

# CREDIT RISK ANALYSIS

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# ABSTRACT

Understand which are the key factors for a certain level of credit risk to occur

Compare the performance of different ML models capable to predict the credit risk level for a company in an year - given past years data

## *Keywords*

Financial Data Science • Credit Risk Analysis • Machine Learning





# GITHUB REPOSITORY

[https://github.com/Amatofrancesco99  
/credit-risk-analysis](https://github.com/Amatofrancesco99/credit-risk-analysis)

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**INTRODUCTION**



# WHAT IS CREDIT RISK ANALYSIS

Credit analysis is a type of financial analysis that an investor performs on companies to measure the issuer's ability to meet its debt obligations (calculated using financial ratios, cash flow analysis, trend analysis, and financial projections)

Credit analysis seeks to identify the appropriate level of default risk associated with investing in that particular entity's debt instruments

A review of credit scores and any collateral is also used to calculate the creditworthiness of a business





# DATASETS

The main dataset contains the following features (from 2015 to 2020), regarding European companies:

- **Name:** name of the company
- **Turnover:** how quickly a business conducts its operations
- **EBIT:** indicator of a company's profitability
- **PLTax:** company tax based on their cumulative income over their lifetime up until the filing date
- **MScore:** credit risk level - the higher the M-score of a company, the more likely the company engages in accounting frauds
- **Country:** worldwide country of the company

# DATASETS

- NACE code: European statistical classification of economic activities
- Sector 1: detailed description of the company's business activities
- Sector 2: general sector
- Leverage: the use of debt to amplify returns from an investment or project
- ROE: measure of a company's annual return
- TAsset: assets owned by the company

Other accessories datasets have been downloaded from [Kaggle](#) to extract other useful information, to gain more effective insights

# MAIN DATASET

No	Company name	Turnover.2020	Turnover.2019	Turnover.2018	Turnover.2017	Turnover.2016	Turnover.2015	EBIT.2020	EBIT.2019	...	ROE.2018	ROE.2017	ROE.2016	ROE.2015	TAsset.2020	TAsset.2019	TAsset.2018	TAsset.2017	TAsset.2016	TAsset.2015	
0	1	LENDLEASE S.R.L.	29458	16716	9612	8097	7941.0	5600.0	-1556.0	-4540.0	...	8.24	-146.65	60.76	-471.72	49263	28268	15455	15992	13597.0	11659.0
1	2	PRICEWATERHOUSECOOPERS BUSINESS SERVICES SRL (...	16731	16403	16843	12241	9252.0	9515.0	1838.0	841.0	...	61.42	-55.57	-127.29	-87.13	16550	16887	16468	10773	6697.0	8933.0
2	3	EVISO S.P.A.	48568	43039	34302	25791	19760.0	6941.0	1661.0	1464.0	...	57.52	42.73	20.34	44.62	13500	9620	7371	5432	4170.0	2862.0
3	4	CASA SERVICE MACHINE	47999	43484	43043	41682	51267.0	52584.0	416.0	255.0	...	-17.24	0.71	2.89	6.45	24978	25032	25729	21632	25403.0	24941.0
4	5	PANFERTIL SPA	45948	47336	45626	48222	57074.0	62263.0	44.0	713.0	...	-5.17	-6.74	0.03	-8.19	36823	34659	36205	38423	41847.0	41323.0
...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	
21249	21250	ASTOR VILLAGE S.R.L.	3161	4635	4742	4499	4277.0	3650.0	985.0	1818.0	...	11.01	8.44	7.83	6.31	15935	15664	14438	13054	12243.0	11695.0
21250	21251	ODONE & SLOA S.R.L.	3161	2562	2559	2334	3692.0	2537.0	60.0	101.0	...	0.62	-4.80	-7.85	-12.84	2487	2317	2351	2521	2797.0	3152.0
21251	21252	GARRIDO MURO SOCIEDAD LIMITADA	3161	3146	2989	3101	2746.0	3154.0	260.0	13.0	...	1.88	3.10	2.90	5.62	2547	1855	1692	1843	1773.0	1699.0
21252	21253	CENTRO INGROSSO JOLLY S.R.L.	3161	2519	2290	2244	1761.0	1821.0	74.0	48.0	...	3.74	3.54	18.85	0.58	2961	2552	2604	2474	1546.0	1222.0
21253	21254	SALONES COMATEL SL	3161	4514	4435	4231	3908.0	2051.0	194.0	733.0	...	15.59	25.60	40.55	-9.98	3576	4259	4747	3993	3027.0	2333.0

