Credit Risk Programme

Module 13

Current Trends in Commercial Banking

Learning Objectives

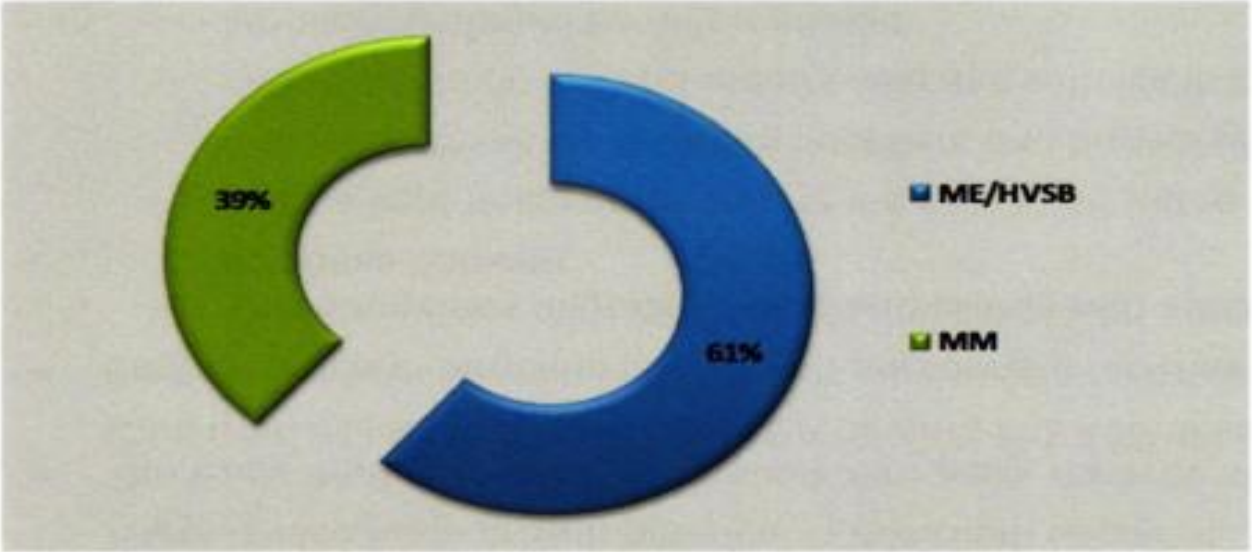
At the end of this session, you will be able to:

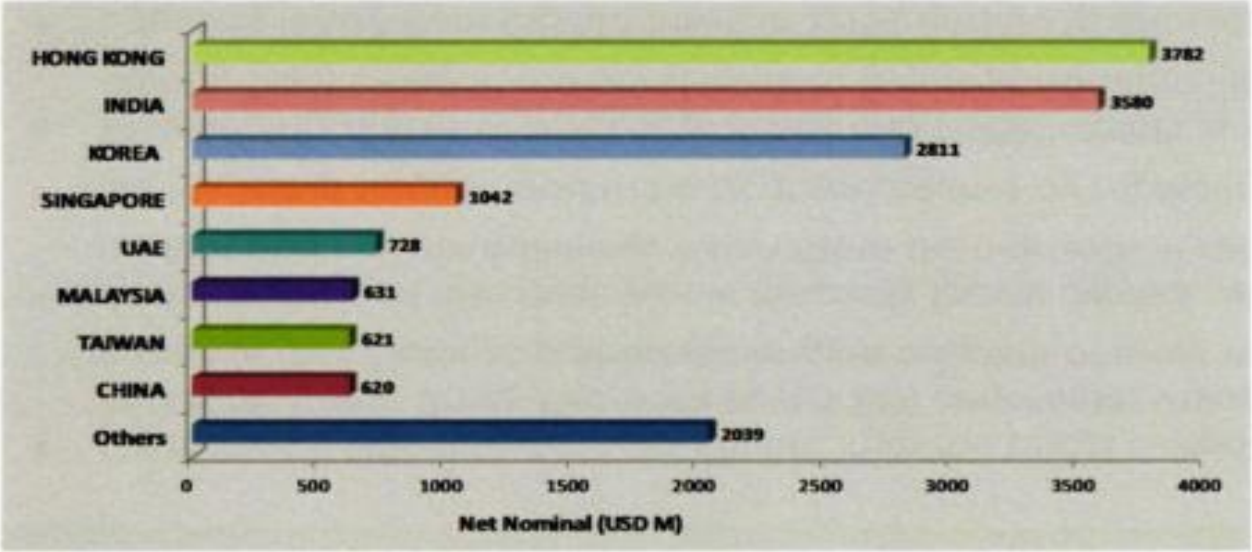
- Understand the key characteristics of the lower end of Commercial Banking (CB) clients.
- Recognize the key trends in the Middle Market (MM), Medium Enterprise (ME), and High Value Small Business (HvSB) portfolios.
- Identify the challenges in lending to clients in MM, ME, and HvSB sub segments

