.

It is a shortcoming of this ratio that the Net Capital Resources comprise balance sheet values and the value of the underlying assets may not be realistically indicated.

This ratio cannot be considered in isolation but in conjunction with gearing and volume factors.

RATIO 2

LIQUIDITY — $\dfrac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$

The study of the relationship between current assets and current liabilities (in conjunction with the acid test - see Ratio 4) is of paramount importance in indicating:-

(a) liquidity;

(b) the ability of the company to sustain and absorb losses without pressure on liquidity;

(c) the ability of the company to build up its liquidity for the purpose of meeting debt maturities in due course;

(d) the capability of the company to enter into capital expenditure programmes.

The shortcomings of this ratio are that there are no overall standards against which to measure, and the true nature of the stock and work in progress content will have a material bearing upon the company's liquidity. A high liquidity ratio may be indicative of inefficient management which is not making the best use of the company's assets.

With a surplus of current assets over current liabilities i.e. a ratio in excess of 100%, an indication of liquidity is given. Ideally this should be sufficient to finance the day-to-day transactions involved in running the business. No two businesses are, however, exactly alike and it is not possible to say in any given set of circumstances that a liquid surplus of £x is sufficient to finance £y of turnover. Different production/selling cycles, terms of trade etc. will lead to different results.

In any established set of circumstances the up to date working of the account, as shown by the M & M forms, may provide an indication of more recent trends.

It is also necessary to consider the effect on the liquid surplus if proposed bank lending is agreed. Will there still be sufficient surplus available to finance the required level of turnover? This will of course depend on the purpose for which our lending is required i.e. for the purchase of fixed assets or for working capital. The ratio can also highlight the potential that may exist for switching the borrowing or a portion thereof to Medium Term Loan lending.

RATIO 3

GEARING

TOTAL BALANCE SHEET BORROWINGS
NET CAPITAL RESOURCES

It is necessary to define at the outset both these terms. Borrowings are interpreted as all borrowed funds (bank, mortgage, debenture, loan stock etc. but excluding hire purchase) outstanding at the balance sheet date. This definition may need to be expanded to include Leasing and Hire Purchase commitments in view of pending possible requirements in the audited presentation of these items. Net capital resources is the accepted formula of share capital, reserves, profit and loss account and that part of deferred taxation which is not considered to be an imminent liability, but after deduction of goodwill and other intangibles.

The ratio is an indication of:-

(a) capital sufficiency or insufficiency;

(b) the extent to which a customer relies upon borrowed funds;

(c) the extent to which further funds could be raised.

It is generally accepted by text book definition that this ratio should not exceed 100%, but the ratio itself either above or below that figure will vary from company to company and from industry to industry. The higher the gearing the more necessary it becomes to look for large operating profits and/or the availability of security. Conversely, a low gearing may suggest inefficient management through the non-utilisation of borrowing potential, with a resultant lack of profit potential.

When considering this ratio it must be borne in mind that borrowing may include such items as debenture stocks and loan stocks which may be regarded as quasi capital. Furthermore, since balance sheet values of assets may not be realistic, allowance for known equities must be taken into account.

It is necessary to emphasise that the amount shown under borrowing will reflect a position on a specific day in the year which may not be typical of the overall pattern and which may be subject, inter alia, to window-dressing. It must be remembered that "total borrowing facilities" are likely to be in excess of "total balance sheet borrowings", but, it would be unrealistic for us to claim that at all times we have an accurate knowledge of our customer's total borrowing arrangements. Therefore, in the interests of consistency, it is considered better to work on the basis of actual borrowings rather than on a quantity which may not be accurate. In so doing our interpretation of this ratio would be similar to that of the financial market place which, of course, is in a less privileged position than ourselves and cannot know other than published data.

RATIO 4

ACID TEST

$$\frac{\text{QUICK ASSETS}}{\text{CURRENT LIABILITIES}}$$

This ratio, which has not hitherto been used to any extent by the bank is, in fact, a purification of the current assets/current liabilities ratio which acknowledges the weakness of including stock and work in progress as current assets. Stock and work in progress are, by their nature, less capable of speedy realisation and likewise less capable of valuation.

Quick assets may be more precisely defined as cash plus marketable securities plus debtors. It is the liquidity ratio more commonly used by customers when looking at their own liquidity rather than our basic liquidity test.

There is no standard against which this ratio can be measured and, seen in isolation, there is little that this ratio will tell us other than to highlight the reliance upon stock and work in progress and remind us to examine the makeup and marketability of these assets both for the purposes of liquidity and, in the ultimate, to consider the effect that liquidation might have

Current liabilities must usually be met in cash and to ignore this requirement can cause the downfall of otherwise apparently successful businesses. This ratio draws attention to the adequacy of cash or near cash to meet current liabilities.

RATIO 5

CAPITAL SUFFICIENCY $\qquad$ $\dfrac{\text{NET CAPITAL RESOURCES}}{\text{FIXED ASSETS}}$

The fundamental concept here is that capital resources should cover the value of fixed assets, thereby ensuring that capitalisation is sufficient to provide a degree of working capital, i.e. a percentage ratio in excess of 100.

This ratio cannot be regarded as absolute as it is also acceptable for fixed assets to be financed by long term borrowing, e.g. loan stocks, debentures, etc.

It is a shortcoming of this ratio that it is based on balance sheet values of fixed assets which may not be realistic, consideration should be given to the effect on the ratio of known equities.

RATIO 6

LEVERAGE

$$\frac{\text{TOTAL BALANCE SHEET LIABILITIES}}{\text{NET CAPITAL RESOURCES}}$$

This ratio is similar in some respects to the gearing ratio (i.e. borrowing divided by net capital resources) but the definition of total liabilities is, of course, wider than the definition of borrowing in that, for example, total liabilities includes trade creditors. The gearing ratio is thus a sub-division of the leverage ratio. (For the avoidance of doubt, it should be noted that the definition of total liabilities excludes share capital and reserves and excludes also that part of deferred tax which is taken into net capital resources; the definition of net capital resources is the Bank's usual definition).

The ratio is an indication of:

(a) capital sufficiency or insufficiency;

(b) the extent to which a company relies upon borrowed funds together with other forms of credit including trade credit;

(c) the extent to which a company has scope for the raising of further funds;

(d) the importance to the company's well-being of the need to match the maturity of its assets and its liabilities (the higher the leverage the greater the need for matching).

A particular advantage of the leverage ratio is that it cannot be affected by one of the common forms of balance sheet "window-dressing" namely an increase in trade and other creditors so as to show a lower bank borrowing on balance sheet date. Trade and other credit can very often be an alternative to overdraft finance but the leverage ratio, unlike the gearing ratio, will be unaffected by changes between these two categories of funding since both are included in the definition of total liabilities. It follows also that in this respect the leverage ratio can often be an early indicator of an increased or increasing imbalance between capital resources and debt finance.

Although there is no generally acceptable or unacceptable level of leverage, and there are variations from company to company and from industry to industry, it is generally true that the higher the leverage the more necessary it becomes for a company to maintain adequate profitability and cash flow and to match its assets and liabilities. As regards an individual company a trend showing increasing leverage over a number of years is at least a matter for inquiry and explanation, and may indeed be a cause of concern.

RATIO 7

OPERATING PROFITABILITY

$$\frac{\text{PROFITS BEFORE INTEREST \& TAX}}{\text{SALES}}$$

This ratio:-

(a) is a prime indicator of business efficiency;

(b) it can illustrate the vulnerability of profit to reduced margins.

Once again this is not a ratio that should be looked at in its own right, but one which should put us on enquiry. The hazards of a low profit ratio are obvious, whilst there are also hazards, perhaps less obvious, to a high profit ratio, e.g. a company manufacturing a "one-off" product may enjoy a high ratio due to its virtual monopoly; however, if this product is viable it will only be a matter of time before competitors enter the field with resultant erosion of profitability. Equally, the demand for such a "one-off" product may disappear overnight due to other external factors.

The value of the ratio will be in our ability to make a trend comparison thus measuring the company's progress over the years and measuring performance against same trade industral averages where these are known.

RATIO 8

PROFITABILITY

$$\frac{\text{PRE-TAX PROFITS}}{\text{TOTAL LIABILITIES}}$$

This ratio provides certain advantages as a measure of establishing the extent to which liabilities can be funded from annual profits of a company.

Whilst this ratio has not hitherto been used within the Bank as an aid to credit assessment, it is a useful indicator of the trend of business efficiency in that the observation of the ratio over a period will possibly highlight those businesses which could run into difficulty through a build-up of liabilities which is not matched by increased profits. From the opposite point of view it may indicate, through low liabilities and high profits, that we may be justified in granting borrowing facilities which may result in a higher gearing ratio than might otherwise be considered acceptable.

RATIO 9

INTEREST COVER

$$\frac{\text{PROFITS BEFORE INTEREST \& TAX}}{\text{INTEREST PAID}}$$

This ratio is an offshoot of the gearing ratio in that it indicates historical cover for borrowed moneys, principally for the servicing of such borrowed funds. From this ratio we may assess:-

(a) the ability to service debt;

(b) the company's ability to exist with a high gearing ratio;

(c) vulnerability of a company to volatile interest rates;

(d) the impact of interest charges upon historic and forecast profitability in relation to any proposed additional borrowing;

(e) in conjunction with the volume of cash flow, the ability to make future repayments of capital sums.

EXPORTS SALES

$$\frac{\text{EXPORTS}}{\text{SALES}}$$

A percentage calucation simply to indicate a company's reliance on Export/Home Trade.

Clearly specific knowledge of a customer's business and product will be of considerable benefit when considering the trend in this ratio over several years.

LENGTH OF CREDIT TAKEN

$$\frac{\text{CREDITORS} \times 30^{+} \times \text{NO. OF MONTH THE BALANCE SHEET COVERS}}{\text{PURCHASES}^{*}/\text{SALES}}$$

It should be borne in mind that the amount of credit taken is less capable of manipulation by a company than the figure for credit given. The experience of recent years is that with the advent of inflation and with money becoming an expensive commodity, so has the management of credit become a more sophisticated operation. It follows that creditors are anxious to turn such debts into cash at the earliest opportunity and are, therefore, less tolerant towards the granting of extended credit.

Knowledge of the length of credit taken is useful to us in order that:-

(a) we can ascertain the extent that our customer is in the hands of his creditors generally;

(b) we may judge the effect of any change in the terms of trade;

(c) when assessing proposals to ascertain what contribution towards increased working capital requirements can be made by the taking of normal trade credit.

Again, no overall standard can be laid down due to the differing terms of trade in the varying industries, but comparisons within an industry are meaningful.

* A true view of this factor can only be taken by using "Purchases" as a denominator, but where this information is not available the "sales" denominator must be used.

+ This figure represents the number of days per month based on a 360 day year.

STOCK TURNOVER (NUMBER OF TIMES PER ANNUM) $\frac{\text{SALES} \times 12}{\text{STOCK} \times \text{NO. OF MONTHS IN BALANCE SHEET PERIOD}}$

Indicates the speed with which quasi liquid assets in the form of stock and work in progress are turned into cash and, therefore, profit. The rate of turnover will vary with the nature of the business; for example, a heavy engineering business's turnover rate will be low in comparison with that of a company which manufactures a simple product.

Knowledge of the rate of stock turnover is useful to us for the purposes of:-

(a) assessing the liquidity/cash flow of a company;

(b) assessing the amount of additional working capital which may be required to be locked up in stock and work in progress for any given expansion of sales;

(c) putting us on enquiry as to the quality and marketability of the stock;

(d) putting us on enquiry as to the work in progress content. In the event of liquidation this may prove to be worthless, or alternatively, may require an injection of cash to see the work in progress through to stock;

(e) ascertaining whether the company is under any contractual liability regarding the work in progress, e.g. building and civil engineering.

No overall standards can be laid down, but it is a useful guide to us to see the company's performance year by year and to compare it with another company in a similar industry.

The production and marketing of pitta

by George Hayes, BSc, MPhil, CEng, AIFST, senior lecturer in bakery engineering, Hollings Faculty, Manchester Polytechnic

KEBAB bread is the [illegible] for the Middle Eastern bread [illegible] as pitta or khubz and popularised in Britain by Greek and Cypriot restaurants which serve the bread with shishkebabs.

The origins of pitta bread manufacture can be traced back to Biblical times when unleavened bread was made by mixing flour, salt and water into a dough which was then wrapped and allowed to ferment in the heat of the sun before being baked in an open oven. Now, [illegible] years later, pitta bread remains the staple diet of many of the inhabitants of the Middle East, where it is regarded in the same way as we regard the white loaf, and has been adopted by the peoples of the Western world due both to the information explosion and to the increasing popularity of foreign travel — and, as I have said, through the efforts of Greek and Cypriot restaurants.

Although the demand for pitta bread is concentrated in those areas of the United Kingdom where certain ethnic groups have settled, nevertheless there has been detected an increasing consumption by the student population of Great Britain.

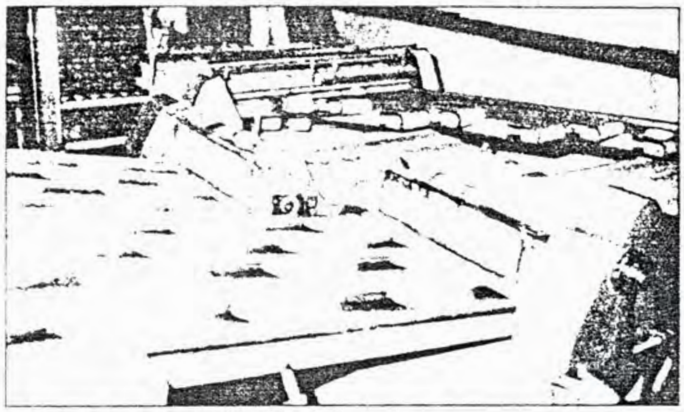
'It was known there was a demand for pitta in the Manchester area'

In 1983 a study was carried out at the Department of Food Manufacture and Distribution, Manchester Polytechnic, on the market for pitta bread in the North West, and most of the conclusions in this article are based upon that study report.

It was known that there was a demand for pitta bread in the Manchester area and that the demand was being met by bakeries based in London.

The research studies revealed that pitta bread was being produced and distributed by two or perhaps three bakeries, and that a number of the larger retail organisations such as Tesco and Sainsbury were finding increasing sales.

Since detailed information was very difficult to obtain from the UK retailers, who obviously desired to keep the situation as closed as possible, an attempt was made to gather market details by means of a questionnaire.



Pitta in production

The Manchester pitta bread market

[illegible] the Manchester area a variety of retail outlets were canvassed including Chorlton, Rusholme, Altrincham, Northenden, Didsbury, Cheetham Hill and [illegible].

Within the areas mentioned all the shops, takeaways and restaurants were confronted with the same typed questionnaire asking them:

- Did they sell pitta bread?
- How much pitta bread did they sell?
- How often was the bread delivered?
- Who was the supplier?
- How much did they pay for the pitta bread?
- What type of pack and state was the bread when purchased?
- Was the demand increasing?
- Would they be interested in a similar product at a lower price?

The results of the survey are summarised in table three and although no claims could be put forward as to their statistical validity the number of potential customers in the Manchester area was estimated based upon these results.

The survey had indicated the sales potential for the product in the Manchester area. An estimate was also made of the maximum and minimum demands.

Outlet	Total Sales (units)	*Weekly Demand*
Shops	150	150 × 150 = 22 500
Takeouts	50-100	100 × 75 = 7 500
Restaurants	20-25	25 × 100 = 2 500
		32 500

From this data the demand profile for

Table one United Kingdom pitta bread market, 1983

Organisation	Percentage of total market	Distribution areas	Distribution network
Arnaout, Wembley, London	[illegible]	London, Leeds, Birmingham, Bradford	Tesco, Safeway, Kendal Milne
Michael's, [illegible], London	45	London, Leeds, Birmingham, Bradford	Leeds depot to Northern region
[illegible]	[illegible]	London	

Table two Estimated demand for pitta bread, 1983

Area	Number of packs per week	Gross annual turnover at 15p per pack
Manchester	30 [illegible]	[illegible]
Birmingham, Leeds, Bradford	100 [illegible]	£750 000

pitta bread in the Manchester area could be [illegible] as

Demand	packs per week
Minimum	21 000
Maximum	32 500
Weighted Average	30 000

Product evaluation

Experiments were carried out in the bakery pilot plant in an attempt to match the pitta bread presently being retailed in the area adjacent to the Hollings Faculty. The trial formulations were sampled and evaluated by the members of staff; the results are summarised in Table 4. The ratios of flour, water and salt were maintained constant while both the level of yeast and the oven temperature were varied.

[illegible]itta bread process

Blend yeast, water, flour and salt together (with shortening if required). Mix to a stiff dough.

[illegible] and portion into 90 gram pieces.

[illegible] to 6-7 inch diameter.

Prove for 10 minutes.

Bake at 230°C (or higher) [illegible] minutes.

'Experiments were carried out on a pilot scheme'

All the formulations were based upon 1 kilo of flour, with 20 per cent salt and 58 per cent water.

In general the quality of the pilot plant product was superior to the commercial product. The inclusion of animal fat was not recommended in view of the religious backgrounds of the ethnic population. The yield per kilo of 12 pieces conformed with the commercial pitta bread product.

Financial evaluation

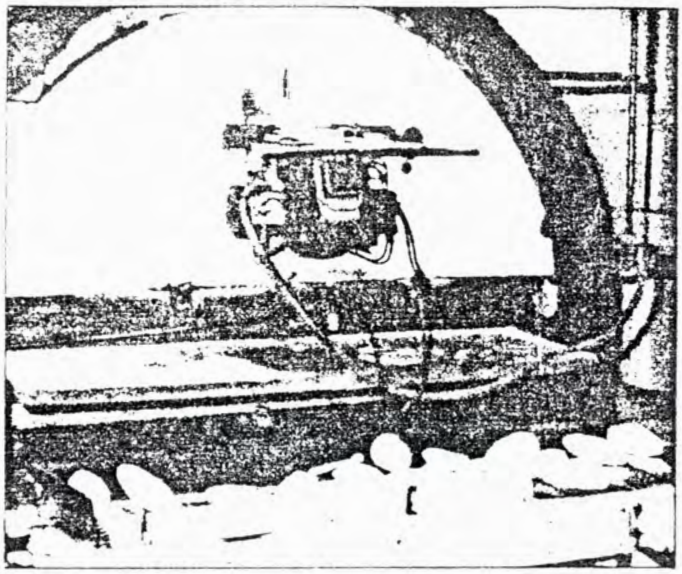
Product costing

Weak flour	1 kilo	= 22p
Yeast	10 grms	= 6p
Salt	20 grms	= 2p
		30p per 12 pieces
		= 2·5 per piece
		15 pence per pack of six pitta pieces

Since the retailers were buying at 22p, it was proposed to retail the new product at 18-21p leaving a minimum contribution to overheads and profit of 3p and a maximum of 6p.

Basic capital investment

Machinery: A number of quotations were received. [illegible]



Will more firms break into this market?

A.R.J. Bakery Equipment [illegible] installed [illegible]

[illegible] capital [illegible]

[illegible]	[illegible]
[illegible]	[illegible]
Sundries	[illegible]
	£25 000
Total capital requirements	£85 000

Estimation of gross profit (weekly basis)

Plant capacity [illegible] pitta pieces per hour

$$\frac{[illegible]00 \times 8 \times 5}{6} = 40[illegible]\ \text{packs per week}$$

Turnover at 18p per pack = £7[illegible] 000 per week

Cost of raw materials [illegible] per week

[illegible] gross profit [illegible]

Manufacturing costs. Fixed and variable

Labour	
1 Manager at £[illegible]	
1 Book-keeper at £8[illegible]	
[illegible] Factory operators at £[illegible]	[illegible]
Rent and rates	100
Transport	100
Power	[illegible]
Bank loan repayment	[illegible]
Machinery and plant depreciation	[illegible]
Advertising and marketing	75
	£1 [illegible]
Minimum net profit weekly	£25

With a modern baking plant it was con-

Table three Results of the questionnaire

Type of outlet	Total units sold per week	Average sales (packs)	Price (p)	Delivery (weeks)
Shop	1 800	15[illegible]	22	[illegible]
Takeout	450	7[illegible]	—	[illegible]
Restaurant	400	100	—	—

Table four Experimental results

Flour type	Yeast [illegible]	Oven temperature [illegible]	Product [illegible]	Product [illegible]	Product [illegible]
Strong	[illegible]	[illegible]	[illegible]	10	3[illegible]
Strong + 20% fat	[illegible]	[illegible]	[illegible]	10	[illegible]
Weak	[illegible]	[illegible]	15	12	[illegible]
Weak + 20% fat	[illegible]	[illegible]	15	12	[illegible]
Wholemeal	[illegible]	[illegible]	[illegible]	11	[illegible]
Weak	[illegible]	[illegible]	[illegible]	12	[illegible]
[illegible]			[illegible]	6	

[illegible] that the [illegible] would be increased and [illegible] with [illegible] [illegible] weekly [illegible] per week

Calculation of breakeven requirements

From the market research it had been [illegible] that a [illegible] pence was [illegible] selling price [illegible] with [illegible]

To [illegible] the breakeven throughout [illegible]

[illegible] packs

[illegible]	Breakeven [illegible]	Number of packs per week
6p	[illegible]	[illegible]

Conclusions

[illegible] The [illegible] had [illegible] that there was [illegible] in the Manchester conurbation [illegible] packs of pitta bread [illegible] week and that the demand was [illegible] by the London [illegible]

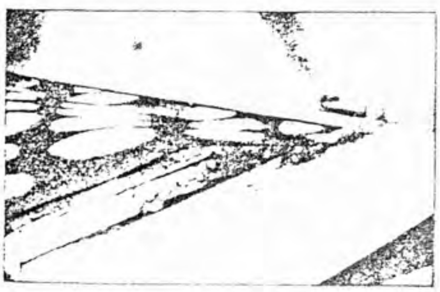
The distribution costs [illegible] supplying the North of the country were thought to be a minimum of £100 per trip. With the limited shelf-life of the bread there required to be at least three deliveries per week to Yorkshire, Lancashire and Cheshire. Therefore the distribution costs to the London-based bakeries were at least £[illegible] 0,000, equal to one pence per pack of pitta bread.

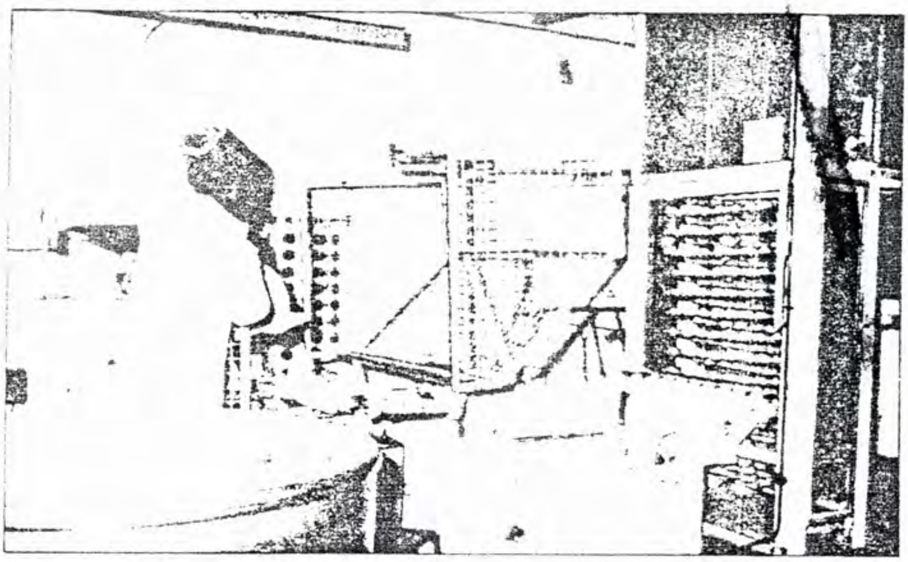
2 The study had related only to the Manchester conurbation. However evidence was gathered suggesting that a much larger market was open to any Manchester-based bakery.

3 The major deterrent to the entrepreneur was undoubtedly the high initial investment required. Bread manufacture and retailing in the UK is highly competitive and the market is dominated by the ever fewer and larger organisations who would be reluctant to invest in any food processing system which did not lend itself to high volume continuous production.

It would be necessary to get the plant to its maximum capacity as soon as possible in order to recover the financial investment.

At maximum plant capacity the financial investment would be recovered in just under two years.





[illegible]

[illegible] and wherever possible [illegible] groups [illegible] of pitta bread [illegible]

Table five Cash flow forecasts

	January	February	March	April	May	June
Total income [illegible] per period	—	£[illegible]	£[illegible]	[illegible]	£[illegible] 000	£10 000
Operating [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	4 [illegible]	4 [illegible]
Purchases	[illegible]	[illegible]	[illegible]	[illegible]	1 906	2 288
Total expenditure per period	[illegible]	[illegible]	[illegible]	[illegible]	[illegible] 606	6 988
						[illegible] 149
Opening [illegible] balance [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible] 413	[illegible] 125

Total income	July	August	September	October	November	December
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[illegible] first year

Table six

Contribution	[illegible]	[illegible]	Net profit	Return on investment
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

THE BALANCE SHEET

1. Introduction

1.1 A Balance Sheet of a business is a financial statement which shows on the one hand where the money came from and, on the other, where it has gone. The two totals must be equal because the business cannot do more than the available resources permit.

1.2 The Balance Sheet is prepared with reference to a specified date. It is often compared to a snap shot which as it were "freezes" the subject of the photograph at an instant of time.

1.3 An understanding of the Balance Sheet enables a manager to grasp more clearly the financial implications of decisions. A Balance Sheet is basically a very simple document and the note which follows takes the example of Will Dooyoo Inc. - the company which was considered in the note on "Business and Money".

2. The Balance Sheet of Will Dooyoo Inc.

2.1 The following is the Balance Sheet of Will Dooyoo Inc. immediately after acquisition of assets.

Sources of Money	$
Share Capital	100,000
Creditor	15,000
Total Sources	$115,000

Uses of Money	$
Fixed assets at cost	40,000
Stocks of raw materials	30,000
Cash	45,000
Total Uses	$115,000

It is as simple as that!

2.2 Now, let us prepare a Balance Sheet of the Company at the end of month 1.

Will Dooyoo Inc.
Balance Sheet at the end of month 1

Sources of Money	$
Share Capital	100,000
Creditor	15,000
Total Sources	$115,000

Uses of Money	$
Fixed assets, at cost	40,000
Stocks of raw materials	30,000
Stocks of finished goods and work in progress	40,000
Cash	5,000
Total Uses	$115,000

2.3 The principle is the same! List the sources of money, list the uses; if the two totals do not agree then something has been omitted and we can think about what it is. Now, the Balance Sheet at the end of month 2.

Will Dooyoo Inc.
Balance Sheet at the end of month 2

Sources of Money	$
Share Capital	100,000
Mortgage	35,000
Creditor	15,000
Total Sources	$150,000

Uses of Money	$
Fixed assets at cost	40,000
Stocks of raw materials	30,000
Stocks of finished goods and work in progress	40,000
Debtors	50,000
	$160,000

The two totals do not agree! Something is missing. Can you identify the missing figure.

2.4 A little thought will show you that we have introduced a figure for Debtors at $50,000. That $50,000 represents sales for which we have not yet been paid. We have assumed it will be paid in full. This is clear from our decision to put $50,000 in the Balance Sheet as an asset. If that is correct then our total use of money has had the result of creating assets of $160,000 which total exceeds by $10,000 the total of resources. This is, of course, profit. It may be demonstrated to be profit as follows:

Sales value of goods despatched to customers	$50,000
Less Cost of those goods	40,000
Profit	$10,000

2.5 Wait a moment, you say. Those sales have not yet been paid for by the customer so they are not yet sales (a sale is only a sale when the cash has been received!). Agreed if we are talking about responsibility for collecting the cash. In practice, if there is no reason to doubt that the customers will pay in full, the sales value of deliveries made to customers is brought into the profit calculation whether or not the customers have paid for the goods. In a sense we are anticipating profit by this practice but it is convenient. It is also safe when we know full well that the customers will pay at the end of the agreed term of credit.

2.6 Adopting the convention that the profit calculation is based on sales value of goods delivered to customers in a period we can now restate the Balance Sheeet at the end of month 2:

Will Dooyoo Inc.
Balance Sheet at the end of month 2

Sources of Money	$
Share Capital	100,000
Retained profit	10,000
Shareholders Funds	$110,000
Mortgage	35,000
Creditor	15,000
Total Sources	$160,000

Uses of Money	
Fixed assets at cost	40,000
Stocks (all)	70,000
Debtors	50,000
Total Uses	$160,000

2.7 This Balance Sheet shows clearly that profit is a source of cash. In a continuing business it is often the main source of cash: notice also that the profit of a company belongs to the shareholders. It increases their stake in the company. They will not receive all of the profit in cash, but only any dividends which the company approves at the Annual General Meeting of its shareholders. The profit after deduction of any taxation (not yet considered), and any dividend is called the RETAINED PROFIT.

2.8 A jargon term used by the business community to describe shareholders funds is "EQUITY". Thus at the end of month 2 the equity of the shareholders is $110,000.

2.9 The Balance Sheet of Will Dooyoo Inc at the end of month 3 will reflect a further month of activity which had a surplus of $10,000. We may prepare this Balance Sheet from the information given.

Will Dooyoo Inc.

Balance Sheet at end of month 3

Sources of Money	$
Share Capital	100,000
Retained Profit	20,000
Shareholders Funds	120,000
Mortgage	35,000
Creditor	15,000
Total Sources	$170,000

Uses of Money	
Fixed assets at cost	40,000
Stocks (all)	70,000
Debtors	50,000
Cash	10,000
Total Uses	$170,000

2.10 The foregoing Balance Sheets appear to satisfy the requirement that the total of sources and the total of uses agree. But a Balance Sheet must show a "True and fair view" of the financial position of the company on the stated date. The foregoing Balance Sheet at end of month 3 does not yet comply with this legal requirement. Can you specify in which respects this Balance Sheet is not yet correct?

2.11 There are three matters which call for attention:

- Interest on the mortgage
- Depreciation of the fixed assets
- Taxation

3. The Correct Balance Sheet

3.1 Consider, first of all, the question of interest payable on the mortgage of $35,000. This money was borrowed on day 1 of month 2. The first payment of interest will be due 6 months later on the last day of month 7. On the last day of month 3 there will be two months accrual of interest. This will not have been paid at the date of the Balance Sheet but if we are going to reflect the "true and fair view" we must recognise that an obligation to pay it at a future date has arisen.

3.2 Expenses which are paid in arrear are said to be accrued expenses or] charges. Another example is rent when payable in arrear. These expenses accrue with the passage of time.

3.3 In the case of Will Dooyoo Inc. we may assume that the rate of interest on the mortgage is 10% per annum. A full year's interest would amount to $3,500. However, at the end of month 3 the proportion of $3,500 which has accrued at that date is 1/6. (Money borrowed on day 1 of month 2). We have to make provision for $1/6 x 3,500 = $583.33 of accrued interest. Such accuracy is not called for. We shall approximate and say that interest accrued at the end of month 3 is $600. The accounting adjustment is shown in para 3.8 below.

3.4 Next comes the question of depreciation. Depreciation is the reduction in value of an asset through use in the business. The annual amount to be provided for depreciation of a fixed asset is determined by dividing the cost of the asset by the estimated number of years of its useful life.

3.5 Today many companies do not depreciate buildings on the grounds that buildings tend to appreciate in value. If buildings are to be depreciated, then the usual term is 50 years. This gives an annual rate of 2%.

3.6 In the case of plant and machinery the useful life of the asset will be estimated by engineers from their knowledge of the manufacturer, the type of machine, the usage of the machine (single, double or treble shifts per day). Depreciation rates will vary for different categories of machine and for different usage patterns.

3.7 Assume that as a result of a reasonably careful estimate the monthly depreciation for the fixed assets of Will Dooyoo Inc. has been set at $500. As the company has been operating for 3 months, the depreciation for the period is 3 x $500 = $1,500.

3.8 We may now restate the profit for the period:

Surplus as before	$20,000
Less Interest	600
Profit before depreciation	$19,400
Less Depreciation	1,500
Profit before tax	$17,900

3.9 It would be normal for a company to provide for ultimate taxation at this point. Taxation is a vast and complicated subject. As a result it is by no means clear, after only 3 months of operating, what will be the taxation liability, if any, on the profits of the first 3 months. At this stage it will be sufficient for our purposes to assume a rate of taxation of 50%. If at the end of the first year of operating this rate is found to be excessive, the company would be able to adjust the figures to the correct taxation level.

3.10 For the present assumed tax rate of 50% would give the following figures:

Profit before tax	$17,900
Less tax at 50%	8,950
Profit available to shareholders	$ 8,950

3.11 Please understand that the company will not yet be called on to pay any tax. It is only providing for the possibility that tax will be payable at a future date.

3.12 The profit figure has now been adjusted to reflect more accurately the amount which may be added to the shareholders funds in the Balance Sheet. These funds would now be stated:

Share Capital	$100,000
Retained Profit	8,950
Shareholders' Funds	$108,950

3.13 The Balance Sheet itself can now be re-stated. The conventional method of reflecting depreciation of assets is to deduct the amount of depreciation from the cost of the asset. Three other poir.ts must be noted -

(a) Interest accrued of $600 has not yet been paid and so it has to be shown in the Balance Sheet as a liability.
(b) Taxation profived for at $8,950 has not been paid and must also be shown separately in the Balance Sheet.
(c) Depreciation is just as much a production cost as materials, wages.

Will Dooyoo Inc.

Balance Sheet as at end of month 3

Sources of Money		$
Share Capital		100,000
Retained Profits		8,950
Shareholders' Funds		108,950
Mortgage		35,000
Future Taxation		8,950
Creditors:		
Materials	$15,000	
Accrued Interest	600	15,600
Total Sources		$168,500
Uses of Money		$
Fixes Assets at cost		40,000
Less aggregate depreciation		1,500
		38,500
Current Assets:		
Stocks (all)	$70,000	
Debtors	50,000	
Cash	10,000	130,000
Total Uses		$168,500

4. Capital Employed and Working Capital

4.1 The Balance Sheet in para. 3.13 above is accurate enough according to the information at our disposal. There are two important concepts in financial management which are not clearly shown on this Balance Sheet. These concepts are -

- Capital Employed
- Working Employed

4.2 When we studied the behaviour of money in a business we saw that the money that circulates rapidly comprises the sums devoted to the short term assets of stocks, debtors and bank balances. The total of these is offset by the money borrowed on a short term basis from suppliers (creditors) to give the net value of the 'pool' of resources called "working capital". In our amended Balance Sheet the value of working capital is:

Current Assets:	$
Stocks	70,000
Debtors	50,000
Cash	10,000
	$130,000
Less Current Liabilities:	
Creditors	15,600
Working Capital	$114,400

4.3 It is a simple matter to show this figure on the Balance Sheet. All we do is to remove the short term creditors from the "Sources of Money" and transfer the total to the "Uses of Money" section, deducting this sum from the current assets.

4.4 The full amended Balance Sheet is now:

Will Dooyoo Inc.
Balance Sheet at end of month 3

Sources of Money		$
Share Capital		100,000
Retained Profits		8,950
Shareholders' Funds		$108,950
Mortgage		35,000
Future Taxation		8,950
Capital Employed		$152,900
Uses of Money		$
Fixed assets at cost		48,000
Less aggregate depreciation		1,500
		38,500
Current Assets:		
Stocks	$70,000	
Debtors	50,000	
Cash	10,000	

Current Assets	130,000	
Less Current Liabilities:		
Creditors	15,600	
Net Current Assets		114,400
Net Total Assets		$152,900

Net Current Assets = Working Capital

4.5 Thus, the term "Capital Employed" is seen to comprise the total of the long term resources available to management. The basis of assessment of the performance of management is the amount of profit it earns on using the long term resources.

4.6 Notice that the capital is employed in -

Fixed Assets

+

Working Capital

which total is referred to as NET TOTAL ASSETS. The word "NET" here refers to the deduction of depreciation from the cost of fixed assets and to the "setting off" of creditors against current assets.

5. Conclusion

5.1 This note will serve as an introduction to the subject. After studying the methods of Profit Determination there will be the opportunity to study Balance Sheets further by means of exercises and further material.

PS. PLEASE NOTE THAT THE RATES QUOTED IN THIS HANDOUT FOR DEPRECIATION, INCOME TAX AND INTEREST ARE FOR ILLUSTRATION PURPOSES ONLY

INTERPRETATION OF BALANCE SHEET

1. WORKING CAPITAL

1.1 This is the amount of cash which can be available to the Company within short term, if all the current assets are realised and all current liabilities are paid.

1.2 The figure of working capital can be determined by deducting current liabilities from current assets.

1.3 Do not include intangible assets, loans to directors as current assets. If directors loans to the company are significant, comment upon possible capitalisation and/or postponement in favour of the Bank.

1.4 Another approach would be to say the capital and reserves should be sufficient to cover fixed and intangible assets and directors loans and something towards financing liquid liabilities.

1.5 Consider how the figures will change if turnover increases.

2. CURRENT RATIO

2.1 This is the ratio of current assets to current liabilities taking current liabilities as one.

2.2 $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ = ... to 1

3. ACID TEST RATIO

3.1 This compares the most liquid assets with the total current liabilities. Thus take total of cash, Bank and Debtors and divide by current liabilities.

3.2 $\frac{\text{Current Assets - Inventory}}{\text{Current Liabilities}}$ = ... to 1

4. NET WORTH TO LONG TERM LIABILITY RATIO

4.1 This shows the capital gearing of the company i.e. whether the company is relying too much or too little on long term borrowed funds. Therefore, it compares shareholders' equity (or net worth) with the long term liabilities taking the long term liabilities as one.

4.2 $\frac{\text{Equity}}{\text{Long Term Liabilities}}$ .... to 1

5. NET WORTH TO TOTAL DEBT

5.1 This also shows the capital gearing of the company i.e. whether the company is relying too much or too little on the total outside liabilities (borrowed funds). Therefore, it compares shareholders' equity (or net worth) with the outside liabilities taking the total debt i.e. total outside liabilities as one.