121253 rows x 49 columns

02

+ DATA CLEANSING





# COLUMNS STATISTICS

	No	Turnover.2020	Turnover.2019	Turnover.2018	Turnover.2017	Turnover.2016	Turnover.2015	EBIT.2020	EBIT.2019	EBIT.2018
count	121253.000000	121253.000000	121253.000000	121253.000000	121253.000000	121176.000000	1.211080e+05	121249.000000	121252.000000	121252.000000
mean	10110.366259	10857.198313	11571.907903	11147.202164	10545.611812	9864.284776	9.416949e+03	504.857203	586.141820	569.848910
std	5843.476583	9101.352870	9544.166163	9293.686070	8966.629317	8935.990541	9.942035e+03	2086.001182	1797.540232	1949.423069
min	1.000000	2058.000000	2003.000000	2000.000000	2000.000000	0.000000	0.000000e+00	-322920.000000	-139167.000000	-188057.000000
25%	5053.000000	4546.000000	4910.000000	4700.000000	4383.000000	3996.000000	3.689000e+03	60.000000	86.000000	87.000000
50%	10105.000000	7193.000000	7825.000000	7518.000000	7081.000000	6537.000000	6.157000e+03	253.000000	270.000000	265.000000
75%	15157.000000	13680.000000	14753.000000	14208.000000	13401.000000	12463.000000	1.185625e+04	698.000000	717.000000	693.000000
max	21254.000000	49993.000000	49997.000000	49979.000000	49996.000000	294752.000000	1.188225e+06	45155.000000	99633.000000	70371.000000

8 rows × 38 columns

...	ROE.2018	ROE.2017	ROE.2016	ROE.2015	TAsset.2020	TAsset.2019	TAsset.2018	TAsset.2017	TAsset.2016	TAsset.2015
...	121239.000000	121246.000000	121181.000000	121180.000000	1.212530e+05	1.212530e+05	1.212530e+05	1.212530e+05	1.212090e+05	1.212040e+05
...	36.877294	16.076334	16.060269	1.693177	1.301078e+04	1.218059e+04	1.177646e+04	1.131364e+04	1.075000e+04	1.031990e+04
...	4668.108915	1997.679619	1693.639336	5216.355970	3.119684e+04	2.971044e+04	2.922767e+04	2.866877e+04	2.857112e+04	2.859595e+04
...	-369200.000000	-450687.370000	-277108.820000	-1000000.000000	7.100000e+01	5.300000e+01	3.700000e+01	8.600000e+01	0.000000e+00	0.000000e+00
...	3.650000	3.810000	3.380000	2.830000	3.465000e+03	3.174000e+03	2.997000e+03	2.790000e+03	2.517000e+03	2.259000e+03
...	11.350000	11.900000	11.320000	10.660000	6.344000e+03	5.858000e+03	5.579000e+03	5.252000e+03	4.830000e+03	4.474500e+03
...	23.590000	24.830000	24.600000	24.560000	1.284300e+04	1.192900e+04	1.147500e+04	1.087100e+04	1.013900e+04	9.552000e+03
...	1000000.000000	287359.790000	365858.980000	1000000.000000	3.109756e+06	2.597637e+06	2.104548e+06	1.953757e+06	1.993535e+06	2.032843e+06