Key Messages

- Commercial Banking includes clients from the Local Corporate, Middle Market, Medium Enterprises (ME) and High-Value Small Businesses (HvSB) segments. Visually, they can vary from a mid sized restaurant, a mobile distributor to a strategic engine supplier of a car manufacturer.
- At the lower end, the business is normally family owned, with a weak CFO or finance personnel, unknown auditor and no real business vision other than growth in revenue and profits.
- Relationship teams need to be upgraded either by replacing RMs or through training.
- Maintaining real time contact with ME and HvSB clients is very important as the client can move very quickly from being in the good book to a non-performing loan.
- Lessons learnt from GSAM flows in 2O14 and 2015 should drive origination, approval and monitoring. There is also huge growth potential in this client segment.
- The Early Alert (EA) process, though improving, must be sharper as more than half of 2015 GSAM flows were from clients that were not in EA or were in EA for less than 3 months.
- Segmenting and targeting clients with appropriate facilities through a multi-faceted approach:
    - This comprises migrating lower end clients with smaller limits and program lending nature to business banking.
    - Offer a light touch approach for the next layer (up to USDS Mn in limits, vanilla products)
    - Focused growth by targeting suppliers and buyers of our existing CIB clients
    - Offer Clients on a stand-alone basis and with limits beyond USDS Mn a broad based relationship
    - Monitoring should be differentiated

Commercial Clients – Portfolio Metrics





Focus of this presention: MM, ME, HvSB

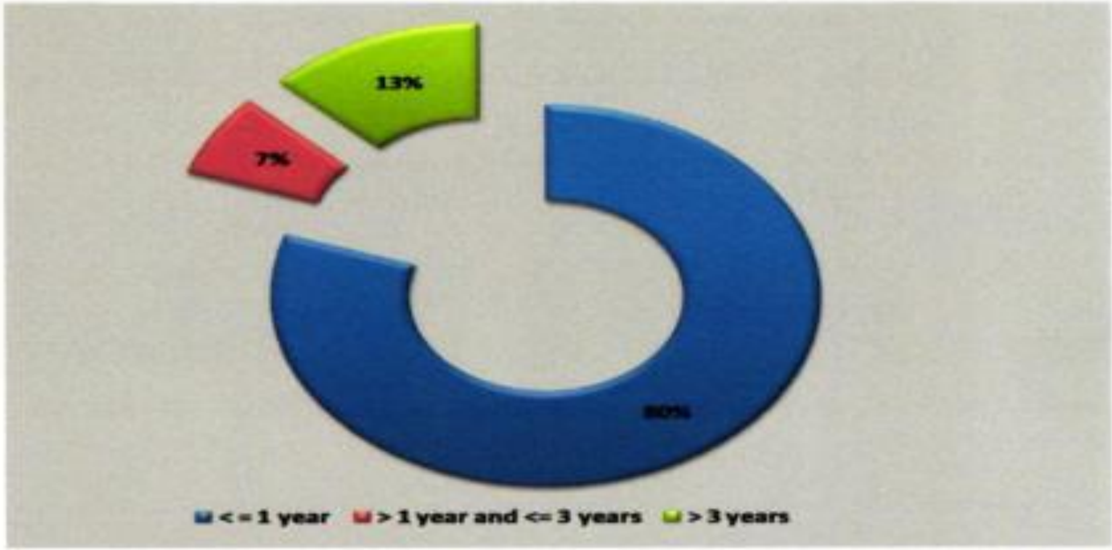
The Net Nominal of the Commercial Clients portfolio declined from USD 18 Bn in Dec. 2014 to USD 16 Bn in Dec. 2015.