5.2 $\frac{\text{Equity}}{\text{Total Debt}}$ .... to 1

6. SALES TO AVERAGE DEBTORS (RECEIVABLE)

6.1 This information indicates roughly the average number of days credit facility allowed by the Company. This is calculated as follows:

6.2 $\frac{\text{Average Trade Debtors}}{\text{Sales}} \times 365 =$ .... days

6.3 If out of line with the average for the trade this may indicate an extremely competitive situation for the applicant or that his pricing policy is incorrect, or an undesirable percentage of bad debts.

7. PURCHASE TO AVERAGE CREDITORS

7.1 This indicates the average credit taken by the company.

7.2 $\frac{\text{Average Trade Creditors}}{\text{Purchases}} \times 365 =$ .... days

7.3 If out of line with the average for the trade this may be a warning. If less than average this may be an indication that unutilised credit is available to the applicant.

8. COST OF SALES TO AVERAGE STOCK (INVENTORY)

8.1 This indicates the average time during which the stock is turned over (sold). Calculate as follows:

8.2 $\frac{\text{Average Stock}}{\text{C.O.G.S.}} \times 365 =$ .... days

8.3 If out of line with the average for the trade this may indicate overstocking or unsaleable stock.

9. NET PROFIT TO NET WORTH

8.1 This shows the profit made in the current year as percentage of the shareholders' equity and this is calculated as follows:

8.2 $\frac{\text{Net Profit}}{\text{Net Worth}}$ x 100 = ... %

8.3 The profits record is important because if adequate and steady profits have been earned they support faith in the balance sheet value of the current assets and in the business capabilities of the management. Profits which have been left to accumulate in the business indicate growth and prudent control.

10. NET PROFIT TO SALES

10.1 This indicates the net profit margin and should be in line with the average for the trade or some inefficiency can be suspected, possibly in buying or perhaps in administration. Gross profit ratios can be compared with the list provided by the Regional Office for guidance purposes.

10.2 $\frac{\text{Net Profit}}{\text{Sales}}$ x 100 = ... %

UDITED/UNAUDITED

QUALIFIED/UNQUALIFIED

NAME

SPREAD SHEET

OF BORROWER'S FINANCIAL STATEMENT

BUSINESS

FIGS IN OOO'S

CURRENCY................

DATE						
ASSETS						
1 Cash in hand cash with bank						
2 Notes Receivable Debtors Bills of Exch						
3 Accounts Receivable — Debtors A/C (Trading Debtors)						
4 Less: Allowance for Bad Debts	(	)	(	)	(	)
5						
6 Inventory / Stock						
7						
8						
9 Listed Stocks and Bonds Marketable Securities						
10 Prepaid Expenses						
11						
12 CURRENT ASSETS						
13 Real Estate — Leasehold Imp. Land Bldg						
14 Machinery-Equipment						
15 Less: Accumulated Depreciation	(	)	(	)	(	)
16						
17						
18 NET FIXED ASSETS						
19 Due from Officers/Employees						
20 [illegible]						
21						
22 Deferred — Other Prepaid						
23 OTHER ASSETS						
24 TOTAL NON-CURRENT ASSETS						
25 TOTAL ASSETS						
26 LIABILITIES						
27 Notes Payable — Banks O.D.						
28 Notes Payable — Others B/E Trade creditors						
29 Accounts Payable — creditors.						
30 Current Part-Long Term Debt						
31 Income Taxes Payable						
32						
33						
34						
35 Accruals						
36 CURRENT LIABILITIES						
37 Secured Term Debt						
38 Other Term Debt						
39 Subordinated Debt						
40						
41						
42 TOTAL NON-CURRENT LIABILITIES						
43 TOTAL DEBT						
44						
45						
46						
47	Tangible NW		= NW —		Intangible Assets	
48 Common Stock						
49 Surplus					Goodwill	
50					Copyright TRADEMARK patents	
51 Tangible NET WORTH	Assets — Current		Liab or Share		Capital + Reserves + P&L	
52 TOTAL						
53 Contingent Liability						
54 Lease Liability						
55						

RATIOS AND COMPARISONS

DATE			
Work Cap. (Line 12 less 36)			
Current Ratio	to 1	to 1	to 1
Worth to Debt Ratio	to 1	to 1	to 1
Acid Test Ratio	to 1	to 1	to 1
Sales to Receivable (Days)			
Cost of Sales to Inv. (Days)			
Profit to Worth (Percentage)	%	%	%

OPERATING DATA (Period Ending)						
Net Sales		100%		100%		100%
Cost of Goods Sold		%		%		%
GROSS PROFIT		%		%		%
Executive Salaries		%		%		%
Depreciation		%		%		%
Income Taxes		%		%		%
Other Operating Expenses		%		%		%
Net – Other Income/Charges		%		%		%
		%		%		%
		%		%		%
NET PROFIT (LOSS)		%		%		%

CHANGES IN WORKING CAPITAL						
Beginning Working Capital						
Net Profit (Loss)						
Dividends/Withdrawals						
24 (Inc.) Dec.-Net Non-Current Assets						
42 Inc. (Dec.) Deferred Debt						
WORKING CAPITAL						

RECONCILIATION OF NET WORTH						
Beginning Net Worth						
Revaluation of Assets						
Net Profits						
Less: Dividends or Withdrawals	(	)	(	)	(	)
Other						
51 ENDING NET WORTH						

ANALYSIS OF THE FINANCIAL STATEMENTS OF

FLIP INTERNATIONAL LIMITED

THE STATEMENTS AS OF 31.03.87 ARE AUDITED

THOSE AS OF 31.03.88 ARE DRAFT AND THOSE OF 30.11.88 ARE UNAUDITED

ALL ACCOUNTS HAVE BEEN PREPARED BY IAN SKOLICK AND COMPANY

FLIP INTERNATIONAL LIMITED

The subject company are retailers of clothes in Covent Garden, London and commenced business only during 1986. The company's major asset is stock which has been growing since incorporation to a satisfactory trading quantity. Stocks are warehoused as well as held at shop premises.

CASH MANAGEMENT

The growth in the volume of stock held by Flip, while obviously necessary for 'start up', has a significant effect on the company's cash flows. While inventories increased in the eight months to 30.11.88 turnover was proportionately the same.

In the period to 31.03.88 all cash generated from operations (£52,739) went toward repaying directors loans (£40K) and short term bank borrowing (£10K). In the period to 30.11.88 additional bank borrowing (£119K) was required to cover £35K cash deficiency and investment in fixed assets. The underlying reasons for this however were the aforementioned increases in stock (without the additional benefit of turnover) and a continued reduction in accounts payable.

STRUCTURAL LIQUIDITY

Current assets exceed current liabilities in the ratio of 2:1 as at 31.03.88 reduced to 1:3 to 1 as at 30.11.88. This is due to a substantial increase in short term bank borrowing (£119K) and in provisions for taxation (£46K).

More importantly we should consider the nature of stocks. The company pays suppliers on 90-120 days credit and sells the goods for cash. The stocks while large in volume are turned around rapidly. In this way we may consider the company more liquid than the quick ratio would suggest. In addition stocks are valued at cost in the balance sheet and the re-sale value is obviously much greater.

It is most probably more accurate to assume that the increases in stocks are a result of stock building rather than the company carrying unsaleable inventories.

EQUITY SUFFICIENCY

Shareholders investment has been negligible although retained earnings have been allowed to build well. In this way shareholders funds have purchased 36% of assets as at 30th November 1988 (50% on 30th March 1988).

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Assets primarily take the form of stocks plus a property situated in Portugal. In the event of liquidation we should be able to look to the value of stocks to (in part at least) repay the proposed facility.

ASSET MANAGEMENT

Stock turnover is surprisingly lengthy although this is in all likelihood due to the build up of stocks from 'start-up' and the volume of stocks held.

As a result of this current asset turnover is reducing although this may be considered a temporary situation.

GEARING

Gearing was substantially reduced as at 31st March 1988 with the retention of profits to the extent that leverage was marginally less than one. Gearing has risen somewhat on 30th November 1988 as a result of increased short term bank borrowing. However, the period to 30th November 1988 does not cover a full trading year and the months over Christmas and New Year should increase profits for the year significantly.

Gearing remains satisfactory as at 30th November 1988 with all liabilities to equity at 1.75.

PROFITABILITY

The gross profit margin is very consistent at 40%. The weakness in the profit and loss to 30th November 1988, such as it is, is in the operating expenses rather than in the trading structure. The reduction in the operating profit margin as at 30th November 1988 has resulted in a significant reduction in the interest coverage ratio to 2.2.

Similarly the extent by which sales can fall before expenses are uncovered has reduced to 11%. This remains an adequate level of protection to the company and is likely to improve in the fullness of the year.

CONCLUSION

The company has been successful in its first two years trading. In addition the cash management is likely to improve now that the company has increased inventory to cater for normal trading purposes.

If as projected the company's weekly turnover can be improved by 50%, stock turnover will further improve the company's terms of trade and generate an improved cash position.

The company is relatively low geared.

ANALYSIS OF THE CONSOLIDATED FINANCIAL STATEMENTS OF WESTLAND GROUP PLC AND SUBSIDIARIES FOR THE YEARS ENDED 30.09.87 AND 30.09.88

****

CASH MANAGEMENT

Over the year to 30.09.88 operations resulted in a healthy cash generation of £19 M which was reduced to £8 M after provisions, and interest. The operating cash result was due mainly to good (encashed) profitability at the gross profit level which can be expected to be maintained in future years although the 1989 result is likely to be affected by certain non-profit earning sales. Any reduction in cash generation is likely to be at least partially offset by a reduction in inventory levels which increased by £16 M in 1988 due to delays in gaining acceptance of helicopters under a major Sea King export contract entered into in 1983. Deliveries are now underway however which should lead to a normalization of inventory levels and cash generation.

Cash generated together with new short term finance was used mainly to meet deferred liabilities of £29 M during the year. Although the company operates a continuous fixed asset renewal programme, in 1988 disposals exceeded additions by £3 M and therefore there was no net cash devoted to this use.

ASSET MANAGEMENT

Days receivable and payable have remained roughly constant at approximately 70 and 90 days respectively implying good debtor control and no pressure from creditors. For reasons mentioned above days inventory rose from 178 days in 1987 to 212 days in 1988 and this is expected to improve in 1989. The ratio of net sales to current assets fell as a consequence from 1.48 times in 1987 to 1.4 times in 1988 but this was also due in part to the fall in turnover.

With regard to fixed asset expenditure the group operates a system of renewal although net additional expenditure was curtailed in 1988 presumably as a result of the continuous rationalisation measures. The group benefits from the fact that development expenditure is, where possible, built into each contract price and the group also receives considerable "launch aid" from the UK Government (£64 M in 1988 and £60 M expected in 1989). This aid is recoverable by the UK Government by way of a levy on subsequent sales.

EQUITY SUFFICIENCY

Equity is equivalent to roughly a third of total assets which provides a comfortable margin for asset shrinkage in the event of liquidation thereby protecting unsecured lenders to a certain extent. Capital and undistributable reserves account for 89% of equity which provides a sound core.

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STRUCTURAL LIQUIDITY

Net working capital fell from £136.5 Million in 1987 to £109.2 Million in 1988 and the current ratio fell from 2.12:1 in 1987 to 1.74:1 in 1988 but this provides sufficient liquidity in view of the fact that debtors and cash alone are equivalent to 49% of total current liabilities and inventories can be expected to realise (on a going concern basis) values significantly in excess of balance sheet figures due to the addition of profit. This was accompanied by a fall in turnover and therefore the ratio of net working capital to sales fell marginally from 0.36:1 in 1987 to 0.3:1 in 1988. This ratio remained reasonably consistent indicating that adequate funds have been allowed to remain within the working capital cycle. It appears that the decrease in working capital was due mainly to an increase in short term debt (associated with the delays in the major Sea King contract mentioned earlier) together with accruals and leasing commitments, which may be construed as an increase in efficiency by making greater use of payables and borrowings to assist short term cash generation.

Cash and receivables account for 27% of total current assets as at 30th September 1988, whilst inventories accounted for 69%, (the group predicts that this will be reduced in 1989). Liquidity was therefore affected in 1988 but as appears to have been the case during 1988 the group does appear to have access to short term borrowing facilities when necessary.

GEARING

Long term debt gearing is low at approximately 29% although total debt to equity stood at 156% as at 30th September 1988. Interest ~~This~~ is however covered 2.68 times by after tax profit and 2.4 times by operating cash generated and it seems safe to suggest that operating cash will continue to be generated at approximately similar levels. It should be borne in mind that equity is understated by the value of minority interests (approximately £20 million as at each year end) and therefore total debt to equity including minority interest is 120%.

PROFITABILITY

Turnover decreased in 1988 by 6% due to the delays in delivery of helicopters under a major contract, but new orders of £413 were received in 1988 compared with £183 in 1987. Despite this downturn the group achieved a record operating profit of £38.4 Million in 1988 due to a consistent gross profit margin and an ability to control manufacturing and administrative costs. This result was affected by net exceptional provisions (for losses) of £13.2 Million in 1988 arising primarily out of a major Indian contract (due to changes in contract terms) and by higher interest costs of £7.8 Million due to higher levels of borrowings and increases in interest rates. The company states that the problems giving the exceptional provisions have been resolved.

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CONCLUSION

The after effects of events in 1985 have been detailed in Westland's latest accounts. In 1985 the group faced serious financial difficulties due to a major order in which substantial funds had been invested and which did not materialise. Since that time new principal directors have been appointed and a capital reconstruction has taken place with UTC (Sikorsky) and Fiat becoming minority shareholders (Fiat has since sold is stake to GKN).

The large helicopter order was eventually signed and deliveries commenced in 1988 but provisions totalling £55 Million have prudently been made in this respect thereby depleting profit. This order also gave rise to distorting rises in inventory and debt all of which had a negative impact on the group's results. The group indicates that the problems have now been resolved and it is perhaps encouraging to note that the group has produced record operating profits despite the difficulties it has faced.

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Analysis of the Consolidation Financial Statements of
Try Group PLC Year end 31.12.87 &88

CPU/MAD/EXT. 4063
6th February 1990

Cash Management

The group achieved cash from operators of £248K in the year to December '88. This relatively modest result should be viewed in the light of an 81% increase in turnover which brought about a significant rise in stock and debtors which absorbed approx £3.8M cash net of creditors.

After payment of tax and the receipt of interest on investments net cash was neutral.

Fresh finance of approx. £2.5M raised increased short term liquidity (liquid assets rose from £3.1M to £5.8M).

Profitability

The 81% increase in sales was accompanied by a marginal fall in the gross profit margin from 11% to 10.6% however increased economies of scale appear to have resulted in an improvement in the net profit margin to 2.94%.

The increase in turnover was mainly attributable to the contracting division but profits for this division were adversely affecting by one contract which is complete. The property investment and housebuilding divisions contributed the bulk of the pre-tax profit but these sectors are likely to experience a decline in prominence due to the depressed market conditions prevailing at present.

Balance Sheet Structure

Current assets accounted for 72% total assets in 87 and 82% in 88 due to the rise in receivables and stock. Stock includes developments in progress (£18M) and land bank of £2M. The group experienced a slowdown is sales during the early part of '89 but the Directors expect steady progress to be made. Debtors appear reliable and represent mainly monies due from major employees in respect if the contracting division. The group lists amongst its clients the following:-

Buckinghamshire County Council
London Borough of Ealing
Great Portland Estates PLC
Wace Group Plc
MCC
PSA
Kuwait Petroleum Limited
W H Breakspear and Sons Plc

The bulk of finance is similarly short term and equity of £14M together with long term debt is sufficient to fully finance fixed assets of £5.3M with the surplus adequately covering non current assets and working capital.

Gearing

Total bank debt to equity stands at a healthy 73% which appears to minimised through maximisation of trade creditors (81 days).

Profit interest coverage improved from 21 times to 33 times in 1988 and operating cash interest coverage stood at 3 times. This level of debt therefore appears sustainable despite foreseeable reductions in profitability due to the housebuilding and development sectors being depressed.

Conclusion

An established company which was successfully floated on the stock exchange in 1989 raising £6.45M net additional capital. This provides a firm foundation for the group to develop its business and has enhanced the groups profile. The additional equity will also have to cushion the group against any future deterioration in the value of its development assets.

Interim results for the 6 months to June 89 indicate and improvement in profitability. Turnover increased 24% whilst net profit increased 39% despite the difficult market conditions in housebuilding. Try's diversity of activities appears to have helped bolster profitability.

Our facility would be linked to the group's contracting activities where they have a proven track record with good cash generating ability.

It is proposed that the indemnifier for our facilities should be Try Holdings Limited whose tangible net worth as at 31.12.88 was £1.75M.

Try Holdings acts as the groups financing arm. Total debtors as at 31.12.88 stood at £6.4M which together equity (£1.7M) and intercompany (and other creditors of £3M financed lending to other group companies of approximately £11M.

We have no reason to doubt that the assets and resources of the rest of the Try Group would not be used support any claim upon Try Holdings Limited.

ANALYSIS OF THE FINANCIAL STATEMENTS OF

BLACKSPUR LEASING PLC

THE STATEMENTS AS AT

31ST DECEMBER 1987 AND 31ST DECEMBER 1988

BLACKSPUR LEASING PLC

The company is involved in financing, printing and associated equipment supplied by group "Blackspur PLC" or third party suppliers and manufacturers. Blackspur Leasing PLC commenced business in 1987.

CASH FROM OPERATIONS

Cash generated from operations in 1988 stood at £3.4 Million due to good profitability and effective utilisation of payables. This was sufficient to meet interest and tax. Further cash was generated through short term hire purchase finance which offset investment in equipment.

Net cash of £2.9 Million was further assisted by income of £500,000 and an extraordinary item of £1.13 Million representing profit on the sale of assets.

Cash generated from operations together with short term debt of £5 Million and long term hire purchase finance of £15.7 Million was utilised to purchase fixed assets that were leased to customers.

In the equity sector £5.4 Million was contributed by way of share capital which together with surplus cash after investment in fixed assets contributed to the £6 Million increase in liquid cash balances.

The company therefore appears to have the ability to generate sufficient cash to meet financing commitments and to maintain growth.

SALES GROWTH AND PROFITABILITY

Although turnover increased from £11 Million in 1987 to £54 Million, gross profit margin has been reduced from 34.03% in 1987 to 21.28% in 1988 due to the "cost" of increasing sales. However, the net profit margin remains stable, due to income of £500,000.00 and an extraordinary item of £1.13 Million.

NET WORKING CAPITAL

Net working capital increased from £2.8 Million in 1987 to £11 Million in 1988 due to retained profit associated in the growth in sales. The percentage of net working capital to sales however reduced from 25% in 1987 to 20% in 1988 which indicates increased efficiency.

The current ratio has remained roughly constant although liquidity has improved due to the increase in cash and debtors. These accounted for 38% of current assets in 1987 and 69% in 1988.

/Contd ... 2

BALANCE SHEET STRUCTURE

Equity and long term financing total approximately £33.4 Million which is sufficient to fully finance fixed assets of £22 Million with a substantial surplus available for working capital. Short term bank borrowing is minimal through the maximisation of payables. The level of equity is such that assets can diminish in value by up to 25% before creditors become uncovered.

ASSET TURNOVER

The relatively low current asset turnover of 1.53 times reflects the large level of current assets carried by the company which require financing, due mainly to the lengthy credit terms (here 97 days). The company is however able to offset this to a certain extent by utilising trade creditors to the maximum (107 days).

DEBT EQUITY MANAGEMENT

Total borrowed funds to equity stood at 2.93 times in 1988. Although this represents an improvement on the 1987 result of 4.2 times, the company remains relatively highly geared. Long term finance to equity stood at 1.07 times but profitability appears reasonably high and profit interest coverage stood at 7.18 times indicating that this level of debit can be sustained.

CONCLUSION

Relatively highly geared company with good profitability and cash generating capability. The accounts available indicate that the company appears to operate a policy of profit retention (Divided only £375,000) which will greatly assist future growth.

The company possesses a fair degree of liquidity in the form of cash and debtors which provides comfort for secured and unsecured lenders alike.

SPREAD SHEET
HISTORICAL & PROJECTED BALANCE SHEETS

Internal Analytical Form used
Group Asset Management Service
to produce interpretation for
'GAMS-321 SYSTEM' - Form F-3 & CLF
Form 19/ADV-F-10C.

NAME ....
CONSOLIDATED/UNCONSOLIDATED

'GAMS-321 SYSTEM'-Form F-1 (Pg 1/3)

Branch:

(In .... 000's)

Date								
AUDITED/UNQUALIFIED/INTERIM		%		%		%		%
CURRENT ASSETS								
1 Cash								
2 Short Term Investments								
3 **Liquid Assets Total** (1+2)								
4 Notes Receivable								
5 Accounts Receivable (incl./excl.bills neg.)								
6 Provision for Bad Debts								
7 **Net Accounts Receivable** (4+5-6)								
8 **Monetary Assets Total** (3+7)								
9 Inventory: Raw Materials								
10 : Work in Progress								
11 : Finished Goods								
12 **Inventory Total** (9+10+11)								
13 Prepaid Expenses								
14 Due From								
15								
16 **Other Current Assets Total** (13+14+15)								
17 **TOTAL CURRENT ASSETS** (8+12+16)								
CURRENT LIABILITIES								
18 Bank Borrowing								
19 Current Portion of Long Term Debt								
20 Notes Payable - Others								
21 **Short Term Finance Total** (18+19+20)								
22 **Accounts Payable**								
23 Due to								
24 Income Tax Payable								
25 Dividends Payable								
26 Accruals								
27								
28 **Other Current Liabilities Total** (23 to 27)								
29 **TOTAL CURRENT LIABILITIES** (21,22 & 28)								
30 **MONETARY NET WORKING CAPITAL** (17 - 29)								
OTHER NON CURRENT ASSETS								
31 Investment Securities								
32 Long Term Receivables (external)								
33 **Investment (external) Total** (31+32)								
34 **Investment-Associates etc.**								
35 Loans to Directors etc.								
36 **Investments Total** (33+34+35)								
37 Deferred Taxation								
38 Other Deferred Charges								
39 Losses/Formation Expenses								
40 **Deferred Charges Total** (37+38+39)								
41 Intangibles - Goodwill								
42 Intangilbes - Other								
43 **Intangibles Total** (41+42)								
44								
45 **TOTAL OTHER NON CURR ASSETS** (36+40+43+44)								
FIXED ASSETS								
46 Land								
47 Buildings (Gross)								
48 Furniture & Fixtures (Gross)								
49 Plant and Machinery (Gross)								
50								
51 Gross Fixed Assets Total (46 to 50)								
52 Accumulated Depreciation								
53 **NET FIXED ASSETS** (51-52)								
54 **TOTAL NON CURRENT ASSETS** (45+53)								
55 **TOTAL ASSETS** (17+54)								

NAME ....

(In .... 000's)

	Date		%		%		%		%
56	**WORKING CAP & NON CURR ASSETS** (30+54)								
	financed by								
	NON CURRENT LIABILITIES		%		%		%		%
57	Bank Loans								
58	Other Debt Capital								
59	Subordinated Debt								
60	Deferred Income								
61	Directors Loans								
62									
63	**LONG TERM DEBT TOTAL** (57 to 62)								
64	Deferred Tax								
65	Other Deferred Credits								
66	Provisions								
67									
68	Minority Interests								
69	**OTHER NON-CURR LIAB TOTAL** (64 to 68)								
70	**TOTAL NON-CURR LIABILITIES** (63+69)								
	EQUITY								
71	Preferred Stock								
72	Common Stock								
73	Treasury Stock								
74	Common Stock (72-73)								
75									
76	**PAID UP CAPITAL** (71,74 & 75)								
77	Capital Surplus								
78									
79									
80	**CAPITAL RESERVE TOTAL** (77 to 79)								
81									
82									
83	**OTHER UNDISTRIBUTABLE RESERVES** (81+82)								
84	**TOTAL UNDISTRIBUTABLE RESERVES** (80+83)								
85	**RETAINED EARNINGS**								
86									
87	**NETWORTH** (76+84+85+86)								
88	Non Current Liabilities and Networth (70 & 87)								
89	Current & Non-Current Liabilities Total (29+70)								
90	**TOTAL LIABILITIES** (87+89)								

CONTINGENCIES

91	Business Contingencies				
	(a) Letters of Credit				
	(b) Letters of Guarantee				
	(c) Foreign Exchange				
	(d) Acceptances				
	(e) Collections				
92	Other Contingencies				
93	**TOTAL CONTINGENCIES** (91+92)				
94	Other Committments				

HISTORICAL & PROJECTED INCOME STATEMENTS

'GAMS-321 SYSTEM - Form F-1 (Pg 3/3

NAME .... (In .... 000's)

Period		%		%		%		%
SALES								
95 Sales Revenue								
96 Other Related Revenue								
97 **NET SALES** (95+96)								
Cost of Goods Sold								
98 Inventory Cost								
99 Wages								
100 Depreciation-Mfg.								
101 Other Manufacturing Costs								
102 **CGS Total** (98 to 101)								
103 **Gross Profit** (97-102)								
Selling Gen & Admin Expenses								
104 Salaries and Wages								
105 Directors' Remuneration								
106 Fees								
107 Property								
108 Depreciation & Amortization on Fixed Assets								
109 Amortization on Intangibles								
110								
111 Advertisements								
112 Bad and Doubtful Debts								
113 Other SGA								
114 **SGA Total** (104 to 113)								
115 **Operating Profit** (103-114)								
Other Income								
116 Interest Exchange & Dividends								
117 Rental Income								
118 Income from Associates								
119 Profit on Sale of Assets								
120 Other -								
121 **Other Income Total** (116 to 120)								
Other Expenses								
122 Financial Charges-Interest etc.								
123 Other -								
124 **Other Expenses Total** (122+123)								
125 **Pre Tax Profit** (115+121-124)								
126 Tax								
127 **Profit After Tax** (125-126)								
128 Minority Interest								
129 Extraordinary Items								
130 **NET INCOME** (127 to 129)								
131 Dividend/Drawings								
132 Other Appropriations								
133 Profit Retained								

ADDITIONAL INFORMATION

Branch:

Spread Prepared by:

Department:

Signature:

Date:

SSAP9 (Revised) – the Stock Answer?

BY DICK EDWARDS AND HOWARD MELLETT

Legal requirements and accounting practice

The published accounts of limited companies have to comply with the requirements of the Companies Act and Statements of Standard Accounting Practice (SSAPs). This sometimes produces problems. For example, the 1981 Companies Act (now incorporated in CA 1985) introduced a requirement for all current assets to be reported at the lower of purchase price (or production cost) and net realisable value. This contrasted with SSAP9 *Stock and Work in Progress* (initially issued in May 1975) which stated that Long Term Contract Work in Progress (LTCWIP) should be included in the balance sheet at cost *plus attributable profit* less any foreseeable losses and progress payments received and receivable. On the face of it a set of accounts could not therefore comply simultaneously with the law and the existing SSAP9 and so, as the law takes precedence, the SSAP had been overruled.

A way out of this dilemma, however, is available to directors who can apply a "true and fair override", which permits them to depart from the detailed requirements of the Act where such action is necessary for the accounts to give a true and fair view. If this approach is adopted, a note must be included which gives particulars of the departure, the reason for it, and its effect. On this basis, the accounts of Vickers plc for the year to 31 December 1987 disclosed that a profit of £1.2m was included in the gross value of LTCWIP of £68.4m with a note that this constitutes "a departure from the statutory requirement for the valuation of stocks to enable the accounts to give a true and fair view". In this way, a set of accounts was able to comply with both the legal requirement and SSAP9.

Although the true and fair override enabled the provisions of SSAP9 to be applied, a further problem remained. The profit on LTCWIP was recognised throughout the life of the contract, but the SSAP did not address the question of how the contract should be reported in the profit and loss account; therefore, the net profit on the LTCWIP could be credited directly to the profit and loss account, or alternatively recognised by including the selling value of LTCWIP for the period and its related costs in cost of sales.

Dick Edwards is the chief examiner for Accountancy and Howard Mellett is the moderator for Structure of Accounts

A revised version of SSAP9 was issued in September 1988 and contains basic changes in the manner of the profit's inclusion in the profit and loss account and the calculation of the value of stock to be shown in the balance sheet. These changes are designed to overcome the problems discussed above.

A further innovation, to be noted in passing, is that SSAP9 extends the definition of what constitutes a long-term contract. The original SSAP excluded contracts which ran for less than one year, while the new version recognises that it *might* be appropriate to include such contracts where a company is substantially engaged in contracts which last for more than one year.

Attributable Profit and Foreseeable Losses

Attributable profit is the profit earned on the portion of a long-term contract completed at the accounting date, subject to the following:

1 A contract must be far enough advanced for its outcome to be assessed with reasonable certainty before any attributable profits may be identified and reported in the accounts.
2 Each long-term contract must be considered separately, and the expected outcome examined after allowing for future cost increases and any likely claims or penalties.
3 In line with the concept of prudence, any losses predicted on individual contracts must be provided for in full.

Example 1 shows how this operates in practice.

Example 1

	Contract A		Contract B	
	£000	£000	£000	£000
Total value of contract		400		400
Costs to date	150		350	
Costs to completion	100		100	
Expected total cost		250		450
Overall profit (loss)		150		(50)

An overall profit is expected to arise on contract A and credit may be taken for the element attributable to work completed at the balance sheet date; immediate provision must be made for the total loss expected to be suffered on contract B.

The Accounting Entries

Contract costs are debited, as they arise, to a LTCWIP account which should be opened for each contract. The following entries are made at the accounting date:

1 *Sales*

The *value* of work completed during an accounting period is credited to turnover and debited to debtors. Payments received or receivable on account of work completed are offset against debtors and if, as is likely, the amount recorded as debtors exceeds the sum received on account, then the net debit balance is reported in the balance sheet as a current asset entitled "amounts recoverable on contracts".

2 *Cost of Sales*

The *cost* of the work completed is credited to LTCWIP account and debited to "cost of sales" in the profit and loss account. Any provision for losses is created by debiting cost of sales and crediting a provision account.

3 *Stocks*

The balance of costs on the LTCWIP account (costs to date less amount transferred to cost of sales) represents the cost of uncompleted work. From this balance are deducted:

i) provisions for anticipated losses, and
ii) any excess of payments received on account of work done over and above the value of recorded sales (negative debtors).

The net balance is disclosed separately within stocks as "long-term contract balances".

Report Preparation

The Balance Sheet

The amounts to be included in the balance sheet are calculated by applying the following steps to each contract separately:

Step 1

Compare the selling value of work completed (SV) with progress payments received and receivable (PP).

If SV is greater than PP, the excess is entered in the balance sheet under debtors as "amounts recoverable on contracts".

[illegible]

Step 2

Deduct cost of sales from total costs incurred, the balance remaining on the LTCWIP account is carried forward to be matched with future revenue (after adjustment, if necessary, under Steps 3 and 4).

Step 3

From the value of stock found in Step 2 deduct any provision for losses up to the value of the stock. The excess of foreseeable losses over the value of stock, if any, is entered in the balance sheet as a provision.

Step 4

From the value of stock found in Step 3, deduct any excess of PP over SV, from Step 1. The excess, if any, is disclosed in the balance sheet in creditors as a payment received on account.

Diagram 1 (see across) shows how these calculations are made for each of four contracts and how the results are then aggregated to give the values to be entered in the published balance sheet.

The data to be processed is given in Diagram 1, and, applying the provisions of SSAP9, as revised, the balance sheet entries are shown in Diagram 2.

The Profit and Loss Account

The inclusion of sales and the related cost of sales (including any provision for anticipated losses) automatically recognises the attributable profit on work completed in the profit and loss account. The figures to be included based on the information given in Example 2 are shown in Diagram 3.

The Longer Term

Circumstances and estimates may change throughout the life of a contract, especially if it extends over a number of accounting periods, and so, at each accounting date, a review must be carried out and any necessary amendments made. Therefore, the results shown for a contract during an accounting year reflect not only that year's activity but also the effect of any changed estimates which have been recognised during the year. Particular accounting problems are likely to be met when, for example, the terms of a contract are modified or a dispute arises as to whether cost increases are recoverable from the customer. In these circumstances the reporting accountant must ensure that the likely outcome remains reasonably assessable; if not, then the prudence concept must be applied and no profit taken.

It Ain't What You Show, It's The Way That You Show It

The revision of SSAP9 should not alter the amount of profit reported for the year, only the way in which it is reported. It is no longer permissible to credit the profit on LTCWIP directly to the profit and loss account and omit its impact on sales and cost of sales. This standardisation of the method for including profit on long-term contracts in the profit and loss account improves comparability. The revised balance sheet presentation means that stock no longer contains any element of profit and so the need to use the true and fair override is removed. However, the new approach results in the introduction into the balance sheet of a number of separate balances, both debit and credit, which arise from the interaction of a number of diverse circumstances; their interpretation will demand a degree of accounting sophistication on the part of the reader. □

Diagram 1

Example 2

The following information relates to four long-term contracts worked on by a building contractor during the year to 31 December 1987 (all figures material and £000):

Contract	C	D	E	F
Selling value of work completed during 1987	250	350	200	100
Progress payments received and receivable in 1987	275	400	60	50
Costs incurred in 1987	240	210	230	155
Cost of work completed in 1987	180	170	220	135

Contracts C and D are expected to make overall profits, but losses of 32 and 10 respectively are forecast for contracts E and F.

There were no balances in respect of LTCWIP brought forward at 1 January 1987, and each contract is far enough advanced for its outcome to be judged with reasonable certainty.

Diagram 2

					Balance Sheet		
Contract	C	D	E	F	*Debtors*	*Stocks*	*Creditor/ Provision*
STEP 1							
Selling value of work completed (turnover)	250	350	200	100			
less: Progress payments	275	400	60	50			
Recoverable on contracts			140	50	190 Dr		
Excess to Step 4	25	50					
STEP 2							
Costs incurred	240	210	230	155			
less: Cost of sales	180	170	220	135			
Stock carried forward	60	40	10	20		130 Dr	
STEP 3							
less: Provision for losses (up to stock value)			(10)*	(10)		20 Cr	
Balance: Provision for losses			(22)*				22 Cr
STEP 4							
less: Excess of PP over SV (up to stock value)	(25)	(40)**				65 Cr	
Payment on account		(10)**					10 Cr
Long term contract balances	35			10		45 Dr	

* Total provision for losses 10 + 22 = 32

** Total excess of PP over SV 40 + 10 = 50

Diagram 3

Contract	C	D	E	F	Total
Sales	250	350	200	100	900
Cost of sales	180	170	220	135	
Provision for losses***	–	–	32	10	
Total charge	180	170	252	145	747
Attributable profit					153

*** The information provided states that this figure is material; it must therefore be disclosed as an exceptional item.

Statements of Standard Accounting Practice

In order to appreciate thoroughly the requirements of these standards it is necessary to study the full texts. These can be obtained from the Institute of Chartered Accountants of England and Wales and purchased singly. Alternatively the full texts of all current standards 'Accounting Standards' can be obtained from the same source. This latter comprehensive publication is brought up to date annually.

Comment on the individual standards and how they affect the lending banker follow, but it is emphasized that more benefit will be obtained from reading and understanding the actual text of each standard.

SSAP 1. Accounting for Associated Companies

In the circumstances of a simple investment a company would bring into its profit and loss account the dividends received. However, where a company carries on a significant part of its business through an associated company a false impression would be given if, in the consolidated accounts, only the dividend income from the associated company was included. It could well be policy to restrict the dividends in the associated company in order to build up the capital base and this would be hidden from shareholders.

This standard of accounting practice was brought in to deal with this problem and the general principle is that the investing company should bring into its profit and loss account the dividends received (and thereby show its correct position as a legal entity) while in the consolidated accounts the investing company's share of the associated company's profits or losses will be brought into the consolidated profit and loss account and its share of the associated company's post-acquisition retained profits or accumulated deficit would be reflected in the consolidated balance sheet. This method is known as the equity method of accounting.

All that is now necessary is to know what is an associated company. First of all we should remember that a subsidiary company is one where a holding company either holds more than 50% in nominal value of its equity share capital or controls the composition of its board of directors. A company would not be classed as an associate if such conditions existed. There is a clear division between subsidiary companies and associated companies.

A temporary investment cannot make one company an associate of another. The investment must be for the long term and substantial in relation to other shareholdings and the investing company or group must be in a position to exercise a significant influence over the company in which the investment is made.

The standard says that significant influence over a company involves participation in the financial and operating policy decisions of that company (including dividend policy) but not necessarily control over those policies. Representation on the board indicates such participation but is not conclusive evidence and neither is it the only way in which participation in policy decisions can be obtained.

It will be seen, therefore, that whether or not a company is an associated one will depend on the facts in any particular instance. However, the standard says that if a company owns 20% or more of the equity voting rights it should be presumed that the investing company can exercise significant influence.

In summary, therefore, a holding company or a group will class another company as an associate if it;

1. is holding its investment for the long term, and
2. can exercise a significant influence over the affairs of the company in which it holds the investment, and
3. it is presumed to exercise such influence if it holds 20% or more (not of course exceeding 50% when it will be a subsidiary) of the equity voting rights.

For further details of the accounting treatment and the bankers' view see Chapter 12.

SSAP 2. Disclosure of Accounting Policies

The directors of companies have commercial judgements to make while the accountants have to decide how to reflect the results in accounts. There obviously can be several ways in which to reflect the results depending upon whether an optimistic or pessimistic view is taken. It can be seen that if one view is taken one year and a different one the following year that no real comparison year by year can be obtained. It is necessary, therefore, that there should be consistency in the policies adopted by each company.

There are four fundamental accounting concepts which, in particular, are mentioned in this standard.

1. Going concern. That is that there is no intention to liquidate or curtail significantly the scale of operation.
2. Accruals. Revenue and costs are accounted for as they are incurred not when money is received or paid.
3. Consistency. As explained above.
4. Prudence. Profits are not anticipated and provision is made for all known liabilities.

Within these concepts it is possible to have considerable variations in, for example, depreciation of assets, valuation of stocks and raw materials, leasing transactions, conversion of foreign currencies and dealing with long term contracts.