# REMOVE NULL ELEMENTS

companies_df.isna().sum().to_frame()		
	0	MScore.2017 0
No	0	MScore.2016 0
Company name	1	MScore.2015 0
Turnover.2020	0	Region 1
Turnover.2019	0	Country 0
Turnover.2018	0	NACE code 0
Turnover.2017	0	Sector 1 0
Turnover.2016	77	Sector 2 0
		Leverage.2020 0
Turnover.2015	145	Leverage.2019 0
EBIT.2020	4	Leverage.2018 0
EBIT.2019	1	Leverage.2017 0
EBIT.2018	1	Leverage.2016 0
EBIT.2017	1	Leverage.2015 0
EBIT.2016	46	ROE.2020 6
EBIT.2015	50	ROE.2019 15
PLTax.2020	2	ROE.2018 14
PLTax.2019	2	ROE.2017 7
PLTax.2018	2	ROE.2016 72
PLTax.2017	2	ROE.2015 73
PLTax.2016	49	TAsset.2020 0
PLTax.2015	51	TAsset.2019 0
MScore.2020	0	TAsset.2018 0
MScore.2019	0	TAsset.2017 0
MScore.2018	0	TAsset.2016 44
		TAsset.2015 49

```
original_len = int(len(companies_df))
companies_df = companies_df.dropna()
print('Removed rows:', str(original_len - int(len(companies_df))))
```

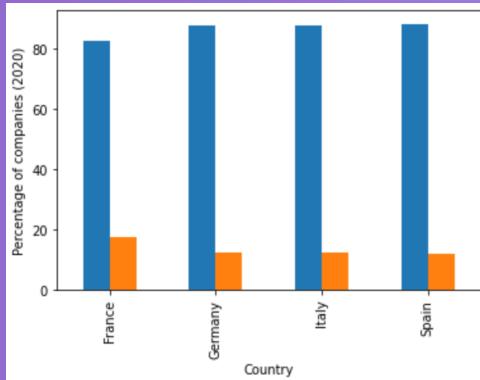
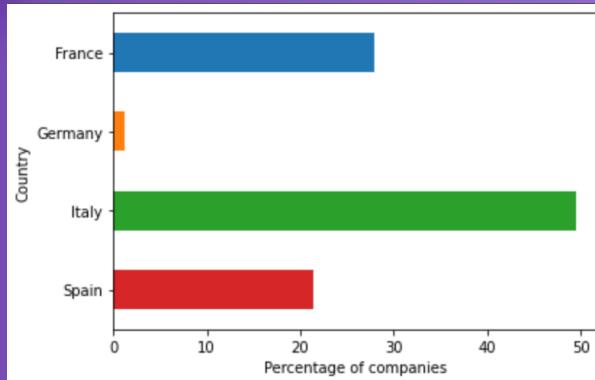
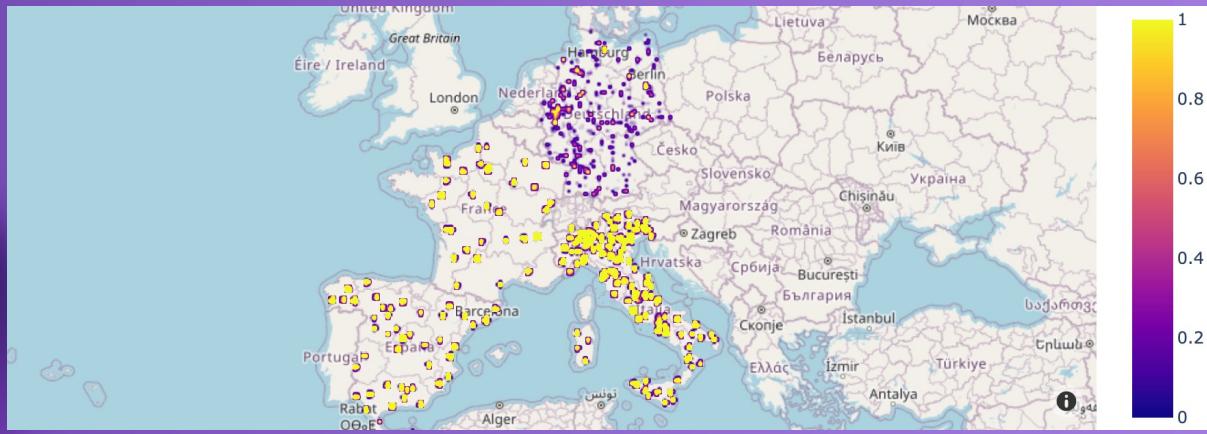
```
Removed rows: 245
```

