ZCAS University

BBF6101 CREDIT ANALYSIS

FINAL EXAMINATION

Friday 31st May 2024

16:30-19:30

TIME ALLOWED: THREE HOURS (plus 5 minutes to read through the paper)

INSTRUCTIONS:

1. Section A: Question One in Section A is **compulsory**.
2. Sections B: Answer Two (2) questions from this section.
3. This examination paper carries a total of **100 marks**.
4. Candidates must **not turn this page** until the invigilator tells them to do so.

SECTION A: Question 1 is compulsory and must be attempted.

Question 1

Vinmas Motors Limited is a dealer in new and used BMWs. The company is a family run business which was established in March 2020 by Mr Peter Mbewe together with his wife Jane Mbewe. Mr Mbewe owns 99% shareholding, with the remaining shares owned by his wife.

The years have been characterised by the steady conservative approach taken by the directors. The business traded profitably until the last two years, when it was affected by declining profit margins and poor management controls. Stronger management controls have been put in place following the trading losses and this, together with a move into used car sales, has helped turn the business around and seen a return to profits.

The business has banked with SVB Bank since it was established in 2020. The customer remains satisfied with the level of service the bank currently provides, although there were problems in the past when trading was difficult.

The company has been operating in an economy currently in decline following a reduction in commodity prices, global geopolitical tensions and adverse weather conditions due to climate change. The exchange rate has been volatile and interest rates elevated due to the Central Banks monetary policy stance. Inflation has been persistently above double digits for the past few years.

Competition is strong in the area, coming from both multi and single site dealers. Profit margins on new car sales have been declining, hence the move into used car sales. Vinmas Motors are the sole suppliers of new BMW's in the country although similar operations are found in neighbouring countries. The business operates from three prime sites on long leases. All sites sell both new and used cars.

Vinmas Motors has a competent management comprised of the Chairman- Mr Mbewe who is in his early seventies. He is now taking less interest in the business and considering leaving the business to his two children. The Managing Director- Mr Times Mbewe is the son of Mr Mbewe and in his early thirties. He is in charge of administration and staff welfare and general site management. He requires a good salary to maintain his expensive lifestyle. The Marketing Director is Ms Rosina Mbewe the daughter who is in her mid-twenties. She ensures that the profile of the company is maintained through advertising and press. The financial consultant is Mr Jack Bwalya who is in his mid-twenties. He joined the company in 2022 and was instrumental in implementing management controls and turning the business around. He is looking forward to being appointed on to the board as Financial Director in due course, although this has been resisted to date by Mr Peter Mbewe who believes that only family members should be on the board.

Below are the company's latest audited financial statements:

Vinmas Motors Limited Profit and Loss Account for the Year Ended 31 December 2024

Details	Note	2023 ZMW000s	2024 ZMW000s
TURNOVER	1	3,820	4,176
Cost of Sales		(3,326)	(3,621)
Gross Profit		494	555
Administrative expenses		(302)	(358)
Profit before interest and tax		**192**	**197**
Other operating income		0	0
Interest receivable		0	0
Interest payable and other similar charges		(53)	(75)
(LOSS)/PROFIT ON ORDINARY ACTIVITIES BEFORE TAX	6	**139**	**122**
Taxation		(77)	(72)
PROFIT AFTER TAX		**62**	**50**
Dividend		(35)	(40)
RETAINED EARNINGS		**27**	**10**

Vinmas Motors Limited Statement of Financial Position as 31 December 2024

Details	**Note**	**2023 ZMW'000s**		**2024 ZMW'000s**	
FIXED ASSETS			**422**		423
Tangible Assets	2				
CURRENT ASSETS					
Stocks		207		300	
Debtors		198		271	
Cash at bank and at had		0		0	
		405		**517**	
CREDITORS-Amounts falling due within one year	3.7	(390)		(561)	
NET CURRENT-ASSETS			15		10
TOTAL ASSETS LESS CURRENT LIABILITIES			437		433
CREDITORS (Amounts falling due after more than one year	4		(214)		(200)
NET TANGIBLE ASSETS			223		233
CAPITAL AND RESERVES					
Called up share capital			21		21
Revaluation reserve			60		60
Profit and loss account			142		152
SHAREOLDERS FUNDS			**223**		**233**

The company has applied for the following banking facilities:

Facility	**Details**
Overdraft	• Unsecured overdraft of ZMW200,000 marked • Margin 5% over MPR
Revolving loan	• 5 year facility of ZMW250,000 to purchase equipment and machinery • Facility will be secured on all leasehold property • Margin of 2% over MPR

Required:

Using the methods of credit analysis such as the CAMPARI framework together with financial and non-financial analysis, comment on the request from Vinmas Motors Limited and make recommendations on whether the facilities should be granted or not.

(Total: 50 marks)

SECTION B: Attempt any TWO questions in this section.