Many other items can be dealt with in a variety of ways and the standard lays down that specific accounting bases should be selected and followed consistently.

These policies have to be shown in the notes to the accounts and a banker should read and understand them in order to interpret thoroughly the figures shown in each set of accounts.

SSAP 3. Earnings per share

This standard applies to listed companies and stipulates that the earnings per share on a net basis should be shown on the face of the profit and loss account together with the figure for the corresponding previous financial period.

The method of calculation is laid down in order to make comparisons between companies on a like basis. Earnings per share are calculated on the profit in the consolidated balance sheet after deducting minority interests and preference dividends but before taking into account extraordinary items.

The net basis is that referred to after taking into account taxation including any irrecoverable advance corporation tax and any unrelieved overseas tax on dividend payments.

From a banker's point of view it is important to keep in mind that the earnings per share are based on the consolidated figures and that this includes the share of profits (not the dividends received) of associated companies.

SSAP 4. The Accounting Treatment of Government Grants

There are numerous types of grants. Those that are made with reference to revenue expenditure cause no problems as the grants should be credited direct to the profit and loss account to offset such expenditure. Those related to capital expenditure should not, however, be treated in the same way as this would boost profits in the year in which the grant was obtained whereas the economic advantage of the fixed asset would be spread over a period. This standard specifies that the grant should also be spread over the expected useful life of the asset.

Balance sheets will show, in such circumstances a deferred credit, a portion of which will be transferred to revenue annually. A banker should keep in mind that in many instances capital grants are only made because no such investment would be made on purely commercial grounds. The deferred credit should, therefore, be looked upon with caution.

SSAP 5. Accounting for Value Added Tax

This standard is not of great importance to a lending banker but he should note that the turnover shown in profit and loss accounts excludes V.A.T. (see p. 174).

SSAP 6. Extraordinary Items and Prior Year Adjustments

In order to avoid distortion in the profit and loss accounts many accountants used to favour putting extraordinary items and prior year adjustments direct to reserves. However, this standard considers that this does not give as correct a view of the progress of the business as is possible. The standard states that such items should generally be credited or debited to the profit and loss accounts in the years in which they occur but should be disclosed as separate items after the ordinary results have been obtained. This is the same treatment as indicated by the profit and loss formats in the Companies Act 1985.

There is an exception, however, for some prior year adjustments. If there are material adjustments arising from changes in accounting policies and from the correction of fundamental errors the adjustments should be made to the prior years with the result that the opening balance of the retained profit will be adjusted. Disclosure by a note to the accounts should be made. Normal recurring corrections, however, should go to the profit and loss account in the same way as extraordinary items and, if material, should be disclosed.

SSAP 8. The Treatment of Taxation under the Imputation System in the Accounts of Companies

The following points should be understood;

1. Advance Corporation Tax (A.C.T.). When a company makes a distribution to shareholders it is required to make an advance payment of Corporation Tax. This is not a deduction from the gross dividend with the shareholder receiving the net amount but a figure on top of the distribution to the shareholder. The shareholder receives a tax credit as he is chargeable to tax on the total of the dividend plus the tax credit.
2. Corporation Tax. This is the tax liability on a company's income and, when paying it, the A.C.T. already paid in the year is normally deducted.
3. Mainstream Corporation Tax. This is the net sum payable. Therefore, Corporation Tax is a combination of Mainstream Corporation Tax and A.C.T.
4. Franked Investment Income. This is the income received from another U.K. resident company with the addition of the related tax credit. The net amount can be redistributed to shareholders of the recipient company without further payment of A.C.T. and the shareholder is entitled to a tax credit on the distribution.
5. Unrelieved Overseas Tax. If the rate of overseas tax exceeds the rate of Mainstream Corporation Tax part of the overseas tax will be unrelieved. In these circumstances it may not be available for calculating overseas tax credit and, if this is the case, it should be debited to the profit and loss account and separately disclosed.

There are some variations in the recoverability of A.C.T. although it is principally recovered by being set off against Corporation Tax in the year in which the related distribution is made to shareholders. The two previous years are also available to absorb the relief. A.C.T. can be carried forward indefinitely but if the A.C.T. is large and the foreseeable future profits are expected to be relatively small the prudent course would be to write off some or all of the A.C.T.

The accounting problem is whether to treat A.C.T. as part of the cost of the dividend or whether it should be treated as part of the tax on the company's profit. This standard says that dividends should be shown in the profit and loss account and that the charge for taxation shown in the accounts is to be the full Corporation Tax i.e. the A.C.T. plus Mainstream Corporation Tax.

Separate disclosure is necessary for the charge for Corporation Tax (and any transfers to and from deferred taxation account), tax on franked investment income, irrecoverable A.C.T., the relief for overseas taxation and the total of overseas taxation.

The balance sheet will treat the A.C.T. on proposed dividends as a current tax liability.

SSAP 9. Stocks and Work in Progress

As it is possible to value these items in so many different ways this standard is an important one. The normal method of valuation laid down is that of cost or, if lower, at net realizable value. Each item of stock should be valued separately or, if this is impracticable, groups or categories can be valued together. Costs can include related production overheads.

It is not permissible to use an estimated replacement cost if the effect is to take into account a loss which is greater than that expected to be incurred. On long-term contract work, if the outcome can be assessed with reasonable certainty, an attributable profit can be added to cost but this must be assessed with prudence.

There are many methods of costing and the standard states that the accounting policies followed in arriving at the amounts for stocks and work in progress must be disclosed in a note to the accounts.

SSAP 10. Statements of Source and Application of Funds

This accounting standard applies to all enterprises with a turnover or gross income of £25,000 per annum or more and it states that this funds statement should form part of the audited accounts of a company.

For details of how this statement is produced see Chapter 1.

SSAP 12. Accounting for Depreciation

The standard states that the allocation of depreciation to accounting periods involves managerial judgement and, as such, requires annual review in the light of possible changed circumstances.

In order to allocate depreciation to appropriate accounting periods managements must take into account the cost of assets, their useful life and the anticipated residual value. Where the residual value is expected to be small it should be regarded as nil with the depreciation calculated accordingly.

Financial statements should state for each major class of depreciable asset;

1. the depreciation methods used
2. the useful lives or the depreciation rates used
3. total depreciation allocated for the period
4. the gross amount of depreciable assets and the related accumulated depreciation.

If there is a change in the depreciation method used it should be brought to the attention of readers through a note to the accounts and it is not permitted to omit charging depreciation on a fixed asset on the basis that its market value has increased. If the new market value is to be used and the asset written up in the books, depreciation must be charged by taking the new value into account.

A banker will be able to see whether the depreciation rates used are prudent by comparing them with the rates used by other companies in similar businesses.

SSAP 13. Accounting for Research and Development

Research and development generally falls into three categories – pure research, applied research and development expenditure. It is difficult to lay down dividing lines between these three categories but the standard emphasizes that prudence in treatment is to be observed. The first two categories are considered to be normal continuing expenditure and should be written off in the periods in which they are incurred. The Companies Act 1985 also does not permit research expenditure to be treated as an asset.

Development work on new or improved products is quite different and it can be asserted that if such development work is expected to bring future commercial benefits, the expenditure should be matched against future revenue.

This is accepted by this standard which gives guidelines for assessing the uncertainties involved. Prudence is stressed, and if the available evidence gives justification, it is permitted to bring forward a balance on development expenditure to be written off over the period expected to benefit.

Detailed disclosure could raise considerable problems of definition and, therefore, disclosure is limited to the movements of unamortized development expenditure during the year. The accounting policy followed must, however, be clearly explained.

SSAP 14. Group Accounts

The normal accounts required by this standard are consolidated accounts and only exceptionally are alternative forms of group accounts permitted.

An overriding aspect is that the group accounts should present a true and fair view and that uniform group accounting policies shall be followed. If differing accounting policies are used this must be disclosed and the reasons given.

Whenever practical the financial statements of subsidiaries shall be prepared to the same accounting date as the holding company and associated companies shall be incorporated by the equity method of accounting (see SSAP 1 and Chapter 12).

SSAP 15. Accounting for Deferred Tax

Deferred tax is related to timing differences between profits and losses as computed for tax purposes. Timing differences are those which originate in one financial period and are capable of reversing in subsequent periods.

The deferred tax payable is computed according to the liability method which is calculated at the rate of tax which is expected to apply when the tax is payable.

Whether there will be a liability or not must be based on reasonable assumptions and a prudent view must be taken.

The amount of deferred tax relating to ordinary activities should be shown in the profit and loss account or in a note, as must deferred tax on extraordinary items. The full amount of any unprovided deferred tax must be shown in a note and analysed into its major components.

The balance on the deferred tax account must also be shown and transfers to and from deferred tax must be disclosed in a note.

For further information on deferred tax see Chapter 14.

SSAP 17. Accounting for Post Balance Sheet Events

Events occurring after the end of a financial period can be:

1. Adjusting events. Those which provide additional evidence relating to conditions existing at the balance sheet date.

2. Non-adjusting events. Events which concern conditions which did not exist at the balance sheet date.

This standard states that if material adjusting events occur after the end of a financial period and up to the time that the balance sheet is signed, changes in the financial statement should be made. In order to assess 'materiality' it is necessary to take into account all matters which will enable users of financial statements to assess the financial position.

If the non-adjusting events are material reference should be made to them in a note.

SSAP 18. Accounting for Contingencies

For the purpose of this standard a contingency is a condition which exists at the balance sheet date where the outcome will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events.

Where it is probable that there will be a material contingent loss this should be accrued in financial statements. A contingent financial gain should, however, not be anticipated but if it is probable that the gain will be realized a note should appear with the financial statement.

Obviously, careful judgement is necessary by the directors to decide on whether to account for contingencies.

SSAP 19. Accounting for Investment Properties

A company can hold investment properties whether or not its main business is that of an investment holding company. It all depends on the facts.

The point is that such investments are not held for consumption in the business enterprise and the disposal would not materially affect the trading activities of the company.

For many investments the depreciation on the lines of SSAP 12 is inappropriate (although leases, especially short ones, provide an exception) and it is more important to know the current value of such investments in order to gain a proper appreciation of the financial position.

The standard requires investment properties to be included in the balance sheet at open market value although it is not necessary to employ an external valuer. If the company is a listed one an external review should be carried out, at least, every five years. The adjusting entries are made through an investment revaluation reserve account which is non-distributable. The balance of such an account is required to be shown in the balance sheet formats specified in the Companies Act 1985.

SSAP 20. Foreign Currency Translation

A company may carry out operations in a foreign currency either on its own behalf or through a foreign enterprise which keeps its own accounting records.

(a) If a company carries out operations on its own behalf it must translate each transaction at the exchange rate ruling at the time of the transaction. If there is little fluctuation in the rate during the period an average rate can be used.

At the balance sheet date the company may be holding non-monetary assets (generally fixed assets) and net monetary assets (generally net current assets) abroad. The non-monetary assets when first translated should be kept at that translation figure without subsequent movement because of exchange rate fluctuations. For monetary assets the closing rate at the balance sheet date should be used unless there are attributable forward or other contracts establishing a different rate. Any long-term contracts are generally dealt with at the closing rate.

It will be seen that there can be gains and losses on exchange differences on revenue and on net current assets and these are considered to be on ordinary activities and appear in the profit and loss account. If there should be gains or losses on extraordinary items they would be treated as extraordinary items in the same way as for non-currency items (see SSAP 16).

(b) If a company has a foreign enterprise carrying on its own activities the investment in the foreign enterprise is really in the net assets and not in the individual items.

The standard says that in these circumstances the closing rate at the balance sheet date is the appropriate rate to use, but it does allow, in certain circumstances, for an average rate to be used. Consistency year by year must apply.

Following the theme that the investment is in the net assets any exchange differences would not be akin to trading activities and gains and losses have therefore to be put through a reserves account.

There can be a combination of these two methods of conducting foreign trade. The situation can be as in (b) above but although there are separate entities they are so closely linked that the results of the overseas entity are more dependent upon the economic environment of the investing company. This would be similar to a head office and a branch. In these circumstances the 'temporal' method of translating is used. This is similar to that used in (a) above.

The standard also deals with borrowing by an investing company in a foreign currency to finance the foreign equity investment. In these circumstances, there is, at least, a partial hedge against exchange movements as foreign currency borrowings can be offset against foreign currency investments. Any translation differences should be dealt with through reserves.

For the banker, therefore, he should look to see which translations have taken place through the profit and loss account and which through reserves.

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For the banker, therefore, he should look to see which translations have taken place through the profit and loss account and which through reserves.

... position accordingly.

SSAP 21. Accounting for Leases and Hire Purchase Contracts

Leases and hire purchase contracts have a great deal of similarity although legally they are quite different.

The ownership of a leased asset rests with a lessor who leases it to a lessee for an agreed regular payment. With the law as it stands at present, ownership cannot pass to the lessee at the end of the lease term. In a hire purchase contract the hirer is able to purchase the asset at the end of the hire period and this is usually for a nominal sum.

Leases are of two types, financial leases and operating leases. The operating lease is one where the lessee pays a rental for use of the asset for a period which is substantially less than the economic life of the asset. A finance lease is one whereby the lessee pays the lessor the full cost of the asset plus an interest amount. The contract provides that substantially all the risks and rewards are accepted by the lessee.

In both lease and hire purchase transactions during the term of the contracts the ownership of the asset rests with the lessor or the hire purchase company, and if legal ownership was the criterion for reflection of the asset in accounts the value of the asset would appear in lessor's or hire purchase company's books with only the lease or hire payments appearing in the accounts of the enterprise actually using the asset.

It will be seen that unless full disclosure takes place a lessee or hirer could produce accounts which would give no indication of the liabilities incurred.

This standard, therefore, provides for disclosure by setting out the method of accounting for these transactions.

Lessees of financial leases and hirers must enter the value of the assets in their balance sheets as if they owned them with a contra entry for the payments due. The methods for calculating these amounts are stated in the standard. A finance lease is, therefore, capitalized by a lessee by which he accounts for the right to use and enjoy the asset with simultaneous recognition of the obligations to make future payments. A hire purchase transaction is accounted for in a similar way but with an operating lease only the rental payments are taken into account by the lessee.

As far as lessors are concerned, the amounts due from a lessee should be recorded in the balance sheet under debtors while the earnings should be allocated to accounting periods to give a constant return on the lessors' net cash investment.

Disclosure in financial statements of both lessee and lessor have to be made in sufficient detail, as set out in the standard, to make the position plain.

SSAP 22. Accounting for Goodwill

The value of a business as a whole can differ from the value of its net assets. This can be either a positive or negative figure and is known as goodwill.

Goodwill can obviously apply to an existing business but it is not the practice to recognize a balance sheet value for goodwill in such circumstances. Where, however, a business has been purchased at a price above that of the net assets, a figure for purchased goodwill will have been paid.

This standard prefers that purchased goodwill should normally be eliminated by immediate write off. This would be consistent with the treatment for non-purchased goodwill. The write off should be against reserves and not as a charge in the profit and loss account.

Conversely, a business may have been purchased for less that its net assets, in which case, a negative amount for goodwill will appear. This should be eliminated by crediting it to reserves.

The standard, however, also allows a company to carry purchased goodwill as an asset subject to writing it off through the profit and loss account over its useful economic life.

The judgement to be made by directors is whether to eliminate goodwill immediately through the reserves account or whether to eliminate it through a reduction in future annual profits through the profit and loss account.

SSAP 23. Accounting for Acquisitions and Mergers

There have been many mergers and take-over bids in recent years and two different methods of accounting have developed.

1. Merger accounting. The financial statements of both enterprises are aggregated and presented as if the combining companies had always been together.
2. Acquisition accounting. The results of the acquired company are brought into consolidation only from the date of acquisition.

In both cases the accounts of the individual companies will be unaffected by the accounting treatment of the group. The legal entities are not disturbed, and it is only the consolidated figures which are affected.

The standard recognizes that there is merit in both methods and it considers that the most appropriate method to be used will depend upon the circumstances in each case.

Merger accounting is considered to be appropriate when two groups of shareholders combine and continue both businesses as before. Acquisition accounting is appropriate when full merger does not take place and substantial resources leave the group. Substantial resources are considered to be 10% or more.

Disclosure of the accounting treatment and any significant accounting adjustments must be made.

2/3 PROFITABILITY (INC OPERATING LEVERAGE)

PROFITABILITY

PATTERN OF SALES GROWTH - ANNUAL %

CONSISTANT

KEEPING AHEAD OF INFLATION

REASONS FOR FLUCTATIONS

PATTERN OF VARIABLE COSTS (ESP. PURCHASES)

ABILITY TO SELL AND BUY (MANUF) AT OPTIMUM PRICES	1 & 2	AS PURCHASE % OF SALES	
	1	a PURCHASE)	
		b MANUF WAGES	TO IDENTIFY PROBLEM AREAS
		c ETC)	
		d DEPRECIATION	GUAGE COST OF USING FIXED ASSETS
	2	GROSS PROFIT	- CONSISTANT OR IMPROVING - GOOD CONTROL OF PURCHASING, DISTRIBUTION, MANUFACTURING - FALLING - WHY

PATTERN OF FIXED COSTS

ABILITY TO CONTROL EXPENSES	1 & 2	AS % OF SALES	
	1	a COSTS OF EMPLOYMENT)	
		b OCCUPANCY	TO IDENTIFY PROBLEM AREAS
		c OTHER MAJOR COSTS)	
		d DEPRECIATION	AS ABOVE
	2	NET OPERATING PROFIT	- CONSISTANT OR IMPROVING - GOOD CONTROL OF OVERHEADS (FIXED COSTS - FALLING WHY

OTHER INCOME

AS A % OF RELEVANT ASSET IS RETURN REASONABLE

OTHER EXPENSES

INTEREST

HOW MANY TIMES COVERED BY OPERATING PROFIT (SAFETY LEVEL)

INDICATION OF AVERAGE BORROWING

OTHER - WHAT IS NATURE

TAX - DOES THE AMOUNT PAYABLE APPEAR COMMENSURATE
WITH LOCAL TAX LAWS, AMOUNT OF PRETAX PROFIT
IF NO TAX WHY - PAST LOSSES, CLEVER AVOIDANCE
SCHEMES

EXTRA ORDINARY ITEMS - WHAT IS THEIR NATURE / EFFECT

RETURN ON EQUITY - CONSISTANT OR RISING
- DOES IT EXCEED RATE OF RETURN ON SAFE INVESTMENT (SMALL FIRMS ADD IN DIRECTORS SALARIES)

DIVIDEND - (SEE ALSO DIRECTORS SALARIES / PARTNERS DRAWINGS)
(EQUITY COST) TOO HIGH - NOT LEAVING ENOUGH FOR FUTURE INVESTMENT / GROWTH

TOO LOW - COMPANY NOT ATTRACTIVE IF IT WANTS TO RAISE FUNDS

IS IT COVERED BY NCFO IF NOT HOW FINANCED

(FREE ENTITY OR SUBSIDIARY - NON PROFIT TRANSACTIONS)

EFFECTIVENESS OF ASSET UTILISATION

RATIO RETURN ON ASSETS

$$\frac{\text{NET INCOME}}{\text{TOTAL ASSETS}}$$

The above is a function of profit margin times asset turnover

The return achieved on sales

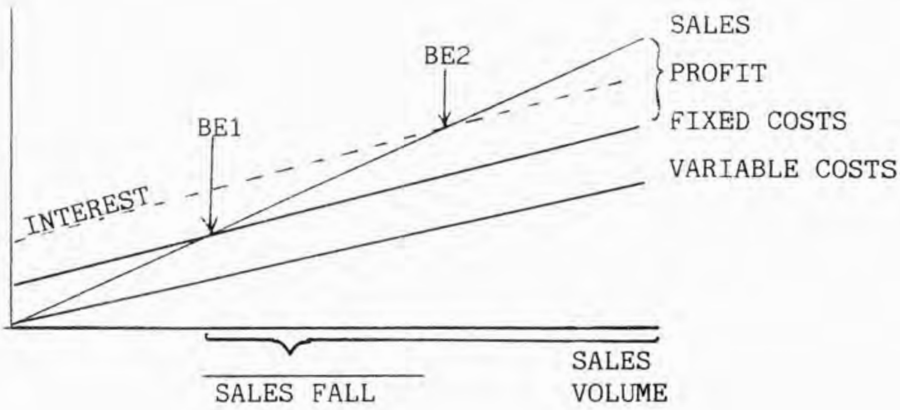
RATIO $\frac{\text{NET INCOME}}{\text{SALES}}$

Efficiency in using assets

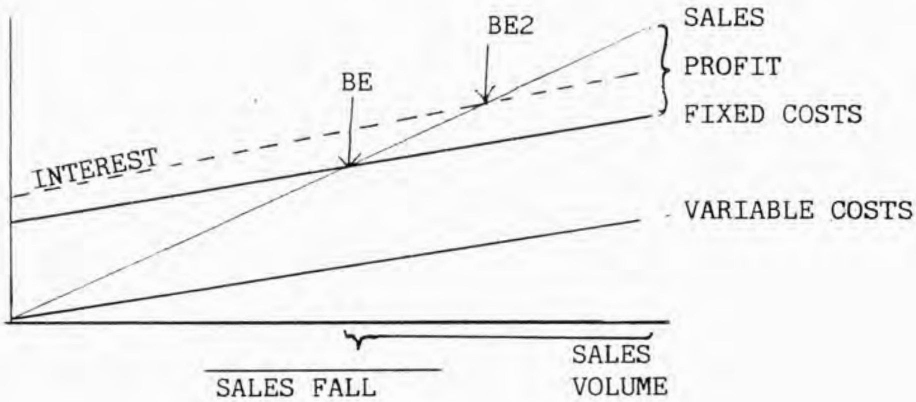
RATIO $\frac{\text{SALES}}{\text{TOTAL ASSETS}}$

Indicates that effective use of assets is as important as return on sales, and a deterioration may indicate insufficient control in this area.

BREAK EVEN
LOW
OPERATIONG
LEVERAGE



BREAK EVEN
HIGH
OPERATING
LEVERAGE



SENSITIVITY - WHAT SALES/GP MARGIN WOULD HAVE TO FALL TO BEFORE COMPANY COULD NOT COVER FIXED COSTS

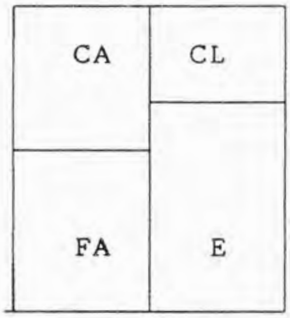
$$\text{SALES} \quad \frac{\text{SGA \& INT}}{\text{GP MARGIN}} \times 100 \qquad \text{G PROFIT MARGIN} \quad \frac{\text{SGA \& INT}}{\text{SALES}} \times 100$$

EFFECT OF OPERATING LEVERAGE ON BREAK EVEN AND THE ADDED EFFECT OF HIGH GEARING - HIGH VULNERABILITY

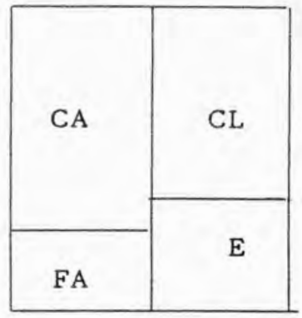
CARE AS TO NATURE OF FIXED AND VARIABLE COSTS SOME SGA MIGHT BE MORE VARIABLE THAN GGS E.G. MANUFACTURING WAGES

BALANCE SHEET STRUCTURE

HIGH



LOW



$$\frac{\text{CURRENT ASSETS}}{\text{FIXED ASSETS}}$$

CAPITAL INTENSIVE | NON CAPITAL INTENSIVE

IMPACT ON PERFORMANCE

HIGH FIXED COSTS | LOW FIXED COSTS

VULNERABLE TO FALL
IN SALES / GP MARGIN

↓

PROFIT DISAPPEARS / CASH
FLOW EFFECTED

TYPES OF TRADE

MANUFACTURER | TRADER

BEWARE CHANGING NATURE OF COMPANY - LEND FOR INVENTORY, SPENT ON INVESTMENT PROPERTY

EXCEPTION SERVICE INDUSTRY - HIGH OUTSTANDING COMMISSIONS
MINIMAL FIXED ASSETS BUT HIGH FIXED COSTS
- SALARIES

FINANCIAL INTENSITY

PROPORTION OF ASSETS IN INVESTMENTS -
COMPANY ITSELF A QUASI FINANCIAL INSTITUTION
WHAT TYPE OF INVESTMENTS
WHAT IS RETURN (CASH - DIVIDEND OR
NOMINAL - BY EQUITY METHOD)

4. ASSET MANAGEMENT

HOW EFFECTIVE IS A COMPANY AT USING ITS ASSETS

TO ACHIEVE ⟶ SALES

↓

NEED

INVENTORY = COST - HOLDING / STORAGE / CONTROL

RECEIVABLES = COST - HOLDING / CONTROL (DISCOUNT)

FIXED ASSETS = COST - HOLDING / MAINTENANCE / DEFPRECIATION

OFFSET

PAYABLES = INTEREST SAVING (BUT LOST DISCOUNT)

THEREFORE FOR

GOOD CONTROL (EFFICIENCY)

↓

MAXIMISE SALES ON MINIMUM ASSETS

BUT

TOO GREAT A REDUCTION WILL LEAD TO

↓

BREAKDOWN IN SUPPLY

↓

CUSTOMER DIS-SATISFACTION

↓

LOST SALES

TOTAL ASSETS TO SALES

1985

50	30	SALES 200
(GROSS 400) NET 300		

0.85 = GOOD OR BAD ?

SAY	1983	1984	1985
	1.2	1.0	0.85

IS IT BECOMING LESS EFFICIENT - POSSIBLY - FURTHER RESEARCH

TRADE COMPARISON - (SEASONALITY)

FIXED ASSETS

	TURNOVER	0.5	
SAY	LAND	250	50
	PLANT & MACHINERY	50	250

TYPE OF ASSETS

PRODUCTIVE	EFFICIENCY GAINING	EGO
PRINTING PRESS	COMPUTOR	ROLLS ROYCE
(TYPE OF BUSINESS)		

ESSENTIALS - EFFECTIVENESS, AGE, APPROPRIATENESS

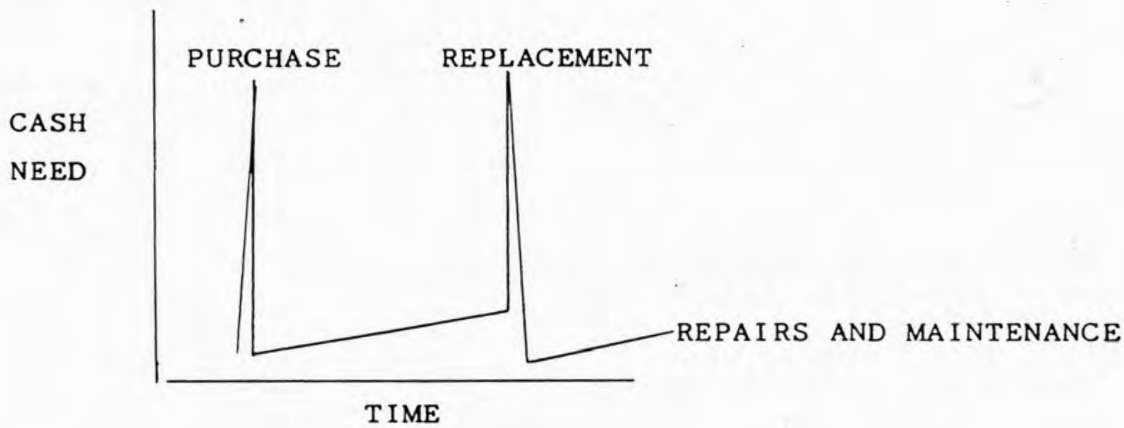
COST OF ASSET - WEARING OUT

DEPRECIATION - METHOD - ARBITRARY, GOVERNED BY CONVENTION

TAX IMPLICATIONS (BUYING TO CUT DOWN TAX NOT FOR REAL NEED)

IMPACT ON PROFIT - DEFERRED COST-DEPRECIATION WRITES OFF AGAINST REVENUE

MAINTENANCE AND REPLACEMENT - CASH IMPACT



FIXED ASSET TURNOVER

1982	1983	1984	1985	
0.3	0.4	0.5	0.5	GROSS

BETTER UTILISATION
FAILURE TO REPLACE IN TIME

$\Big\}$ FURTHER ENQUIRY

↓

CHECK INDIVIDUAL ASSETS
IS THERE A CONTINUOUS REPLACEMENT OF PRODUCTIVE ASSETS

CURRENT ASSETS

TURNOVER 4

1983	1984	1985
6	5	4

WHY - FURTHER ANALYSIS

ACCOUNTS RECEIVABLE

$$\frac{\text{A/C REC}}{\text{SALES}} \times 365$$

1983	1984	1985
55	58	62

Why deterioration in ability to collect sales

CHANGE OF PRODUCT / MARKET

INEFFICIENCY - CONTROL SYSTEMS

DEBTOR CONTROL - Indication of managerial ability

How long on average it takes to collect debtors

- Is it typical for trade if not why
- Is it constant trend
- Can customers produce aged debtors list

NOTE .Age,spread,Who(Small Companies,Multi Nationals),Encumberances(Factors)

If collection period days reduced cash released

EG Sales £5 mill

Collection period 65 days

If reduced to 60 days

Then $\frac{5 \times 5{,}000{,}000}{365} =$ £68000 freed as cash resource

Could this be done without los ing sales

without los ing profit (discount not given)

BAD DEBTS

As percentage of average receivables. How does it compare

How are customers (debtors) being assessed

Status enquiries

Balance sheet analysis

Are invoices sent out promptly

Is a prudent provision made

How are bad debts dealt with.

Provision Ratio Provisions - Gross Receivables.

INVENTORY

INV / CGS × 365	1983	1984	1985
	67	90	95

BUILD UP AHEAD OF PRICE RISE, SUPPLY DISPUPTION
INVENTORY SPECULATION
UNSALEABLE INVENTORY
CHANGE OF PRODUCT / MARKET
INEFFICIENTY - STOCK CHECKING SYSTEMS?
W.I.P. BUILD UP

ACCOUNTS PAYABLE

A/C PAY / CGS × 365	1983	1984	1985
	37	30	19

TAKING DISCOUNTS
PRESSURE FOR EARLY PAYMENT - WHO
CHANGE OF SUPPLIER

5. EQUITY SUFFICIENCY

ANALYSIS OF EQUITY SUFFICIENCY

- How much is there, as a percentage of total assets how much has been bought with owners funds. Higher the better in general.

- Where did it come from. From other sources or 'sweat equity'.

- Quality of assets - Break up value.

LOSS SUSTAINING CAPACITY

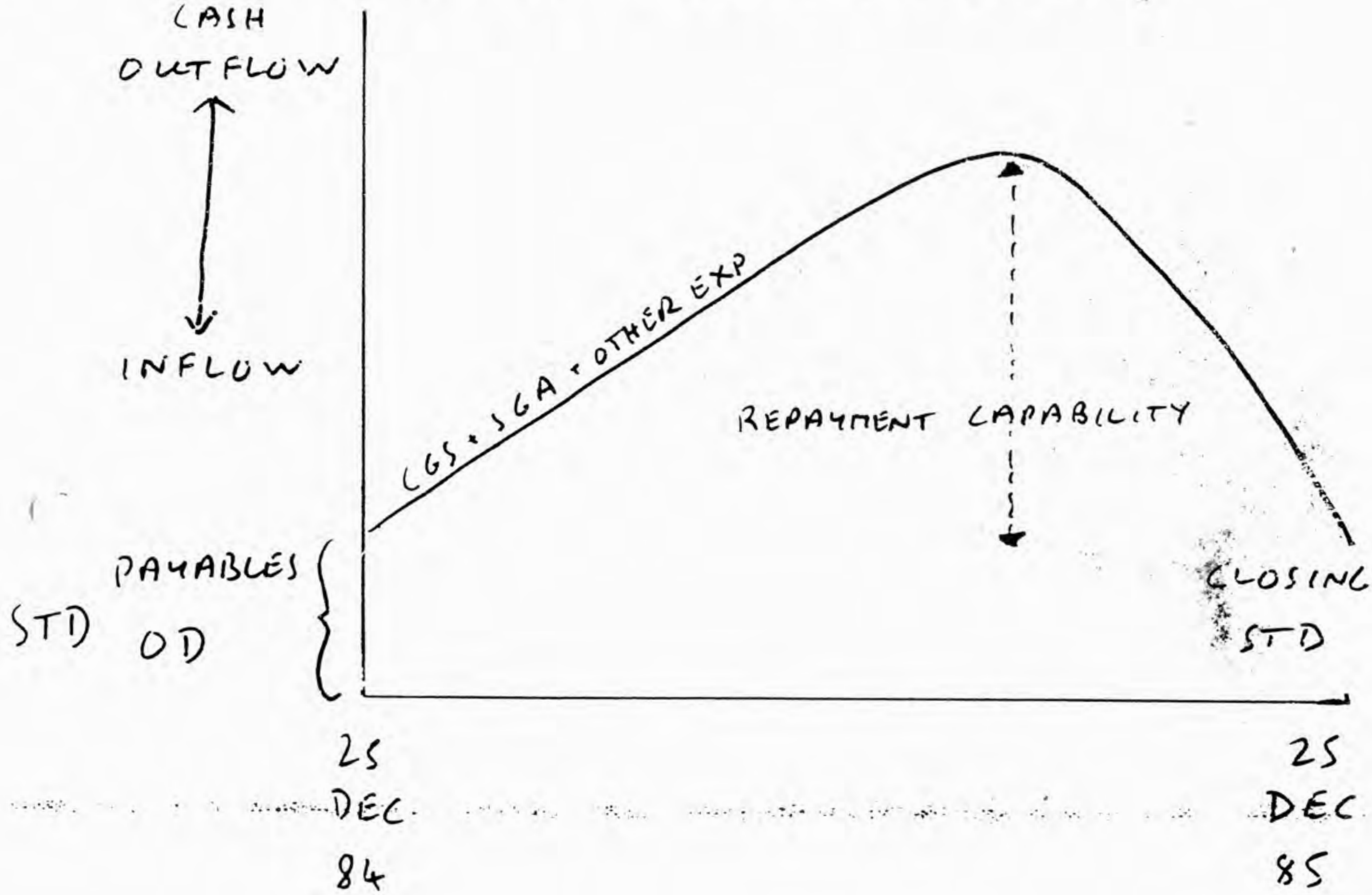
EXTENT TO WHICH A COMPANY COULD SUSTAIN LOSSES AND STILL SURVIVE

CASH SITUATION	YEAR	LOSS SUSTAINING CAPACITY
EASY TO GET SHORT TERM FUNDS ∴ NO CASH CRISIS	1 10 | 5 / E=5 P = 2	GOOD EQUITY SUFFICIENT PROFITS - LSC 7
STILL NO IMMEDIATE PROBLEM	2 10 | 5 / E=5 P = 0	EQUITY POSITION STILL FAVOURABLE - LSC 5
CRISIS IMMINENT COMPANY COULD FOLD ON CREDITOR PRESSURE IF IT COULD NOT SELL ASSETS	3 9 | 7 / E=2 L = 3	LSC 2
COMPANY MIGHT STILL BE SURVIVING BY PLAYING ONE CREDITOR OFF AGAINST ANOTHER	6 / NNW=1 | 7 L = 3	LSC NIL COMPANY IS INSOLVENT

