BANKING JUDGMENT LAB · THE IN-TRAY · THE GROUNDWORK · WORKSHEET

The Borrower

Ten files on reading a business: earnings, cash, the balance sheet, the business, assurance.

Ten one-minute files. Each gives a short setup, a few numbers and four possible calls. Make the call on paper; the reads are on the last pages — each names the senior banker's call and shows the working, with no score. Most files have more than one defensible call; the read says how far each sits from the senior's.

Free to reuse under CC BY 4.0 — copy a file into your notes, a tutorial or a slide, with a link back to https://www.bankingjudgmentlab.com/in-tray/groundwork. Every business on these pages is a composite built for teaching, not a client. Money is in US dollars. The files, with the same reads read in place, and 114 more like them, are at https://www.bankingjudgmentlab.com/in-tray/groundwork.

THE FILES

FILE 1 OF 10 · THE BORROWER · CASH

A wholesaler asks to size its working capital line.

DEBTOR DAYS	STOCK DAYS	CREDITOR DAYS	SALES A DAY
55	70	40	US$100k

What is its cash conversion cycle?

[A] 125 days, before counting what suppliers fund.

[B] 165 days.

[C] 15 days.

[D] 85 days.

FILE 2 OF 10 · THE BORROWER · EARNINGS

A distributor's EBITDA rose from US$4.0m to US$5.1m. The CFO's bridge adds back US$0.9m of 'one-off' restructuring costs. There have been restructuring costs in each of the last three years.

What do you ask first?

[A] What drove the underlying revenue.

[B] Nothing. EBITDA is up more than a quarter.

[C] Whether a cost that comes every year is really one-off.

[D] Whether the auditor signed off the add-backs.

FILE 3 OF 10 · THE BORROWER · CASH

A distributor's year, in four numbers:

OPERATING CASH FLOW	MAINTENANCE CAPEX	GROWTH CAPEX	DIVIDENDS
US$4.0m	US$1.5m	US$2.0m	US$1.0m

How much cash does it generate after keeping its assets in shape, before growth and dividends?

[A] US$2.5m.

[B] US$1.5m, after dividends as well.

[C] Minus US$0.5m, after everything.

[D] US$4.0m.

FILE 4 OF 10 · THE BORROWER · BALANCE SHEET

A retailer adopts a new lease standard. Its balance sheet now shows US$40m of lease liabilities that used to sit only in the notes, and its debt to EBITDA moves from 1.5 to 3.8 times overnight.

What changed in the business?

[A] Its covenants may need restating on the new basis.

[B] Its risk more than doubled with its leverage.

[C] Nothing, so the leases can be ignored.

[D] Nothing. The rent was always owed; now it is on the balance sheet.

FILE 5 OF 10 · THE BORROWER · CASH

A supplier offers its customers 2% off for paying in 10 days instead of 40.

Roughly what annual rate is the supplier paying to be paid early?

[A] 2%.

[B] About 8% a year.

[C] About 25% a year.

[D] Nothing. It's just a discount.

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FILE 6 OF 10 · THE BORROWER · BUSINESS

A bakery sells 150,000 units a year at an average of US$10 each. Variable costs are US$6 a unit and fixed costs US$400k a year.

How far can its sales fall before it makes a loss?

[A] By 50,000 units, if prices hold.

[B] About a third: it breaks even at 100,000 units.

[C] By 60%: its costs are 60% of the price.

[D] They can't. It is profitable at this volume.

FILE 7 OF 10 · THE BORROWER · ASSURANCE

Three borrowers send accounts. One set is audited, one was reviewed by an accountant, and one was compiled from the owner's records.

What does each tell you about how far the numbers were checked?

[A] The audited set is the most reliable; the others need more questions.

[B] Audited: tested. Reviewed: checked for plausibility. Compiled: assembled, not checked.

[C] That the audited set is free of errors.

[D] Nothing. All three were prepared by accountants.

FILE 8 OF 10 · THE BORROWER · EARNINGS

A distributor's reported EBITDA is US$5.1m. The CFO's bridge adds back three items.

REPORTED EBITDA	RESTRUCTURING	LEGAL SETTLEMENT
US$5.1m	US$0.9m · third year running	US$0.3m · first in ten years

OWNER'S PAY ABOVE MARKET
US$0.2m

What EBITDA do you lend against?

[A] US$6.5m — every add-back.

[B] US$5.4m — the settlement only.

[C] US$5.1m — none of them.

[D] US$6.3m — the restructuring and the settlement.

