

Developing a Corporate Credit Rationale

OBJECTIVES

This course will cover topics including:

- Evaluating the various aspects of fundamental credit analysis for a corporate entity
- Explaining the market view of credit risk
- Incorporating all of the above in developing a sound credit rationale

Course overview: The course will be a combination of lecture, group and individual exercises, and group discussion. One case study will be used throughout the course to highlight specific learning points. S&P Capital IQ's products will be discussed when appropriate.

This course does not teach the Standard & Poor's Ratings Services' Credit Ratings criteria or methodologies. The instructors are independent consultants sourced through our training firm partner, Global Financial Markets Institute, Inc. The instructors teach courses on behalf of S&P Capital IQ and as such, their views do not necessarily reflect the views of S&P Capital IQ.

CPE Credits: 21.9

CFA CE Credits: 18.75

DAY 1

9:00 a.m. – 9:30 a.m.

Course Objectives and Participant Introduction

9:30 a.m. – 10:45 a.m.

Session 1: Overview of Credit and Credit Analysis

The opening session discusses the characteristics and importance of credit analysis. Participants will be exposed to the types of credit risk, the cyclical nature of credit, the need to form a macro view, and to conduct industry and competitive analysis. By the end of this session, course participants should be able to:

- Identify users of Credit Analysis
- Appreciate the importance of a top-down approach
- Develop macro opinion on the market
- Perform industry and competitive analysis
 - Using the Porter Model and SWOT analysis
- Evaluate management
- Manage credit risk
- Factor in default concepts
 - Default probability
 - Loss severity
 - Exposure at default

Exercise: SWOT analysis on Office Depot, Inc. and OfficeMax, Inc.

10:45 a.m. – 11:00 a.m.

Coffee Break

11:00 a.m. – 12:30 p.m.

Session 2: Financial Statement Analysis

In this session, participants will see the structure and uses of the key financial statements and how they are related, understand the importance of normalizing and adjusting financials, and apply the concept of working capital. At the end of this session, course participants should be able to:

- Discuss the importance, differences and interrelationships among the key financial statements, and key concepts
 - Income statement, balance sheet and cash flow
 - Definition of EBITDA
- Understand the concept and importance of working capital
- Discuss financial flexibility – access to funding sources
 - Harris Entertainment failed syndication

Exercise: Construct a generic cash flow statement and contrast net income and cash flow

12:30 p.m. – 1:30 p.m.

Lunch

1:30 p.m. – 3:30 p.m.

Session 3: The Importance of Sustainable Cash Flow and Creative Accounting Practices

In this session, participants will distinguish the difference between various definitions of free cash flow and discuss early warning signs in a firm's financial statements. At the end of the session, course participants should be able to:

- Discuss the definition of free cash flow
- Discuss the importance of arriving at sustainable cash flow
 - Key drivers of operating cash flow
 - Common cash flow statement adjustments
 - The differences between Generally Accepted Accounting Principles (GAAP) earnings and free cash flow (FCF)
 - Examine the various definitions of free cash flow
- Discuss whether the cash flow statement is sacrosanct
- Identify some of the early warning signs of financial statements
- Identify possible sources of financial statement manipulation
- Review the most commonly used pension accounting acronyms
- Discuss pensions and how a financial statement can be adjusted and massaged
- Understand the importance of statement normalization and analytic adjustments
 - Off-Balance Sheet Financing
 - Operating vs. Capital Leases

Exercise: JC Penney. Participants will review quarterly financial statements to determine what caused JC Penney's precipitous decline in stock value.

3:30 p.m. – 3:45 p.m.

Coffee Break

3:45 p.m. – 5:00 p.m.

Session 3: The Importance of Sustainable Cash Flow and Creative Accounting Practices (cont'd)

Exercise: Examine AMERCO's (parent company of U-Haul) annual report in an attempt to spot potential early warning signs in a firm's financial statements. Participant teams will discuss the early warning signs.

DAY 2

9:00 a.m. – 10:30 a.m.