8. REPAYMENT CAPABILITY

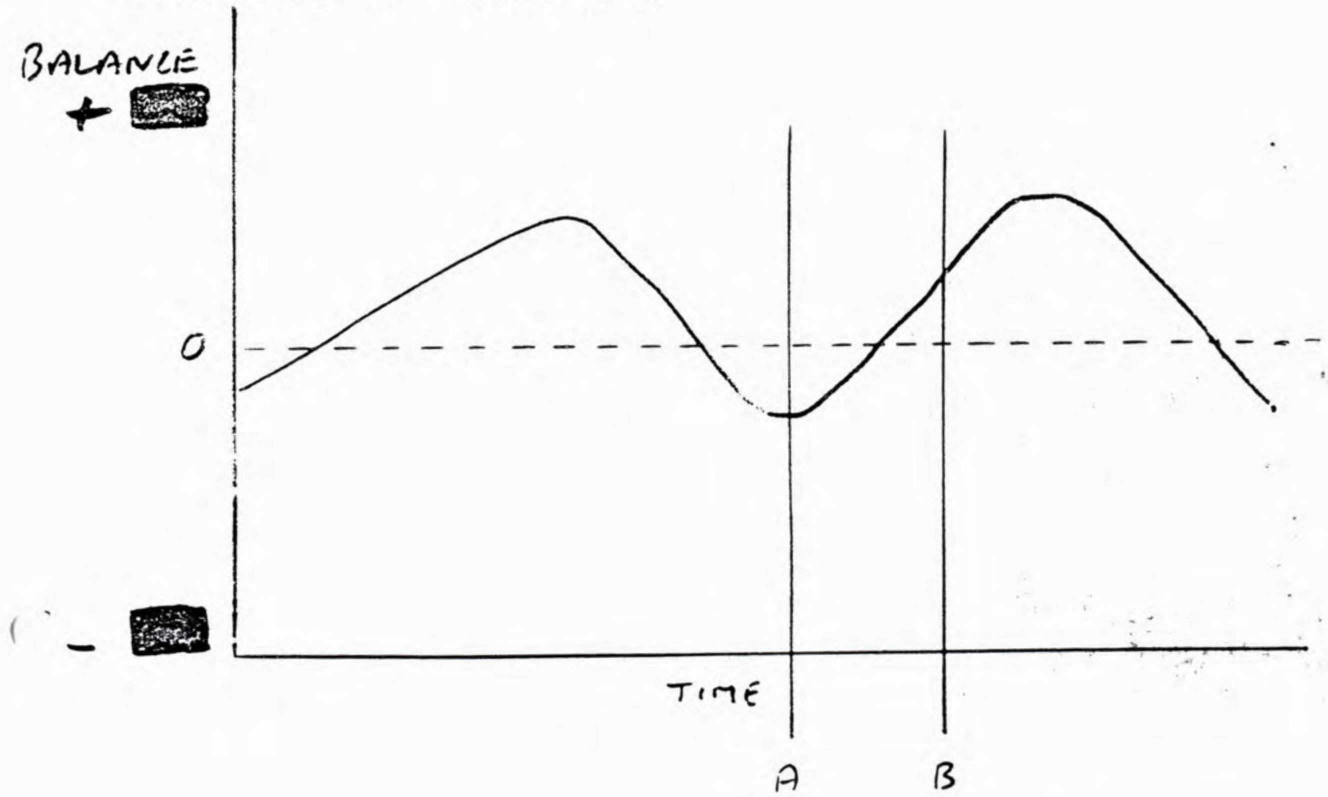
DYNAMIC REPAYMENT ABILITY

PLASTIC SANTA MANUFACTURER



RESIDUAL REPAYMENT ABILITY

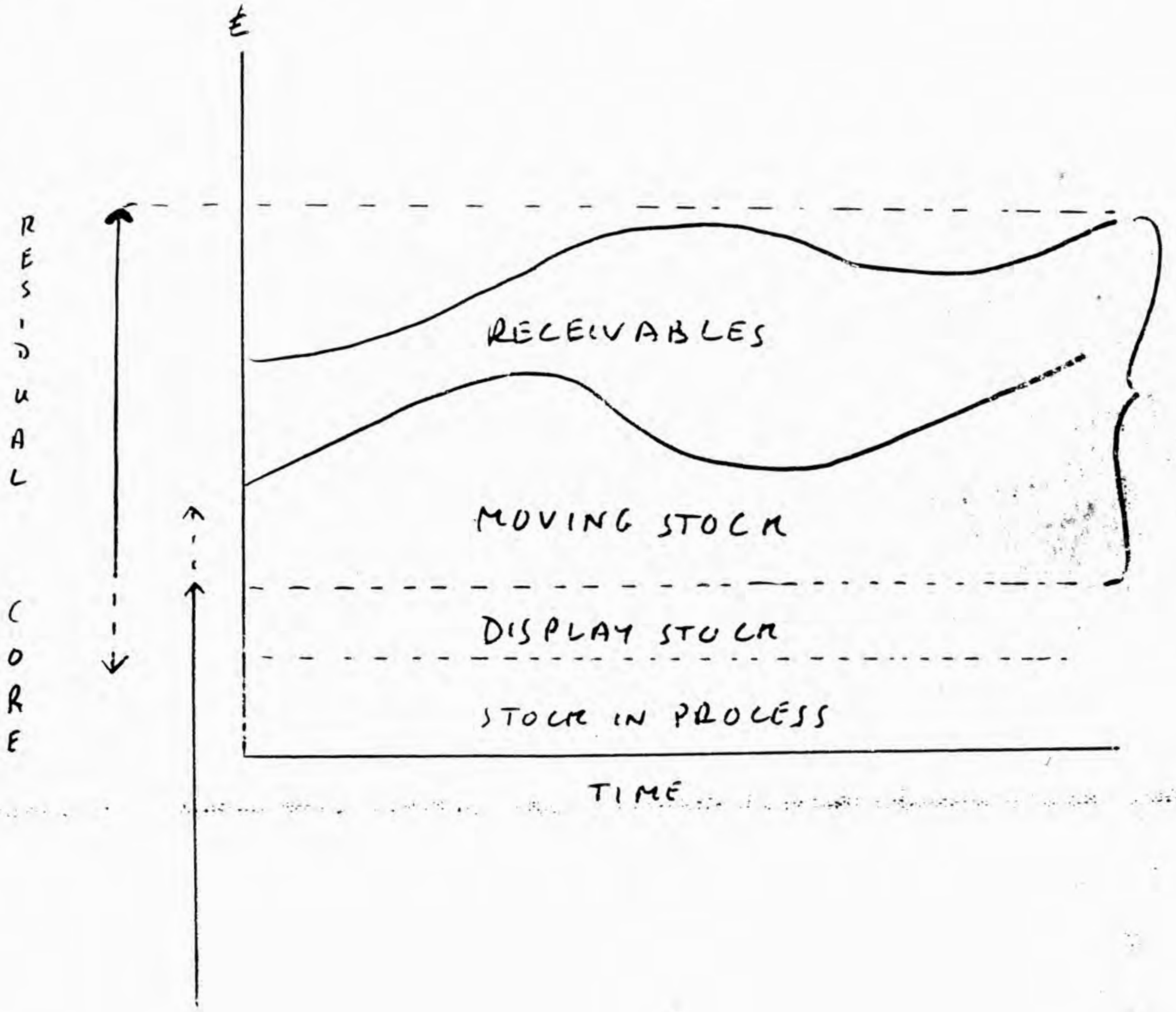
RESIDUAL AS DYNAMIC



A - BALANCE SHEET DATE - APPEARS RESIDUAL BUT WILL BE REPAID SOON

B - NO OVERDRAFT SHOWN

REGULAR RESIDUAL



RESIDUAL REPYAMENT ABILITY

OVERDRAFT APPEARING AS REGULAR FEATURE

IS NCFO SUFFICIENT TO COVER (Inc liquid resources)

$$\boxed{\frac{\text{NCFO + Cash \& S.T.Inv.}}{\text{CLOSING STD \& A/CS PAYABLE \& OPENING CURRENT LTD}}}$$

IF NOT

CAN CURRENT ASSETS BE REDUCED TO COVER

IF NOT

CAN ACCOUNTS PAYABLE BE INCREASED TO COVER
(OR ASSOC COYS)

<u>IF NOT</u> OVERDRAFT MAY HAVE BEEN USED

TO a) FINANCE CORE HOLDINGS
b) FINANCE FIXED ASSET PURCHASE

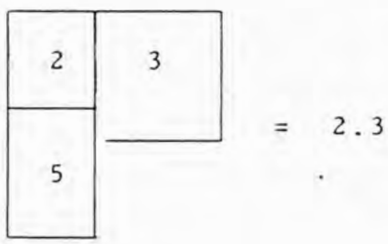
REPAYMENT WILL THEREFORE BE LONG TERM AND PROFITABILITY MUST BE SUFFICIENT AND CONSISTANT ENOUGH TO INDICATE THAT THERE WILL BE SUFFICIENT ANNUAL CASH INFLOW TO REPAY. O.D. SHOULD BE PLACED ON LOAN ACCONT TO SHOW POSITION.

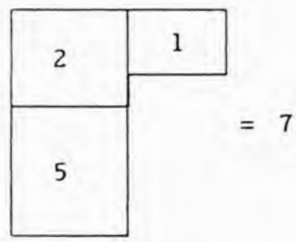
RESIDUAL REPAYMENT RELATIONSHIPS

CURRENT RATIO

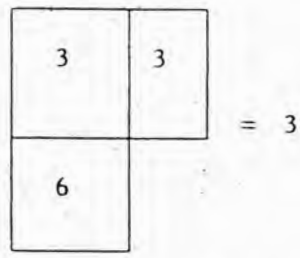
$$\frac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$$

INDICATION OF COVER AVAILABLE TO MEET SHORT TERM COMMITMENTS AS THEY FALL DUE





GREATER USE OF
LONG TERM
WHY



EFFECT OF PROFIT
PLOUGHED BACK INTO
WORKING CAPITAL

ACID TEST

$$\frac{\text{CASH RECEIVABLES ST. INV}}{\text{CURRENT LIABILITIES}}$$

HIGHLIGHTS LIABILITIES COVER OF THOSE ITEMS NEAREST TO CASH

LOOK FOR CONSISTANCY ESPECIALLY WHEN SALES RISE, FIND OUT REASON FOR DECLINE

Daily Telegraph Article 24/9/90
by Stephen Bell.

RESIDENT GAINS OUTSIDE UK

When a company ceases to be resident in the United Kingdom, it is liable to corporation tax on capital gains, based on the assumption that the company has sold its assets at market value before it becomes non-resident.

In contrast, there is no general capital gains tax charge on British resident trusts which become resident outside the country. The only liability is to capital gains which have previously been hold over on assets transferred into the trust at an earlier time.

Overseas resident trustees are not themselves liable to capital gains tax. However, gains realised by such trustees do become liable to capital gains tax if and when capital is distributed from the trust to United Kingdom resident beneficiaries.

These arrangements provide scope for capital gains tax planning, and may be particularly attractive to the owners of a rapidly growing family company. Shares in such a company may be settled on United Kingdom resident trustees, any gains arising at that point being held over. At a later stage the trust may be exported.

The only liability to capital gains tax arising at that point is the charge on the gain previously held over (which will not be substantial provided the shares were transferred to the trust before the company experienced major growth). Later on, in a tax year throughout which the trust is resident abroad, the shares in the company may be sold.

During a recent parliamentary debate on the Committee stage of the Finance Bill the Opposition tabled an amendment which would have curtailed severely the use of offshore trusts in capital gains tax planning, by bringing the treatment of migrating trusts into line with that of companies going abroad. An export charge based on a deemed disposal of assets at market value would have been imposed in respect of trusts becoming non-resident after 30 June 1990.

As this measure was not a Government amendment it stood little chance of being enacted. Nevertheless, it is a straw in the wind. Such legislation has been expected for some years now. Those concerned with United Kingdom trusts need to consider with the aid of professional advice where necessary, whether it would be appropriate to move them overseas in the coming months.

LOGO

COMPANY AND TRUST FORMATION

ADMINISTRATION CHARGES

1. Company Formation

Fee for incorporation of a private Isle of Man Company limited by shares or guarantee (including all Government filing fees)	£575.00

Government filing fees as above based on an authorised capital of £2,000 or less

2. Annual Administration Charges

Provision of:

Registered Office	£150.00
Corporate Secretary (including all Statutory Duties)	£175.00
Directors (each)	£275.00
Nominee Shareholders (where requested)	£125.00

All administration matters in connection with the day to day operation of the company, including;

attendance at directors meetings
preparation of minutes
preparation of financial statements
receiving and disbursing funds
asset administration

Charge to be calculated on an hourly rate or on a fixed fee basis to be negotiated.

It should be noted:

All Isle of Man non resident companies are required to pay annual non resident company duty of £450.00

All Isle of Man exempt companies are required to pay annual exempt company duty of £250.00

All Isle of Man resident companies are charged corporate income tax of 20% on their net profits

All Isle of Man companies are subject to an annual return filing fee of £35.00.

3. Dissolution

Cost of winding up an Isle of Man company by declaration of dissolution under Section 273 Companies Act Legislation (including all disbursements) £300.00

TRUSTS

1. Cost of establishing a trust including preparation of the Trust Deed. Arranging for signing receipt of Trust Assets. £400.00

2. Annual Administration Charges

To include:

Trustee meetings
Preparation of Minutes
Maintaining and changing trust assets, including investment portfolio management.
Preparation of trust accounts
Cash management, collection of income and disbursements
Bank account documentation and funds transfers etc.

Value of Assets

0	-	£1,000,000	1%
£1,000,000	-	£2,000,000	.75%
£2,000,000	-	£4,000,000	.5%
on excess over	-	£4,000,000	.25%

With a minimum fee of £800 per annum.

3. A distribution fee of 2% of all funds distributed will be charged annually

NOTE: The minimum fee will be reduced to £400.00 per annum where the only asset of the trust is a company for which we provide full administration services.

TERMS AND CONDITIONS

1. All company formation, trust establishment and annual administration charges are invoiced and payable in advance.

2. All invoices are payable within 30 days of issue and interest will become chargeable thereafter at the rate of 1.5% per month on the outstanding amount.

3. All hourly rate/fixed fee administration charges are invoiced and payable quarterly in arrears.

4. All invoices will include disbursements such as postage, telephone, fax and telex charges as well as regulatory filing fees and duties payable to the Isle of Man Government.

5. Where a company or trust ceases to use our services during a year, no portion of the annual administration charge will become refundable.

6. Where the administration of a company or Trust is transferred elsewhere, a termination charge of £250.00 will be made in addition to any other remuneration.

7. Fixed fee quotations for special situations are available upon request.

8. All invoices exclude VAT which will be added as appropriate.

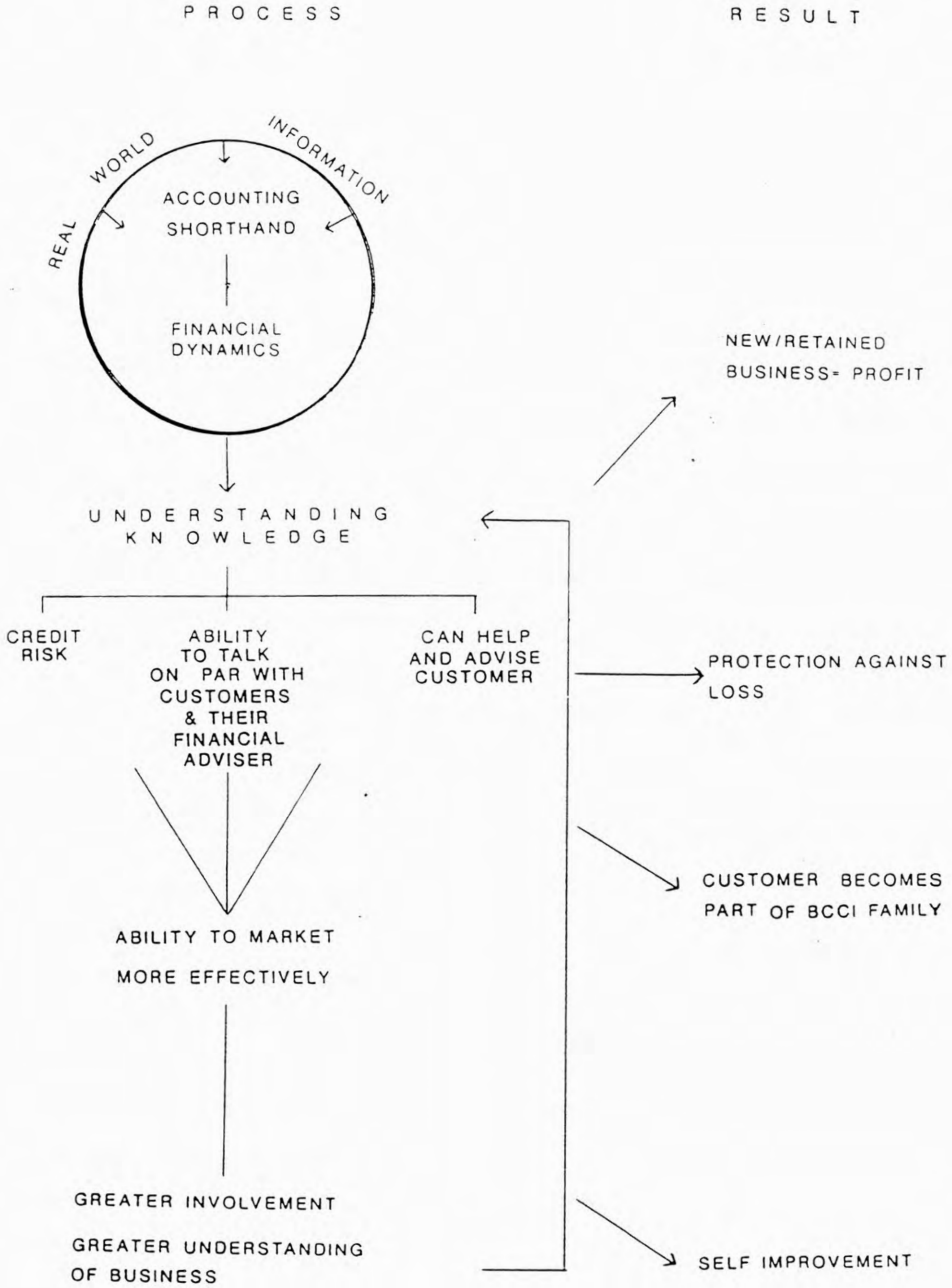
9. The client will be expected to complete a formal agreement with BCC Trust Corporation Limited and be prepared to supply satisfactory references.

CREDIT

ANALYSIS

1

OVERVIEW

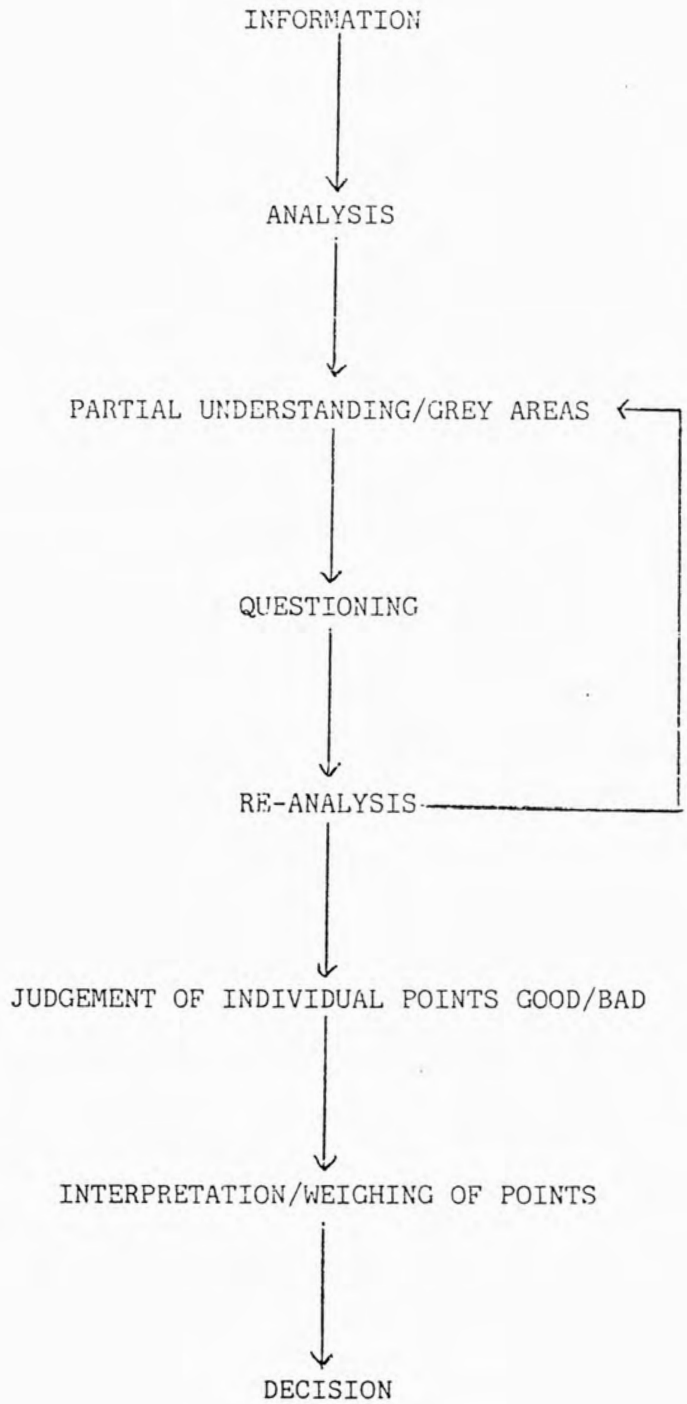

PROCESS
RESULT
REAL WORLD
INFORMATION
ACCOUNTING
SHORTHAND
FINANCIAL
DYNAMICS
UNDERSTANDING
KNOWLEDGE
CREDIT
RISK
ABILITY
TO TALK
ON PAR WITH
CUSTOMERS
& THEIR
FINANCIAL
ADVISER
CAN HELP
AND ADVISE
CUSTOMER
ABILITY TO MARKET
MORE EFFECTIVELY
GREATER INVOLVEMENT
GREATER UNDERSTANDING
OF BUSINESS
NEW/RETAINED
BUSINESS= PROFIT
PROTECTION AGAINST
LOSS
CUSTOMER BECOMES
PART OF BCCI FAMILY
SELF IMPROVEMENT

WHAT TYPE OF MENTAL PLAN DO YOU USE IN INTERVIEWS

INFORMATION - WHAT DO WE WANT TO KNOW ABOUT?

INDIVIDUAL	ANALYSIS	COMPANY
CHARACTER	PEOPLE	REPUTATION - RELIABLE - TRUSTWORTHY
		LIFE STYLE OF DIRECTORS - GAMBLER - PRUDENT
		OUTLOOK - CONSERVATIVE - INNOVATORS
EARNINGS CAPITAL	PAST PERFORMANCE	ANALYSIS OF BUSINESS OPERATIONS VIA FINANCIAL STATEMENTS ETC
		TRUE VALUE OF BALANCE SHEET ITEMS LESS LIABILITIES = CAPITAL
CAREER PROSPECTS	POTENTIAL	MARKET/INDUSTRY ANALYSIS
	TRANSACTION	
	PURPOSE AMOUNT	IN LINE WITH BCCI POLICY
		IS IT COMMENSURATE WITH CUSTOMER FINANCIAL STANDING AND BUSINESS ABILITY?
		IS IT CORRECT FOR REQUIREMENTS
	REPAYMENT	CASH SUFFICIENCY IN FUTURE FROM SOURCE RECOGNISED AT OUT SET
	SECURITY	ADEQUATE FOR CIRCUMSTANCES
	EARNINGS	INCOME EXCEEDS COST OF FUNDS, OPERATIONAL COSTS, STAFF COSTS - NOW OR IN FUTURE.

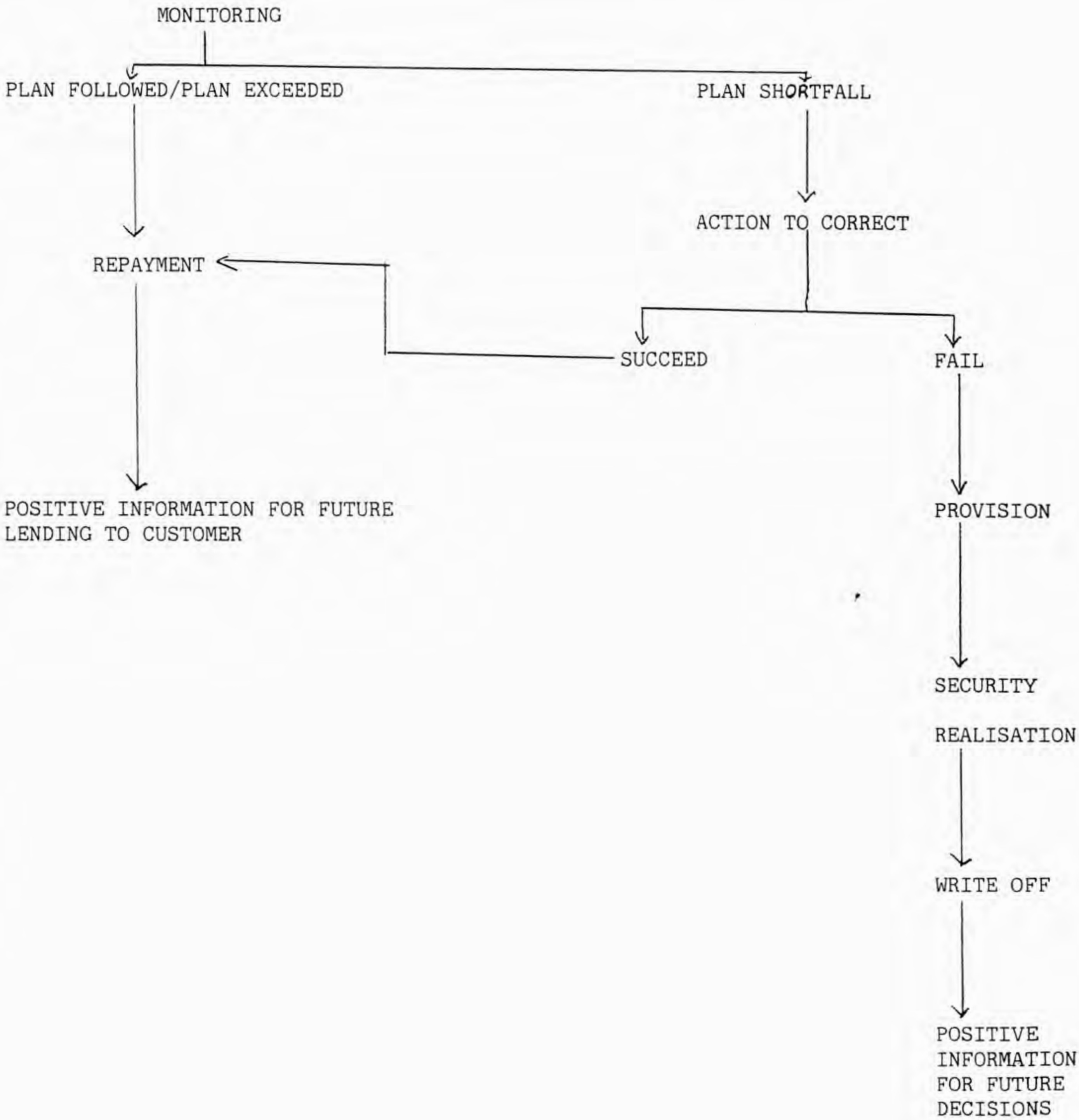
PROCESS


INFORMATION
ANALYSIS
PARTIAL UNDERSTANDING/GREY AREAS
QUESTIONING
RE-ANALYSIS
JUDGEMENT OF INDIVIDUAL POINTS GOOD/BAD
INTERPRETATION/WEIGHING OF POINTS
DECISION

INFORMATION - TYPES

CUSTOMER	OTHER
HISTORIC	INDUSTRY REPORTS/FORCASTS
FINANCIAL STATEMENTS	
OTHER - DIRECTORS EXPERIENCE	
BANK ACCOUNT ACTIVITY	PRODUCT REPORTS/FORCASTS
STATUS ENQUIRY	
BORROWING RECORD	
EYES/EARS	ECONOMIC REPORTS/FORCAST
SITE VISIT	
QUALITY OF ASSETS	
ORGANISATIONAL EFFICIENCY	
LABOUR RELATIONS	
CUSTOMER ATTITUDE/DEMEANOUR	
QUESTIONING	
FUTURE PLANS	
FINANCIAL PROJECTIONS	
PRODUCT CHANGES	
OPERATIONAL CHANGES	
SECURITY	
NECESSITY	
AVAILABILITY	BCC POLICY
VALUE/UTILITY	REPAYMENT CENTERED LENDING
	NOT PAWNBROKER
	VENTURE FINANCE

AFTER LENDING



ADVANCES DEPARTMENT CIRCULARS FILE MEMORANDUM NO 3

[illegible] August [illegible]

Regional Office

All Branch Managers in the UK and the Isle of Man

OFFER/FACILITY LETTER - DOCUMENTATION PROBLEMS

During a recent meeting of certain Branch Managers in Regional Office it became evident that the draft Offer/Facility Letter set out in the blue pages 46 to 46(f) of the Advances Department Circulars File was not being used in a way which was most beneficial to Branches.

It was intended that Branches should retain the draft in word processor or typewriter memories, or otherwise, in a manner which made it a simple matter to utilise only those paragraphs or parts or paragraphs relevant to the transaction.

The amended heading to blue page 46 now distributed draws attention to the need to utilise only what is relevant and as an illustration a new page 46(g) is distributed also as a specimen of the letter to be sent for an unsecured overdraft transaction.

Branches may find it helpful to use pages 46(h) to 46(i) to assist them in preparing specimen Offer Letters for the issue of Bank Guarantees for customers and for one off Letters of Credit which are requested by certain customers.

To cover those circumstances where release of funds is allowed before full sanction or documentation, a footnote has been added to the end of page 46(f) now distributed requiring Branches to seek assistance from Legal Department in preparing suitable undertakings from borrowers. Legal Department will only prepare undertakings against two authorised signatures of Regional Office.

As Branches report difficulties arising from renewals of Bank Guarantees when instructions cannot be obtained, an optional Bank Guarantee Clause has been inserted in amended page 46(e) also distributed with this memorandum.

Page 46(b) is enclosed because the sentences of the second paragraph dealing with Interest Rates have been re-arranged.

It was further suggested by Branches that a draft file note would assist in gathering information to allow full analysis of proposals both commercially and legally before submission for sanction. A specimen is enclosed and Managers are invited to discuss with Legal Department relevant paragraphs which may cause difficulties before commencing an interview. Brief checklists on various types of security are included so that the lists dealing with security offered are available at the meeting. Customers must not be asked to fill in the details. A copy of the interview note must accompany your Credit Line Proposal.

By obtaining details on these various points it will be possible for Branches to submit more detailed proposals and to prepare and have executed more complete documentation.

P B SUGDEN
LEGAL DEPARTMENT

A R VELMI
GROUP-IN-CHARGE

FORM J/83-UK OFFER/FACILITY LETTER - A copy of all letters issued must be sent to Legal Department as part of the security documentation when documents are first sent for examination. **MANAGERS SHOULD USE ONLY THOSE PARAGRAPHS OR PARTS OF PARAGRAPHS RELEVANT TO THE PARTICULAR FACILITY(IES).** A specimen letter for an unsecured overdraft is given at page 46(g) and specimen letters for guarantees & L/C's are at pages 46(h) - (i).

Principal Changes — The interest clause has been simplified.

To Complete **Make the insertions shown in this type and see optional clauses referring to "occupancy" and "negative pledge" and "cash".**

Dear — **Insert** Sir/Madam **or the addressee's name according to the relationship.**

Borrower — **Insert the correct full names of the borrower; if a proprietorship name include all names of the proprietors determined by search or enquiry in accordance with page S.1.; if a group facility, complete a separate letter for each company.**

Guarantor — **If applicable insert the correct full names of all guarantors including persons other than the borrower(s) charging their security; do not type in "GUARANTOR" if not applicable.**

Purpose — The borrower shall apply the proceeds of the facility in or towards [**insert**].

We refer to our recent meeting with you (or "our recent telephone conversation") and have pleasure in setting out below the terms and conditions upon which we have agreed to place at your disposal credit facilities, subject to completion of all formalities including insurance, acceptable valuations, and where applicable a satisfactory solicitor's report on title.

Amount — **Insert the figure for each facility and clearly identify with the appropriate purpose. If the lending is in a currency other than the currency which will be obtained by realising the security or is in more than one currency the documentation must contain a "currency clause" and the following sentence duly amended must be inserted.** The agreed currency/ies for these facilities is/are **(insert currency/ies as intended).**

Repayment — Whilst in accordance with banking practice, the facilities will become due and owing on demand, it is amounting to **(insert as authorised by Regional Credit Department)** % of the total loan offered is to be sent with the acceptance of the terms of this letter together with amounts of fees quantified below.

Management Fee	There will be fee of 1% per annum on the amount of the facility.
Commitment Fee	This will be a fee of **(insert amount) %** on the amount of the facility payable on acknowledgment of this letter.
Other Fees **This paragraph should not be inserted if no further documentation has to be completed**	Documentation **(obtain from Legal Department and insert).** Valuation **(obtain from valuer and insert)**
Out of Pocket	These will be debited to your account as Expenses and when they occur.
Interest Rates	In this connection and without prejudice to our stated discretion and interest charging details above, your attention is drawn to alternative interest rates expressed in any charge form(s) you have to execute. WE RETAIN THE RIGHT TO VARY THE MARGIN OVER BASE RATE/LIBOR. Interest will be calculated on the daily balances outstanding and charged to you monthly and any interest unpaid will be compounded with monthly rests both before and after any demand we may make or judgement we may obtain. Interest will be payable at the rates specified in this letter and any charge form executed or to be executed. Changes of base rate are advertised in the Financial Times. ***Note, if LIBOR is to apply instead of base rate the interest paragraphs must be amended and LIBOR clearly defined eg "(insert Margin"** % over six months Sterling LIBOR, minimum **(insert figure)**%".
Security	Your borrowing is to be secured by the following securities in the manner prescribed hereinafter. All clauses, terms, conditions, covenants, etc of our standard charge forms will apply, unless expressly

Should the margin fall below the minimum agreed level it is understood that you will provide or procure the provision of additional funds to restore such margin. It is to be understood that whilst we shall allow reasonable time for the margin to be increased, or the limits offered in this letter to be reduced effectively to maintain the minimum agreed margin, a further fall in the margin to less than 7.5%/10% **(delete according to the facility being granted)** shall allow us to adjust from the deposits under lien or charge otherwise subject to our standard security documentation without further demand or notice to you.

Third Party(ies)

The proposed advance is made on condition that as represented by you and the chargor(s) any and all monies charged and/or subject to our standard security forms in accordance with the above detailed security, are By beneficially and legally owned by the person(s) in whose name(s) the funds are deposited and that no other rights and interests of a legal equitable or beneficial nature exist in or over the monies by virtue of any deed covenant statute or other instrument and that no such interests arise out of any office or occupation held by the person(s) mentioned above or out of any other capacity whatsoever in which the monies are held by the/those person(s) or otherwise.

Following acceptance of the terms stipulated in this letter and completion of the necessary formalities, the facility(ies) will be available to you for availment at any time until (insert the last day the facility may be utilised). Please advise us as to when you wish to make use of the facility and we will make arrangements accordingly.

Optional Guarantee Clause

The guarantee will be issued on the understanding that your liability in respect thereof shall also apply to any extension or renewal (whether in the same terms or otherwise) of the guarantee and to any amendments or modifications to the guarantee and your indemnity will remain valid until notification to you of the cancellation thereof. When renewal is necessary at a time we cannot contact you, your acceptance of this letter is your agreement that we may renew, with amendments if requested, or pay at our absolute discretion.

Completion Instructions for
Security documents in England
and Wales.

Page No: 46(f)
Issue Date: July 1988
Queries To: Regional Credit
Legal Department

Do not type in if authorities are not sent We are enclosing the necessary authorities to enable the the facility to be established in due course and to cover the repayments. Please sign and return these to us.

Please return the duplicate of this letter duly signed together with any security not already in our possession.

Insert Your faithfully/Sincerely **as appropriate**

Branch Signatory

Branch Signatory

On the enclosed duplicate type the following:

I/We hereby acknowledge receipt of the original of the above letter and accept the offer contained therein **(if applicable insert "for which we accept joint and several liability")** and undertake to comply with its terms and conditions.

For and on behalf of **(Insert the full name of Company if applicable)**
Insert appropriate description. All partners to sign.

Director/Partner Proprietor
or name of individual

Director/Partner Proprietor
or name of individual

Date

IF RELEASE OF FUNDS IS TO BE ALLOWED BEFORE FULL SANCTION OR DOCUMENTATION IS COMPLETED APPLY TO LEGAL DEPARTMENT FOR A DRAFT OF THE UNDERTAKINGS REQUIRED FROM THE BORROWER AND SUCH ACKNOWLEDGMENT OF TERMS AND CONDITIONS AS MAY BE APPROPRIATE.

Complete fully and accurately to include all the security taken or not yet received. When applicable qualify any security not fully examined by typing against it, for example, "Subject to the bank's approval after examination/report on title/professional valuation".

Any other security which may, now or hereinafter be held by us, all of which is to be available to us as security for all your liabilities at any time.

Complete in the manner shown on page 46(f).

qualify any security not fully examined by typing against it, for example, "Subject to the bank's approval after examination/report on title/professional valuation".

Any other security which may, now or hereinafter be held by us, all of which is to be available to us as security for all your liabilities at any time.

Complete in the manner shown on page 46(f) if sanction has been given, if it has not and the phrase "are prepared to consider placing" is used complete the letter in the following manner.

Please return the duplicate of this letter duly signed together with any security not already in our possession.

ON THE DUPLICATE TYPE THE FOLLOWING:

I/we hereby acknowledge receipt of the (above) terms and conditions imposed by you to enable you to consider allowing the one off letter of credit I/we have requested which you have described in detail and I/we undertake to comply with these terms and conditions if the letter of credit is issued.

For and on behalf of **(Insert the full name of Company if applicable)**

Insert appropriate description. All partners to sign.

Director/Partner
Proprietor or name of
individual

Director/Partner
Proprietor or name of
individual

If telexing the terms and conditions before sanction omit the word "above" and give the telex number and date after the words "imposed by you" eg "in telex 1234 dated 6.12.88".

CREDIT ANALYSIS

2

FINANCIAL STATEMENT

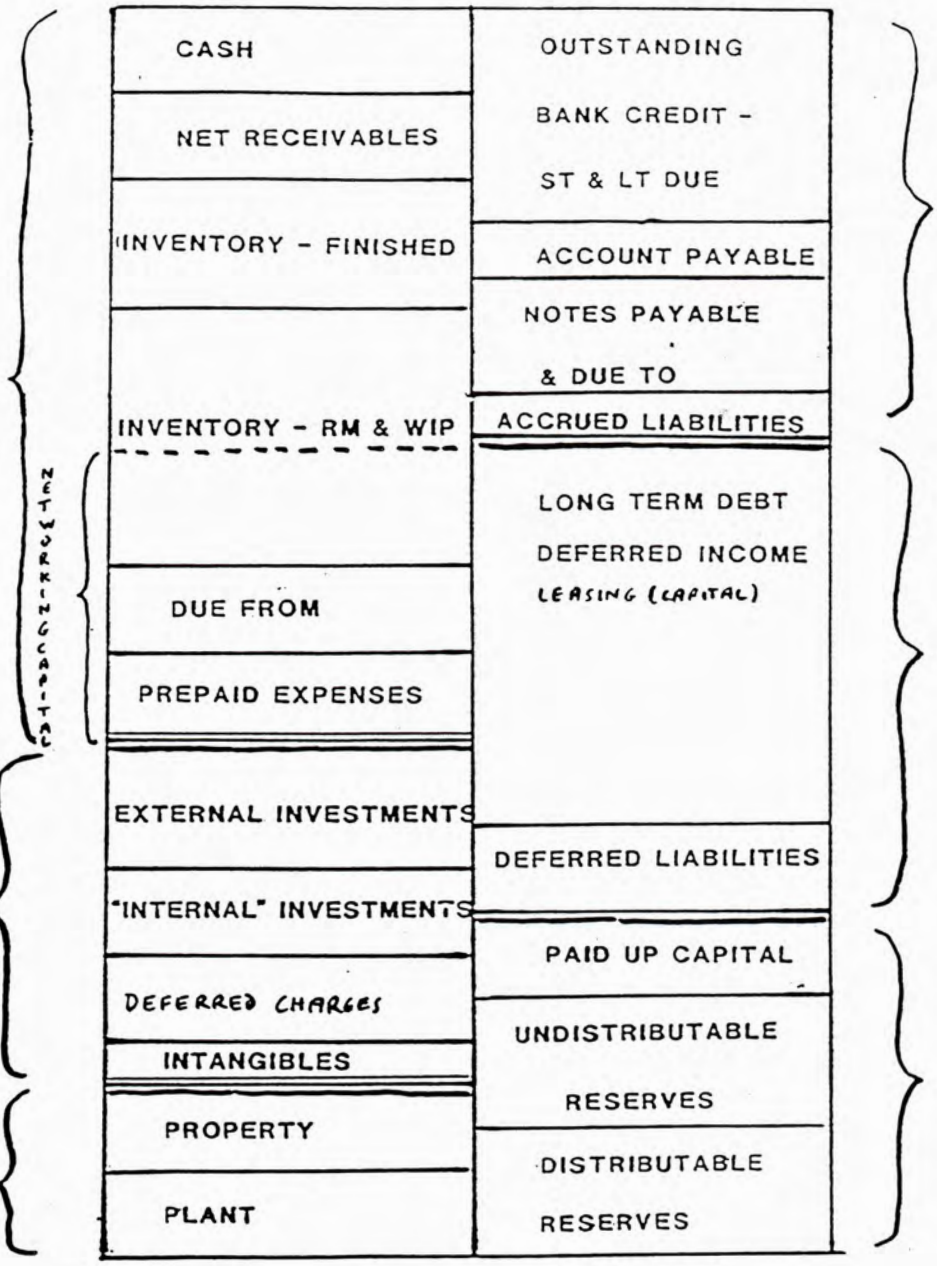
INTRODUCTION

WHAT ARE FINANCIAL STATEMENTS?