03

## EXPLORATORY ANALYSIS



# COUNTRIES



## Credit risk

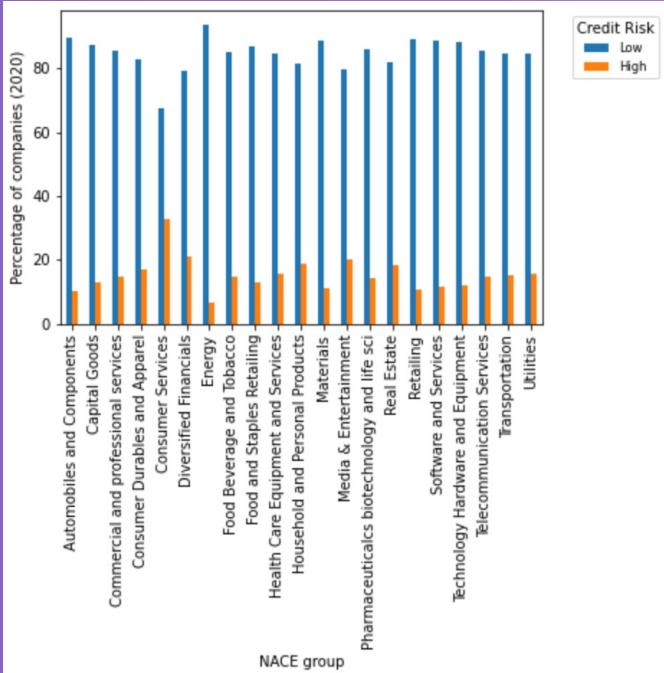
- Low = 0  $\Leftrightarrow$  MScore  $\in [A, B]$
- High = 1  $\Leftrightarrow$  MScore  $\in [C, D]$

	MScore.2020.int	0	1
Country	Region		
Ain	88.418079	11.581921	
Aisne	82.547170	17.452830	
France	Allier	83.941606	16.058394
	Alpes-Maritimes	79.387755	20.612245
	Alpes-de-Haute-Provence	96.624473	3.375527
...	...	...	...
	Valencia	91.955307	8.044693
	Valladolid	90.909091	9.090909
Spain	Vizcaya	84.916865	15.083135
	Zamora	95.454545	4.545455
	Zaragoza	88.707654	11.292346

584 rows × 2 columns

# SECTORS

	Sector 2	%
	Automobiles and Components	2.735356
	Capital Goods	14.461854
	Commercial and professional services	8.953953
	Consumer Durables and Apparel	3.950978
	Consumer Services	2.948565
	Diversified Financials	0.666072
	Energy	0.075202
	Food Beverage and Tobacco	5.879777
	Food and Staples Retailing	7.297038
	Health Care Equipment and Services	2.305633
	Household and Personal Products	0.348737
	Materials	9.881991
	Media & Entertainment	2.398189
Pharmaceuticals biotechnology and life sci		0.528891
	Real Estate	2.004000
	Retailing	24.923146
	Software and Services	1.832937
	Technology Hardware and Equipment	0.866885
	Telecommunication Services	0.244612
	Transportation	6.339250
	Utilities	1.356935



Country	Sector 2	%
	Automobiles and Components	1.778317
	Capital Goods	14.395195
France	Commercial and professional services	13.433542
	Consumer Durables and Apparel	1.600781
	Consumer Services	3.373180
	...	...
	Software and Services	1.664607
	Technology Hardware and Equipment	0.428704
Spain	Telecommunication Services	0.266492
	Transportation	6.936505
	Utilities	1.602812

