

KASNEB

CCP PART III SECTION 6

CORPORATE LENDING

FRIDAY: 25 November 2016.

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) Describe five criteria that could be followed by a corporate lender when classifying agricultural loans. (5 marks)
- (b) Ecoblu Limited is a petroleum exploration company operating in Kenya since 1998. The company was originally called Niltwo Limited, but changed its name after being acquired by a Russian energy company, "The Zimcom Group" in the year 2001.

In June 2011, Ecoblu Limited announced that it was seeking funding of 20 billion shillings to finance the Kenyan oil pipeline and upgrade its infrastructure.

In July 2013, it was reported by a local press that Ecoblu Limited had defaulted on license renewal. It had only paid 8 billion shillings of the total 10 billion shillings for a new 15-year concession license.

In December 2015, Ecoblu Limited's market share was around 30% while its competitors Max Energy Limited and Ken Trezo Limited had a market share of 37% and 21% respectively. The remaining 12% market share was owned by unlicensed operators. Max Energy Limited and Ken Trezo Limited are both owned by the Kenyan government and have been very aggressive to increase their market presence after discovery of crude oil in the country.

In the year 2015, Ken Trezo Limited and Max Energy Limited lost 9% in market share to Ecoblu Limited after they increased prices of their products. The two companies also lost most of their experienced staff.

The following is an industry extract of the three energy companies for the financial year ended 31 December 2015:

	Max Energy Limited Sh."billions"	Ecoblu Limited Sh."billions"	Ken Trezo Limited Sh."billions"
Total revenue	20	25	12
Total assets	29	32	21
Total liabilities	14.3	18.8	14
Capital	10	15	10

Required:

Using Michael Porter's five forces of competitive position model, evaluate the strategic variables of Ecoblu Limited and the industry in relation to lending. (10 marks)

- (c) Filtrex Limited, a corporate customer, seeks to obtain a Sh.100 million line of credit from Quadrax Bank. Filtrex Limited agrees to pay a 9% interest rate and make compensating balances of 6% of the total credit line and 3% of the amount actually borrowed. These will be held in non-interest bearing transactions deposits at the bank for one year.

The bank charges a 1% loan origination fee on the amount borrowed and a 0.25% commitment fee on the unused line of credit. The expected draw down (loan amount) is 60% of the credit line for one year. Reserve requirements are 10%.

Required:

The expected rate of return to the bank.

(5 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Secretive insider lending in the banking sector in the recent past has been cited by the banking regulator as one of the major causes of some banks being put under statutory management or under liquidation.

In relation to the above statement:

- (i) Explain the term “insider lending”. (1 mark)
- (ii) Examine four warning signs of a potential fraud and insider abuse in the banking sector. (4 marks)
- (iii) Suggest three ways which could be used to mitigate against insider lending in the banking sector. (3 marks)
- (b) In relation to the Basel Accord, distinguish between “Tier 1 Capital” and “Tier 2 Capital”. (2 marks)
- (c) Ponvesto Limited is considering borrowing Sh.200 million from a bank and has submitted the following financial statements to the bank for consideration:

Statement of financial position as at 31 December:

	2013	2014	2015
	Sh. “000”	Sh. “000”	Sh. “000”
Non-current assets	662,764	791,651	962,284
Current assets	238,868	298,081	573,704
Equity	373,129	277,351	368,810
Non-current liabilities	681,286	870,058	1,267,370
Current liabilities	593,474	497,121	637,524
Cash	46,737	63,916	60,653

Statement of financial performance for the year ended 31 December:

	2013	2014	2015
	Sh. “000”	Sh. “000”	Sh. “000”
Revenue	1,034,549	971,209	1,103,839
Other income	157,006	69,482	133,781
Operating expenses	870,825	908,253	1,092,322
General and administrative expenses	165,931	148,273	166,795
Finance income	20,250	2,303	23,512
Finance cost	216,987	156,334	329,559
Loss before tax	41,939	169,866	327,543
Tax	57,486	(81,670)	-

Required:

Compute and interpret each of the following ratios for the year ended 31 December 2014 and 31 December 2015:

- (i) Current ratio. (2 marks)
- (ii) Cash ratio. (2 marks)
- (iii) Operating profit/loss ratio. (2 marks)
- (iv) Net profit/loss ratio. (2 marks)
- (v) Return on assets ratio. (2 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Examine four salient features of a not-for-profit making organisation as a corporate customer. (4 marks)
- (b) For purposes of appraising a borrower’s creditworthiness, lenders may seek credit rating from established credit reference bureaus (CRB). Other lenders utilise internal tools for scoring and arriving at credit ratings for prospective borrowers.

With reference to the above statement, suggest four factors that are usually considered when assigning a credit rating score to a borrower. (4 marks)

- (c) (i) Discuss three types of letters of credit that could be used by multinational corporations to manage credit default risks. (3 marks)
- (ii) Explain three advantages of letters of credit. (3 marks)
- (d) When a bank receives a lending proposal from a prospective borrower, it normally considers the following two important factors:
- What the customer would like to get from the bank.
 - What the bank is willing to offer within its lending policy.

In relation to the above statement, evaluate the bank's perspective on:

- (i) The pricing of the facility. (3 marks)
- (ii) The amount requested. (3 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Vantom Limited is considering borrowing Sh.500 million from Zanco bank in the next financial year to finance its ambitious regional expansion program.

As the credit manager of the company, advise the management of Vantom Limited on the requirements they should meet before approaching the bank for the loan facility. (5 marks)

- (b) After lending to a company, there is need for commercial banks to continuously monitor the trading performance of the company.

Required:

- (i) Examine three occasions when a company's business account could be said to be "out of order". (3 marks)
- (ii) Propose three warning signs of a company experiencing trading difficulties. (3 marks)
- (c) Citing appropriate reasons, justify why commercial banks could undertake the following appraisal methods for financial statements before granting a customer a loan facility:
- (i) Pro-forma analysis. (2 marks)
- (ii) Loan-to-value ratio. (2 marks)

- (d) Collaterals are contractual devices used by borrowers and lenders around the world. They could be in property or other form of assets that a borrower can offer to a lender to secure a loan. If the borrower defaults in making the promised loan payments, the lender can seize the collateral to recoup its loan.

In relation to the above statement, argue five cases against use of collaterals as security for loans to both lenders and borrowers. (5 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Analyse four characteristics of a good ethical banking practice. (4 marks)
- (b) Explain the following terms as used in corporate lending:
- (i) Loan-loss provisions (LLPs). (1 mark)
- (ii) Loan-loss reserves (LLRs). (1 mark)
- (iii) Non-performing loan (NPL) ratio. (1 mark)

- (c) Zurian Bank Limited has non-performing loans (NPLs) totalling to Sh.350 million. The bank's loan-loss coverage amounts to Sh.200 million and it has shareholders' equity of Sh.100 million.

Required:

The bank's adjusted non-performing loan coverage ratio. (3 marks)

- (d) Discuss four items that should be addressed by an effective credit policy as outlined in the risk management guidelines issued by the banking regulator in your country. (4 marks)

- (e) Describe six key types of information that the credit officer might check in a business plan when evaluating a loan proposal of a corporate client. (6 marks)

(Total: 20 marks)

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