A WAY OF EXPRESSING WHAT IS HAPPENING IN A BUSINESS IN MONETARY TERMS.

BALANCE SHEET =	AT A POINT IN TIME: 1) What a company owes to outsiders including the shareholders, of the company. These are called liabilities and can be considered the sources of funds for the company. and 2) What a company owns or rather a stated monetary value of these items. These are called assets and can be considered as the uses to which a company has put its funds.
PROFIT AND LOSS A/C =	For a period, value of goods delivered which has been or will be received by the company, less cost of those goods, any other costs of producing those goods and the expenses of running the business.
STATEMENT OF SOURCES AND USES OF FUNDS =	Profit for a period plus non cash items to show funds generated in period plus or minus funds raised or funds expended. This equals the funds employed in or released from the working capital elements.

BANKER'S RECLASSIFIED BALANCE SHEET



INCOME STATEMENT STRUCTURE

	$\boxed{\text{NET SALES}}$
LESS	$\boxed{\text{COST OF GOODS SOLD (CGS)}}$
=	GROSS PROFIT
LESS	$\boxed{\text{SELLING GENERAL AND ADMINISTRATIVE (SGA) EXPENSES}}$
=	OPERATING PROFIT
ADD	$\boxed{\text{OTHER INCOME}}$
LESS	$\boxed{\text{OTHER EXPENSES}}$
=	PRE TAX PROFIT
LESS	$\boxed{\text{TAX}}$
=	PROFIT AFTER TAX
LESS	$\boxed{\text{EXTRAORDINARY ITEMS}}$
=	$\boxed{\text{NET INCOME}}$
LESS	$\boxed{\text{DIVIDENDS}}$
	$\boxed{\text{PROFIT RETAINED}}$

FUNDS FLOW STATEMENTS

SHOWS - NON CASH ITEMS

- GROSS MOVEMENTS OF ASSETS - SALES/PURCHASE
- GROSS INVESTMENT MOVEMENTS ETC
- GROSS ACTUAL TAX/DIVIDEND
- INCREASE/DECREASE IN WORKING CAPITAL

  MOVEMENTS IN

  - INVENTORY
  - ACCOUNTS RECEIVABLE
  - CREDITORS
  - CASH/ST INV

LIMITATIONS OF FINANCIAL STATEMENTS

HISTORIC

OUT OF DATE

ONLY FINANCIAL APPROXIMATIONS OF ASSET VALUE - COST

NOT VALUE NOW OR REPLACEMENT COST

PRODUCED TO SHOW FAVOURABLE TAX POSITION

AUDITED

INDEPENDENT VIEW

PROFESSIONAL TREATMENT

PRODUCE FIGURES IN ACCORDANCE WITH:

LEGAL REQUIREMENTS

RULES OF ACCOUNTANCY BODY

CONSISTANT

LIMITATIONS 1 SAMPLING

2 LACK OF AUDITOR ABILITY IN TECHNICAL AREAS

3 'TRUE AND FAIR' NOT TRUE AND CORRECT (OPINION ONLY)

4 RELYS ON DIRECTORS VALUATIONS

ELSAL LIMITED

FINANCIAL ANALYSIS

STATUS	PRIVATE COMPANY
OWNERSHIP	DIRECTORS
EXECUTIVES	MRL
	MAL

A CASH MANAGEMENT - OPERATIONS

There has been a fall off in the company's ability to turn sales to cash 88%, the increasing sales have meant an increase in receivables and stock. The stock increase has been disproportionate and although some use has been made of accounts payable this has not been sufficient, costs are turned 100% cash and there has been an outflow of cash from the selling operations in both 1984 and 1985. This has been exacerbated by rising interest costs and the short fall has had to be covered by extending short term finance. Given the terms of trade such a situation on rising sales is to some extent inevitable but appears ill controlled.

QUESTION

1. Do company appreciate the cash implications of their sales?

2. What is situation re accounts payable?

NON OPERATING SECTOR

Fixed asset purchased in 1986 have been funded by short term debt, also in 1986 long term debt has been reduced, again increasing the short term burden, an unsatisfactory situation.

QUESTIONS

1. Why has long term debt been repayed?

2. Do customer see danger of using factoring for long term funding?

B PROFITABILITY

Sales are rising well and consistantly, with constant (improved in 1985) gross margin. SGA is reasonably well controlled, in 1985 however a rise is seen which is out of line. However, both operating and pre-tax profit are rising and the plough back and return on equity are satisfactory. Sales would have to fall 17% before expenses were uncovered so there is a good safety margin here. Gross profit margin would have to fall to 22% from 27% again a good lee-way except that gross margin to date has been circa 21%.

QUESTIONS

1. Why rise in SGA costs?

2. Why exceptional rise in Gross Profit Margin is it sustainable.

C ASSET MANAGEMENT

Although one might expect some slow down in asset turnover as a company grows, the fall here is quite significant and although the improved gross margin compensates in 1985 it does appear that assets are building unduly in relation to sales. Both inventory and receivables days indicates the situation, one which on the face of it, indicates poor control.

QUESTION

1. What is the reasoning behind the build up of receivables and inventory.

D EQUITY SUFFICIENCY

Equity is building well however, and is an increasing percentage of assets although still only 15%. The withdrawal of directors loan brings into doubt their intention here, but if the remainder is to stay it increases their commitment to 20%. On break up however, one is very dependant on sale of stock and collection of debtors (after factors) so in that event there is little safety.

E STRUCTURAL LIQUIDITY (NWL)

The amount of working capital rose in line with current liability level until 1984. Satisfactory, but the fall in 1985 signals a disturbing weakness particularly as the velocity of current asset conversion is slowing faster than the time allowed by creditors. The relationship of working capital to sales although showing previously a consistant trend worsend in 1985 because of part withdrawal of directors loans this has weakened the safety margin and induced a potential over trading situation.

F GEARING

Long term 0.6, long and short 3.2, the gearing has been satisfactory, also if directors loans are quasi capital then the overall ratio falls to 2.3, not particularly out of line but still a deteriorating situation bearing in mind the unsatisfactory cash generation. Interest cover although falling still acceptable at 3 on profits, however there is no cash cover a situation that must be remedied.

QUESTION

1. What is the intention with the directors loans?

G REPAYMENT CAPABILITY

Acceptable in 1983/1984 but it shows a marked deterioration in 1985 indicating that the amount of core assets might be building. This idea is reinforced by the lack of residual repayment capacity and it is almost certain that much of the existing short term debt is locked in as the ability to reduced receivables or cut stock must be limited. It is doubtful also if payables could be pressed further? Any short term lender must ensure that they do not get locked into this borrowing which should be term financed with regular repayments.

With current ratio more or less consistant at 1.3 and acid test at 0.7 after reducing from o.9, the situation is not ideal but leeway is probably sufficient if the receivables are good - factoring company would presumably have checked debtors. Little margin however if problems are major.

H CONCLUSION

A growing and profitable company but cash and asset control appears poor, and current short term lending has little chance of being repaid in the short term. Company is vunerable and until it has consolidated its position would be a poor risk.

SPREAD SHEET
HISTORICAL & PROJECTED BALANCE SHEETS

Internal Analytical Form used by Group Asset Management Service to produce interpretation for 'GAMS-321 SYSTEM' - Form F-3 & Cl Form 19/ADV-F-10C.

NAME ELSEL LTD

CONSOLIDATED/UNCONSOLIDATED

'GAMS-321 SYSTEM'-Form F-1 (Pg 1/

Branch:

(In .... 000's)

	Date	30/04/82		30/04/83		30/04/84		30/04/85
	AUDITED/UNQUALIFIED/INTERIM		%		%		%	
	CURRENT ASSETS							
1	Cash							
2	Short Term Investments							
3	**Liquid Assets Total** (1+2)							
4	Notes Receivable							
5	Accounts Receivable (incl./excl.bills neg.)							
6	Provision for Bad Debts							
7	**Net Accounts Receivable** (4+5-6)	212		280		324		469
8	**Monetary Assets Total** (3+7)							
9	Inventory: Raw Materials							
10	: Work in Progress							
11	: Finished Goods							
12	**Inventory Total** (9+10+11)	78		120		171		300
13	Prepaid Expenses							
14	Due From							
15								
16	**Other Current Assets Total** (13+14+15)							
17	**TOTAL CURRENT ASSETS** (8+12+16)	290		400		496		769
	CURRENT LIABILITIES							
18	Bank Borrowing	36		12		97		93
19	Current Portion of Long Term Debt							
20	Notes Payable - Others	34		28		94		244
21	**Short Term Finance Total** (18+19+20)	70		40		191		337
22	**Accounts Payable**	143		234		170		298
23	Due to							
24	Income Tax Payable	7		21		17		29
25	Dividends Payable							
26	Accruals							
27								
28	**Other Current Liabilities Total** (23 to 27)							
29	**TOTAL CURRENT LIABILITIES** (21,22 & 28)	220		295		378		664
30	**MONETARY NET WORKING CAPITAL** (17 - 29)	70		105		118		105
	OTHER NON CURRENT ASSETS							
31	Investment Securities							
32	Long Term Receivables (external)							
33	**Investment (external) Total** (31+32)							
34	**Investment-Associates etc.**							
35	Loans to Directors etc.							
36	**Investments Total** (33+34+35)							
37	Deferred Taxation							
38	Other Deferred Charges							
39	Losses/Formation Expenses							
40	**Deferred Charges Total** (37+38+39)							
41	Intangibles - Goodwill							
42	Intangilbes - Other							
43	**Intangibles Total** (41+42)							
44								
45	**TOTAL OTHER NON CURR ASSETS** (36+40+43+44)							
	FIXED ASSETS							
46	Land							
47	Buildings (Gross)			–		8		
48	Furniture & Fixtures (Gross)	9		9		12		
49	Plant and Machinery (Gross)							
50		22		27		39		
51	Gross Fixed Assets Total (46 to 50)	31		36		59		93
52	Accumulated Depreciation	3		9		13		27
53	**NET FIXED ASSETS** (51-52)	28		27		46		66
54	**TOTAL NON CURRENT ASSETS** (45+53)	28		27		46		66
55	**TOTAL ASSETS** (17+54)	318		427		542		835

NAME ....

(In .... 000's

	Date	8	%	[illegible]	%	[illegible]	%	5
56	**WORKING CAP & NON CURR ASSETS** (30+54)							
	financed by							
	NON CURRENT LIABILITIES		%		%		%	
57	Bank Loans							
58	Other Debt Capital							
59	Subordinated Debt							
60	Deferred Income							
61	Directors Loans	67		77		74		36
62								
63	**LONG TERM DEBT TOTAL** (57 to 62)	67		77		74		36
64	Deferred Tax	7		6		7		8
65	Other Deferred Credits							
66	Provisions							
67								
68	Minority Interests							
69	**OTHER NON-CURR LIAB TOTAL** (64 to 68)							
70	**TOTAL NON-CURR LIABILITIES** (63+69)	74		83		81		44
	EQUITY							
71	Preferred Stock							
72	Common Stock							
73	Treasury Stock							
74	Common Stock (72-73)							
75								
76	**PAID UP CAPITAL** (71,74 & 75)							
77	Capital Surplus							
78								
79								
80	**CAPITAL RESERVE TOTAL** (77 to 79)							
81								
82								
83	**OTHER UNDISTRIBUTABLE RESERVES** (81+82)							
84	**TOTAL UNDISTRIBUTABLE RESERVES** (80+83)							
85	**RETAINED EARNINGS**	23		50		83		127
86								
87	**NETWORTH** (76+84+85+86)	23		50		83		127
88	Non Current Liabilities and Networth (70 & 87)	97		133		164		171
89	Current & Non-Current Liabilities Total (29+70)	294		378		459		708
90	**TOTAL LIABILITIES** (87+89)	317		428		542		835

CONTINGENCIES

91	**Business Contingencies**				
	(a) Letters of Credit				
	(b) Letters of Guarantee				
	(c) Foreign Exchange				
	(d) Acceptances				
	(e) Collections				
92	Other Contingencies				
93	**TOTAL CONTINGENCIES** (91+92)				
94	Other Committments				

HISTORICAL & PROJECTED INCOME STATEMENTS

CAMS-321 SYSTEM - Form F-1 (Pg

NAME .... (In .... 000's

	Period	81/82	%	82/83	%	83/84	%	84/85
	SALES							
95	Sales Revenue							
96	Other Related Revenue							
97	**NET SALES** (95+96)	673		846		964		1250
	Cost of Goods Sold							
98	Inventory Cost -	520		667		765		914
99	Wages							
100	Depreciation-Mfg.							
101	Other Manufacturing Costs							
102	**CGS Total** (98 to 101)	520		667		765		914
103	**Gross Profit** (97-102)	153		179		199		336
	Selling Gen & Admin Expenses							
104	Salaries and Wages	15	2	29	3	44	5	81
105	Directors' Remuneration	63		41		26		36
106	Fees	3		4		4		4
107	Property	9		10		12		20
108	Depreciation & Amortization on Fixed Assets	3		6		9		14
109	Amortization on Intangibles							
	Advertisements							
112	Bad and Doubtful Debts	2		14		(1)		10
113	Other SGA	17		30		43		83
114	**SGA Total** (104 to 113)	116	17	134	16	137	14	248
115	**Operating Profit** (103-114)	37		45		62		88
	Other Income							
116	Interest Exchange & Dividends							
117	Rental Income							
118	Income from Associates							
119	Profit on Sale of Assets							
120	Other - DISCOUNTS	4				3		5
121	**Other Income Total** (116 to 120)	4				3		5
	Other Expenses							
122	Financial Charges-Interest etc.	4		6		19		31
123	Other - LOSS ON DISPOSAL OF M/V					1		
124	**Other Expenses Total** (122+123)	4						
125	**Pre Tax Profit** (115+121-124)	37		39		45		62
126	Tax	14		13		12		19
	Profit After Tax (125-126)							
	Minority Interest							
129	Extraordinary Items							
130	**NET INCOME** (127 to 129)	23		26		33		43
131	Dividend/Drawings							
132	Other Appropriations							
133	Profit Retained	23		26		33		43

ADDITIONAL INFORMATION

Branch:

Spread Prepared by:

Department:

Signature:

Date:

STATEMENT OF CHANGES IN FINANCIAL POSITION (SOCFP)

BORROWER	CAMS-ADV-RSA-F(2)
	CURRENCY
	UNITS

PERIOD	80 to 81		81 to 82		82 to [illegible]	
OPERATING SECTOR	Cr source	DR use	Cr source	DR Use	Cr source	Dr use
1/ Net Sales (Ln 97)	1,291		1,416		1,508	
2/ A/C Receivable (Ln 7) (dec-CR)		[illegible]		12	19	
3/ **OPERATING CASH INCOME** Ln 1,2	1,281		1,404		1,527	
4/ Cost of Goods Sold (Ln 102)		1,183		1,295		1,387
5/ Inventory (Ln 12) (dec-CR)	37			11	[illegible]	
6/ A/C Payable (Ln 22) (dec-DR)	1		38			45
7/ **CASH CGS** Ln 4 to 6		1,145		1,268		1,418
8/ SGA Expenses (Ln 114)		108		106		107
9/ Annual Depreciation (Ln 100 & 108)	4		4		4	
10/						
11/ Prepaid Expenses (Ln 13) (dec-CR)						
12/ Accrued Liabilities (Ln 26) (dec-DR)						
13/ **CASH SGA** Ln 8 to 12		104		101		103
14/ Operating Cash Expenses Ln 7 & 13		1,249		1,369		1,521
15/ **NET OPERATING CASH** Ln 3 - 14	32		35		6	
16/ Financial Expenses (Ln 122)		2		1		4
17/ Tax (Ln 126)						
18/ Tax Payable (Ln 24) (dec-DR)						1
19/ Other (Ln 15) (dec-CR)						
20/ Other (Ln 27) (dec-DR)						
21/ **NET CASH FROM OPERATIONS (NCFO)**	30		34		1	
22/ Other Income (Ln 121)	13					
23/ Other Expenses (Ln 123)						
24/ Extraordinary Items (Ln 129)						
25/ Due To (Ln 23) (dec-DR)						
26/ Due From (Ln 14) (dec-CR)						
27/ **NET CASH FROM OPERATIONS** (FINAL N.C.F.O)	43		34		1	
FINANCING SECTOR						
28/ Short Term Finance (Ln 18,20) (dec-DR)		62		12	17	
29/ Current LT Debt (Ln 19) (dec-DR)						
30/ Long Term Debt (Ln 63) (dec-DR)						5
31/ **CUMULATIVE NET CASH FLOW**		19	22		13	
NON CURRENT SECTOR						
32/ Investments (Ln 36) (dec-CR)						
33/ Fixed assets-gross (Ln 51) (dec-CR)		5		11		
34/ Depreciation Difference Note 1						
35/						
36/ Other Assets (Ln37-44) (dec-CR)						
37/ Other Liabilities (Ln 69) (dec-DR)						
38/						
39/						
40/ **NON-CURRENT SECTOR NET**		5		11	13	–
EQUITY SECTOR						
41/ Paid up Capital (Ln 76) (dec-DR)						
42/ Undistributable Reserves (Ln 84) (dec-DR)						
43/ Retained Earnings Diff Note 2		1	–			
44/						
45/ Dividends Payable (Ln 25) (dec-DR)						
46/						
47/ **EQUITY SECTOR NET**		1				
48/ **FINAL NET CASH**		25	11		13	
49/ Liquid Asset Change (Ln 3) (dec-CR)	24			11		

Notes

1) Line 34 FOR YEAR 19X2: LINE 52 19X2 MINUS LINE 100 AND 108, 19X2 AND LINE 52 19X1 (POSITIVE ANSWER IN CR COLUMN, NEGATIVE ANSWER IN DR COLUMN)

2) Line 43 FOR YEAR 19X2: DIFFERENCE BETWEEN LINES 85 + 86 IN 19X1 AND LINES 85 + 86 IN 19X2 (ANSWER PLUS OR MINUS) MINUS LINE 130 YEAR 19X2 EQUALS RETAINED EARNINGS DIFFERENCE (POSITIVE ANSWER IN CR COLUMN NEGATIVE ANSWER IN DR COLUMN)

STATEMENT OF CHANGES IN FINANCIAL POSITION (SOCFP)

GAHS-ADV-BSA-F(2)

CURRENCY

BORROWER

UNITS

PERIOD	80 to 81		81 to 82		82 to 83	
OPERATING SECTOR	Cr source	DR use	Cr source	DR Use	Cr source	Dr use
1/ Net Sales (Ln 97)	1291		1416		1508	
2/ A/C Receivable (Ln 7) (dec-CR)		10		12	19	
3/ **OPERATING CASH INCOME** Ln 1,2	1281	-	1404	-	1527	
4/ Cost of Goods Sold (Ln 102)		1183		1295		1387
5/ Inventory (Ln 12) (dec-CR)	37			11	14	
6/ A/C Payable (Ln 22) (dec-DR)	1		38			47
7/ **CASH CGS** Ln 4 to 6		1145		1268		1420
8/ SGA Expenses (Ln 114)		108		105		107
9/ Annual Depreciation (Ln 100 & 108)	4		4		4	
10/						
11/ Prepaid Expenses (Ln 13) (dec-CR)						
12/ Accrued Liabilities (Ln 26) (dec-DR)						
13/ **CASH SGA** Ln 8 to 12		104		101		103
14/Operating Cash Expenses Ln 7 & 13		1244		1369		1523
15/ **NET OPERATING CASH BIT** Ln 3 - 14	32		35		4	
16/ Financial Expenses (Ln 122)		2		1		4
17/ Tax (Ln 126)				1		
18/ Tax Payable (Ln 24) (dec-DR)			1			1
19/ Other (Ln 15) (dec-CR)						
20/ Other (Ln 27) (dec-DR)						
21/ **NET CASH FROM OPERATIONS (NCFO) AIT**	30		34			1
22/ Other Income (Ln 121)	13					
23/ Other Expenses (Ln 123)						
24/ Extraordinary Items (Ln 129)						
25/ Due To (Ln 23) (dec-DR)						
26/ Due From (Ln 14) (dec-CR)						
27/ **NET CASH FROM OPERATIONS (NCFO)**	43		34			1
FINANCING SECTOR						
28/ Short Term Finance (Ln 18,20) (dec-DR)		62		12	17	
29/ Current LT Debt (Ln 19) (dec-DR)						
30/ Long Term Debt (Ln 63) (dec-DR)						5
31/ **CUMULATIVE NET CASH FLOW**		19	22		11	
NON CURRENT SECTOR						
32/ Investments (Ln 36) (dec-CR)						
33/ Fixed assets-gross (Ln 51) (dec-CR)		5		11		
34/ Depreciation Difference year 1 + Ln 9 - year 2						
35/						
36/ Other Assets (Ln37-44) (dec-CR)						
37/ Other Liabilities (Ln 69 + 128) (dec-DR)						
38/						
39/						
40/ **NON-CURRENT SECTOR NET**		5		11		
EQUITY SECTOR						
41/ Paid up Capital (Ln 76) (dec-DR)						
42/ Undistributable Reserves (Ln 84) (dec-DR)						
43/ Retained Earnings Diff (Ln 85,86 + 130) (dec-DR)						
44/ Dividends Declared MEMO ITEM						
45/ Dividends Payable (Ln 25) (dec-DR)						
46/ Cash Dividends Paid MEMO ITEM Ln 44 & 45						
47/ **EQUITY SECTOR NET**						
48/ **FINAL NET CASH**		24	11		11	
49/ Liquid Asset Change (Ln 3) (dec-CR)		24	11		12	

SPREAD BY

BRANCH

FOODS LIMITED

FINANCIAL ANALYSIS

STATUS	PRIVATE COMPANY - UK		
OWNERSHIP	FINANCE LTD		45%
	HOLDINGS LTD		45%
EXECUTIVES	CHAIRMAN	K D	
	DIRECTORS	K L U D H C	

QUESTION

1. What is relationship with investing companies?

A CASH MANAGEMENT - OPERATIONS

Conversion of sales to cash is consistantly near 100% and up until 1983 costs in cash terms were 96/97% of total giving company an advantage in cash management, this with the underlying profitability led to a positive cash inflow from the selling operation of 2p in £1 of sales. The surplus was well able to cover interest 16 times in 1981, 35 times in 1983. However, in 1983 accounts payable had to be reduced even though sales rose and although the company still managed to balance the cash position on operations and cover interest there was no surplus. In the previous years free funds used to clear short term debt. However, in 1983, short term borrowing had to be increased, partly to cover a repayment of the long term debt, although there was existing cash available (unless this was ear-marked to cover other liabilities).

NON OPERATING SECTOR

There have always been sufficient funds available to cover the minimal fixed asset purchases and any residual funds have been held in cash.

QUESTIONS

1. Why high cash balance?
   Why have accounts payable been pushed down?

B PROFITABILITY

Good steady sales growth with well maintained gross margin. Operating profit is small although there has been a reasonable plough-back and a good return on equity. Expenses have been reasonably controlled, however salary costs (including directors) are quite high in relation to the gross profit figure and only a fall of 7% would be required to uncover expenses. However the sales pattern appears consistant and we should confirm that this state is likely to continue. A 1% fall in gross margin would also expose company to losses and it is important to ensure that their supply costs do not escalate too quickly. (Possible reason for pushing down accounts payable).

QUESTION

1. Why no tax liabilities shown?

C ASSET MANAGEMENT

Overall total asset turnover has improved and more importantly for this type of business so has the current asset turnover with tighter control of both inventory and receivables. Positive development overall although situation with accounts payable needs clarifying.

QUESTION

1. What is situation re bad debts?

D EQUITY SUFFICIENCY

Equity has been growing steadily although it is still only 21% of assets. In the event of break-up the property would probably fetch more that its book value (shown as £50K for last 4 years) however, stock and receivables would be difficult to realise.

QUESTION

1. What is value of property now?

E STRUCTURAL LIQUIDITY (NWL)

Although growing, net working capital is still minimal. However the company have always managed to balance their terms of trade and as long as this state is maintained the lack of cover should not be a problem, especially if the company maintain a cash float. We must however be sure of their relations with their suppliers.

F GEARING

Debt at a satisfactory level, long term 0.4, long term and short term 0.8. The long term debt is from holding company and appears to be interest free at the moment as their finance costs are low.

QUESTION

1. What is the debt repayment programme for loans?

G REPAYMENT CAPABILITY

Very consistant coverage of costs and outstanding at 0.88 indicating that borrowing would fluctuate (see statements) however, the ability to clear residual outstandings from operations and cash float is limited to 16p in £1 and with scope for cutting receivables or increasing payables being limited there is the situation where increasing trade might create a core holding of stock with a debt that could only be cleared over the longer term. If we are relying on realisation of current assets there is little depth of cover indicated by the current/acid ratio. At present the repayment situation is satisfactory, however the margin is such that we should scrutinise carefully any future increase in trade.

H CONCLUSION

Successful company with sensible growth pattern. Marginal for unsecured lending, there are various points to clarify. However, with a satisfactory source of secondary repayment there is scope for lending.

FOODS LTD

MONTH	HIGHEST CREDIT OR LOWEST DEBIT (DR)	HIGHEST DEBIT (DR) OR LOWEST CREDIT
1	27	30 DR
2	24	45 DR
3	22	37 DR
4	29	50 DR
5	23	49 DR
6	24	43 DR
7	28	39 DR
8	26	48 DR
9	18	47 DR
10	27	28 DR
11	22	41 DR
12	26	45 DR

Customer ______________________ Branch ______________________

CONTROL OF UNSECURED AND DEBENTURE LENDING

1). DRAWING POWER ALLOCATION (Based on last audited accounts and adjusted for up to date information where necessary).

Currency ....

At end of ...Apr 86...	Amount	%
1 Cash (under lien)		
2 Receivables	4[illegible]	40
3 Inventory	6[illegible]	60
4		
5		
6		
TOTAL		100

% for Lending	Lending Value
[illegible]	240
30' [illegible]	~~2[illegible]~~ 180
	440[illegible]

Charge on current Assets

Drawing Power

420 - 36

Total Lending Value Less Preferentials = $\boxed{384}$

70/ [illegible] 224

Unsecured [illegible] 608

Total Lending Value Less Current Liabilities (except BCCI) = $\boxed{147}$

or Final NCFO (NCFO is lower of last year or average of last 3 years)

NB. MAX= Networth minus long and non BCCI short term debt

NOTE IF OD RESTRICTED SPECIFY HERE

- - - - - - - - -

- - - - - - - - -

LIMITS	
Facility	Amount

(To be completed at each review end of .... (Month/Quarter/½ Year)

[illegible] 7

[illegible]

NW 372

[illegible]

2). MONITORING REQUIREMENTS

Required	Frequency or not required (N/R)	Action
Management Accounts or sales for period if not available		Complete seperate set of spread sheets, and cashflow/relationship analysis Investigate any deterioration. Check sales level maintained.
Quick Figures		Check lending values against limit and investigate any deterioration in difference between current assets and liabilities.
Aged Receivables Premium due		Check overdues, any concentrations building, have new receivables been vetted NOTE: IF INSURED CHECK PREMIUM PAID AND COVER ADEQUATE-ATTACH COPY OF RENEWAL NOTE.
Aged payables		Check overdues, any concentrations building, are taxes VAT, PAYEE up to date.
Inventory who by .... Premium due		How valued:- has stock-take been undertaken or is it estimate by directors. If independent valuation required attach report. NOTE: CHECK INSURANCE PREMIUMS PAID AND COVER ADEQUATE-ATTACH COPY OF RENEWAL NOTE.
Bank Account		Check how turnover compares with sales level. Check with cashflow forcast, investigate variations. Payments not in line with facility purpose.
Other insurance inc Loss of profits due		Paid and cover adequate - attach copy of renewal note.

-3-

You have been sent the attached study with a request that you assist the company with overdraft facilities. They wish to move to a larger factory unit and automate production of their product specialist (pitta type) bread. They took over the running of the existing production facility from the existing factory's owner, who although he retains an interest, no longer contributes to the management of the operation.

a) List pros and cons of proposal based on existing information.

b) List questions you might wish to ask before giving the proposal further consideration.

Cash flow shows 634 sales - PL shows 684
what does improvement to premises represent.
overheads on cashflow don't match
b). extent of interest of factory owner.
previous balance sheets / P+L A/c's.
what market analysis has been carried out. - 6x increase in sales.
Have they the owners previously operated similar factory.
what are the outlets - how have they grown so rapidly.
what security - directors Gtee
subordinate loans?
Repayment schedule on directors loan.
what term - only for 7 months.
movements in fixed/variable cost.

C
a). lack of experience

P. Injecting own funds

No track record with bank.
Sales increases not substantiated.

S B F O O D S L I M I T E D

BREAD FACTORY FEASIBILITY STUDY

INDEX

Bread Factory Feasibility Study

Outline of Project

The Company has now had 5 months experience in operating a factory producing specialist bread for the large population of ethnic groups and tourists. The factory that the Company is now running has itself been operating for some 18 months. The product is a new one with very limited competition to date. Sales have been increased from approximately £400 per week to £2,000 per week in the past 4 months and the Company expects to reach £2,500 per week within the next 2 months.

Four types of bread were produced when the factory was acquired; the range has now been increased to five and will shortly become eight types of bread. There is also in the pipeline many other related products for which it is quite clear there is a considerable market demand which is yet to be supplied.

The Company already employs an experienced Manager who had some 2 years as a Production Manager in oriental sweetbread outlets. The Company's nan bread receipe was invented after experimentation by the Company's own Manager. The Company has many receipes and know-how from all over Saudi Arabia, Lebanon and Iraq.

The Company now has approximately 150 customer outlets which has increased from 28 five months ago. The Company has deliberately limited growth until extra capacity was available from new machinery. The Company has on order a new automated machine of Italian/Lebanese manufacture, which has been specially tailored for its products and is labour efficient. The machinery is capable of producing 6,000 pieces of bread per hour. The calculation in the attached schedules assume that the machine is being used to 50% of its maximum capacity, that is, to produce a maximum of 3,000 pieces of bread per hour.

The proprietors will put £100,000 of their own funds into the company in order to finance the new machinery and the new development. £50,000 of this will be by way of ordinary share capital and the remaining £50,000 by way of unsecured loan notes. The attached cash flow suggests that by the end of the full trading year the Company, the majority of who's sales will be cash sales, should have a substantial cash surplus. However, it is possible that the projected growth in sales will take longer to achieve than anticipated in the projections attached. If that is the case the Company's cash flow will not be positive for a longer period.

BREAD FACTORY FEASIBILITY STUDY

Budgeted Profit & Loss Account

	£000's	£000's
Sales		684
Cost of Sales		
Materials	290	
Labour	60	
Bags and wrapping	44	
Electricity and Gas	8	
		402
Gross Profit		282
Overheads		
Wages and Salaries	59	
Directors remuneration	5	
Rent	25	
Rates	7	
Bank interest	10	
Insurance	1	
Telephone	1	
Motor and Van expenses	12	
Maintenance of plant and machinery	2	
Maintenance of buildings	1	
Cleaning	2	
Printing and stationery	3	
Advertising	3	
Audit and accountancy	2	
Entertainment	5	
Bad debt Provisions	2	
Miscellaneous and contingencies	5	
		145
		137
Depreciation		20
		117
Corporation Tax		33
Net Profit		84

BREAD FACTORY FEASIBILITY STUDY

Budgeted Balance Sheet - End of Year 1

	£000's	£000's
Fixed Assets		
Plant and Machinery at cost		100
Improvements to Premises at cost		35
Motor Vehicles at cost		20
		155
Depreciation		20
		135
Current Assets		
Stock of Raw Materials and Bags	26	
Debtors	50	
Cash at Bank	59	
		135
		270
Current Liabilities		
Creditors	53	
Corporation Tax	33	
		86
		£184
Shareholders funds		
50,000 Ordinary Shares of £1 each		50
Loans		50
Unappropriated Profit		84
		184

BREAD FACTORY FEASIBILITY STUDY

1 YEAR CASH FLOW

£000's	M1	M2	M3	M4	M5	M6	M7	M8	M9	M10	M11	M12	TOTAL
SALES	15	20	35	45	55	60	62	65	67	70	70	70	634
COST OF SALES	(9)	(13)	(22)	(28)	(35)	(38)	(39)	(41)	(42)	(43)	(44)	(44)	(398)
OVERHEADS	(16)	(7)	(7)	(16)	(7)	(8)	(17)	(7)	(7)	(16)	(7)	(7)	(122)
	(10)	-	6	1	13	14	6	17	18	11	19	19	114
PLANT & MACHINERY	(100)												(100)
PREMISES	(35)												(35)
MOTOR VEHICLES	(20)												(20)
EQUITY CAPITAL	50												50
LOAN	50												50
CASH FLOW	(65)	-	6	1	13	14	6	17	18	11	19	19	59
OPENING BANK BALANCE	-	(65)	(65)	(59)	(58)	(45)	(31)	(25)	(8)	10	21	40	-
CLOSING BANK BALANCE	(65)	(65)	(59)	(58)	(45)	(31)	(25)	(8)	10	21	40	59	59

HISTORICAL & PROJECTED BALANCE SHEETS

M/S......................FOODS LTD..............................