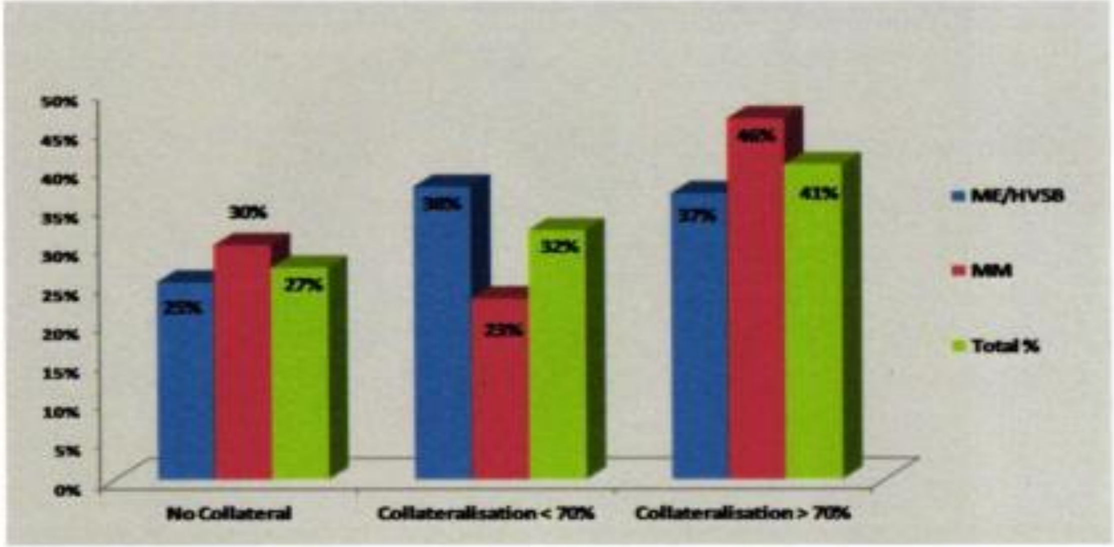
The reduction is on account of:

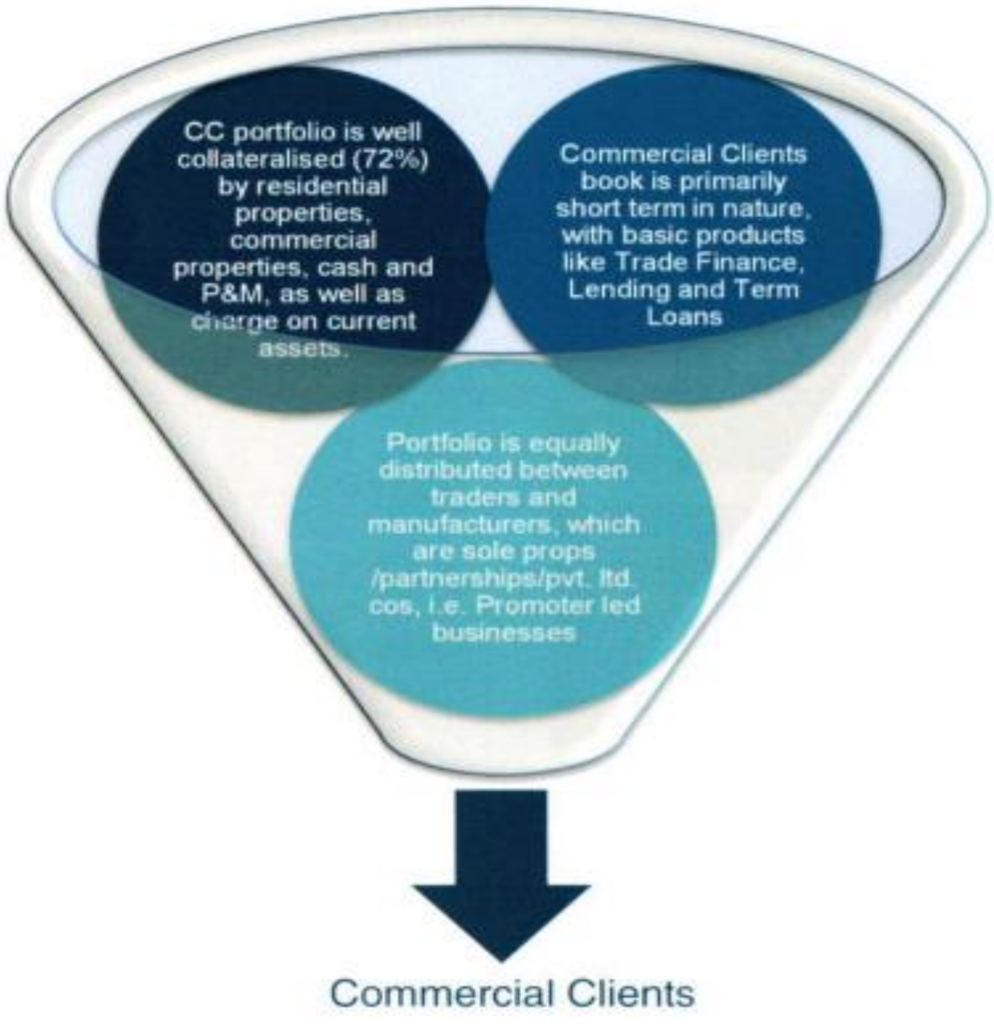
- De-risking the China portfolio
- UAE requalification exercise
- Tail end management.