Question 2

SBV Bank is a mortgage lender that specialises in sub-prime lending to middle income customers. Its loan portfolio has grown tremendously over the years, but it would like to expand further. However, it is limited by bank capital regulations that limit how much loans it can offer. One solution for the bank is to consider **securitisation** of some of its loans.

Required:

Write short notes on how SBV Bank can use the process of securitisation in order to expand its loan portfolio. In your notes, explain how this process works and the types of instruments that can be issued from the securitisation process.

(25 marks)

Question 3

'BAD BANK' TO CLEAN UP INDIA'S $27BN DEBT MOUNTAIN

With more than 150,000 branches loaded with $2tn (£1.46tn) worth of deposits and serving over a billion customers, India's banks look impressive on paper.

In reality, they are in a mess.

A clutch of banks is saddled with tens of billions of dollars of bad loans after years of injudicious lending to dud projects. State-owned banks account for more than 60% of the sour debt. Five banks have been rescued from collapse since 2018.

Bad loan recoveries have traditionally been low - up to a third of total loans - and have only improved a bit (40-45%) after a 2016 bankruptcy law which allows for liquidation of assets. And now borrowers hit by the pandemic could further default and add to the soaring debt in the coming months.

The bailouts - more than $35bn of taxpayers' money was injected to revive ailing banks between 2005 and 2009 alone - haven't helped much. In July last year, Fitch Ratings said India's struggling banks would need between $15bn-$58bn in infusion of fresh funds by 2022.

Now the government plans to float a long talked-about "bad bank" which will try to tame $27bn of bad loans and clean up the balance sheets of commercial banks.

This would still be a quarter of India's estimated $100bn of bad loans on the books of commercial banks. The resultant squeeze on credit has not only hobbled banking but undermined growth: private investments have nosedived as risk-averse banks are unwilling to lend freely.

A "bad bank" - also described as an asset reconstruction company - typically buys bad loans from affected banks at an agreed price. Then it liquidates or sells assets that borrowers have offered as securities against loans. The proceeds from the sales help the banks recoup some of the money they had lent to companies.

This is not the first time India has faced a bad loan crisis or launched a "bad bank". In fact, there have been 28 such firms, all privately owned, in the past two decades, but recoveries have been underwhelming. This time, the government has formed two companies - one which will acquire the bad loans and will be state owned; and the other, partly privately owned, will try to sell the assets. The government will pay the difference between the expected value of assets by the commercial bank and what the "bad bank" will be able to raise from the asset sales.

It will not be easy. For one, the banks have to agree on valuations.

"Say there are 20 lenders in one company. All of them have to agree on many things. How much are the loans worth today? How much are the assets of the borrowers worth? Convincing a bank to sell loans at a loss is a challenge," says Anil Gupta, vice-president of financial sector ratings at ICRA, an investment and credit rating agency.

"Banks are usually skilled in lending but not recovery and resolution of bad loans."

Here, the second company will come into play. It will bid for the assets of ailing and defunct companies: mainly land, plant and machinery, and some of it at scrap value. Half-a-dozen industries account for some 80% of the bad loans: they are in iron and steel, aviation, mining, roads, power and telecoms sectors.

Among the bouquet of 12 big defaulting firms - called "The Dirty Dozen' - are ones that used to make steel, textiles, infrastructure and ships; distribute electricity; develop real estate and build infrastructure. Some of their assets need to be sold, and that will be a challenge in a slowing economy.

In the long term, India needs to radically clean up its banking. At less than 60% India's credit to GDP ratio remains low, yet its banks have some of the highest non-performing loans in the world. The loans began piling up between 2006 and 2008, when growth was buoyant and borrowing was easy. The global financial crisis of 2007-8 and the slowdown of growth left India relatively unscathed, and enthusiasm for investing didn't wane.

"Bad loans are sown in good times," says C Rangarajan, a former central bank governor.

(Source: BBC News)

(i) Discuss the rationale of the Indian Government establishing a 'bad bank'. **(5 marks)**

(ii) Critically analyse the implications of the Non-Performing Loans (NPLs) on the Indian economy which could have prompted the Indian government to establish the 'Bad Bank' **(15 marks)**

(iii) Some commentators have argued that the creation of 'bad banks' increases 'moral hazard' in the banking sector. Explain this argument. **(5 marks)**

(Total: 25 marks)

Question 4

You have been appointed as a Premium Banking Manager with a responsibility of managing a portfolio of medium sized businesses. One of your Key Performance Indicators (KPIs) is to grow your loan portfolio by 10 percent on an annual basis.

Required:

(i) Explain to the Premium Banking Manager the importance of growing the Corporate loan portfolio. **(5 marks)**

(ii) Discuss any five (5) factors that the Bank must consider when constructing a loan portfolio. **(10 marks)**

(iii)Write short notes on how the following lending products can be used by a Corporate customer:

a) Floor Planning **(2 marks)**

b) Inventory Lending **(2 marks)**

c) Participation loan **(2 marks)**

d) Letter of Credit **(2 marks)**

e) Line of credit **(2 marks)**

(Total: 25 marks)

END OF EXAM