Internal analytical form used (by AMS) to produce interpretation and summarised data on ADV-F 10C & CLP-19

Branch: (In....£......000's)

DATE	31-3-80	31-3-81	31-3-82	31-3-83
AUDITED/UNQUALIFIED				
CURRENT ASSETS				
1 Cash	30	6	17	29
2 Short term investments				
3 Liquid Assets Total (1+2)				
4 Notes Receivable				
5 Accounts Receivable(incl/excl bills neg)				
6 Provision for bad debts				
7 Net Accounts Receivable (4+5-6)	63	73	85	66
8 Monetary Assets Total (3+7)				
9 Inventory: Raw Materials				
10 : Work in progress				
11 : Finished Goods				
12 Inventory Total(9+10+11)	135	98	109	95
13 Prepaid Expenses				
14 Due From				
15				
16 Other Current Assets Total(13+14+15)				
17 TOTAL CURRENT ASSETS(8+12+16)	228	177	211	190
CURRENT LIABILITIES				
18 Bank Borrowing	82	20	8	25
19 Current portion of Long Term Debt				
20 Notes Payable - Others				
21 Short Term Finance Total (18 to 20)				
22 Accounts Payable	157	158	196	151
23 Due to				
24 Income Tax Payable			1	
25 Dividends Payable				
26 Accruals				
27				
28 Other Current Liabilities Total(23 to 27)				
29 TOTAL CURRENT LIABILITIES (21, 22 & 28)	239	178	205	176
30 MONETARY NET WORKING CAPITAL (17-29)	(11)	(1)	6	14
OTHER NON CURRENT ASSETS				
31 Investment Securities				
32 Long Term Receivables (external)				
33 Investment(external) Total (31+32)				
34 Investment-Associates etc				
35 Loans to Directors etc				
36 Investments Total(33+34+35)				
37 Deferred Taxation				
38 Other Deferred Charges				
39 Losses/Formation expenses				
40 Deferred Charges Total(37+38+39)				
41 Intangibles-Goodwill				
42 Intangibles-other				
43 Intangibles Total(41+42)				
44				
45 TOTAL OTHER NON CURR ASSETS(36+40+43+44)				
FIXED ASSETS				
46 Land				
47 Buildings (Gross)	50	50	50	50
48 Furniture & Fixtures (Gross)	13	13	14	14
49 Plant and Machinery (Gross)				
50 Motor Vehicles	1	6	16	16
51 Gross Fixed Assets Total (46 to 50)	64	69	80	80
52 Accumulated Depreciation	12	16	20	24
53 NET FIXED ASSETS (51-52)	52	53	60	56
54 TOTAL NON CURRENT ASSETS (45+53)	52	53	60	56
55 TOTAL ASSETS (17+54)	280	230	271	246

NAME .... GAMS-ADV-BSA: F.1 (page 2 of 3)

(In .... 000's)

	Date		%		%		%		%
56	**WORKING CAP & NON CURR ASSETS** (30+54)								
	financed by								
	NON CURRENT LIABILITIES								
57	Bank Loans								
58	Other Debt Capital	24		24		24		19	
59	Subordinated Debt								
60	Deferred Income								
61	Directors Loans								
62									
63	**LONG TERM DEBT TOTAL** (57 to 62)	24		24		24		19	
64	Deferred Tax								
65	Other Deferred Credits								
66	Provisions								
67									
68	Minority Interests								
69	**OTHER NON-CURR LIAB TOTAL** (64 to 68)								
70	**TOTAL NON-CURR LIABILITIES** (63+69)	24		24		24		19	
	EQUITY								
71	Preferred Stock								
72	Common Stock								
73	Treasury Stock								
74	Common Stock (72-73)	10		10		10		10	
75									
76	**PAID UP CAPITAL** (71,74 & 75)	10		10		10		10	
77	Capital Surplus								
78									
79									
80	**CAPITAL RESERVE TOTAL** (77 to 79)								
81									
82									
83	**OTHER UNDISTRIBUTABLE RESERVES** (81+82)								
84	**TOTAL UNDISTRIBUTABLE RESERVES** (80+83)								
85	**RETAINED EARNINGS**	8		18		32		42	
86									
87	**NETWORTH** (76+84+85+86)	18		28		42		52	
88	Non Current Liabilities and Networth (70 & 87)	42		52		66		71	
89	Current & Non-Current Liabilities Total (29+70)	263		202		229		195	
90	**TOTAL LIABILITIES** (87+89)	281		230		271		247	

CONTINGENCIES

91	Business Contingencies				
	(a) Letters of Credit				
	(b) Letters of Guarantee				
	(c) Foreign Exchange				
	(d) Acceptances				
	(e) Collections				
92	Other Contingencies				
93	**TOTAL CONTINGENCIES** (91+92)				
94	Other Committments				

HISTORICAL & PROJECTED INCOME STATEMENTS

GAMS-ADV-BSA: F.1 (page 3 of 3)

NAME .... (In .... 000's)

	Period	31-3-80	%	31-3-81	%	31-3-82	%	31-3-83	%
	SALES								
95	Sales Revenue	1170		1291		1416		1508	
96	Other Related Revenue								
97	**NET SALES** (95+96)	1170		1291		1416		1508	
	Cost of Goods Sold								
98	Inventory Cost	1082		1183		1295		1387	
99	Wages								
100	Depreciation-Mfg.								
101	Other Manufacturing Costs								
102	**CGS Total** (98 to 101)	1082		1183		1295		1387	
103	**Gross Profit** (97-102)	88		108		121		121	
	Selling Gen & Admin Expenses								
104	Salaries and Wages	27		31		26		33	
105	Directors' Remuneration	21		33		30		34	
106	Fees	2		3		3		3	
107	Property	8		7		6		7	
108	Depreciation & Amortization on Fixed Assets	3		4		4		4	
109	Amortization on Intangibles								
110									
111	Advertisements								
112	Bad and Doubtful Debts	1		13		14		–	
113	Other SGA	19		17		22		26	
114	**SGA Total** (104 to 113)	81		108	8	105	7	107	7
115	**Operating Profit** (103-114)	7		–		16		14	
	Other Income								
116	Interest Exchange & Dividends								
117	Rental Income			3					
118	Income from Associates								
119	Profit on Sale of Assets								
120	Other -			10					
121	**Other Income Total** (116 to 120)			13					
	Other Expenses								
122	Financial Charges-Interest etc.	5		2		1		4	
123	Other -								
124	**Other Expenses Total** (122+123)	5		2		1		4	
125	**Pre Tax Profit** (115+121-124)	2		11		14		10	
126	Tax								
127	**Profit After Tax** (125-126)								
128	Minority Interest								
129	Extraordinary Items								
130	**NET INCOME** (127 to 129)	2		11		14		10	
131	Dividend								
132	Other Appropriations								
133	Profit Retained								

ADDITIONAL INFORMATION

Branch:

Spread Prepared by:

Department:

Signature:

Date:

STATEMENT OF CHANGES IN FINANCIAL POSITION (SOCFP)

GAMS-ADV-BSA-F(2)

BORROWER

CURRENCY

UNITS

PERIOD		82 to 83		83 to 84		84 to 85	
OPERATING SECTOR		Cr source	DR use	Cr source	DR Use	Cr source	Dr use
1/ Net Sales (Ln 97)		846		964		1250	
2/ A/C Receivable (Ln 7) (dec-CR)			68		44		14
3/ **OPERATING CASH INCOME**	Ln 1,2	778		920		1105	
4/ Cost of Goods Sold (Ln 102)			667		765		91
5/ Inventory (Ln 12) (dec-CR)			42		51		12
6/ A/C Payable (Ln 22) (dec-DR)		91			64	128	
7/ **CASH CGS**	Ln 4 to 6		618		880		91
8/ SGA Expenses (Ln 114)			134		137		24
9/ Annual Depreciation (Ln 100 & 108)		6		9		14	
10/							
11/ Prepaid Expenses (Ln 13) (dec-CR)							
12/ Accrued Liabilities (Ln 26) (dec-DR)							
13/ **CASH SGA**	Ln 8 to 12		128		128		23
14/Operating Cash Expenses	Ln 7 & 13		746		1008		114
15/ **NET OPERATING CASH BIT**	Ln 3 - 14	32			88		4
16/ Financial Expenses (Ln 122)			6		19		31
17/ Tax (Ln 126)			13		12		19
18/ Tax Payable (Ln 24) (dec-DR)		14			4	12	
19/ Other (Ln 15) (dec-CR)							
20/ Other (Ln 27) (dec-DR)							
21/ **NET CASH FROM OPERATIONS (NCFO) AIT**		27			123		81
22/ Other Income (Ln 121)				3		5	
23/ Other Expenses (Ln 123)					1		
24/ Extraordinary Items (Ln 129)							
25/ Due To (Ln 23) (dec-DR)							
26/ Due From (Ln 14) (dec-CR)							
27/ **NET CASH FROM OPERATIONS (NCFO)**		27			121		76
FINANCING SECTOR							
28/ Short Term Finance (Ln 18,20) (dec-DR)			30	151		146	
29/ Current LT Debt (Ln 19) (dec-DR)							
30/ Long Term Debt (Ln 63) (dec-DR)		10			3		38
31/ **CUMULATIVE NET CASH FLOW**		7		27		32	
NON CURRENT SECTOR							
32/ Investments (Ln 36) (dec-CR)							
33/ Fixed assets-gross (Ln 51) (dec-CR)			5		23		34
34/ Depreciation Difference year 1 + Ln 9 - year 2					5		
35/							
36/ Other Assets (Ln37-44) (dec-CR)							
37/ Other Liabilities (Ln 69 ~~+ 128~~) (dec-DR)			1	1		1	
38/							
39/							
40/ **NON-CURRENT SECTOR NET**			6		27		33
EQUITY SECTOR							
41/ Paid up Capital (Ln 76) (dec-DR)							
42/ Undistributable Reserves (Ln 84) (dec-DR)							
43/ Retained Earnings Diff (Ln 85,86 + 130) (dec-DR)		1				1	
44/ Dividends Declared MEMO ITEM							
45/ Dividends Payable (Ln 25) (dec-DR)							
46/ Cash Dividends Paid MEMO ITEM	Ln 44 & 45						
47/ **EQUITY SECTOR NET**		1				1	
48/ **FINAL NET CASH**		2			0		0
49/ Liquid Asset Change (Ln 3) (dec-CR)			0		0		0

XX

SPREAD BY

BRANCH

STATEMENT OF CHANGES IN FINANCIAL POSITION (SOCFP)

CAMS-ADV-RSA-F(2)

BORROWER

CURRENCY UNITS

PERIOD	82/83 to		83/84 to		84/85 to	
OPERATING SECTOR	Cr source	DR use	Cr source	DR Use	Cr source	Dr use
1/ Net Sales (Ln 97)	846		964		1,251	
2/ A/C Receivable (Ln 7) (dec-CR)		68		44		145
3/ **OPERATING CASH INCOME** Ln 1,2	778		920		1,106	
4/ Cost of Goods Sold (Ln 102)		667		765		915
5/ Inventory (Ln 12) (dec-CR)		42		51		129
6/ A/C Payable (Ln 22) (dec-DR)	91			64	128	
7/ **CASH CGS** Ln 4 to 6		618		880		916
8/ SGA Expenses (Ln 114)		124		137		236
9/ Annual Depreciation (Ln 100 & 108)	6		9		14	
10/						
11/ Prepaid Expenses (Ln 13) (dec-CR)						
12/ Accrued Liabilities (Ln 26) (dec-DR)						
13/ **CASH SGA** Ln 8 to 12		128		128		222
14/ Operating Cash Expenses Ln 7 & 13		746		1,008		1,138
15/ **NET OPERATING CASH** Ln 3 - 14	32			88		32
16/ Financial Expenses (Ln 122)		6		19		11
17/ Tax (Ln 126)		13		12		19
18/ Tax Payable (Ln 24) (dec-DR)	14			4	12	
19/ Other (Ln 15) (dec-CR)						
20/ Other (Ln 27) (dec-DR)						
21/ **NET CASH FROM OPERATIONS (NCFO)**	27			123		50
22/ Other Income (Ln 121)			3			5
23/ Other Expenses (Ln 123)				1		31
24/ Extraordinary Items (Ln 129)						
25/ Due To (Ln 23) (dec-DR)						
26/ Due From (Ln 14) (dec-CR)						
27/ **NET CASH FROM OPERATIONS** (FINAL N.C.F.O)	27			121		86
FINANCING SECTOR						
28/ Short Term Finance (Ln 18,20) (dec-DR)		14	151			42
29/ Current LT Debt (Ln 19) (dec-DR)		6			150	
30/ Long Term Debt (Ln 63) (dec-DR)				3		
31/ **CUMULATIVE NET CASH FLOW**	7		27		22	
NON CURRENT SECTOR						
32/ Investments (Ln 36) (dec-CR)						
33/ Fixed assets-gross (Ln 51) (dec-CR)		6		23		
34/ Depreciation Difference Note 1				5		
35/						
36/ Other Assets (Ln37-44) (dec-CR)						
37/ Other Liabilities (Ln 69) (dec-DR)		1				
38/						
39/						
40/ **NON-CURRENT SECTOR NET**		7		28		
EQUITY SECTOR						
41/ Paid up Capital (Ln 76) (dec-DR)						
42/ Undistributable Reserves (Ln 84) (dec-DR)						
43/ Retained Earnings Diff Note 2						
44/						
45/ Dividends Payable (Ln 25) (dec-DR)						
46/						
47/ **EQUITY SECTOR NET**				1		
48/ **FINAL NET CASH**	—	—				
49/ Liquid Asset Change (Ln 3) (dec-CR)						

Notes

1) Line 34 FOR YEAR 19X2: LINE 52 19X2 MINUS LINE 100 AND 108, 19X2 AND LINE 52 19X1 (POSITIVE ANSWER IN CR COLUMN, NEGATIVE ANSWER IN DR COLUMN)

2) Line 43 FOR YEAR 19X2: DIFFERENCE BETWEEN LINES 85 + 86 IN 19X1 AND LINES 85 + 86 IN 19X2 (ANSWER PLUS OR MINUS) MINUS LINE 130 YEAR 19X2 EQUALS RETAINED EARNINGS DIFFERENCE (POSITIVE ANSWER IN CR COLUMN NEGATIVE ANSWER IN DR COLUMN)

CREDIT ANALYSIS

3

CASH FLOW

CASHFLOW ANALYSIS

UNDERSTANDING THE COMPANY'S ABILITY TO GENERATE CASH AND HOW EFFECTIVELY THEY MANAGE IT.

Derived from profit and loss for year and the balance sheet of that year and the previous year.

METHOD:

EXAMPLE Sales = goods delivered not necessarily cash received

If in 19X1 Sales were 120k
and in 19X0 balance sheet accounts receivable
were 30k, in 19X1 balance sheet 40k then.

1) TOTAL POSSIBLE CASH RECEIVABLE =

30k	Last years accounts receivable collected
120k	Sales for 19X1
150k	
	but not all collected so
40k	less 19X1 outstanding accounts received.
110k	Therefore cash received

or 120k minus increase in accounts receivable of 10k

REMEMBER Asset up cash decrease. Asset down cash increase. Liability up cash increase. Liability down cash increase.

BALANCE SHEET - FOWLSHAC LTD

			1982		1983		1984
CASH FLOW	SALES		4,020		3,400		3,320
	RECEIVABLES ADJ		160		260		100
	CASH INCOME FROM SALES		3,860		3,660		3,220
	CGS	(2,860)		(2,380)		(2,300)	
OPERATING SECTOR	INVENTORY ADJ	(110)		75		(15)	
	PAYABLES ADJ	130		(210)		65	
	CASH CGS		(2,840)		(2,515)		2,250
	SGA	1,130		(1,045)		1,000)	
	PREPAIDS ADJ	(20)		20		–	
	ACCRUALS ADJ	(10)				10	
	DEPRECIATION ADJ	15		20		35	
	CASH SGA		(1,145)		1,005		955
NCFO	NET CASH FROM OPERATIONS		(125)		140		15
FINANCE SECTOR	SHORT TERM FINANCE	75		(5		–	
	LONG TERM FINANCE	(20)	55	(20)	25	20	20
NON CURRENT SECTOR	PURCHASE SALE FIXED/ OTHER ASSETS		(10)		(70)		(30)
	CAPITAL INFLOW						20
	DIVIDEND						10
	CASH MOVEMENT		(80)		45		(25)

BALANCE SHEET - FOWLSHAC LTD

	1981		1982		1983		1984	
CASH		80				45		20
ACCOUNT RECEIVABLE		500		660		400		500
INVENTORY		200		310		235		250
PREPAIDS		20		40		20		20
FIXED ASSETS GROSS	90		100		170		200	
LESS DEPRECIATION	30		45		65		100	
NET FIXED ASSETS		60		55		105		100
TOTAL ASSETS		860		1065		805		890
OVERDRAFT		-		75		70		70
ACCOUNTS PAYABLE		250		380		170		235
ACCRUALS		40		30		30		40
LOAN		80		60		40		20
RETAINED EARNINGS		140		170		145		155
CAPITAL		350		350		350		370
TOTAL LIABILITIES		860		1065		805		890

PROFIT & LOSS

	1981		1982		1983		1984	
SALES	3050		4020		3400		3320	
PURCHASE COST (CGS)	2130		2860		2380		2300	
GROSS PROFIT		920		1160		1020		1020
RENT	60		65		65		70	
SALARIES	675		850		770		695	
DEPRECIATION	15		15		20		35	
OTHER EXPENSES	150		200		190		200	
TOTAL EXPENSES (SGA)		900		1130		1045		1000
NET PROFIT/(LOSS)		20		30		(25)		20
DIVIDEND		-		-		-		(10)
TO RETAINED EARNINGS		20		30		(25)		10

		1982		1983		1984	
CASH FLOW	SALES		+4020		+3400		+3320
	RECEIVABLES ADJ	0.96	- 160	1.08	+ 260	0.97	- 100
	CASH INCOME FROM SALES		+3860		+3660		+3220
	CGS	-2860		-2380		-2300	
OPERATING	INVENTORY ADJ	- 110		+ 75		- 15	
SECTOR	PAYABLES ADJ	+ 130		- 210		+ 65	
	CASH CGS	0.99	-2840	1.06	-2515	0.97	-2250
	SGA	-1130		-1045		-1000	
	PREPAIDS ADJ	- 20		+ 20		-	
	ACCRUALS ADJ	- 10		-		+ 10	
	DEPRECIATION ADJ	+ 15		+ 20		+ 35	
	CASH SGA	[illegible]	-1145	0.96	-1005	0.95	- 955
NCFO	NET CASH FROM OPERATIONS	[illegible]	- 125	0.04	+ 140	0.005	+ 15
FINANCE	SHORT TERM FINANCE inc in OD.	+ 75		- 5		-	
SECTOR	LONG TERM FINANCE dec in STD.	- 20	+ 55	- 20	- 25	- 20	- 20
NON CURRENT SECTOR	PURCHASE SALE FIXED/ OTHER ASSETS		- 10		- 70		- 30
	CAPITAL INFLOW					+ 20	
	DIVIDEND					- 10	+ 10
	CASH MOVEMENT		- 80		+ 45		- 25

High Sales but -ve NCFO due to inventory and receivables build up. Financed by [illegible] of cash reserves and STD and increase in payables. Was finance [illegible] arranged.

lower sales but better management of debtors. Less stock holding reduced generating NCFO +140. Sufficient to service STF large investment in assets? [illegible]

[illegible] sales [illegible] reduced more with NCFO of +15 due to less control of debtors, although or extending credit to generate sales.

BORROWER | CURRENCY | UNITS

PERIOD		to		to		to		
OPERATING SECTOR		Cr source	DR use	Cr source	DR Use	Cr source	Dr use	
1/ Net Sales (Ln 97)		4020		846				
2/ A/C Receivable (Ln 7) (dec-CR)			160		68			Cash generated from sales
3/ **OPERATING CASH INCOME**	Ln 1,2	3,860		778				
4/ Cost of Goods Sold (Ln 102)			2,860		667			
5/ Inventory (Ln 12) (dec-CR)			110		42			
6/ A/C Payable (Ln 22) (dec-DR)				91				Cash paid out to cover cost of goods
7/ **CASH COS**	Ln 4 to 6				618			
8/ SGA Expenses (Ln 114)					134			
9/ Annual Depreciation (Ln 100 & 108)				6				
10/								Overhead expenses of running the business in cash terms
11/ Prepaid Expenses (Ln 13) (dec-CR)								
12/ Accrued Liabilities (Ln 26) (dec-DR)								
13/ **CASH SGA**	Ln 8 to 12				128			
14/ Operating Cash Expenses	Ln 7 & 13				746			
15/ **NET OPERATING CASH**	Ln 3 - 14			32				Cash generated by basic buying/selling operation of business.
16/ Financial Expenses (Ln 122)								
17/ Tax (Ln 126)								
18/ Tax Payable (Ln 24) (dec-DR)								Cash amounts paid for interest/tax etc
19/ Other (Ln 15) (dec-CR)								
20/ Other (Ln 27) (dec-DR)								
21/ **NET CASH FROM OPERATIONS (NCFO)**								Cash generated after financial costs
22/ Other Income (Ln 121)								
23/ Other Expenses (Ln 123)								
24/ Extraordinary Items (Ln 129)								Other income etc in cash terms
25/ Due To (Ln 23) (dec-DR)								
26/ Due From (Ln 14) (dec-CR)								
27/ **NET CASH FROM OPERATIONS (NCFO)**								Cash generated from overall trading operations
FINANCING SECTOR								
28/ Short Term Finance (Ln 18,20) (dec-DR)								
29/ Current LT Debt (Ln 19) (dec-DR)								Amount raised or paid back to Banks/Financial Institutions
30/ Long Term Debt (Ln 63) (dec-DR)								
31/ **CUMULATIVE NET CASH FLOW**								(Running balance)
NON CURRENT SECTOR								
32/ Investments (Ln 36) (dec-CR)								
33/ Fixed assets-gross (Ln 51) (dec-CR)								
34/ Depreciation Difference								
35/								Cash used in purchase of non current assets or derived from their sale
36/ Other Assets (Ln)37-44) (dec-CR)								
37/ Other Liabilities (Ln 69 (dec-DR)								
38/								
39/								
40/ **NON-CURRENT SECTOR NET**								
EQUITY SECTOR								
41/ Paid up Capital (Ln 76) (dec-DR)								
42/ Undistributable Reserves (Ln 84) (dec-DR)								
43/ Retained Earnings Diff								Cash injections or payouts
44/								
45/ Dividends Payable (Ln 25) (dec-DR)								
46/								
47/ **EQUITY SECTOR NET**								
48/ **FINAL NET CASH**								Final total should equal movement in 'cash'

BRANCH ....

CASH FLOW FORECAST for Vi[illegible] (Company)

COMPLETED BY *BRANCH/*COMPANY (*delete not applicable)

INDICATE UNITS USED (£: £100; £1,000)

Enter Month or Quarter		JAN	FEB	MAR	APL	MAY	JUN				
RECEIPTS Cash Sales											
Debtors				167	167	167	167				
Rents											
Capital		250									
TOTAL – A		[illegible]		167	167	167	167				
PAYMENTS Cash Purchases		166	[illegible]	83	83	83	83				
Creditors											
Wages/Salaries/Drawings		50	50	50	50	50	50				
Telephone/Advertising											
Capital items (Specify overleaf)		30									
Repairs/Renewals											
Rent/Rates		50									
Printing/Stationery											
Heating/Power, etc.											
Transport/Packaging etc.											
Bank/Finance Charges											
Other Overheads											
PAYE NAT. INS.											
V.A.T. (Net)											
Dividend											
Corporation Tax, etc.											
TOTAL – B		296	133	133	133	[illegible]	133				
A minus B or B minus A **C**	CR or DR			34	34	34	34				
		46	133								
Bank balance at end of previous month/quarter brought forward **D**	CR or DR										
			[illegible]	79	145	111	77				
Bank balance calculated at end of month/quarter carried forward i.e. net of C & D	CR or DR										
		4	[illegible]	145	111	77	43				
OVERDRAFT LIMIT SANCTIONED.											

2	3	4	5	TRANSACTION FLOW/MODUS OPERANDI	TIME LAG	LG	LC	ACCEPT	CASH	MARGIN AMOUNT

Branch Customer

Description of Transaction

RISKS

FACILITY CONDITIONS

CASH FLOW

MONTH

	1	2	3	4	5	6	7	8	9	10	11	12	TOT
SALES EXISTING	125	125	125	125	125	125	125	125	125	125	125	125	1500
NEW		15	75	75	75	75	75	75	75	75	75	75	765
	125	140	200	200	200	200	200	200	200	200	200	200	2265
CASH IN EXISTING	125	125	125	125	125	125	125	125	125	125	125	125	1500
NEW			55	75	75	75	75	75	75	75	75	75	730
	125	125	180	200	200	200	200	200	200	200	200	200	2230
PURCHASES EXISTING	115	115	115	115	115	115	115	115	115	115	115	115	1380
NEW		70	70	70	70	70	70	70	70	70	70	70	770
	115	185	185	185	185	185	185	185	185	185	185	185	2150
OVERHEADS	10	11	11	11	11	11	11	11	11	11	11	11	131
CAPITAL EXPENDITURE	5												5
LOAN REPAYMENT						5							5
INTEREST			1			3			3			3	10
	130	196	197	196	196	204	196	196	199	196	196	199	2301
NET	(5)	(71)	(17)	4	4	(4)	4	4	1	4	4	1	(71)
BFWD	4	(1)	(72)	(89)	(85)	(81)	(85)	(81)	(77)	(76)	(72)	(68)	4
CFWD	(1)	(72)	(89)	(85)	(81)	(85)	(81)	(77)	(76)	(72)	(68)	(67)	(67)

NOTE SMALL DIFFERENCES OCCUR BECAUSE OF ROUNDING

CREDIT ANALYSIS

4

EVALUATION

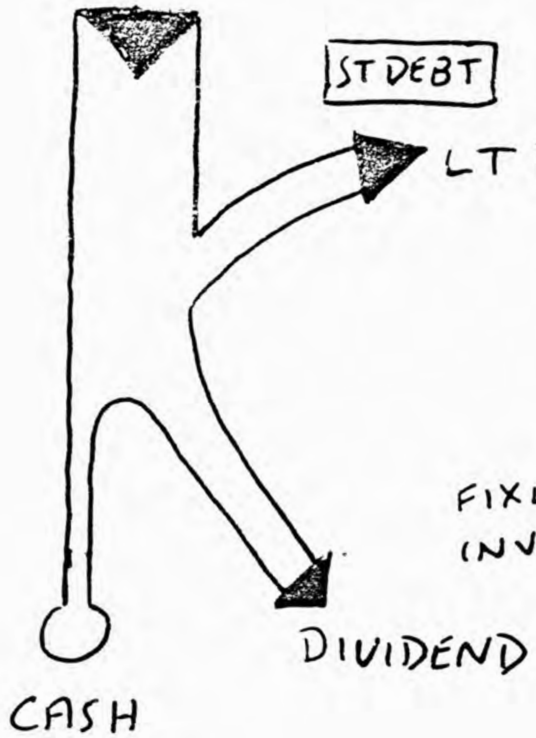
CRITERIA

1. CASH MANAGEMENT

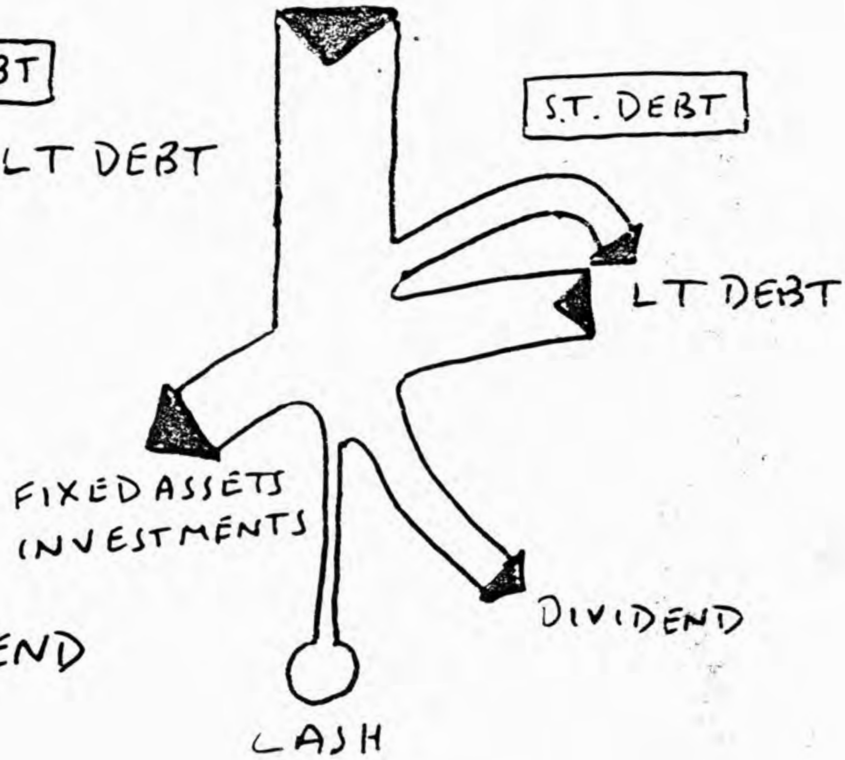
CASH FROM OPERATIONS

TOTAL CASH MANAGEMENT

NCFO +



NCFO +



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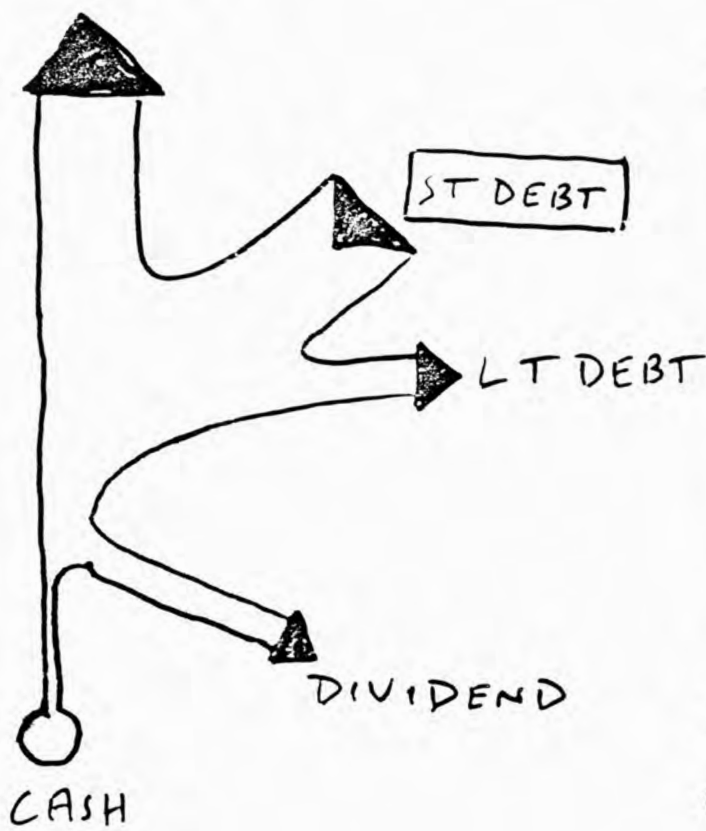

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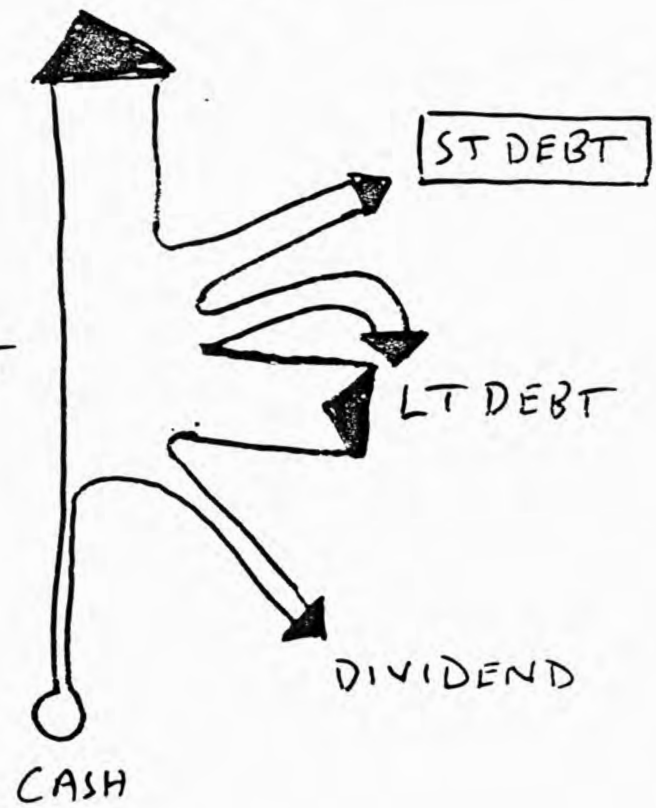


CASHFLOW ANALYSIS

AIM - EXAMINE HOW A COMPANY GENERATES AND USES CASH
- HIGHLIGHTS SHORT TERM CASH GENERATION
- INTERPRET HOW WELL A COMPANY MANAGES ITS CASH
- AID TO COMPANY QUESTIONING

AREAS FOR INTERPRETATION

ADEQUATE CASH FROM OPERATIONS OVER TIME

TO - FINANCE BUSINESS EXPANSION
- REPAY CURRENT PORTION OF LONG TERM DEBT
- DIVIDENDS

QUALITY OF GENERATION -
- CRISIS OR PLANNED MANAGEMENT
- PROFIT BASED
- RUN DOWN OF CURRENT ASSETS
- INCREASING USE OF CURRENT LIABILITIES

HOW IS FINANCING SECTOR USED?
- IS SHORT TERM LENDING USED ON A TEMPORARY BASIS?
- ARE CORE CURRENT ASSETS AND NON CURRENT ASSETS PROPERLY FINANCED FROM LONG TERM DEBT/EQUITY?

HOW ARE FREE FUNDS AND NEW LONG TERM DEBT USED

INVESTMENT
FIXED ASSETS
} DISTINGUISH PURCHASES FROM REVALUATIONS COMPARE BUYING PATTERNS, ADEQUACY OF REPLACEMENT

OTHER - DEFERRED - WHAT IS NATURE

RESERVES - UNUSUAL MOVEMENTS WRITE OFFS

NEGATIVE CASH FROM OPERATIONS

WHAT IS REASON

- COMPANY NOT MAKING PROFIT
- CHANGE IN TERMS OF TRADE
- EXPANSION OF SALES CREATING HIGHER DEBTORS & STOCK (OVERTRADING OR PLANNED)
- OTHER
- CAN IT BE JUSTIFIED HOW WAS IS FINANCED

COMPANY - HOLDS STOCK 3 MONTHS
RECEIVABLES PAY AFTER 4 MONTHS
PAYABLES MUST BE PAID AFTER 1 MONTH

	Years			or
	1	2	3	4
SALES	100	200	400	200
GGS	80	170	360	170
GP	20	30	40	30
SGA	18	20	25	20
OPERATING PROFIT	2	10	15	10
CASH TIE UP IN STOCK		(23)	(47)	
LESS CREDIT PURCHASES		8	16	
CASH TIEDUP IN RECEIVABLES		(33)	(67)	
CASH FROM OPERATIONS	2	(38)	(83)	10

RELATIONSHIP INDICATORS

SALES ENCASHMENT	$\frac{\text{SALES CASHED}}{\text{SALES}}$ N. Pen[illegible] [illegible] pound sales turned into cash.
SALES A/C REC MOVEMENT	
CASH COST OF GOODS SOLD	$\frac{\text{CSH CGS}}{\text{CGS}}$
CGS A/C PAYABLE MOVEMENTS INVENTORY MOVEMENT	
CASH EXPENSES	$\frac{\text{CASH SGA}}{\text{SGA}}$
SGA ACCRUALS MOVEMENTS PREPAYMENTS MOVEMENTS	
CASH GENERATION	$\frac{\text{NET OPERATING CASH}}{\text{SALES}}$
INTEREST COVERAGE	$\frac{\text{NET OPERATING CASH}}{\text{INTEREST}}$
TAX COVERAGE	$\frac{\text{NET OPERATING CASH}}{\text{TAX} + \text{INTEREST}}$
DIVIDEND COVERAGE	$\frac{\text{NET OPERATING CASH}}{\text{TAX} + \text{INTEREST} + \text{DIVIDEND}}$
CASH BUILD UP	$\frac{\text{CASH AT CLOSE}}{\text{CASH AT START} + \text{NCFO}}$

PROJECTIONS - WHAT PROCEDURE

EXISTING COMPANY

NEW COMPANY

ADD TO SPREAD, COMPARE
WITH PAST (USE RATIOS)

SPREAD COMPARE WITH
SIMILAR INDUSTRIES

CHECK INTERNAL
COHERENCE OF
FIGURES

QUESTION CUSTOMER RE

ANNOMALIES/CHANGES

BASIS FOR ASSUMPTIONS

DOES CURRENT ORDER BOOK

TIE UP WITH SALES PROJECTION

ARE THESE SENSIBLE

COMPARE CUSTOMER RESPONSES WITH

- MARKET/INDUSTRY/ECONOMIC INFORMATION

CHECK PHYSICAL CAPACITY

- PRODUCTION
- STORAGE
- PEOPLE

WILL ADDITIONAL SALES MEAN EXTENDING CREDIT TERMS

HAVE THEY CONSIDERED IMPACT OF VAT IN CASHFLOW
FORCAST

HOW HAVE THEY INTEGRATED NEW FACILITY IN CASHFLOW
PROFIT FORCAST

TERM LENDING

FURTHER CONSIDERATION

GREATER CONSISTANCY OF PROFITABILITY AND CASHFLOW

REPAYMENT COVERAGE RATIOS

- PROFIT
- CASH

PROJECTIONS TO COVER FULL PERIOD OF ADVANCE

INDUSTRY/PROJECT ANALYSIS (CUSTOMER PROVIDED AS AN
AID TO QUESTIONING VIABILITY

REPAYMENT COVERAGE RATIO

$$\frac{\text{INTEREST + LEASING CHARGES + PRETAX PROFIT + DEPRECIATION}}{\text{INTEREST \& LEASING CHARGES \& CAPITAL REPAYMENTS/LEASE PAYMENTS}}$$

INDICATES SUFFICIENCY OF FUNDS TO COVER REPAYMENTS
GREATER THE COVERAGE THE BETTER.

(CAPITAL REPAYMENT = PREVIOUS YEARS CURRENT PORTION OF LONG DEBT
LEASE PAYMENTS)

CASHFLOW COVERAGE

$$\frac{\text{NCFO + LEASING CHARGE + INTEREST}}{\text{INTEREST + LEASING CHARGES + CAPITAL REPAYMENTS + LEASE PAYMENTS}}$$

INDICATES REAL CASH COVER FOR REPAYMENTS, SHOULD BE ADEQUATE
OVER LONG TERM (UNCOVERED POITIONS COVERED BY SHORT TERM
BORROWING PREVIOUSLY PLANNED ACCEPTABLE)

RELATED TO ANY OF THE ABOVE PRUPOSED - A AND B WHETHER THERE IS A FACILITY OR NOT	
TO COVER FOREIGN EXCHANGE RISK	FEX LIN SPOT FORWARD SWAP
GUARANTEES/STANDBY	FINANCIAL GUARANTEE OR STANDBY TO COVER PURPOSES A - B
	SHIPPING GUARANTEE
	BID BOND
	PERFORMANCE GUARANTEE
	ADVANCE PAYMENT GUARANTEE

Structural?

6. RESIDUAL LIQUIDITY
(NET WORKING CAPITAL)

St

NET WORKING CAPITAL - TRADITIOINAL

DEFINITION	-	CURRENT ASSETS MINUS CURRENT LIABILITIES
		OR
		EQUITY PLUS NON CURRENT LIABILITIES MINUS NON CURRENT ASSETS
		OR
		LONG TERM SOURCES OF FUNDS USED TO BUY CURRENT ASSETS
IMPORTANCE	-	BUFFER TO COPE WITH SET BACKS GIVE FLEXIBILITY TAKE OPPORTUNITIES
ASSESSMENT	-	THE MORE THE BETTER

VELOCITY OF ASSET TURNOVER AND THE NEED FOR NWC

Tabacconists kiosk

Held on average 14 days

Current Assets	Current Liabilities
Stock of cigarettes etc.	A/c payable 30 days
Negative NWC	

Furniture Manufacturer

Current Assets	Current Liabilities
Stock of Wood Cloth Varnish Fitments Etc. Etc.	A/c payable 60 days
Receivables Stores Needing Credit	Positive NWC

Tabacconists kiosk	Furniture Manufacturer
Small Core	Large Core requirement
Stock quickly into cash	Stock/receivable a long way from cash
Negative NWC acceptable	Depth in NWC required.

NET WORKING CAPITAL IN RELATION TO SALES

A business can sustain a level of sales with a certain amount of Net Working Capital; this is related to the velocity of the current assets and liabilities. However it is more the company's ability to manage on a day to day basis rather than a precisely calculated figure for NWC that is important.