The top 8 countries contribute to 87% of the portfolio.

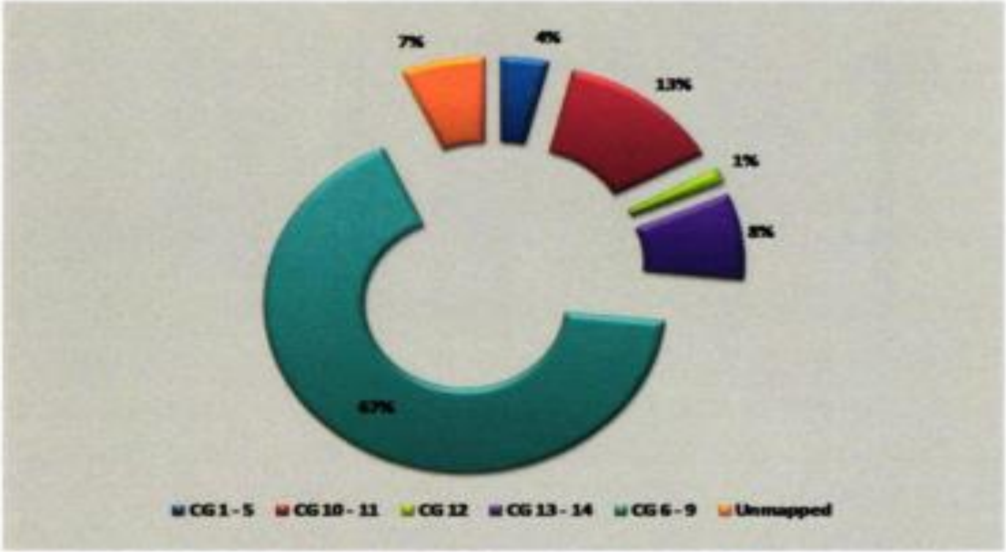
Commercial Clients - Portfolio Metrics (Contd)





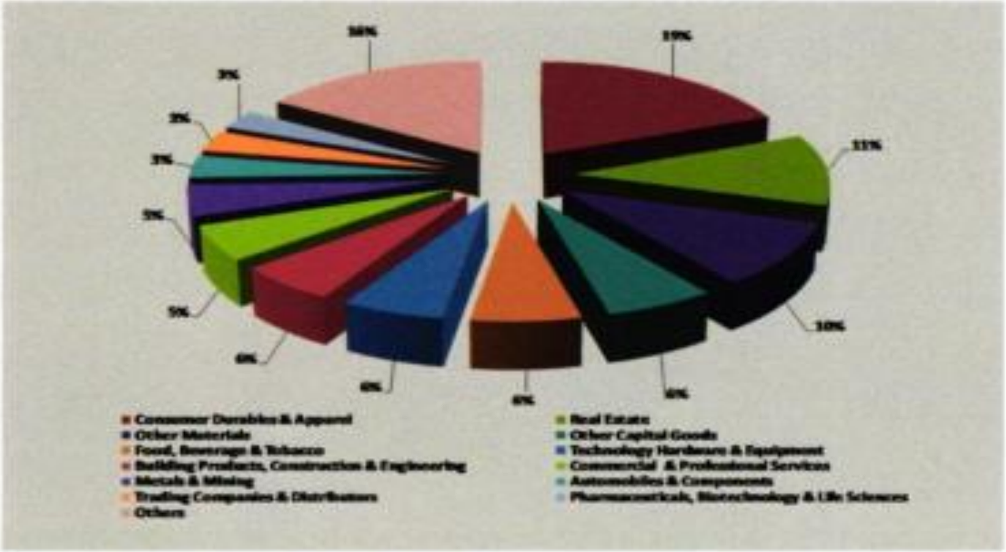


Commercial Clients - Portfolio Metrics (Contd)



Weighted Average Credit Grade (WACG)

