



CCP PART III SECTION 6

CORPORATE LENDING

FRIDAY: 1 December 2017.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Cash flows are classified and reported under three main categories in a statement of cash flows.

With reference to the above statement, examine the three categories of cash flows giving two examples in each case. (12 marks)

(b) An important aspect emphasised by a credit manager while reviewing a prospective borrower's business strategy is to understand where the borrower's business is placed in its trading market(s). This entails the establishment of status of the borrower's business in its life cycle.

With reference to the above statement, evaluate the key points a credit manager should note when the prospective borrower's business is at:

- (i) The start-up stage. (2 marks)
- (ii) The survival stage. (2 marks)
- (iii) The expansion stage. (2 marks)
- (iv) The maturity stage. (2 marks)

(Total: 20 marks)

QUESTION TWO

Super Tents Limited is a corporation that has been in the tents' making and supply business for the last ten years and is quoted on the country's securities exchange. The company is planning to expand its business to cover three neighbouring countries, hence an estimated Sh.10 million is needed. The company has sufficient assets base to support a long-term bank loan to finance this expansion.

The company's finance manager has approached you as a credit expert with the following two options for analysis before presentation to the board:

Option A

Use of the company's freehold property as collateral for a Sh.10 million bank loan that will be repaid within ten years. The bank's interest rate has been negotiated at 13.20%. The bank charges a loan processing fee of 5% and Sh.100,000 as legal fee for charging the property to be used as collateral.

Option B

Issue a corporate bond secured on the company's asset with Sh.20,000 par value, 12% coupon rate and maturing after ten years. The bonds will be sold at a discount of Sh.1,000 but the redemption price will be Sh.20,500. The company's required rate of return is 18%.

Required:

Using effective yield criteria, advise the finance manager on the best financing option to present to the board.

(20 marks)

QUESTION THREE

- (a) Banking institutions have formulated and continue to review prudential guidelines to lending business so as to ensure sound management of credit risk and embrace better cannons of lending.

This was partly necessitated by the fact that Basel Accords were not fit for all sizes of banking institutions.

Required:

Assess four pitfalls of Basel I in relation to the above observation.

(8 marks)

- (b) Despite the rigorous review process undertaken by banks before lending to customers, the banks should bear in mind general external and internal factors not recognised at the time of original assessment. These factors are likely to affect the risk of non-repayment of borrowed funds.

Required:

With reference to the above statement, summarise six internal factors and six external factors not recognised at the time of original assessment of the loan.

(12 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Distinguish between “position limits” and “risk rating loans” as used in loss exposure by banks. (4 marks)

- (b) Suggest six benefits that could accrue to a lending institution from upholding a code of conduct. (6 marks)

- (c) Explain the 5 P’s model of evaluating credit application as suggested by the Federal Reserve Centre in the year 2004. (10 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Analyse five features of a syndicated loan. (10 marks)

- (b) Highlight five disadvantages of asset based lending. (5 marks)

- (c) Risk assessment to a lender’s operations entails examination of the most urgent business functions identified during business impact analysis. The assessment considers the probability and impact of a variety of specific threats that could cause a business disruption.

Required:

With reference to the above statement, describe five objectives that risk assessment was expected to achieve. (5 marks)

(Total: 20 marks)

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