FILE 9 OF 10 · THE BORROWER · BALANCE SHEET

A retailer's accounts keep its store leases off the balance sheet. Its banker restates them as if the leases were capitalised.

NET DEBT, AS REPORTED	EBITDA, AS REPORTED	LEASE LIABILITY IF CAPITALISED
US$6m	US$4m	US$15m

ANNUAL RENT INSIDE OPERATING COSTS
US$3m

What is net debt to EBITDA with the leases on the balance sheet?

[A] 1.5 times. Leases are not debt.

[B] 3.0 times.

[C] 5.3 times, with the leases added to debt.

[D] 1.5 times on the accounts, with the rent read as a fixed charge.

FILE 10 OF 10 · THE BORROWER · BUSINESS

A craft brewery sells through three channels: its own taproom, paid at the till; supermarkets, on 60-day terms and listing fees; and export distributors, on 90 days in their currency. Revenue is US$12m, up a quarter, and all of the growth is in supermarkets.

What do you ask first?

[A] What the gross margin is by channel, after the listing fees.

[B] Whether the taproom can be expanded.

[C] What the overall margin is.

[D] Whether the brand is strong.

THE READS

FILE 1 · THE BORROWER · CASH

The senior read: D. 85 days.

Debtor days plus stock days, less the days suppliers wait: 55 + 70 – 40 = 85. At about US$100k of sales a day, roughly US$8.5m is tied up before the business is paid. This is the cash conversion cycle.

FILE 2 · THE BORROWER · EARNINGS

The senior read: C. Whether a cost that comes every year is really one-off.

A cost that appears three years running is part of running the business, whatever it is called. Adjusted EBITDA is management's own number, outside the audit. Read it with the add-back taken out until a year arrives without one. This is the quality of adjusted earnings.

FILE 3 · THE BORROWER · CASH

The senior read: A. US$2.5m.

Maintenance spending keeps the business able to earn; growth spending and dividends are choices it can put off. US$4.0m less US$1.5m leaves US$2.5m that can carry debt. This is free cash flow, split between what must be spent and what may be.

FILE 4 · THE BORROWER · BALANCE SHEET

The senior read: D. Nothing. The rent was always owed; now it is on the balance sheet.

The standard moved an existing obligation onto the balance sheet; the shops cost the same to rent. What matters is that rent ranks like debt in a downturn, and that covenants are measured on one consistent basis. This is lease capitalisation.

FILE 5 · THE BORROWER · CASH

The senior read: C. About 25% a year.

Giving up 2% to be paid 30 days sooner is borrowing for 30 days at about 2%, which over a year comes to roughly 25%. Few overdrafts cost that much. This is the cost of an early settlement discount.

FILE 6 · THE BORROWER · BUSINESS

The senior read: B. About a third: it breaks even at 100,000 units.

Each unit leaves US$4 towards fixed costs, so US$400k of fixed costs needs 100,000 units. Selling 150,000, the bakery can lose a third of its volume before it loses money. This is contribution, break-even and the margin of safety.

FILE 7 · THE BORROWER · ASSURANCE

The senior read: B. Audited: tested. Reviewed: checked for plausibility. Compiled: assembled, not checked.

An audit gives reasonable assurance against material misstatement; a review gives limited assurance from enquiry and analysis; a compilation gives none. Pages that look alike carry very different weight. This is the level of assurance behind a set of accounts.

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FILE 8 · THE BORROWER · EARNINGS

The senior read: B. US$5.4m — the settlement only.

A cost that has come three years running is a cost of running the business, whatever it is called, so the restructuring stays in. A settlement with no precedent can come out, with the papers. The owner's pay is what the job costs. US$5.1m plus US$0.3m is US$5.4m. This is adjusted EBITDA.

FILE 9 · THE BORROWER · BALANCE SHEET

The senior read: B. 3.0 times.

Capitalising a lease changes both sides: the US$15m liability joins net debt, US$21m, and the US$3m rent comes out of operating costs and back into EBITDA, US$7m. Twenty-one over seven is 3.0 times, double the reported figure. Adding the liability without the rent gives 5.3, a different mistake. This is lease-adjusted leverage.

FILE 10 · THE BORROWER · BUSINESS

The senior read: A. What the gross margin is by channel, after the listing fees.

A business is read channel by channel: who pays, when, and what it costs to reach them. Growth that is all in the channel with the longest terms and the biggest fees can leave a bigger business poorer. The first question is where the margin is made, not how much there is. This is how a business makes money.

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