Credit Risk Analysis I
FIN 242f (1)
Spring 2018
Mondays and Wednesdays, 11:00 am – 12:20 pm
Lemberg 54

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OVERVIEW

In this course, we examine credit risk – the possibility that an obligor will fail to perform as agreed – from the perspective of the commercial banker (as well as participants in the non-bank leveraged finance market). Based on a sound understanding of the firm and its business plan, the lender constructs the appropriate structure for the senior loan. Topics include asset-based, cash flow, and syndicated lending. All cases take place in the U.S.

LEARNING GOALS & OUTCOMES

❖ You will learn how commercial bankers (and participants in the non-bank leveraged finance market)
  ✓ think about credit risk
  ✓ value qualitative as well as quantitative analysis
  ✓ structure and syndicate loans
  ✓ identify problems early and assess viability

❖ You will also learn how “the story” shapes the lender’s perception of risk/return

❖ If you fully apply yourself, by the end of the course you will be able to:
  ✓ orally present a lending opportunity and key issues in 30 seconds!
  ✓ write a 2-page memo highlighting a lending opportunity and key issues
  ✓ write a full-blown credit analysis

COURSE REQUIREMENTS

Prerequisite
FIN 212a, ideally with a grade of B+ or better.

Required Reading
I have created a course area on the Harvard Business Online website where you can order the required materials for this course. Click on the link to order: [http://cb.hbsp.harvard.edu/cbmp/access/72663438](http://cb.hbsp.harvard.edu/cbmp/access/72663438) If you have not registered with Harvard Business Online, you will be required to do so.
**Attendance and Class Participation**

Lively class participation is expected of everyone in this course and class attendance is required. In 7 of the classes, there will be a case assigned and you are expected to be prepared to discuss the case in detail, including a thorough analysis of the financial statements. To facilitate participation, place a name card on your desk.

- You must attend classes 1 and 2. You are permitted one absence for any reason for classes 3-13.
- Each additional absence – or absences in classes 1 or 2 – results in a reduction in this grading element (B+ to B, and so on).
- If you come to every class (or miss one of classes 3-13) but do not participate, your participation grade will be C.
- Generally, I look for volunteers to speak, but sometimes I “cold call,” especially when there is no written assignment due that day. (If I “cold call” when there is a team assignment, I expect you to be able to answer for any part of the assignment, not just the section you may have worked on.)
- Class participation is not expected, nor will it be graded, in the 5 classes where I give a lecture.
- Keep an accurate record of your participation, as I may ask for a self-evaluation at the end of the course for participation grades of B+ or better. Quality is far more important than quantity, though always try to contribute something useful in each of the 7 case classes – especially in those without written assignments!

**Written Assignments**

Team assignments must be done in groups of 3 students. Grades on each assignment are assigned to all members of the team (although I reserve the right to alter individual grades when it is clear to me that an individual did not contribute to the assignment in a consistent and meaningful way). Students may form a different team for the second team assignment, so long as the affected students are given at least 3 days to find a new team.

**Grading** (60% individual, 40% team)

| Class Participation | INDIVIDUAL | 40% | ---
| Short-form Analysis for Clarkson Lumber | INDIVIDUAL | 20% | 1/24
| Long-form Analysis for Advanced Medical Technology | TEAM | 20% | 2/5
| Long-form Analysis for Blaine Kitchenware | TEAM | 20% | 2/12

**Office Hours:** Students can meet with me during office hours (Tuesdays, 2-4 pm) or by appointment. It is advisable to email me for an appointment, even for my office hours, as I advise over 100 undergraduates in addition to assisting students in three courses this semester.

**Academic Honesty**

You are expected to be honest in all of your academic work. Please consult Rights and Responsibilities for all policies and procedures related to academic integrity. You may be required to submit work to TurnItIn.com software to verify originality. Allegations of alleged academic dishonesty will be forwarded to the Director of Academic Integrity. Sanctions for academic dishonesty can include failing grades and/or suspension from the university. Citation and research assistance can be found at LTS - Library guides. Under no circumstance may you search the internet, or turn to any other outside source, for any information regarding these cases without my permission. Failure to comply with this directive is cheating.

