Risk Grading System

Operating Margins/Cash Flow

DSC = debt service coverage calculations are based on 12 months historical financial information or projections that include our loan using Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) and 12 months of full loan payments

Points

1. Highly profitable firm, repayment ability is unquestioned. Historical cash flow indicates no difficulty in servicing debts. Substantial margins exist to cover any contingencies. DSC is 2x or better for previous 2 years. Must have at least 3 years of operating history.
2. Profitable firm with a track record of servicing debt. Historical statements indicate that the firm will have little difficulty generating sufficient cash flows to service all debts, including the new loan, and have margins sufficient to cover contingencies. DSC is 1.6x to 1.9x based on historical cash flows. Must have at least 2 years of operating history.
3. Financials should clearly demonstrate profitability and ability to service all senior debt including SED/DCLF. Previous year's results indicate firm can generate sufficient cash flow, with "thin" margins for contingencies. DSC is 1.2x to 1.5x on either a historical or pro-forma basis. Must have at least 1 year of operating history.
4. Improvement in financial performance is needed to improve debt service. Historic DSC only slightly higher than 1.0x. There is little to no margin for contingencies. Start-up, acquisitions, or expansion loans with little or no actual recorded financial history on the project.
5. Borrower generally makes payments on time, but may need concessions from time to time. DSC is less than 1. All restructured loans will be graded as a minimum of a 5.
6. The likelihood that the loan will be paid from the primary source of repayment is uncertain. Cash flow covers interest, but not principal. Loan has been restructured.
7. Borrower is unable to make loan payments. Primary source of repayment is gone.

Balance Sheet

Points

1. Firm has strong financial ratios; low debt to worth, above average working capital, substantial net worth. Strong overall balance sheet with strength coming from annual capital injections from retained earnings. Accounts payable are current.
2. Strong balance sheet with better than average debt to worth ratio, satisfactory working capital, significant net worth, and current in accounts payable. Probability of serious financial deterioration is unlikely.
3. The firm has an average debt to worth ratio, adequate working capital, and acceptable net worth, and is not significantly slow in paying accounts payable. There is a sound source of secondary repayment to support the loan.
4. Higher than average debt to worth ratio, little working capital, and is somewhat slow in paying accounts receivable. Occasionally has an unexpected need for working capital.
5. The firm has a high debt to worth ratio, negative working capital, little to no net worth, and may be quite slow in paying accounts payable.
6. Financial deterioration is under way and very close attention is warranted to ensure the loan is collected without loss. Loan is inadequately protected by the current net worth and paying capacity of the obligor.
7. Debt to worth ratio is high. Negative working capital. No net worth. Slow in paying accounts payable.

Management/ Credit History

Points

1. Unquestionable character. 5+ years experience in the same industry. Excellent track record, financial performance and budgeting ability. The firm is well led, recognizes the value of a quality workforce and provides employee training, benefits and performance incentives.
2. Proven experience in the same business, who has management experience and a good track record. The business must produce adequate financial statements on a timely basis. The CEO operates under a financial plan and budget and demonstrates an ability to manage the firm's working capital and term financing. The firm has good management depth and no obvious organizational shortcomings.
3. Firm is under the control of a CEO who has the ability to manage firms of this type. Adequate management depth and no organizational shortcomings.
4. Firm is under the control of a CEO whose ability to manage firms of this type is unproven. Management depth is questionable and could lead to overall organizational shortcomings.
5. The firm is under the control of a CEO who doesn't appear to have adequate knowledge or resources to help the company become more profitable. Serious organizational shortcomings are probable.
6. Management is inadequate, lacks depth, and there are serious organizational shortcomings.
7. CEO has lost control.

Collateral/Secondary Source of Repayment

Points

1. Strong collateral in the form of CD's, stocks, bonds, cash equivalents, real estate, or equipment. Discounted value greater than 125% of loan amount.
2. Possess a sound secondary repayment source. Collateral and guarantor(s) are very strong to pay the loan. CCR is 2:1 or higher; LTV is 50% or lower.
3. Collateral and guarantor position are undoubtedly sufficient to pay the loan. CCR 1.3:1 or higher; LTV is 75% or lower.
4. Collateral and guarantors are perceived as adequate to pay the loan. CCR is 1:1 or higher; LTV is 100% or lower.
5. Guarantors will likely be required to repay the loan. CCR less than 1; LTV greater than 100%.
6. A write off of some amount, probably less than 50% of the credit, is likely.
7. A write off of an amount of the credit in excess of 50% of the loan amount is likely the SED/DCLF is simply holding off on charge-off.

Industry, Market, Competitive Advantage

Points

1. Business is operating in an environment that is enjoying good economic times. The industry competitive, most firms operating in this industry making good profits and profits would not be significantly impacted by recession.
2. This business is part of a profitable industry that is enjoying good economic health. It is not a cyclical industry and would not be significantly impacted by national or local negative economic trends.
3. This firm is part of a reasonably profitable industry that is presently enjoying good economic health, but is cyclical and would be impacted by national or local negative economic trends. This is a competitive industry and only the better-managed firms will get through downturns without suffering significantly.
4. This is a tough business in which to make a profit. It may be a fiercely competitive business, one presently experiencing an economic recession, or a cyclical business in which company profits would be significantly impacted by national or local negative economic trends. Only the better-managed firms will survive in this industry.

5. Business has seen a downturn due to commodity prices, rate sensitivity, and has been significantly impacted by national or local negative economic trends.
6. There have been significant deterioration in market conditions and the borrower is highly vulnerable to these conditions.
7. Significant deterioration in markets has manifested itself in severe weakness in the borrower.

Financial Statements and Accounting Systems

Points

1. Reviewed or audited statements from a Certified Public Accountant (CPA).
2. Reviewed or compiled statements.
3. Company produces regular and adequate internal financial statements, including a budget.
4. Company does not always produce timely or fully reliable financials. Does not work off of a budget.
5. Company does not produce timely or reliable financials statements. Does not work off a budget.
6. Business does not produce financial statements.
7. Business has not produced valuable financials in quite some time. Creditor has very little idea of actual company financial position.

Scoring

1. Operating Margins and Cash Flow (1-7) _______
2. Balance Sheet (1-7) _______
3. Management History and Personal Credit History (1-7) _______
4. Collateral and Secondary Source of Repayment (1-7) _______
5. Industry and Market and Competitive Advantage (1-7) _______
6. Financial Statements and Accounting Systems (1-7) _______

Combined Numerical Rating _______

Letter Rating _______

Key:

> 7 = A or 1
8-14 = B or 2
15-21 = C or 3
22-28 = D or 4
29-35 = E or 5
36-42 = F or 6
43-48 = G or 7