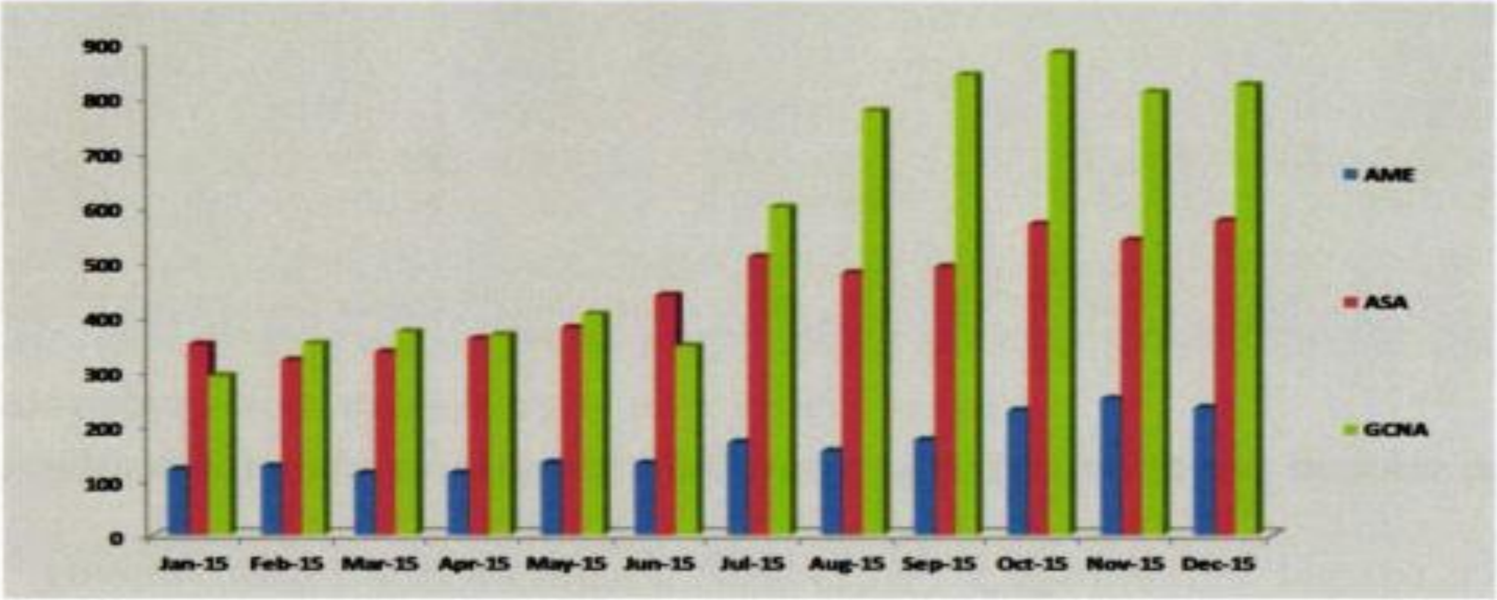
- The WACG of the portfolio is 9A and 67% portfolio is between CG 6 and CG 9.



Industry Mix

- The Commercial Clients portfolio is well diversified in terms of industries. No single industry contributes more than 20%.

Commercial Clients - Portfolio Metrics (Contd)



- The CC Early Alert (EA) book has increased over the last 12 months due to:

GSAM Metrics in Commercial Clients

- A total of 363 clients with outstandings of USD 792 M were downgraded during 2015. Q3 and Q4 were
- particularly worse.
- These accounts resulted in an impairment provision of USD 232M.
- Out of these downgrades, 183 clients were either not in EA (36), or were in EA for less than 1 month (68) or less than 3 months (79). These quick mortality accounts had outstandings of USD 375 M at the time of downgrade to GSAM.
- The following countries had significant provisions coming from 2015 downgrades:
  - Nigeria (92"h),Taiwan (88%), Kenya (85%), UAE (77%), China (64%), HK (51%) and Singapore (45"/")
- India did not have significant issues in new downgrades in 2015 due to the actions taken in prior years.
- Overall, the Commercial Clients GSAM book is at USD 1.4 Bn.

CASE STUDY

Case Study
Section 1: Background

Introduction

Prosper land is an Asian country with large population and significant growth potential.

Ambition Group (the Group) is a major automobile dealer and is one of Daimler-Benz's top three dealerships in the Country

The Group operates three entities related to the Daimler-Benz dealership:

(i) Ambition Auto Ltd. (AAL), a car dealership

(ii) Ambition Commercial Vehicles Ltd. (ACVL), a truck dealership; and

(iii) Ambition Motor Ltd (AML), a Daimler-Benz servicing and maintenance company and supplier components and spare parts

AAL & AML were established in 1993 and held by Macau based Ambition Holdings Ltd (HoldCo) which was owned by Ms X, who was not a resident of Prosper Land. ACVL was established in 2003 and held by Hong Kong based Ambition Industries Ltd. (Intermediate Holdco) which was also owned by Ms X and family. [Refer to Group Structure in Exhibit (1) below]

SCB's relationship with the Group started in 2008. SCB offered facilities to AAL (with AML as co-borrower) and ACVL. Exposures managed under CB were USD 3.00 Mn in AAL / AML and USD 5.75 Mn in ACVL in July 2015.