**Special Accommodation**

If you are a student with a documented disability on record at Brandeis and wish to have a reasonable accommodation made for you in this class, please see me immediately. Please keep in mind that reasonable accommodations are not provided retroactively.
COURSE OUTLINE

CLASSES ONE and TWO
Wednesday, 1/10 and 1/17

“Salesperson or analyst?” Successful commercial bankers are both first-rate salespeople and excellent credit analysts. They must convince their prospect that they understand the company, can structure financings that meet its needs, and can “deliver” their bank. The marketing effort must be two-pronged: to the client and to bank management. Make a misstep along the way, and the deal is lost to another bank. What does the credit analysis involve? How is a loan structured?

Course introduction: syllabus review. This should take about 20 minutes of the first class.
Lecture: loan purpose and structure, financial ratio analysis, template for short- and long-form assignments

READING for CLASS TWO: Note on Bank Loans (291-026)
A Primer on Deals for Middle Market Bankers (see LATTE)

CLASS THREE
Thursday, 1/18
“Purpose of the loan”. Sometimes it’s clear, often it’s not. Let’s look at a successful owner-manager of an established company who realizes that he cannot repay his loan on time and needs more money. To solve this case, think cash (vs. accrual accounting).

READING: Hampton Machine Tool Co. (280-103) + the cash flow template on LATTE

There is no written assignment. Consult LATTE for study questions. I will “cold call” today to discuss your analysis.

CLASS FOUR
Monday, 1/22
Lecture on asset-based lending and Porter’s 5 forces

READING: Michael Porter, “The Five Competitive Forces That Shape Strategy,” HBR #R0801E

CLASS FIVE
Wednesday, 1/24
“Financing Growth.” As companies grow, their working capital requirements can outpace their ability to generate cash from internal sources.

READING: Clarkson Lumber Company (297-028) + spreadsheet supplement

Please consult LATTE for the specifics of this individual assignment. Please submit at the beginning of class a short-form analysis, with exhibits as required. Please propose a loan structure in the final section (which you may call “Recommendation”) that meets the needs of the firm. Do not use the 90-day note structure mentioned in the case; instead propose a one (or more) year working capital line of credit. Be sure to incorporate a Five Forces analysis into your Business + Strategy section (and in every assignment from now on).
CLASS SIX
Monday, 1/29

Lectures on problem loan identification and a first look at cash flow lending.

CLASS SEVEN
Wednesday, 1/31

“It's the Economy, Stupid.” (So went a phrase from a past US presidential campaign.) The recession has hit our borrower. Timing may not be everything but it does matter.

READING: Classic Fixtures & Hardware Company (915-523) + spreadsheet supplement

There is no written assignment. Consult LATTE for study questions. I will “cold call” today to discuss your analysis.

CLASSES EIGHT and NINE
Monday, 2/5 for the assignment; discussion continues Wednesday, 2/7

“Dreaming the dream.” The US economy is powered by the creativity and drive of entrepreneurs. Those same visionaries can be a challenge for the banker who prefers to operate in a more predictable environment.

READING: Advanced Medical Technology Corporation (287-028) + spreadsheet supplement

Please consult LATTE for the specifics of this team assignment.

CLASS TEN
Monday, 2/12

“Managing private wealth.” Sometimes long-term investors will want to achieve liquidity, perhaps to diversify their holdings. In this case, the bank considers extending a nine-figure loan to help finance a very large dividend (which is different from what the case considers). This type of transaction can be called a “leveraged recap.”

READING: Blaine Kitchenware, Inc.: Capital Structure (#40-40) + spreadsheet supplement

How to Negotiate a Term Loan (recommended)

Please consult LATTE for the specifics of this team assignment. Please submit at the beginning of class a long-form analysis in which you propose a loan structure that meets the needs of the firm.
“Time to sell?” There are several times in a company’s life cycle when the owners should consider selling; in this case, the owner has an offer on the table which he really doesn’t want to accept. Does he have an alternative, especially on such short notice?

READING: Owens Precision Machining (813-036)

There is no written assignment. Consult LATTE for study questions. (I have “updated” the story to make it very applicable to the course.) I will “cold call” today to discuss your analysis

Time permitting, I will give a lecture on leveraged finance

CLASS TWELVE
Monday, 2/26
Lectures on syndicated lending and acquisition financing

READING: Note on LBO Capital Structure (214-039)
RECOMMENDED: The High-Yield Debt Market (UV6756)

Also an invaluable 50+ page document on leveraged lending, see LATTE

CLASS THIRTEEN
Wednesday, 2/28

A look at current transactions in the leveraged finance bank and non-bank markets, both broadly syndicated and middle market. Where is pricing today? What is happening to loan structures? Let’s have an open discussion.

syllabus date: 1/3/18