Given the above however is is still important for the business to maintain a level of NWC relative to increasing sales and this is judged by the ratio.

$$\frac{\text{NWC}}{\text{SALES}}$$

If this is reasonably consistant then it indicates that the company is putting adequate funds into the working capital cycle as it grows. If it falls it could be a danger signal (overtrading) — however — it could be a sign of higher efficiency, better control of current assets, more use of accounts payable.

CREDIT ANALYSIS

7

CUSTOMER

INTERVIEW

INTERVIEW PLANNING

Time spent in planning interviews with corporate customers will help to sell more effectively and impresses the customer with our business like approach. Much customer information may be obtained before the visit. If we can't obtain it in advance, then we should try to get the information in the interview. First, there is the balance sheet information which we should interpret to identify possible financial needs of the company, as well as guaging its financial health. Other information is indicated by the following checklist:-

1. Whom are we meeting? What is his job? How important is he in the decision making process?
2. What is the decision making process? Who is the decision maker?
3. Whom do we know in the company? Are they allies?
4. Whom do we need to get to know?
5. What business is the company in?
6. What is the company's market position?
7. What is the company's reputation?
8. What do we know of the quality of management?
9. How many employees?
10. What questions have been raised by our financial analysis?
11. What is its credit rating?
12. Is the company growing/static/declining?
13. What do we know of - problems facing the company?
    - opportunities facing the company?
    - planned developments?
14. Are there any known economic, market, social, legal etc factors affecting the company significantly?
15. What part of the company are we visiting?
16. Does BCCI do business with the company elsewhere?
17. Can any part of BCCI give us introductions or referrals?

NEGOTIATING

Negotiating is generally associated with the discussions that take place between employers and trade unions or at political and diplomatic level. The Concise Oxford Dictionary definition of the word negotiable is - "to confer with a view to compromise or agreement". This implies that there must be an area of disagreement before there is any need to negotiate. A banker's day-to-day work must, therefore, frequently involve negotiating with his customers about such matters as security charges, repayment of facilities etc.

For there to be any chance of success in a negotiating situation, there must be an area of "common ground" and an experienced negotiator will always seek to identify the likely areas of agreement before the negotiations start. In most cases, the two parties will start off from positions which they know will be unacceptable to the opposite side, with the obvious intention of leaving themselves "room to manoeuvre".

Only by careful planning can you hope to be successful when negotiating with a customer. He must set out to retain the initiative throughout the meeting and he will only achieve this objective if he prepares a plan of action designed to persuade his customer to move towards his point of view. The following notes might help in this respect.

1. BEFORE THE INTERVIEW

a) Know and understand all the facts and figures

b) Check accuracy of all the facts and figures - this may be important if support required for your arguments after all concessions have been made.

c) Identify if possible the likely areas of common ground.

d) Consider fully the strengths and weaknesses of your case.

e) Decide what concessions you are prepared to make and at what stage you will dig your heels in.

f) Have there been any other negotiations with this man? If so what was the outcome?

g) What are his main arguments likely to be?

h) Is he likely to raise any other matters which might weaken your position?

i) Did he meet his obligations last time?

j) Did we meet our obligations last time?

k) What possible effect is there likely to be on other customers i.e. will the Bank lose business if he goes away unhappy with the outcome?

l) Are there particular factors which might influence his attitude? (Toughest negotiators are often young 'first-timers' who are obviously intent on impressing those they represent).

m) Should you keep a final concession "up your sleeve" until the end or will it pay to set your cards firmly on the table at the outset?

n) Select the best time of day for the interview. When do you feel at your best? If you are to retain the initiative you must be alert and quick of thought.

o) Make sure his first impression of your room is favourable - desk clear, room tidy etc.

p) Consider advantages if interview can be completed without interruptions.

2. DURING THE INTERVIEW

a) Create the right atmosphere initially - a warm welcome and friendly manner will do much to start moving him towards your point of view before the negotiations start.

b) State your case clearly and with conviction.

c) Listen while he is speaking and let him see you are listening.

d) Look for "non-verbal" communication - can you detect any relaxation in his attitude?

e) Seek information and clarification at every opportunity.

f) Separate fact from opinion.

g) Frame questions carefully along positive lines seeking affirmative answers.

h) Don't talk about the "increase" but "the new figure".

i) Summarise progress frequently.

j) Seek to narrow the area of disagreement by using constructive argument.

k) Keep calm - he will aslo be watching for "non-verbal" communication.

l) If you have to give ground, do so gracefully.

m) Use your knowledge of our competitors' charges, policy to counteract their arguments where possible.

3. AFTER THE INTERVIEW

a) Write to your customer setting our the arrangement agreed during the interview.

b) Make careful note of the conclusion in the customer's file.

c) Diarise to follow through if necessary.

Remember! An intelligent and prudent man will obviously pay as little as possible for what he is buying and a Financial Director would not be doing his job if he did not negotiate the best possible terms with his Bank. If follows, therefore, that most negotiations must be handled very carefully if we are to achieve our objectives.

In planning the interview itself we should ask ourselves four questions:-

- What am I trying to achieve in this interview, what is my objective?
- What is known of the customer's likely needs for BCCI services?
- What still has to be found out during the interview concerning the customer's needs?
- What resistance can be forseen and how may it be overcome ?

Most reasons for resistance can be foreseen. Resistance will normally be on the grounds of price, or because the customer is comparing BCCI with some competitive offer, or because of a known weakness in the service that BCCI is selling, or, if he is a non-customer, because he is worried about the difficulties involved in changing banks. If objections can be foreseen, we should be able to prepare ourselves to over-come them.

Matching Benefits to Customer Needs

The essence of successful selling is the ability to identify the customer's needs, to agree them with him, and then to present the benefits of BCCI services in such a way that the customer is persuaded they meet those needs.

A need may be a clear requirement for a particular service; a Letter of Credit from third world; help in exporting; or a need may be some fundamental in the customer's mind that has to be satisfied before he will give the business to the Bank; the need to be assured of the banker's business acumen; or the need to be satisfied that he will get a high standard of service; or, simply, the need to like you. This relationship between customer needs and the benefits of our services is fundamental to selling. It affects all that we do in an interview. It is perhaps where many of us go wrong.

Too often the banker launches in to a presentation of the services of the bank before he has discovered enough of the customer's business or of his requirements. Too often managers present the services by technically describing them, which is how we have learned them, instead of presenting the benefits of those services to the customer.

Early in an interview we should ask questions, and continue asking questions, until we build up a picture of the customer's business and his needs. We may, of course, have to deduce from what he tells us what those needs are. We may even have to create those needs in his mind. Once we have a picture of the needs we try to get the customer to agree them. Then we present our service by explaining those benefits which meet the needs that he has agreed. As we do so, we try to get him to acknowledge each benefit. If a customer agrees he has certain needs, and then agrees that each of the benefits we present meet those needs, it logically becomesincreasingly difficult for him to say no in the end.

Giving The Customer Confidence

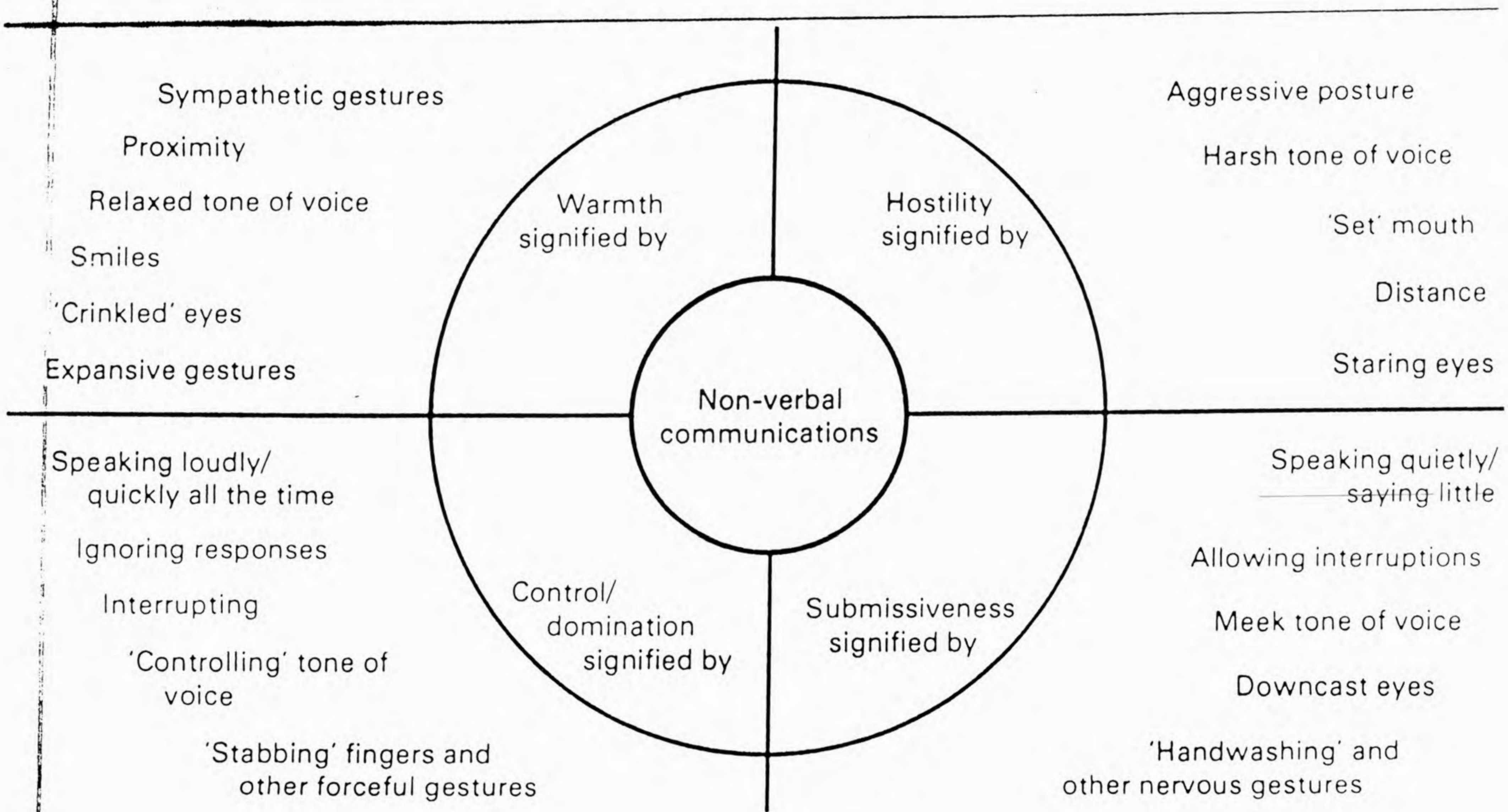
The chances of obtaining new business is obviously improved if we show interest in the customer's business and his problems, and demonstrates by the sort of questions he asks and comments he make that he understands that business. New prospects, particularly, need to have confidence in you as a businessman, Showing interest is not achieved by saying 'I am interested' in increasingly frantic terms, but by the nature of one's comments and questions. A new customer will not be lost by our inability to make an instant loan decision. Businessmen know about lending authorities. It may be lost if we leave the customer with the feeling that we are disinterested in his business.

Finally, the objective of marketing is profit, and not volume for its own sake. This means that, in business development, we do not take on bad business nor do we risk offending the customer by a hard sell. We should know how to assess credit worthiness and how not to offend customers. Nothing in the selling of banking services changes those basic disciplinies one bit.

BODY LANGUAGE

Non-verbal cues and possible underlying processes

Non-verbal cues	*Possible processes*
Furrowed forehead, knitted brows.	Thinking, rehearsing in an internal dialogue; giving self a bad time.
Tapping foot and/or drumming fingers.	Impatience; irritation; anger; agitation.
Avoiding eye contact.	Discomfort; anxiety; suspicion; confusion.
Intense eye contact.	Anger; concern; sexual attraction.
Rapid, light breathing.	Anxiety; fear; distress.
Irregular breathing.	Approaching an important issue; forcing self; controlling feelings.
Deep, slow breathing.	Supporting strong feelings – often precedes catharsis.
Physical stroking of face, arms and neck.	Comforting self *or* holding back from stroking others *or* holding back the need for comforting.
Scratching, pinching, gouging, severe pressing.	Punishing self, reflecting self-criticism or holding back from provoking or punishing someone else.
Controlled, low, quiet voice.	Suppressing energy/interest; excitement.
Fast, high voice.	Excitement; tension; fear.
Tightness/rigidity in jaw, neck, shoulder.	Holding back anger, sadness.
Clenching fists, tightness in arms.	Holding back anger, sadness.
Body leaning forward in chair.	Interested; concerned; about to 'happen'.
Body leaning backward in chair, sprawling.	Detached; uninvolved; unconcerned.
Arms tightly folded; legs tightly crossed.	Defending; putting up barriers; resistance.
Lounging extravagantly in the chair.	Detachment; cynicism; discounting.
Hand covering mouth.	Hiding; playing games; uncertain.
Finger jabbing.	Critical; putting down; fencing with.


Sympathetic gestures
Proximity
Relaxed tone of voice
Smiles
'Crinkled' eyes
Expansive gestures
Warmth signified by
Hostility signified by
Aggressive posture
Harsh tone of voice
'Set' mouth
Distance
Staring eyes
Non-verbal communications
Speaking loudly/ quickly all the time
Ignoring responses
Interrupting
'Controlling' tone of voice
'Stabbing' fingers and other forceful gestures
Control/ domination signified by
Submissiveness signified by
Speaking quietly/ saying little
Allowing interruptions
Meek tone of voice
Downcast eyes
'Handwashing' and other nervous gestures

Summary

1. Be clear about the purpose of your questions before you ask them. Concentrate on using open and probe questions when interviewing but remember *not* to ask too many closed questions, unless the situation really calls for it.

Question Type	Purpose	Question Form	Illustrations
OPEN	To establish rapport	Contact	Introductory questions/comments to establish the first superficial relationship and to put respondent at ease; e.g. in a selection interview reference to mutually shared experiences, unusual leisure interests indicated on application form etc.
	To explore broad background information	General	'Please tell me about . . .?'
	To explore opinions/attitudes	Opinion-seeking	'How do you feel about . . .?' 'What do you think about . . .?'
		Trailer	Making a broad comment on a subject and then pausing in anticipation of a response (i.e. the question is hidden)
PROBE	To show interest/encouragement	Non-verbal noises	Umm? Er? Ah? Oh? Hmm? together with appropriate facial expressions (smiles, raised eyebrows) and head movements
		Supportive statements	'I see . . .?' 'And then . . .?' 'That's interesting . . .?' (i.e. tell me more)
		Key word repetition	Repetition of one or two words to encourage further response
		Mirror	Repetition of short reply as a query
	To seek further information	The pause	Allied to various non-verbal signals
		Simple interrogative	'Why?' 'Why not?'
		Comparative	'How do your responsibilities now compare with those in your last job?'
		Extension	'How do you mean?' 'What makes you say that?'
		Hypothetical	'What would you do if . . .?' 'How would you feel if . . .?'

Question Type	Purpose	Question Form	Illustrations
PROBE (continued)	To explore in detail particular opinions/attitudes	Opinion-investigation	'To what extent do you feel . . .?' 'Just how far do you think . . .?'
		The reflection	'You think that . . .?' 'It seems to you that . . .?' 'You feel that . . .?'
	To demonstrate understanding/ clarify information already given. To regain control	Summary	'As I understand it . . .?' 'If I've got it right . . .?' 'So what you're saying is . . .?'
CLOSED	To establish specific facts/ information	Yes/No response	'Are you . . .?' 'Do you . . .?' 'Have you . . .?'
		Identification of person, time, location, number	'How many people do you have reporting to you . . .?' 'How long did you have that job?'

Use link questions to make the transition smoothly from one type of question to another: e.g. 'You mentioned just now that. . . . How did this affect your work?' 'You were saying earlier on that. . . . What happened after that?'

2. Do not use counter-productive questions: the aim is to get the respondent talking, not to suggest 'right' answers; embarrass, confuse or mislead him; to prevent him from saying anything; or to discourage him.

Question Type	Purpose	Question Form	Illustrations
COUNTER PRODUCTIVE	To prompt desired answer	Leading	'I take it you believe that . . .?' 'You don't *really* think that . . . do you?' 'You must admit that . . .?' 'Isn't it a fact that . . .?'
	To confuse or mislead	Trick	'Do you drink?'
		Multiple	Two or more questions presented as a package. 'You did say you wouldn't mind being away from home occasionally? Oh, and you do have a current driving licence, don't you? I presume it's clean? And, er, by the way . . .?' etc.
		Marathon	Asking a question in a rambling, incomprehensible way
		Ambiguous	'What about religion?'
	To prevent respondent from saying anything	Rhetorical	Answering your own questions. 'Do you . . .? Of course you do. I always say that . . . etc.'
	To discourage respondent/ indicate bias	Discriminatory	'When do you intend to start a family?'

7. FINANCIAL GEARING

GEARING

WHAT - RELATIONSHIP BETWEEN LONG TERM DEBT AND EQUITY
EXPRESSED AS A RATIO
LONG TERM DEBT ÷ EQUITY

WHY - 1) BUSINESS STRATEGY
2) COMMON IN TYPE OF BUSINESS (HAVE SALEABLE ASSETS-AEROPLANES)

HIGH	LOW
1) AIRLINES	1) CAPITAL GOODS MANUFACTURED
2) HOUSING/PROPERTY	2) PHARMACUTICALS
3) HOTELS	

3) NECESSITY : IS ONLY WAY YOU CAN GET MONEY IE DEBT FINANCE

NOTE - DIRECTORS LOANS (CAPITAL OR DEBT)
PREFERENCE SHARES " " "
- WHAT IS THE REAL LEVEL OF DEBT (GROSS UP INTEREST)

EFFECT - HIGH GEARING / LOW GEARING

HIGH GEARING: ORDINARY SHAREHOLDERS	HIGH GEARING: BANK	LOW GEARING: ORDINARY SHAREHOLDERS	LOW GEARING: BANK
Possible high return	High risk	Low return	Low risk
Lower amount to lose		Company stability	

High inflation -
Asset value rises / Debt value falls

HIGH GEARING CAN <u>ONLY</u> BE JUSTIFIED BY EXPECTATION OF RELIABLE CASH FLOWS.

RATIO $\dfrac{\text{LONG TERM \& SHORT TERM DEBT}}{\text{EQUITY}}$ - (IS IT SHORT TERM) - HIGH GEARING CAUSED BY SHORT TERM DEBT

RATIO $\dfrac{\text{TOTAL LIABILITIES}}{\text{EQUITY}}$ - HIGH USE OF EXERNAL FUNDS

RATIO $\dfrac{\text{INTEREST \& OPERATING PROFIT}}{\text{INTEREST}}$ - DEPTH OF COVER

OVERTRADING

Expansion without additional capital depends on either ability to borrow or tolerance of creditors (another form of borrowing).

OTHER WAYS OF CREATING

WRONGLY FINANCED CAPITAL EXPENDITURE

Capital assets with cash from current sector.

REPAYMENT OF LONG TERM DEBT

As above.

ESCALATING FACTORS

INTEREST COST

LOST DISCOUNTS

CUTTING MARGINS TO MOVE STOCK TO CASH

HARD CORE ON BANK A/C

CHEQUES FOR ROUND AMOUNTS

LONGER (SHORTER) CREDIT TAKEN/DEBTORS COLLECTED EARLIER

$$\frac{\text{TURNOVER}}{\text{EQUITY}}$$

LOOK FOR CONSISTANCY

TYPE OF BUSINESS - STOCK BROKERS HIGH

CAPITAL GOODS MANUFACTURERS LOW

ADDITIONAL EQUITY IF NOT USED FOR FIXED ASSETS INCREASES WORKING CAPITAL THEREFORE

$$\frac{\text{SALES}}{\text{WORKING CAPITAL}}$$

CONSISTANCY

ROUGH INDICATION OF WHAT WORKING CAPITAL NEEDED FOR GIVEN SALES INCREASE.

RATIOS AS TOOLS OF ANALYSIS

There are a number of comparative indicators and measures to help appraise the financial condition, efficiency, and profitability of a business. As opposed to cash flow analysis an appraisal of the soundness of the decisions for shifting funds, ratio analysis shows the results of the business operations as reflected in the relationship among balance sheet and operating statement items.

When a lending officer concerns himself with the financial facts of a business, he should ask questions about its ability to meet current obligations, the true worth of its various assets, the extent and character of its liabilities, its resourcefulness and ability to earn a fair return on its investment, its ability to withstand possible setbacks from external or internal sources, its ability to raise new funds when needed, etc. The analyst, who is reviewing a business for purposes of extending credit, will wish to make certain tests and apply certain standards to be able to determine 1) the current status of the business, 2) a trend, favourable or unfavourable, over a period of time, and 3) a relative comparison to other companies of a similar nature.

It is often helpful, therefore, to relate financial data to each other to obtain ratios, or index numbers, which express a significant comparison more useful than the raw figures themselves. For example, to compare the amount of the current assets on the balance sheet to the amount of current liabilities is more meaningful than simply to look at each amount without reference to the other, since current assets are frequently considered the major reservoir of funds for meeting current obligations, especially when the future of the firm is in jeopardy. On the other hand, it would be nonsensical to compare "other assets" with "accounts payable" and hope to obtain a significant relationship. Our basic caution must be remembered here :

> Ratio analysis of financial statements must be preceded by careful thought as to the kinds of insights the analyst wishes to obtain. Ratios are not ends in themselves, rather, on a selective basis they may help answer significant questions.

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(1) This article has been liberally adopted from "Note on Financial Analysis", Copyright 1961 by the President and Fellows of Harvard College.

It is very important to call attention to the many limitations inherent in ratio analysis. The first and most obvious drawback lies in the differences found among the accounting methods used by various companies, which seriously impair the comparability of many situations, even in the same industry. Methods of recording and valuing assets, write-offs, costs, expenses, etc. vary with the customs, policies, and character of the company investigated. For example, the various methods for establishing inventory values leave great leeway to management, just as the extent of depreciation claims can fluctuate widely. In short, the balance sheet accounts do not necessarily correspond to the value of the firm, either as a going concern or in liquidation, and liability accounts may be incomplete or understated (e.g., nonrecording of lease obligations). Thus no one business is exactly comparable to any other.

More importantly, however, financial statements are based upon past performance and past events, and we must project our evaluation of the future from this basis. Needless to say, for any such evaluation, be it for credit extension or internal control, the significance lies in what can be expected to happen. Past events are guides only to the extent they can reasonably be considered as clues to the future. Their use must be tempered by the best possible knowledge about the outlook for the business.

Where, then, lies the usefulness of ratio analysis? Within relatively rough limits ratio analysis will provide guides and clues especially in spotting trends towards better or poorer performance, and in finding significant deviations from any average or relatively applicable standard. It is in the interpretation of such trends and deviations that the analyst will use his skills, experience (and intuition) to the fullest extent.

Keeping the limitations and possible uses of ratios in mind, we can now turn to the major ratios and discuss each briefly. An indication will be given of the kinds of answers each ratio can provide, and its significant applications will be pointed out. Fiscal 1959 figures for United States Steel Corporation have been used to illustrate the ratios (Exhibit I).

(a) Ratios Measuring a Company's Liquidity and Indebtedness

(1) The Current Ratio

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$1,423.8}{\$808.2} = 1,76:1$$

The current ratio is one of the most commonly used indexes of financial strength, although it is a rather crude measure. The basic question underlying this ratio is the ability of the business to meet its current obligations with a margin of safety to allow for a possible shrinkage of value in its various current assets, such as inventories and receivables. This test applied at a single point in time, implies a liquidation approach rather than a judgement on the going concern, for it does not explicitly take into account the revolving nature of current assets and current liabilities.

The general impression regarding the measure is that the higher the better. From the point of view of the creditor this may be true, but from the standpoint of prudent management there may be serious doubts about the wisdom of an excessive buildup especially of redundant cash lying idle, or worse, a buildup of inventories out of proportion to the needs of the business. Another distorting factor is the seasonal character of some businesses which can be reflected to a great extent in a fluctuating current ratio. In the interpretation of this ratio thought should therefore be given to the components (e.g., cash, account receivable, inventories, accounts payable, etc.) forming the ratio, the character of the business and the industry, and the point of time during the arrival cycle of the business at which this ratio is computed.

A generally popular rule of thumb for the current ratio is considered to be a 2: 1 relationship. Used without caution and discrimination, however, such a vague over-all standard is rather dangerous. A 2: 1 current ratio, or even a 10: 1 current ratio, does not of itself guarantee reserve strength to meet current obligations, or the ability to turn current assets, (especially inventories) into cash as needed (liquidity). Much depends on the quality of the current assets, and the relative composition as among cash, receivables, and inventory. Furthermore, the type of industry involved plays a major role in the need for more or less current financial strength and liquidity. For instance, a public utility, with a preponderance or fixed assets and a steady cash flow faces needs for current payment much different from those of a wholesaler, whose primary investment is in inventory and receivables subject to changes in value. A manufacturer has financial problems different from those of a dime store, because of differences in the character of investments and operations.

A figure related to the current ratio is the item "net current assets" or "working capital". This is simply the difference between current assets and current liabilities. The analyst (especially the credit analyst) looks upon this figure, and its movements over several periods, as an indicator of reserve strength to weather adversities. Bank loans are often tied to a minimum requirement for working capital.

(2) The Liquidity Ratio or "Acid Test"

$$\frac{\text{Cash, marketable securities receivables}}{\text{Current Liabilities}} = \frac{\$258.4 + \$257.0 + \$312.0}{\$808.2}$$

= 1:02:1

This ratio arises from the same basic desire to measure a business' ability to meet its current obligations through the use of its current assets as does the current ratio. It is, however, a far more severe test since it is an attempt to eliminate some of the disadvantages of the current ratio by concentrating on strictly <u>liquid</u> assets whose value is fairly certain. By eliminating inventories from consideration, the question asked in fact becomes:

"If the business were to stop selling today, what are its chances for paying off its current obligations with the readily convertible funds on hand? "The acid test thus again moves away from the assumption of a going concern, by not considering future funds flows of the business.

A rule of thumb of 1:1 is commonly applied here with a little more justification, since a preselection of presumably liquid assets has been made. A result far below 1: 1 can be a warning signal, but <u>a blind application of this rule should be avoided</u>.

(3) Debt Ratios

There are several ratios used to express the balance between borrowed and equity funds, which together constitute the resources of a business. The purpose of such an analysis is to appraise the relationship with regard to the company's ability to weather times of stress, and to meet both its short and long term obligations. The ratios supply some insight into the relative size of the "cushion" of ownership funds creditors can rely upon to absorb possible losses from operations, decreases in asset values, and poor estimates of future funds flows. This measurement <u>explicitly</u> looks at a firm from a liquidation standpoint - the ability to realize on the assets 100% for the benefit of all creditors, with any shrinkage in value being absorbed by the equity holders. It also is, however, an <u>implicit</u> judgement as to the adequacy of future cash flow to service the debt burden.

Debt standards are not absolute, but relative. They vary by industry and by company according to the risk characteristics of the particular firm and the area in which it operates. Utilities, for example, are normally highly leveraged due to the predictability of their revenues and costs. A research and development firm, at the other extreme, should have a low debt structure in view of the competitive nature of its work, volatility of contracts, etc. In between these two extremes, lie the majority of firms. An appraisal of adequacy of equity, therefore, must necessarily be subjective, looking <u>relatively</u> at the trend of a particular firm, and <u>absolutely</u> at comparable companies in the same industry. Two ratios commonly used are :

(a) $\frac{\text{Long-Term Debt}}{\text{Capitalization}} = \frac{\$454.5}{\$454.5 + \$3,183.7} = \underline{\underline{12.49\%}}$

(net worth + long term debt)

OR:

$\frac{\text{Long-Term Debt}}{\text{Net Worth (Equity)}} = \frac{\$454.5}{\$3,183.7} = \underline{\underline{14.3\%}}$

This is a selective measure of the proportion of debt in the capital structure of the company, which does not take into account current liabilities. This very common ratio is used as an expression of a company's long term financial policy in selecting the sources of long term funds. Both measures reflect United States Steel's great reliance on equity (ownership) funds, and little risk from the point of view of the creditors.

(b) $\frac{\text{Total Debt}}{\text{New worth (Equity)}} = \frac{\$808.2 + \$454.5}{\$360.3 + \$899.3 + \$1,924.1} = \underline{\underline{39.65\%}}$

This measure helps to appraise the relative position of creditors and owners, by determining what proportion of the firm's total assets have been financed by equity, and what proportion by its creditors, both short and long term. As in all other ratios, the absolute standard to be applied varies among companies and industries. In the particular example given. United States Steel has a fairly conservative position with a large cushion against asset shrinkage and losses.

(B) Ratios Appraising Funds Management ("Turnover" Relationships)

(1) Accounts Receivable

The value of receivables, if no detailed credit information on their age is available, can be roughly appraised by relating the accounts to the sales from which they arose. The result is expressed in terms of "days sales represented by receivables" or more commonly, as the "collection period". This measure can be evaluated by noting the trend within the company and by a comparison to the credit terms granted to customers in the industry in question. A major deviation from this norm towards slower collections will be a warning signal especially if there is a trend over a number of periods. The promptness with which accounts are collected is an indicator of the managerial effectiveness of the credit department, as well as a reflection of the quality of the accounts receivable. Extremely close adherence to credit terms could, on the other hand, mean that the credit policies of the company are unduly strict, and profits from sales to somewhat slower customers are being lost. The ratios can be computed as follows : - .

(a) Obtain the average daily sales:

$$\frac{\text{Sales}}{\text{Days}} = \frac{\$3,598.0}{360} = \underline{\underline{\$10.00/\text{day}}}$$

(b) Obtain days' sales represented by receivables:

$$\text{Receivables} = \frac{\$312.0}{\$10.00} = \underline{\underline{31.2 \text{ days}}}$$

A quicker way of obtaining the same result is to calculate the percentage of receivables to sales for the period, and to apply this percentage to the number of days in the period. The end result will be the same.

As pointed out before, the collection period is a rough measure of the over-all quality of the accounts receivable and of the credit policies of a business, but is subject to distortion especially if sales fluctuate widely in a given period. Also, a business selling both for cash and on account presents a problem, since a separation of credit sales must be made. For a more exact picture, a detailed "aging" of accounts receivable can be prepared, through a classification of accounts into groups by dates of sale, in monthly or other relevant time intervals (depending on the credit terms) to see which portion is current and which is overdue. A ratio analysis of overdue accounts in proportion to outstanding accounts from selected, or all periods can then be made. This information is not a ways available to the outsider, however, The United States Steel collection period appears normal.

(2) Accounts Payable

From the point of view of the creditor of a business, as well as the financial analyst, it is often desirable to apply a test to accounts payable similar to the one for accounts receivable. The basis of this measure is a comparison of the accounts payable balance with the purchases for the period. Again, a detailed aging of the accounts would yield the most exact picture of the way in which the business handles its obligation to trade creditors, that is how promptly its bills are paid. In the absence of such data, the rougher measure must suffice. The calculation of day's purchases is made exactly as in the previous example, by dividing the number of days for the period into the purchases made during the period. The result is divided into accounts payable to obtain 'days' purchases represented by payables. This figure can then be compared to the credit terms extended by the suppliers of the business to see if any abuses of these terms are made, and trends may be significant.

This ratio is seldom available to outsiders, however, since the amount of purchases is not commonly made public. In the case of a manufacturing firm purchases may be approximated by taking the material cost from the operating statement and adjusting for the change in the raw materials content of inventories. Lacking such detail, some analysts take cost of goods sold and adjust for the change in inventories. The latter measure is a very crude approximation, sinceusually cost of goods sold contains many cash charges, such as labor, repairs, etc. It can be used without difficulty in the case of a merchandising firm, however. Another difficulty lies in the fact that accounts payable often include debits incurred for purposes other than raw material purchases and such debts may vary greatly from time to time. Consequently the ratio, if obtained, is usually less reliable than the accounts receivable measure.

(3) Inventories

The inventory account is of interest in terms of 1) the value of the material or merchandise involved, 2) its size in relation to other funds needs, and 3) the sales volume it supports. An exact appraisal of the true value of the inventories is usually not possible short of a detailed count and verification. The financial analyst can make some judgements via a ratio analysis, however, by relating the inventory account to the current assets, or total assets, and more commonly to cost of sales (cost of goods sold) and the volume of sales generated during the period.

There are three main ways of presenting the relationship of inventory to other relevant figures :

(a) Turnover

$$\frac{\text{Cost of Sales* (cost of goods sold)}}{\text{Average inventory (One-half of sum of beginning and ending inventories)}} = \frac{\$2,720.1}{1/2\ (\$665.3 + \$596.4)} = \underline{\underline{4.32\text{ times}}}$$

(b) Days Sales on Hand

1. Obtain the average days' inventory sold:

$$\frac{\text{Cost of Sales*}}{\text{Days}} = \frac{\$2,720.1}{360} = \underline{\underline{\$7.60\text{ a day}}}$$

2. Obtain the days' sales represented by inventory:

$$\frac{\text{Average Inventory}}{\text{Sale per Day}} = \frac{1/2\ (\$665.3 + \$596.5)}{\$7.60} = \underline{\underline{82\text{ days}}}$$

*Includes depreciation of $189.8

These relationships express the frequency with which the average level of inventory investment was "recouped" or "turned over" through operations. Presumably, the higher the turnover, the better is theperformance by the firm, for it has managed to operate with a relatively small average commitment of funds. This in turn may indicate that the inventory must be relatively "current" and useful, and containes little unusable stock. On the other hand, a high turnover could mean inventory shortages and incomplete satisfaction of customer desires. The final judgement will depend upon the industry, company, the method of valuing inventories, and any observable trends.

(c) $\frac{\text{Sales}}{\text{Ending Inventory}} = \frac{\$3,598.0}{\$596.4} = \underline{\underline{6.03 \text{ times}}}$

This ratio is a cruder standard for the same purpose as (a). Its most important shortcoming lies in the use of the ending inventory figure, which may not be representative of the level of inventory throughout the year. Furthermore, the investment in inventory corresponds in terms of value to the cost of goods sold, where as sales contain the markup for other costs and profit over and above the recorded cost of the goods as carried in inventory. Thus, the relationship is not entirely that of comparable figures. Finally, comparability between companies may be impaired through differences in the gross margin taken on sales, which is more adequately represented by cost of goods sold. In both of these tests, United States Steel shows a normal experience in an industry characterized by large inventories.

(C) Ratios Referring to Profitability

When speaking of profitability, the analyst has in mind the return of value over and above the values put into a business endeavor, as was already demonstrated in the funds flow section of this note. This return, or profit, is generated through the sales or service efforts carried on by the company, and the extent or relative size of profit can be measured and compared by two major groups of ratios:

(1) Profitability as Related to Investment

The relationship between the size of the annual profits and the investment committed to attaining this profit is one of the most basic fundamentals of business enterprise. Many arguments have been raised about the various methods of calculating this relationship, since accounting methods, asset valuation, expense policies, etc., all affect the components of the relationship. Several ratios are commonly used.:

(a) $\frac{\text{Earnings before interest \& taxes (EBIT)}}{\text{Total assets}} = \frac{\$513.3}{\$4,559.1} = \underline{\underline{11.23\%}}$

This ratio measures the earnings of the business on all of its assets, before taxes and compensation of the various contributors of these assets (creditors and stockholders). Some analysts adjust this measure by using average assets held during the year, while others prefer beginning balances or ending balances.

A variation is found in the following formula :

(b) $\frac{\text{Net profit}}{\text{Totas assets}} = \frac{\$254.5}{\$4,559.1} = \underline{\underline{5.58\%}}$

This measure relates the profits left after taxes and after compesation of part of the contributors of the company's assets (the creditors who are paid interest) to the total assets shown. For the latter reason the ratio is often considered not to be completely adequate measure of profitability for all purposes. The outside analyst appraising the earnings power of the assets may not use the measure while the stockholder interested in the earnings belonging to him relative to the company assets may find the measure relevant.

A third and very common measure relates net profit to the net worth (net assets) of a business:

(c) Net Profit $= \frac{\$254.5}{\$360.3 + \$899.3 + \$1,924.1} = \underline{\underline{8.0\%}}$

This is a way of measuring the return to the owners of the business after all taxes and interest have been paid. In this sense it is a fair measure (with limitations) for appraising the earning power of the ownership investment, which is especially crucial to the financial analyst interested in investing equity funds. Frequently, the net worth figure is adjusted to reflect the average amount during the year (result: 8.09%). Also, the credit analyst will often wish to adjust the formula to reflect only the "tangible net worth", by subtracting from the owner's investment all intangible assets such as goodwill, patents, organization expense, etc. His reasoning is based on the desire to appraise in the most conservative way the values of the various assets. Again, the accounting and operating policies of a firm influence the reliability of this measure.

A relative comparison among firms in the same industry can be distorted based on differing proportions of equity and long term debt held. To a certain extent these proportions are within the control of management. For this reason, this ratio is often calculated as Net Profit/ Total Capitalization. The United States Steel figures reflect a fair performance, in line with the industry.

(2) Profitability as Related to Sales ("Profit Margin")

The analyst is also concerned about the relationship of profits to the sales volume attained. This ratio helps him appraise the efficiency of the operations, although there are such considerations as pricing and volume fluctuations, which may limit the reliability of this measure. Also, as pointed out before, the more crucial test of business efficiency and profitability lies in the return on investment ratio, since it is possible that a high profit percentage on sales could still mean a very low profit percentage on investment if the sales volume is relatively low. Conversely, a low profit margin coupled with a rapid turnover on net worth (high sales volume) could result in a large profit percentage on net worth.

(a) Earnings before interest and taxes = $\dfrac{\$513.3}{\$3,598.0} = \underline{\underline{14.23\%}}$

(b) $\dfrac{\text{Net Profit}}{\text{Sales}} = \dfrac{\$254.5}{\$3,598.0} = \underline{\underline{7.08\%}}$

Both ratios shown are used by analysts and are general indicators of relative efficiency, especially in intra-industry comparisons where United States Steel stands up well.