Whilst SCB was the sole bank lor ACVL, five local banks offered combined facilities of USD 28 Mn in total to AAL and AML. All facilities to the three entities were additionally secured by cross guarantees in favour of the lendors, in addition to the HoldCo and Intermediate HoldCo (the HoldCos) corporate guarantees. Note that both HoldCos were located outside Prosper Land. SCB'S security position was inferior to that of the local banks.

The SCB facilities granted to the Group Companies were largely in the form of Import Invoice Financing (IIF) followed by Short Term (ST) Loans.

Case Study
Section 1: Background

Account performance in SCB was satisfactory until Q1 of 2015

Facility Summary

	Counterparty	Total Limits	EL
Facilities I	Borrower: AVCL Guarantor: AAL, AML, Intermediate HoldCo	USD 5.8 Mn	(USD 196K)
Facilities 2	Borrower: AAL Co-Borrower: AML Guarantor: AVCL, HoldCo	USD 3 Mn	(USD 49K)
	Total	USD 8.8 M	(USD 245K)

Corporate Structure

The Group was closely held by Ms. X, who was not a resident of Prosper Land. The Holdco and Intermediate Holdco were also

registered outside Prosper Land.

In 2013, the Group acquired a trading company whose activities were unrelated to the Group's primary business activities for

USD 4 M, the details of which were not revealed at the time.:

Case Study
Section 2: Financial Summary

Key Financial Metrics for AVCL

Values in USD MN unless stated otherwise

Date	31/12/2011 Audited	31/12/2012 Audited	31/12/2013 Audited	31/12/2014 Proforma
Total Sales	17.7	19.3	41.1	45.2
Gross Profit Margin (%)	24.50%	23.20%	14.70%	18%
NPBT	0.7	1.3	2.6	3.6
NPAT (%)	3.90%	4.90%	4.80%	6.00%
NCAO	-0.3	1.0	-3.8	1.3
CADA	-0.5	1.0	-3.8	1.3
Total Debt	1.6	0.9	5.7	5.5
Net Worth	5.2	6.2	8.1	10.8
Gearing (X)	0.30x	0.14x	0.70x	0.54x
Leverage (X)	0.57x	0.42x	0.49x	0.49X
Activity Ratios	2011	2102	2013	2014/07
SDOH	178	132	72	112
DDOH	21	21	26	66
CDOH	49	7	7	54
NWCC	150	146	91	124

Case Study
Section 2: Financial Summary

In 2013, AVCL sales increased by more than 100%. This was attributed to an expansion of sales activities and channels across West and South China. In addition, the Company benefited from a robust replacement market for 10 year old trucks in 201 3.

NCAO and CADA were negative due to increase in the NWCC.

AVCLs business model was unique in nature. In addition to securing Bank Finance, AVCL also availed credit lines from Daimler. AVCL used SCB's IIF to Finance its truck purchases from Daimler-Benz. Subsequently, AVCL sold the trucks to individual endnbuyers against auto financing arranged by Daimler-Benz. The financier would then settle SCB's IIF for the release of the truck certificates. The tenor of the IIF facility ranged between 135 to 180 days.

In January 2015, two of AVCL'S local banks recalled their facilities to AVCL on the grounds that the banks wanted to exit the

auto-financing industry given the downturn in the economy. This resulted in overdues with SCB and other banks. However, AVCL was confident the lost lines of credit would be replaced by its remaining local bank relationships.