Session 4: The Importance and Limitations of Ratio Analysis

In this session, participants will learn not only about ratio analysis but also how to adjust the numbers before computing ratios and to contextualize them by comparing with peers. By the end of this session the course participants should be able to complete:

- Comparative corporate analysis
- Credit-adjusted financials
- Peer analysis via credit ratios and sector averages
- The pitfalls and merits of ratio analysis
- The importance of key credit ratios
- Contrast different ratios for different industries
- Calculating debt-service capacity and overall debt capacity
- Understand differences between equity and credit markets from a valuation perspective
- Compare equity valuation and internal valuation methods
- Financial forecasting – key drivers and techniques

10:30 a.m. – 10:45 a.m.

Coffee Break

10:45 a.m. – 11:30 a.m.

Session 4: The Importance and Limitations of Ratio Analysis (cont'd)

Exercise: Case Exercise – Office Depot Inc. and Office Max Inc.
Identify Key Industry Drivers And Metrics, Project Sales and EBITDA Growth and Project Base Case for both companies

11:30 a.m. – 12:30 p.m.

Session 5: Corporate Funding and Structuring

In this session, participants will distinguish between the equity markets and the credit markets as to how to value a firm. By the end of this session the course participants should be able to:

- Examine the different types of funding sources and uses
 - Banks, investment banks, hedge funds, private equity – how do they compare
- Describe the different banking and capital market products that are available to fund corporate needs
 - Debt, equity and hybrid – short-term and long-term products

12:30 p.m. – 1:30 p.m.

Lunch

1:30 p.m. – 2:30 p.m.

Session 5: Corporate Funding and Structuring (cont'd)

- Evaluate Weighted Average Cost of Capital (WACC) implications (the tax benefits of debt)
- Identify and discuss the factors that impact the cost of funding, including:
 - Creditworthiness, covenants and collateral
 - Capital structure (secured vs. unsecured, senior vs. subordinated)

Exercise: Forecasting Difficulties

- Evaluate Office Depot's and OfficeMax's position in the event of financial difficulty
 - Determine what options the companies have
 - How can the companies raise cash and at what price?

2:30 p.m. – 2:45 p.m.

Coffee Break

2:45 p.m. – 5:00 p.m.

Session 6: The Market View of Credit Risk

In this session, participants will be introduced to the different ways that a corporate can be analyzed. By the end of this session, course participants should be able to:

- Define Credit Default Swaps (CDS) single name and Index contracts and describe their corresponding markets
- Differentiate between CDS index contracts: CDX, iTraxx and S&P
- Analyze market view of credit risk in terms of:
 - Bond prices/Spreads
 - Credit default swaps
- Analyze CDS spreads in the context of CDS Indices
- Define a CDS-based Market Derived Signal and compare to a Fundamental Credit Rating

DAY 3

9:00 a.m. – 10:30 a.m.

Session 7: Assessing Relative Value in Corporate Credit

In this session, participants will be able to interpret relative value and trends in corporate credit markets. In this session they will experience how credit fundamentals drive relative value, discuss the usefulness of quantitative models, learn to interpret market signals and information, and appreciate the process of identifying mispriced bonds. By the end of this session, course participants should be able to:

- Review principal risk measures
- Explain the fundamentals of bond pricing
- Explore the components of market and credit risk
- Discuss the evolution of credit default models in the marketplace
- Explore reduced form probability of default models and interpretation of results
- Explain risk neutral default probability and expected loss in relation to credit spreads

10:30 a.m. – 10:45 a.m.

Coffee Break

10:45 a.m. – 12:00 p.m.

Discussion with S&P Ratings Analyst

12:00 p.m. – 1:00 p.m.

Lunch

1:00 p.m. – 2:30 p.m.

Session 8: Develop and Defend a Credit Rationale

After thoroughly analyzing Office Depot, Inc and OfficeMax Inc, participants will be asked to formulate and defend their analysis. By the end of this session, course participants should be able to:

- Discuss how credit analysts form a rationale and what the results may be
- Make better-informed business and financial decisions by developing a relative attractiveness assessment from all of the previous sessions
- Analyze both qualitative and quantitative factors

Exercise: Apply the learning objectives to develop and present a sound credit rationale utilizing the team-based case studies.

2:30 p.m. – 2:45 p.m.

Coffee Break

2:45 p.m. – 4:00 p.m.

Group Presentations

4:00p.m. – 4:30 p.m.

Course Feedback and Close

Course agenda is subject to change without notice.

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