There are many more ratios which can be developed from the operating statements to obtain indicators of the way individual expenses have been controlled by the business. Among these are :

(c) $\dfrac{\text{Cost of Sales}}{\text{Sales}} = \dfrac{\$2,720.1}{\$3,598.0} = \underline{\underline{75.59\%}}$

(d) Gross margin : $\dfrac{\text{Sales - Cost of Sales}}{\text{Sales}} = \dfrac{\$3,598.0 - \$2,720.1}{\$3,598.0} = 24.41$

Ratios (c) and (d) reflect the markup of the cost of merchandise or products and may also indicate high-cost operations, price pressures, volume fluctuations, etc. Examination of other ratios and data will be helpful to shed additional light upon the situation.

(e) Relationship to sales of individual expense items selected at the discretion of the analyst. These ratios are useful to check on the relative efficiency of operations, especially in period-to-period analysis, budgetary control, etc. In fact, one of the best starts to appraising the operations of a company can be made by tracing changes in gross margins, operating expenses, profit before taxes, etc. all expressed as percentages of net sales.

Relationships between Ratios.

As is apparent, there are not only common risks of misinterpretation in the family of ratios, but there are also many close interrelationships which help the analyst confirm or alter his tentative conclusions.

An example of the need for grouping of ratios is the investigation of the current position of a business. To derive the current ratio only is not as meaningful as adding to the picture an investingation of the components of the ratio. Thus, a turnover of inventories will bespeak the quality of the inventory, while analysis of receivables and payables will help assess the current situation. Finally, a test of the growth or decline of net working capital may indicate significant funds movements.

Other Comments

A number of references have been made throughout as to the caution which must be exercised in the use of the tools of analysis described. Here is a summary of useful hints to keep in mind.

(a) Select the limited number of relationships which can have real significance in the situation to be investigated. The purpose of the investigation itself yields clues to the nature of the ratios which will be helpful.

(b) Calculate these ratios, if possible, for several past periods as well as for the current period, to be able to observe any noticeable trends.

(c) Compare the ratios with an industry standard(s).

(d) Present the results in the most effective manner, e.g., in tabular or graphic form, together with the applicable standard, such as industry averages, requirements by lenders, etc.

(e) Concentrate on all major variations from the standard especially if there is a consistent trend over a period of time.

(f) Investigate the causes of these variations whereever possible, by cross-checking with other ratios and raw data.

NAME OF COMPANY ____________________

QUICK ASSETS / LIABILITIES

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
CASH & BANK												
DEBTORS *	231	356	435	444	430							
STOCK	685	746	599	661	678							
W.I.P.												
TOTAL	916	1,082	1,034	1113								
OWING TO BANK	291	256	343	352	481							
CREDITORS *	82	248	135	81	171							
CULLPORTN LTD + PREFERENTIALS	126 72	49 67	26 57	35 36								
TOTAL	521	622	561	504								
NWC	395	451	473	609								

* BREAKDOWN ON SEPARATE SHEET

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
WHERE STOCK HAS BEEN PURCHASED AND TITLE HAS BEEN RESERVED TO THE VENDOR TOTALS SHOULD BE RECORDED HERE	7 120	48										

NAME OF COMPANY ______________________________

BREAKDOWN OF DEBTORS

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
O/S 1 - 4 WEEKS												
O/S 4 - 8 WEEKS												
O/S 8 -12 WEEKS												
O/S OVER 12 WEEKS												
TOTAL												

BREAKDOWN OF CREDITORS

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
O/S 1 - 4 WEEKS												
O/S 4 - 8 WEEKS												
O/S 8 -12 WEEKS												
O/S OVER 12 WEEKS												
TOTAL												

ANALYSIS OF RATIOS & INTERRELATIONSHIPS

Internal analytical form used to produce interpretation and summarised data on ADV-F 10C & CLP-19

F3 (Abbreviated)1

YEAR	82/83	83/84	84/85		COMMENTS
OPERATIONS					
Items from F2 in brackets					
CASH MANAGEMENT - OPERATIONS Final N.C.F.O	27	(121)	(76)		
NET OPERATING CASH TO SALES (15/1)	0.04	0.09	(0.03		
FINAL NET CASH FROM OPERATIONS (27/1)	0.03	0.13	0.06		
CASH INTEREST COVERAGE (-15/17) 15/16 ?	5.3	—	—		

CASH MANAGEMENT - NON OPERATING SECTOR	CR	DR	CR	DR	CR	DR	CR	DR
FIXED ASSETS - GROSS (LN 33)		5		23		34		
(a) Property - Disposals/Additions				8				
(b) Plant & Fixtures - Disposals/Additions		1		3				
(c) Others		4	9	21				
(d) Valuations & FX Translation								
(e) Acquisition								
(f) Capitalization of Interest								
Depreciation Difference (Ln 34)				5				
INVESTMENTS (LN 32)								
(a) Disposals/Additions - Investments & Lt Rec								
(b) Disposals/Additions - Associates								
(c) Revaluation & FX Translation								
(d) Other								
UNDISTRIBUTABLE RESERVES (Ln 42)								
(a) Capital Surplus/bonus etc								
(b) FEX, value adjustments, write offs								
(c) Transfer from/to Retained Earnings		27		33		44		
RETAINED EARNINGS DIFFERENCE (LN 43)	1				1			
(a) Transfer From/To Capital Reserves								
(b) Dividends Declared								
Dividends Payable (Ln 45)								

81/85				
PROFITABILITY				
SALES GROWTH %	25.7	13.9	29.7	
GROSS PROFIT MARGIN 103/97 %	21.2	20.6	26.9	
OPERATING PROFIT MARGIN 115/97 %	5.3	6.4	7	
NET INCOME TO EQUITY 130/87 %	52	39.3	33.9	
SALES FALL TO BREAK EVEN (% OF SALES)	21.6	23	17	
GROSS MARGIN FALL TO BREAK EVEN (% POINTS)		5	[illegible]	

ANALYSIS OF RATIOS & INTERRELATIONSHIPS

Internal analytical form used to produce interpretation and summarised data on ADV-F 10 & CLP-19

F3 (Abbreviated)2

	YEAR	82	83	84	85	COMMENTS
ASSET MANAGEMENT						Decline in total [illegible]
TOTAL ASSET T/O	97/55	2.1	2	1.7	1.5	assets [illegible]
FIXED ASSET T/O	97/51	22	24	16	13	[illegible]
CURRENT ASSET T/O	97/17	2.3	2.1	2	1.6	[illegible]
DAYS INVENTORY	12x365/102	55	66	82	120	Stock [illegible]
DAYS RECEIVABLES	7x365/97	115	121	123	137	[illegible]
DAYS PAYABLE	22x365/102	100	128	81	119	[illegible]
Adverse Terms [illegible]		15	7	42	138	[illegible]
STRUCTURE						
BALANCE SHEET STRUCTURE						[illegible] Quality
NET WORTH CONTRIBUTION TO ASSETS	87/55 %	7.2	11.7	15.3	15.2	Decreasing trend [illegible]
[illegible] loans [illegible] quasi-capital		28	30	29	20	Quality [illegible] doubtful debtors
NET WORKING CAPITAL						[illegible]
NET WORKING CAPITAL	30	70	105	118	105	NWC [illegible]
SALES TO NWC	30/97	0.10	0.12	0.12	0.08	[illegible]
FINANCIAL GEARING						[illegible]
LONG TERM DEBT TO EQUITY	63/87	2.9	1.5	0.9	0.3	[illegible]
LONG AND SHORT DEBT TO EQUITY	63+21/87	5.9/0.8	2.3/0.[illegible]	3.2/1.2	2.9/1.3	improvement [illegible]
ALL LIABILITIES TO EQUITY	89/87	13	7.6	5.5	5.6	[illegible]
ABILITY TO REPAY BANK BORROWING						
INTEREST COVERAGE	125+122/122	10	8	3.4	3	[illegible]
See Also Cash Interest Coverage	NCFO/[illegible]	—	5.3		—	
REPAYMENT CONSISTANCY	(14)+Opening 21&22 - Closing 21&22 /(14)+Opening 21&22		0.7	0.72	0.58	Repayment [illegible]
RESIDUAL REPAYMENT CAPACITY	(27) + 3/ 18+20+22 +Opening 19	—	0.10	—	—	Little residual repayment capacity
CURRENT RATIO	17/29	1.3	1.4	1.3	1.2	Current [illegible]
ACID TEST	8/29	1	1	0.9	0.7	due to [illegible]

CONCLUSION

IMPACT OF LENDING OF

FINANCIAL STATEMENTS

A NEW FACILITY = CHANGE

WHAT CHANGE

PURPOSE OF FACILITY	SECTOR	REPAYMENTS	CHARACTERISTICS
LC - LTR/LIM		FROM SPECIFIC STOCK/ RECEIVABLES	SHORT DURATION EASIER TO GET OUT OF
COVERING DELAY IN RECEIPT OF RECEIVABLES	DYNAMIC	RECEIVABLES	
SGA / GGS OTHER EXPENSES		NCFO	
STOCK/RECEIVABLES HOLDING	RESIDUAL	NONE BUT NCFO SHOULD BE ADEQUATE	IF IT BECOMES CORE NEED FOR ADJUSTMENT
CORE CURRENT ASSETS EG DISPLAY STOCK FIXED ASSETS EG PLANT & MACHINERY	BASE	NCFO BUT REQUIRES THIS TO BE BASED ON CONSISTANT PROFITABILITY	EARLY WITHDRAWAL NOT POSSIBLE EXCEPT IN CASE OF DEFAULT? DISPOSAL OF ASSET

EFFECT ON

SECTOR LENT TO	BALANCE SHEET	INCOME STATEMENT
DYNAMIC OD	NON UNLESS	SALES UP? PROFIT UP? INTEREST COST
RESIDUAL OD	INCREASED CURRENT SECTOR SIZE(OR OD REPLACES CREDITORS) NWC LOWER IN RELATION TO SALES UNLESS INCREASED PROFIT COMPENSATES WHAT SALES TO MAINTAIN C.A.T/O	SALES UP? PROFIT UP? INTEREST COST

MORE PRODUCTIVITY
MORE WORKING
CAPITAL

BASE LOAN	INCREASED NWC OR FIXED ASSETS/ INVESTMENTS ANNUAL REPAYMENT	INTEREST COST DEPRECIATION SALES AND OR PROFITS UP?

WHAT SALES TO
MAINTAIN FA T/O

EFFECT ON

	CASH GENERATION IN YEAR
SECTOR LENT TO	
DYNAMIC	
TAKE OVER EXISTING FACILITY	MINIMAL LESS EXTRA INTEREST
REPLACE PAYABLES	
ANOTHER BANK	
INCREASE SALES	
COVER ADDITIONAL GGS/SGA	INCREASED CASH (IF PROFITABLE) LESS EXTRA INTEREST COST UNLESS
RESIDUAL	DECREASED TEMPORARILY UNLESS HIGH MARGIN BUSINESS WHICH OFFSETS WITH HIGH PROFIT
BASE	
FIXED ASSETS	REDUCED BY INTEREST AND REPAYMENT UNLESS EXTRA BUSINESS COMPENSATES. BUT
IF SALES INCREASE REPEAT CYCLE	

LAWN EQUIPMENT COMPANY

TIME FEBRUARY 1985

Wholesale supplies of garden equipment banked with us for 6 years. They have limit of £1.1m and urgently require a short term increase to £1.4m, present balance £1m overdrawn. We have financial statements up to Dec '83 (shown below) and the account has operated well but 1984 financial statements are not yet prepared and will not be ready for some weeks. At the interview you learn the following figures for year ended Dec '84. At 31 Dec accounts receivable £1100k, accounts payable £300k, stock £2200k and cash balances in company's books stood at £1210k, the overdraft was approximately the same as the figure in our books. The tax outstanding was about the same as last year. The loan was reducing by £250k pa including interest, £1100k of fixed assets were purchased late during the year, other assets remained at the same level. Sales were £19000k and the gross margin was exptected to be maintained. Expenses (excluding depreciation) rose by the inflation rate of 6%. Tax remained at the same rate. Interest charge 127k, (120k in 1983).

PREPARE ESTIMATED BALANCE SHEET/PROFIT AND LOSS FOR YEAR ENDING DEC '84

BALANCE SHEET (£000)
31 DEC 1983

			84
? CASH		650	1,210
A/C RECEIVALBE		920	1,100
INVENTORY		1900	2,200
FIXED ASSETS	9500 10,600		
LESS DEPRECIATION	2700 3,400		
NET		6800	7,200
OTHER ASSETS		290	290
		10560	12000
OVERDRAFT		600	1,000
A/C PAYABLE		250	300
TAX DUE		1600	1,600
LOAN		3750	3,500
SHARE CAPITAL		2000	2,000
RETAINED EARNINGS		2360	3,500
		10560	11,900

PROFIT AND LOSS (£000)
YEAR ENDED 31 DEC '83

		84
SALES	16000	19,000
COST OF GOODS SOLD	9000	10,700
	7000	8,300
EXPENSES (INCLUDING INTEREST AND DEPRECIATION OF 700) 7330	6100	6,400
	900	1,900
TAX	360	760
	540	1,140

	84	83
NWC =	4,510	3,470
–	2,900	2,450
	1,610	1,020

BCC FACILITY TYPES - (abbreviations as per Advances Manual)

1) TOD 2) COD 3) SOD - Overdrafts, temporary, clean, secured
4) CC - Cash Credit
5) PC - Loan against packing credit and RC - Red Clause LC
6) SLC-PAD - Sight LC. Payment against documents
7) SLC-LTR - Sight or Usance LC. Loans against trust receipt
8) LC-LIM - LC loan against imported merchandise
9) ULCA (TR) - Usance LC Acceptance. Documents released against TR
10) ULCN(S) - Usance LC negotiated and reimbursed on sight basis - Usance LTR
11) ULCN(U) - Usance LC negotiated and paid at maturity - Usance TR
12) LBD. CL - Local bill discounted clean
13) LBD Doc - LBD Documentary
14) FBP/FBD Clean - Foreign bills purchased/disounted clean
15) FBP/FBD Doc - FBP/FBD Documentary (under LC and non-LC)
16) BDR - Bills discounted and rediscountable
17) LAFB Clean - Loans against foreign bills clean
18) LAFB Doc - DA, DP - Loans/Advances against foreign documentary bill sent on collection on DA or DP basis
19) PND - Promissory notes discounted
20) GSD - Government Securities discounted
21) OAP - Own Acceptance Purchased
22) BAP - Bankers Acceptance Purchased
23) CL - Clean Loan
24) SLM - Loan secured by mortgage
25) LG - Letter of Gurantee
26) BBLC - Back to Back LC sight/usance.

Month

1	2	3	4	5	6	7	8	9	10	11	12
FBD 150	150	150	150	150	150	150	150	150	150	150	150
FBC 120	120	120	120	120	120	120					
LC 150	150	150	150	150	150	150					
LC 50	50	50	50	50	50	50					

EN
EXP IN

SN
out

FACILITY STRUCTURING

EXAMPLE

How would the following be structured

Customer asks for £800,000 OD on the basis of analysis you are agreeable without security but, wish to exercise the maximum control.

Other details of customers business:

MONTHLY RECEIVABLES: FBP/D £420k	£150,000	In Foreign Bills 60 days usance - open account FBD £300k
	£120,000	In Foreign Documentary Bills - On collection basis sight £120k
LAPC upto £230	£150,000	Inward Letters of Credit for which he needs to buy in Raw Materials to manufacture and dispatch within the month. - when will pymt be recd? OD
MONTHLY IMPORTS sight LC/PAD + LTR £150k	£ 50,000	Worth of goods which he needs to assemble before sale in approximately 3 months. He sells on cash basis. He pays by sight L/C.

£720 / £800

Andrew / Mustaya.

ANALYSIS OF RATIOS & INTERRELATIONSHIPS

Internal analytical form used to produce interpretation and summarised data on ADV-F 10C & CLP-19

F3 (Abbreviated)1

YEAR	80		81		82		83	
OPERATIONS								
Items from F2 in brackets								
CASH MANAGEMENT - OPERATIONS NCFO			43		34		(1)	
NET OPERATING CASH TO SALES ~~(16/11)~~ (15/1)			·025		·025		·003	
FINAL NET CASH FROM OPERATIONS ~~(28/11)~~ (27/1)			·033		·024		NIL	
CASH INTEREST COVERAGE ~~(16/17)~~ (15/16)			·16		3·5		1	
CASH MANAGEMENT - NON OPERATING SECTOR	CR	DR	CR	DR	CR	DR	CR	DR
FIXED ASSETS - GROSS (LN 51)				5		11		
(a) Property - Disposals/Additions								
(b) Plant & Fixtures - Disposals/Additions						1		
(c) Others				5		10		
(d) Valuations & FX Translation								
(e) Acquisition								
(f) Capitalization of Interest								
DEPRECIATION DIFFERENCE								
INVESTMENTS (LN 36)								
(a) Disposals/Additions - Investments-Ln 31								
(b) Disposals/Additions - LT Receivables-Ln 32								
(c) Disposals/Additions - Associates-Ln 34								
(d) Revaluation & FX Translation								
(e) Income Adjustment								
(f) Other								
(ii) Retained Earnings Difference								
(a) Transfer From/To Capital Reserves								
(b) Dividends Declared								
Dividends Payable (Ln 25) (dec-DR)								
PROFITABILITY								
SALES GROWTH			16·6		9·6		6·5	
GROSS PROFIT MARGIN 103/97	7·5		8		8·5		8	
OPERATING PROFIT MARGIN 115/97	1		NIL		1		1	
NET INCOME TO EQUITY 130/87	11		39		33		19	
N-Leverage. SALES FALL TO BREAK EVEN (% OF SALES)	2		6·5		12		8	
GROSS MARGIN FALL TO BREAK EVEN (% POINTS)	0·2		·5		1		0·7	

COMMENTS

NCFo declining most notably in 82/83. In 80/81 cash generation was distorted by rental income and sale of lease. Reasonable control of stock and debtors but less reliance on creditors possibly indicating creditor pressure. ~~The~~ Build up of cash holding since '81 but in 83 this seems to have occured at the expense of an increase in OD. Cash interest cover has also declined and any further reduction is likely to cause difficulty.

Modest increase in fixed assets in '81 and '82. In 1982 this was financed entirely through NCFo

Rate of sales growth falling. Gross profit margin remaining constant indicating ability to increase sale prices in line with increasing purchases costs.

Operating profit margin is low due mainly to ~~high~~ salaries and remuneration.

Due to retention of net profits, return on equity has fallen since '81

ANALYSIS OF RATIOS & INTERRELATIONSHIPS

Internal analytical form used to produce interpretation and summarised data on ADV-F 10 & CLF 19

F3 (Abbreviated)2

	YEAR	80	81	82	83
ASSET MANAGEMENT					
TOTAL ASSET T/O	97/55	4.2	5.6	5.2	6.1
FIXED ASSET T/O	97/51	18.4	18.7	17.7	18.9
CURRENT ASSET T/O	97/17	5.1	7.2	6.7	7.9
DAYS INVENTORY	12x365/102	46	30	31	25
DAYS RECEIVABLES	7x365/97	19	21	22	16
DAYS PAYABLE	22x365/102	53	49	55	40
To trade		12	2	(2)	1
STRUCTURE					
BALANCE SHEET STRUCTURE					
NET WORTH CONTRIBUTION TO ASSETS	87/55	6	12	15	21
ASSET MAKE UP	17/55	81	77	78	77
NET WORKING CAPITAL					
NET WORKING CAPITAL	30	(11)	(1)	6	14
SALES TO NWC	30/97	-	-	-	0.01
FINANCIAL GEARING					
LONG TERM DEBT TO EQUITY	63/97	1.3	0.9	0.6	0.4
LONG AND SHORT DEBT TO EQUITY	63+21/87	5.9	1.6	0.8	0.8
ALL LIABILITIES TO EQUITY	89/87	14.6	7.2	5.4	3.8
ABILITY TO REPAY BANK BORROWING					
INTEREST COVERAGE	125+122/122	1.4	6.5	1.6	3.5
See Also Cash Interest Coverage					
REPAYMENT CONSISTANCY	(15)+Opening 21&22 - Closing 21&22 /(15)+Opening 21&22		.88	.87	.89
RESIDUAL REPAYMENT CAPACITY	(~~28~~ 27) + 3/ 18+20+22+Opening 19		.29	.25	.16
CURRENT RATIO	17/29	1.0	1.0	1.0	1.1
ACID TEST	8/29	0.4	0.4	0.5	0.5

CONCLUSION

COMMENTS

Asset turnover ratios show improving trend in the efficiency of the use of assets. Most improvement apparent in current asset turnover as a result of the decreases in stock and debtors.

Improving terms of trade enables fast conversion of stock into cash. Efficient use of payables to finance stock/debtors

Are creditors exerting any pressure? What has caused reductions in debtors/stock?

The overall reduction in assets (debtors/stock) and increase in net worth due to profit retention has meant that an increasing proportion of assets has been financed by equity. Good assets in the form of F/H buildings - £50k and cash - highly liquid - £29k.
What is spread of debtors? Is stock fast moving? Is F/H property to be revalued

Improvement in NWC with high velocity of conversion of stock into cash. Liquidity enhanced by cash holding

Low gearing with little short and long term finance ~~with~~ and an improving trend. However cash generation is low for 83 although surplus cash holding available as buffer to meet repayments.

What are the repayment terms on LTD?

Interest coverage fluctuating

Repayment consistency stable but residual repayment capacity falling due to lower cash generation caused by reduction in payables.

Current and acid test ratios constant. Although at low levels the speed at which stock is converted to cash indicates that this position is sustainable.

CREDIT ANALYSIS

8

MONITORING

MONITORING

WHAT - Obtaining on going information that gives continuous understanding of customers operations

WHY - If an account is secured by 100% cash is there any need to monitor

Additional requests Temporary excess	Marketing opportunity	Debt matched by credit
How can you cope	Lost through lack of knowledge	If debt not repaid interest margin lost time expense csot for no return

HOW

ACCOUNT ACTIVITY

CUSTOMER PROVIDED INFORMATION

THIRD PARTY INFORMATION

VISITS

15/5/85

WHY DOES A COMPANY GET INTO DIFFICULTIES?

EXTERNAL	INTERNAL
	MISMANAGEMENT
RECESSION	WRONG PRODUCT Failure to adapt to market
	POOR CONTROL OF COSTS
POLITICAL	DISRUPTION OF SUPPLY/PRODUCTION
EXCHANGE RATE FLUCTUATIONS WAR COMMODITY PRICE RISE	HIGH GEARING
	POOR STOCK CONTROL
	FAILURE TO UNDERSTAND CASH REQUIREMENTS
ACCIDENT	OVERTRADING
	INAPPOPRIATE FINANCING
CUSTOMER FAILURE	POOR DEBTOR CONTROL
	POOR CONTROL OF PERSONNEL
	STRIKES
ECONOMIC BLOCK ON CURRENCY	

15/5/85

THIRD PARTY INFORMATION

TRADE - Specific information from those in the trade

General reports on trade out look

PRESS - Customer involvement with new projects.

Country Court Judgements.

VISIT

How does the business appear - busy/self generated chaos
Swift customer service/no customers.
Fast moving stock/dust covered obsolete stock
Modern plant (where did cash come from/plant vehicles on last legs
Efficient Admin/can't find anything
Sensible capital expenditure/ Rolls Royce

<u>ACTION</u>

FIND OUT CAUSE

CUSTOMER

EXTERNAL

CAN THE PROBLEM BE CURED

POSSIBLY

ARE FACILITIES NEEDED FROM
US TO CONTINUE AT SAME
LEVEL.TO BE INCREASED

WILL WE HAVE TO JOIN IN
RECONSTRUCTION SCHEME AND
FOREGO INTEREST/CAPITAL

CREDIT ANALYSIS BASED ON
THE SCHEME ADDITIONAL
SECURITY IF NECESSARY/
AVAILABLE

IS IT BETTER
TO GO AHEAD WITH
SCHEME OR REALISE
SECURITY

NO

ACTION FOR DELINQENT DEBT

NO

YES - GO AHEAD
SET UP
MONITORING
SCHEME

IF PROBLEM CAN BE CURED

INTERNAL PROBLEM AREA

PROFIT DEFICIENCY	CASH DEFICIENCY
→	PROFIT RELATED
SALES FALLING - New revamped product	OVER TRADING - Cut Sales
	POOR DEBATOR/STOCK CONTROL - Tighten System
INADEQUATE GROSS MARGIN - Raise Sale Price - Cut production costs	
	ILL CONSIDERED ASSET PURCHASE/ LONGTERM DEBT REPAYMENT - Sell or refinance
INADEQUATE PROFIT - Cut overheads	
FINANCE COST TOO HIGH - Capital injection	REPAYMENT OF DEBT TOO HIGH - capital injection - reschedule

OTHER

SUPPLY DISTRIBUTION
STRIKE
ACCIDENT
CROSS BOARDER

Can only be viewed in light of incident and customers past strength.

15/5/85

ACCOUNT ACTIVITY

REDUCTION IN ACCOUNT TURNOVER

REDUCTION IN ITEMS PASSING THROUGH ACCOUNT ESPECIALLY CREDITS

CHEQUES TO SUPPLIERS FOR ROUNDED AMOUNTS

INCREASES IN TRANSFERS BETWEEN CONNECTED COMPANIES

EXCESS OVER LIMIT - UNREQUESTED
REQUESTED AGAINST RECEIVABLES DUE

LOWER SWING

HARD CORE BUILD UP

ACCOUNTS PAID LATER IN MONTH

MAJOR DEVIATION FROM CASH FLOW FORCAST

NO	TRANSACTION FLOW/MODUS OPERANDI	TIME LAG	FACILITY TYPE & LIMITS MOVEMENT				NET EXPOSURE
			LG	LC	ACCEPT	CASH	MARGIN AMOUNT

RISKS UNDER BBLC

1. Uncovered Sales Risk (Issuing BBLC before receipt of MLC)
2. Documents Rejection Risk by Borrower (Documents Checking Risk)
3. Cargo Release Risk:
   a. by Issuing Bank under BBLC, if documents with discrepancies are received for collection only, followed by problem of drawing under MLCs
   b. by Issuing Bank under MLC if documents with discrepancies are sent for collection only.
4. Unsold surplus stock Risk due to quantity difference in imports and exports.

(* Risks in case of re-shipment only)

RISKS UNDER MLC

5. Documents Rejection Risk by Issuing Banks & Recourse Risk (under Advice Credits).
6. Documents Rejection Risk by Issuing Banks and Non-Recourse Risk to exporters (under confirmed Credits).
*7. Non-Performance Risk (Non-submission of documents under MLC) due to selling to other buyers.
8. Documents Submission Delay Risk
*9. Documents Diversion Risk (to other Banks).
10. MLC Amendment Risk (if MLC not advised through BCCI)

TITLE DOCUMENTS RISKS

AIRWAY BILLS

*11. Consignee Risk
*12. Received for shipment Risk

BILLS OF LADING

13. Third Party Bills of Lading Risk (in case of Direct shipment only)

MERCHANDISE RISKS

*14. Merchandise loss/damage Risk (post import but pre export stage)
15. Merchandise Quality Risk
*16. Customs Risk

CREDIT RISKS

17. Exports Profits - Release Risk and Net Worth build-up
18. Overdraft Exposure (including EOL possibility) Risk for expenses
19. Exchange Risk
20. BCC Group's overall exposure risk (eg. Both MLC and BBLC confirmed/issued by BCCI)

INHERENT RISKS

*21. Trust Receipt Risk
22. Commercial and Country Risks Buyers and Issuing Banks.

Section VI : Facility terms & conditions (Place ✓ for selected conditions)

1. BBLC would be issued only;
   a. for importing .... (fill in description of goods)
   b. on receipt of MLC from acceptable issuing Banks/Countries (MLCs to be deposited with BCC)
   c. up to .....% only of the amount of MLC (being margin on sale)
   d. Subject to review of unsold stock on hand, not covered by previous MLCs.
2. No single import LC (BBLC) to exceed $....., under the LC facility limit of $...... The aggregate outstandings under LC and related cash facilities for import financing not to exceed $...... at any time.

3a. Airway Bills to be consigned to Bank and marked with flight number and date to evidence on board shipment.

b. In case of airfreight, goods received in advance of LC documents to be:

   i) kept in bank custody pending receipt of documents or

   ii) released to borrower against an indemnity with a document discrepancy waiver clause.

4. Merchandise to be fully insured at all times (covering also the entire transit period in the borrower's country for handling, processing, packaging goods etc.) Policies

5. Borrower to route through BCC, export bills either under MLCs or otherwise, covering the entire quantity of imported goods under BBLC. (Additional FBP/related facilities may be needed if bills are submitted under pure export LCs).

6. MLCs to be restricted for negotiation to BCC office financing the borrower and deposited with BCC under lien .

7. MLCs to provide for third party Bills of Lading.

8. Borrower to submit:
   - In ADVANCE, all internal documents (invoice, bill etc) required under MLC (except transport documents)
   - Performance Bond from packers of merchandise (at borrower's location)
   - Copy of his sale contract with MLC buyer.

9. MLCs, where required, to be confirmed by other Banks located in acceptable countries or at the borrower's place.

10. No profit component of the export sale proceeds to be released to borrower (say via FBP Account) before receipt of remittance from issuing banks.

11. Difference between sale proceeds and cost of imported goods to be kept in deposit with BCC for covering Bank charges, borrower's operating expenses etc. and the balance profit retained, if required, in balance sheet to build up Net Worth, to be reviewed half yearly by BCC through the borrower's management accounts.

12. In the event of expiry of BBLC or discrepancies in the documents submitted under BBLC, BCC will assume only collection responsibility, according to terms to be stipulated later outside this Facility Agreement.

13. In case of currency difference between BBLC and MLC, a suitable forward cover contract to be booked with BCC.

14. All cargo related expenses (to be estimated and advised to BCC) in case of either direct shipment or reshipment, to be met from either:

   a. Borrower's own cash flow

   OR

   b. Overdraft from BCC, in which case the overdraft outstandings should be repaid (unless secured by full cash margin) from export proceeds.

Customer ______________________ Branch ______________________

CONTROL OF UNSECURED AND DEBENTURE LENDING

1). DRAWING POWER ALLOCATION (Based on last audited accounts and adjusted for up to date information where necessary).

Currency ....

At end of	Amount	%	% for Lending	Lending Value
1 Cash (under lien) – if not under lien give same % as stock.	326			100
2 Receivables	921		70	645
3 Inventory Raw Mat	} varying amts.			
4 WIP				
5 Fin Good.	39	30	20	8
6 Short term invest.				
TOTAL		100		753

(To be completed at each review end of .... (Month/Quarter/½ Year)

Charge on current Assets	Drawing Power
Total Lending Value Less Preferentials =	747
Unsecured	
Total Lending Value Less Current Liabilities (except BCCI) =	753 - 685 = 68
or	
Lesser of Networth or Final NCFO (NCFO is lower of last year or average of last 3 years)	NOTE IF OD RESTRICTED SPECIFY HERE

LIMITS	
Facility	Amount

84 NCFO 450 NW 603

lower last 3 = (249) av last 3 = 107

2). MONITORING REQUIREMENTS

Required	Frequency or not required (R/R)	Action
Management Accounts or sales for period if not available		Complete seperate set of spread sheets, and cashflow/relationship analysis Investigate any deterioration. Check sales level maintained.
Quick Figures		Check lending values against limit and investigate any deterioration in difference between current assets and liabilities.
Aged Receivables Premium due		Check overdues, any concentrations building, have new receivables been vetted NOTE: IF INSURED CHECK PREMIUM PAID AND COVER ADEQUATE-ATTACH COPY OF RENEWAL NOTE.
Aged payables		Check overdues, any concentrations building, are taxes VAT, PAYEE up to date.
Inventory who by .... Premium due		How valued:- has stock-take been undertaken or is it an estimate, by directors. If independent valuation required attach report. NOTE: CHECK INSURANCE PREMIUMS PAID AND COVER ADEQUATE-ATTACH COPY OF RENEWAL NOTE.
Bank Account		Check how turnover compares with sales level. Check with cashflow forcast, investigate variations. Payments not in line with facility purpose.
Other insurance inc Loss of profits due	eg Keyman	Paid and cover adequate - attach copy of renewal note.

HISTORICAL & PROJECTED BALANCE SHEETS

Internal Analytical Form used by Group Asset Management Service to produce interpretation for 'GAMS-321 SYSTEM' - Form F-3 & CLF Form 19/ADV-F-10C.

NAME ....

CONSOLIDATED/UNCONSOLIDATED

'GAMS-321 SYSTEM'-Form F-1 (Pg 1/3)

(In .... 000's)

Branch:

	Date				
	AUDITED/UNQUALIFIED/INTERIM				
	CURRENT ASSETS				
1	Cash				
2	Short Term Investments				
3	**Liquid Assets Total** (1+2)				
4	Notes Receivable				
5	Accounts Receivable (incl./excl.bills neg.)				
6	Provision for Bad Debts				
7	**Net Accounts Receivable** (4+5-6)				
8	**Monetary Assets Total** (3+7)				
9	Inventory: Raw Materials				
10	: Work in Progress				
11	: Finished Goods				
12	**Inventory Total** (9+10+11)				
13	Prepaid Expenses				
14	Due From				
15					
16	**Other Current Assets Total** (13+14+15)				
17	**TOTAL CURRENT ASSETS** (8+12+16)				
	CURRENT LIABILITIES				
18	Bank Borrowing				
19	Current Portion of Long Term Debt				
20	Notes Payable - Others				
21	**Short Term Finance Total** (18+19+20)				
22	**Accounts Payable**				
23	Due to				
24	Income Tax Payable				
25	Dividends Payable				
26	Accruals				
27					
28	**Other Current Liabilities Total** (23 to 27)				
29	**TOTAL CURRENT LIABILITIES** (21,22 & 28)				
30	**MONETARY NET WORKING CAPITAL** (17 - 29)				
	OTHER NON CURRENT ASSETS				
31	Investment Securities				
32	Long Term Receivables (external)				
33	**Investment (external) Total** (31+32)				
34	**Investment-Associates etc.**				
35	Loans to Directors etc.				
36	**Investments Total** (33+34+35)				
37	Deferred Taxation				
38	Other Deferred Charges				
39	Losses/Formation Expenses				
40	**Deferred Charges Total** (37+38+39)				
41	Intangibles - Goodwill				
42	Intangibles - Other				
43	**Intangibles Total** (41+42)				
44					
45	**TOTAL OTHER NON CURR ASSETS** (36+40+43+44)				
	FIXED ASSETS				
46	Land				
47	Buildings (Gross)				
48	Furniture & Fixtures (Gross)				
49	Plant and Machinery (Gross)				
50					
51	Gross Fixed Assets Total (46 to 50)				
52	Accumulated Depreciation				
53	**NET FIXED ASSETS** (51-52)				
54	**TOTAL NON CURRENT ASSETS** (45+53)				
55	**TOTAL ASSETS** (17+54)				

NAME ....

(In .... 000's)

Date				
56 **WORKING CAP & NON CURR ASSETS** (30+54)				
financed by				
NON CURRENT LIABILITIES				
57 Bank Loans				
58 Other Debt Capital				
59 Subordinated Debt				
60 Deferred Income				
61 Directors Loans				
62				
63 **LONG TERM DEBT TOTAL** (57 to 62)				
64 Deferred Tax				
65 Other Deferred Credits				
66 Provisions				
67				
68 Minority Interests				
69 **OTHER NON-CURR LIAB TOTAL** (64 to 68)				
70 **TOTAL NON-CURR LIABILITIES** (63+69)				
EQUITY				
71 Preferred Stock				
72 Common Stock				
73 Treasury Stock				
74 Common Stock (72-73)				
75				
76 **PAID UP CAPITAL** (71,74 & 75)				
77 Capital Surplus				
78				
79				
80 **CAPITAL RESERVE TOTAL** (77 to 79)				
81				
82				
83 **OTHER UNDISTRIBUTABLE RESERVES** (81+82)				
84 **TOTAL UNDISTRIBUTABLE RESERVES** (80+83)				
85 **RETAINED EARNINGS**				
86				
87 **NETWORTH** (76+84+85+86)				
88 Non Current Liabilities and Networth (70 & 87)				
89 Current & Non-Current Liabilities Total (29+70)				
90 **TOTAL LIABILITIES** (87+89)				

ADDITIONAL INFORMATION

CONTINGENCIES

91 Business Contingencies				
(a) Letters of Credit				
(b) Letters of Guarantee				
(c) Foreign Exchange				
(d) Acceptances				
(e) Collections				
92 Other Contingencies				
93 **TOTAL CONTINGENCIES** (91+92)				
94 Other Commitments				

Prepared by:

Department:

.... (In .... 000's)

Period								
SALES								
95 Sales Revenue								
96 Other Related Revenue								
97 **NET SALES** (95+96)								
Cost of Goods Sold								
98 Inventory Cost								
99 Wages								
100 Depreciation-Mfg.								
101 Other Manufacturing Costs								
102 **CGS Total** (98 to 101)								
103 **Gross Profit** (97-102)								
Selling Gen & Admin Expenses								
104 Salaries and Wages								
105 Directors' Remuneration								
106 Fees								
107 Property								
108 Depreciation & Amortization on Fixed Assets								
109 Amortization on Intangibles								
110								
111 Advertisements								
112 Bad and Doubtful Debts								
113 Other SGA								
114 **SGA Total** (104 to 113)								
115 **Operating Profit** (103-114)								
Other Income								
116 Interest Exchange & Dividends								
117 Rental Income								
118 Income from Associates								
119 Profit on Sale of Assets								
120 Other -								
121 **Other Income Total** (116 to 120)								
Other Expenses								
122 Financial Charges-Interest etc.								
123 Other -								
124 **Other Expenses Total** (122+123)								
125 **Pre Tax Profit** (115+121-124)								
126 Tax								
127 **Profit After Tax** (125-126)								
128 Minority Interest								
129 Extraordinary Items								
130 **NET INCOME** (127 to 129)								
131 Dividend/Drawings								
132 Other Appropriations								
133 Profit Retained								

ADDITIONAL INFORMATION

Branch:

Spread Prepared by: **Signature:**

Department: **Date:**