However, Daimler-Benz was concerned with AVCL's overall liquidity position

Case Study
Section 2: Financial Summary

Key Financial Metrics for AAL

Values in USD MN unless stated otherwise

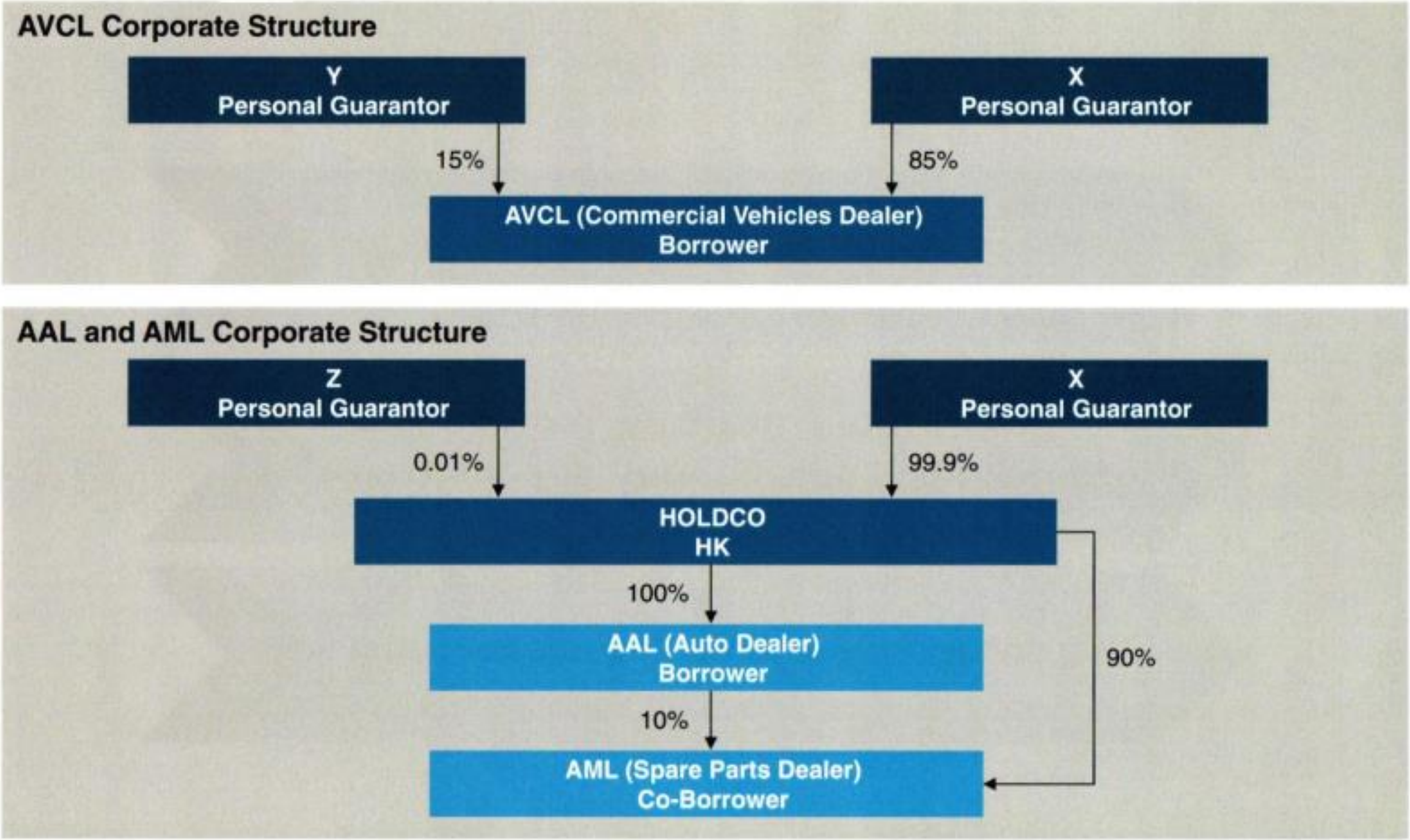
Date	31/12/2011 Audited	31/12/2012 Audited	31/12/2013 Audited	31/12/2014 Proforma
Total Sales	283.1	262.2	82.4	107.1
Gross Profit Margin (%)	4.80%	5.20%	12.30%	8.00%
NPBT	2.1	1.7	1.1	1.6
NPAT	1.6	1.3	0.8	1.2
NCAO	6.7	-17.1	28.1	1.4
CADA	5.4	-18.9	26.7	0.7
Total Debt	21.5	46.5	29.2	32.8
Net Worth	22.0	23.3	25.0	26.2
Gearing (X)	0.98x	2.0x	1.17x	1.25x
Gearing, Adjusted (X)	0.75x	1.74x	0.76x	0.85x
Leverage (X)	0.62x	0.71x	0.59x	0.60x

In 2013, AAL sales decreased drastically due to a shift f rom a volume based sales strategy in 201 1 and 20121o a margin based sales strategy in 2013

Case Study
Section 3: Discussion Points

- What are the key risks in this Group?
- What are the warning signs that you can pick up from the given information?
- What do you think went wrong?