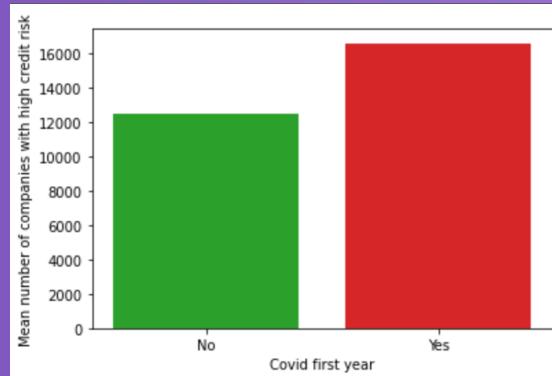
# YEARS

Is it possible that after a company gets D credit risk level in an year, the consequent one still gets a D?

```
test_df = companies_df[companies_df['MScore.'+str(year_widget.value)] == companies_df['MScore.'+str(year_widget.value+1)]]
n = test_df[test_df['MScore.'+str(year_widget.value)] == 'D'].count()[0]
```

153 companies had a D credit risk level in 2019 and the consequent year

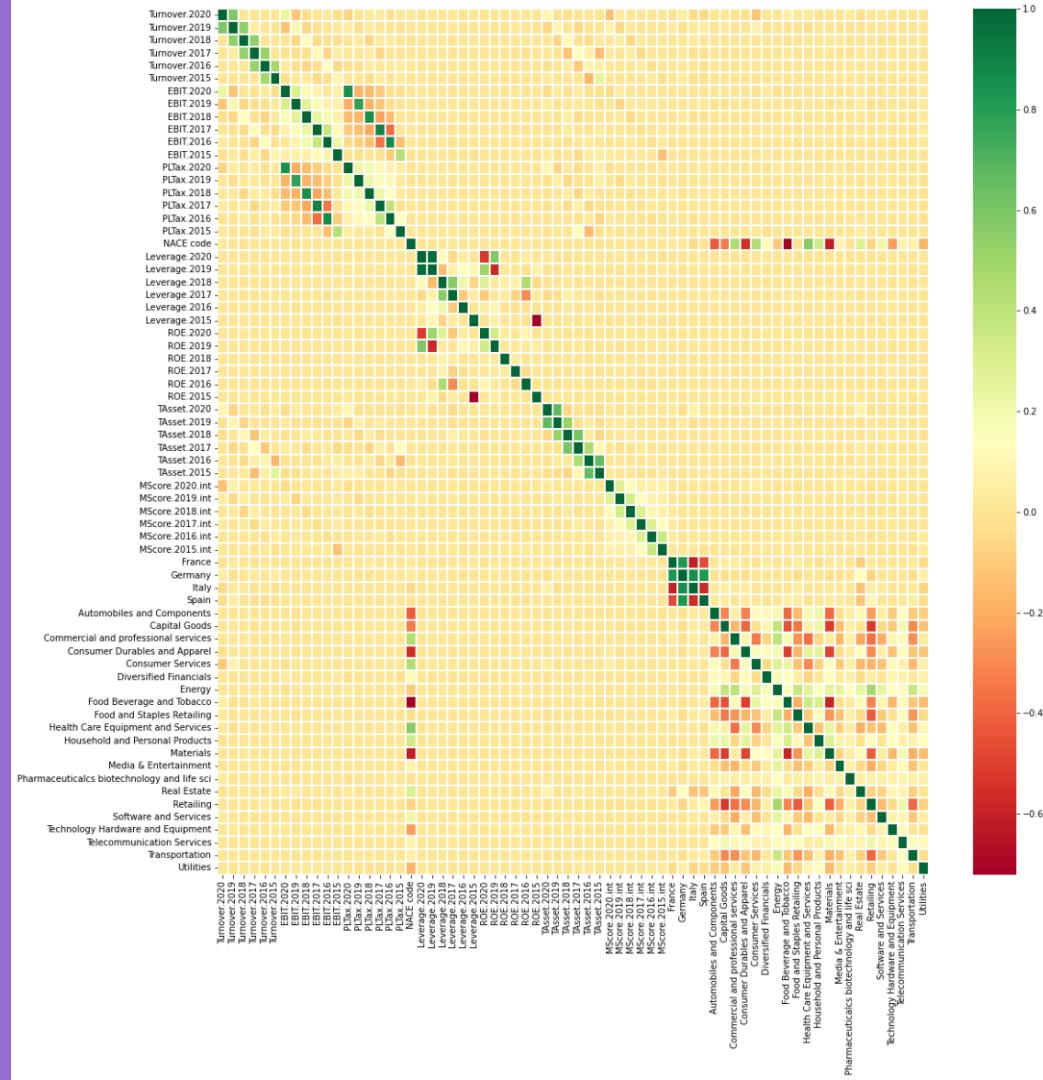
Did Covid-19 led an increase in the number of high credit risk companies?



