

Five Cs of Credit

Character

- The financial character of the client.
- Do they have the skills, work ethic and training to succeed?
- How have they managed credit in the past?
- How long have they been in the industry?
- Do they have strong integrity?

Cash Flow

- How will we get repaid?
- How dependable is the payment source?
- What is the Debt Service Coverage Ratio?

Capital

- What resources does the company have if cash flow is short?
- What resources does the guarantor have to meet shortfalls?
- Are these resources liquid?

Conditions

- Does the asset mature before the loan?
- Is the debt structure appropriate for the company?
- Are the terms reasonable for the bank?

Collateral

- How marketable is the collateral?
- What is the liquidation value?

Key Questions

1. Does the loan make sense?
2. Where is this relationship going

Terms

- **CMLTD** – Current Maturity of Long Term Debt (Principal due in one year)
- **DSCR** – Debt Service Coverage Ratio (How many payments does cash flow support)
- **Times Interest Coverage Ratio** – (How many times can company profits pay interest due)
Earnings before Interest & Tax / Interest Expense
- **Working Capital** – Current Assets minus Current liabilities

Key Ratios

Liquidity Ratios

- Current Ratio
 - $\text{Current Assets} / \text{Current Liabilities}$
- Quick Ratio
 - $(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$
- Days Inventory Ratio
 - $365 / (\text{Cost of Goods Sold} / \text{Inventory})$
- Days accounts Payable Ratio
 - $365 / (\text{Cost of Goods Sold} / \text{Accounts Payable})$
- Days Accounts Receivable Ratio
 - $365 / (\text{Credit Sales} / \text{Accounts Receivable})$

Financial Leverage Ratios

- Debt to Equity Ratio
 - $\text{Total Liabilities} / \text{Total Equity}$
- Debt to Asset Ratio
 - $\text{Total Liabilities} / \text{Total Assets}$

Profitability Ratios

- Return on Sales
 - $(\text{Net Profit} / \text{Sales}) \times 100$
- Return on Assets
 - $(\text{Net Profit} / \text{Total Assets}) \times 100$
- Return on Equity
 - $(\text{Net Profit} / \text{Total Equity}) \times 100$