Case Study
Exhibit 1: Group Structure

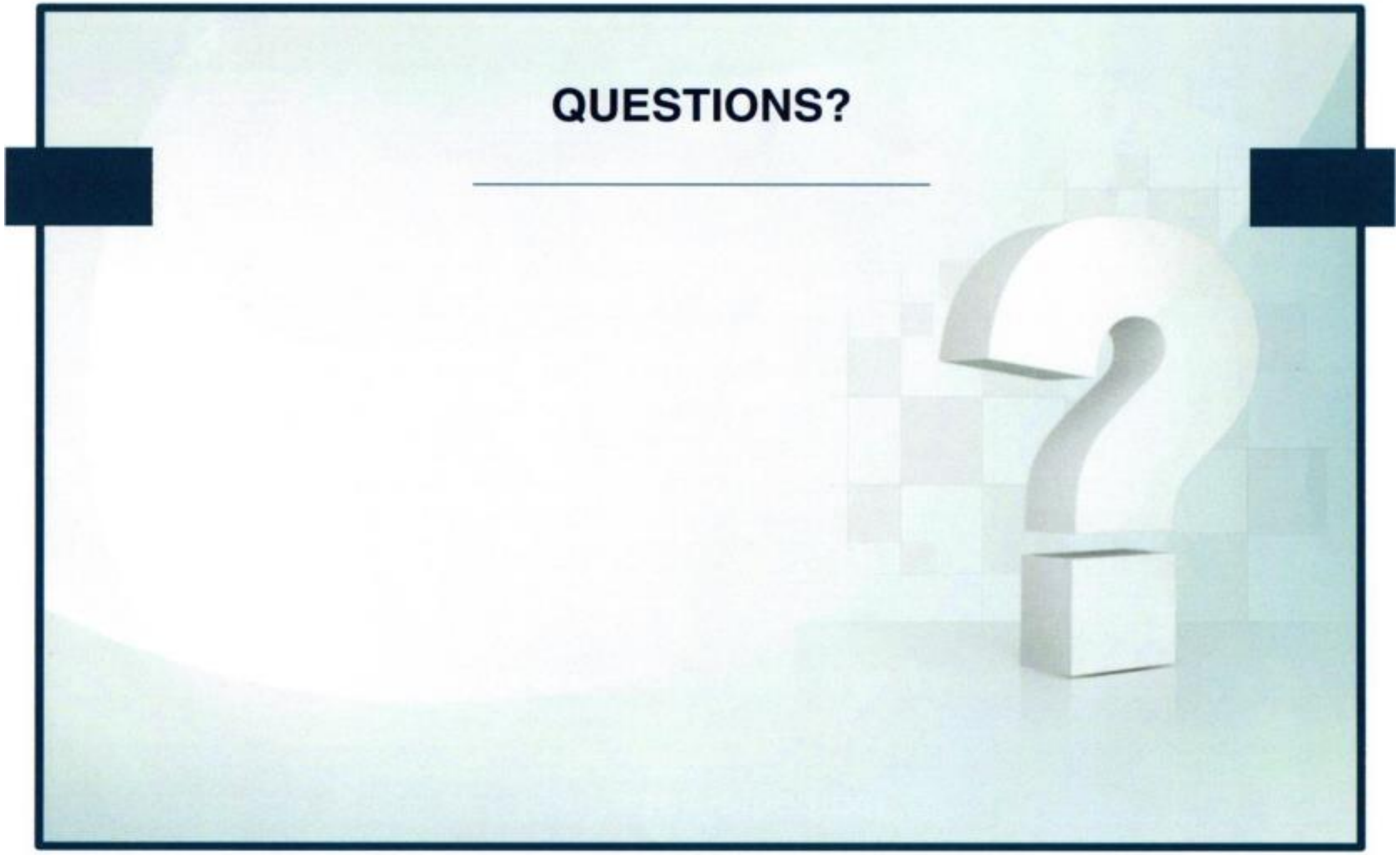


Module summary

Let’s revisit some of the important points of this module:

- Borrowers with very thin capital base vis-à-vis company size and extent of bank funding.
- Weak financial analysis.
- Inappropriate facility structure.
- Numerous deviations allowed in trade transactions.
- Collateral perfection not done in a timely manner, partly due to local market constraints.
- Funded limits more than net working capital gap.
- Client specific risks not addressed in few cases.
- Risks associated with government counterparties not assessed at origination.
- Independent verification on buyers, suppliers, bankers, and/or competitors was not done or was insufficient.
- Facilities offered to businesses with low experience.
- Incremental exposures were allowed too quickly too soon

Questions



Notes