Percentage increase in high risk level companies in 2020 (with respect to previous years): **32.6%**

Correlation is not causation!

# PARTIAL CORRELATIONS



# 04

## ML MODELS



# UNBALANCED CLASSES

Average number of low level credit risk companies: 107824

Average number of high level credit risk companies: 13184



```
# Fix the unbalanced case
high_risk_df = companies_df[companies_df['MScore.2019.int'] == 1]
low_risk_df = companies_df[companies_df['MScore.2019.int'] == 0].sample(n=len(high_risk_df), random_state=0)
restricted_df = pd.concat([low_risk_df, high_risk_df])
restricted_df.sort_index(inplace=True)
```

Beware of the year choice, because of the already mentioned Covid-19 effect  
**Objective:** predict 2019 credit risk level

# FEATURE SELECTION

Start considering a very easy model (LogReg).

Whether features are ranging not in [0, 1], MinMax scaling has been applied.

 Easiest model: credit risk level of previous year, to predict the one of next year

```
X = restricted_df[['MScore.'+str(year_widget.value) + '.int']]
y = restricted_df[['MScore.'+str(year_widget.value + 1) + '.int']]
X_train, X_test, y_train, y_test = train_test_split(X, y, random_state=0, test_size=0.2, shuffle=True)
X
```

MScore.2018.int	
0	1
4	1
7	0
11	0
16	0
...	...
120994	0
120995	1
120998	0
121003	0
121004	1

```
lr = LogisticRegression(solver='liblinear', random_state=0)
lr.fit(X_train, np.ravel(y_train))
print_performances('Logistic Regression', lr, X_train, y_train, X_test, y_test)
```

Logistic Regression  
- Train accuracy: 78.7%  
- Test accuracy: 79.3%

	Test	precision	recall	f1-score	support
	0	0.72	0.96	0.83	2467
	1	0.94	0.62	0.75	2397
	accuracy			0.79	4864
	macro avg	0.83	0.79	0.79	4864
	weighted avg	0.83	0.79	0.79	4864

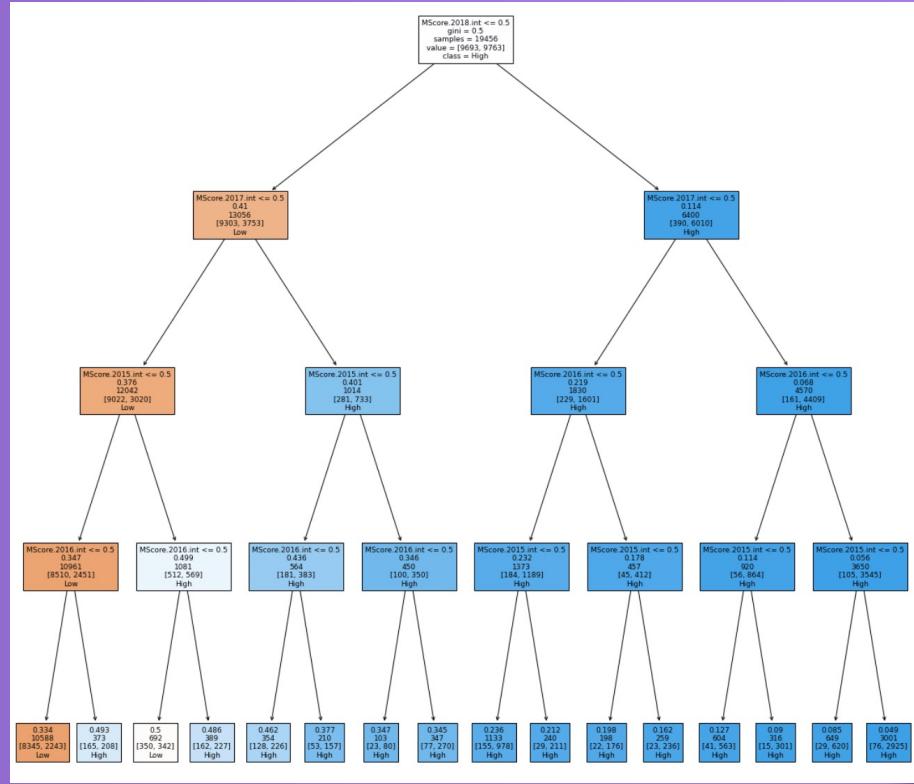
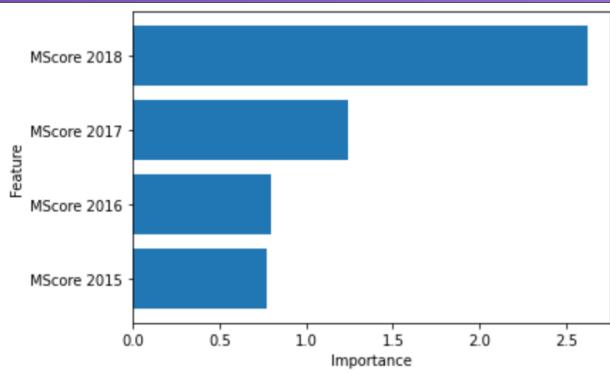
# FEATURE SELECTION

The overall obtained performances can be considered good, but what if we add other features?

 Adding other previous year data like EBIT, Leverage, Turnover, PLTax, ROE, and/or constant features (general sector, country), singularly does not significantly improve the performance metrics. Whereas, combining all of them together it changes, but not so much to justify the loss of interpretability (0.4% of test accuracy increase)

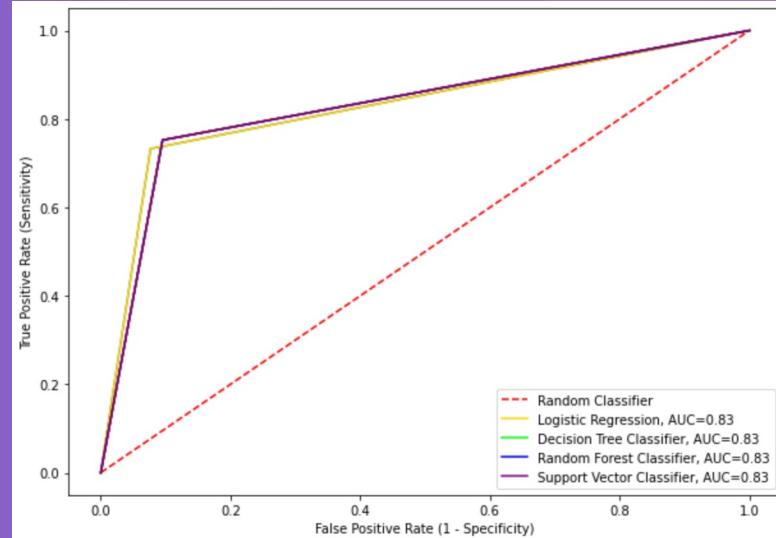
Add more than one year old data, like all past years credit risk level scores allows to improve significantly the performance metrics (4% of test accuracy increase). Instead, adding other more than one year old data (EBIT, Leverage, ROE, Turnover, ...) does not improve so much the performance metrics

# FEATURE IMPORTANCE AND DECISION TREE



# MODEL COMPARISON

What happens to performances metrics if we consider other more complex ML models?





# THANKS!

QUESTIONS?

*Author's GitHub  
profile*



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