

## Paul Robbins training and consultancy

### Credit Management

#### Credit Scoring

#### Worked Example

You have been provided with a summary from the Financial Statements for the last two years of Golf Equipment Ltd, a new customer requesting trade credit.

	Year 1 (£000)	Year 2 (£000)
<b>Sales Revenue</b>	749	798
<b>Cost of Sales</b>	326	352
<b>Current Assets</b>	470	481
<b>Current Liabilities</b>	197	213
<b>Inventory</b>	56	71
<b>Trade Receivables</b>	104	116
<b>Trade Payables</b>	85	92
<b>Profit from Operations</b>	128	129
<b>Interest Paid</b>	21	25
<b>Net Profit</b>	107	104
<b>Long Term Debt</b>	55	80
<b>Equity</b>	350	400

Note that Current Liabilities includes short-term debt and trade payables only.

#### Tasks

1. You should calculate the performance indicator ratios shown in the table below for Year 1 and Year 2, expressing your answers to two decimal places.
2. You should then complete the credit scoring for each ratio, using the scoring criteria provided, in the table below for Year 1 and Year 2.
3. You should then calculate the Total Credit Rating in the table below for Year 1 and Year 2.
4. In the box provided below, state the level of risk for Year 1 and Year 2 and advise whether we should grant trade credit to Golf Equipment Ltd.

	<b>Indicator Year 2</b>	<b>Rating Year 2</b>	<b>Indicator Year 1</b>	<b>Rating Year 1</b>
<b>Operating Profit Margin %</b>				
<b>Interest Cover</b>				
<b>Current Ratio</b>				
<b>Gearing %</b>				
<b>Total Credit Rating</b>				

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<b>Credit Rating (Scoring) System</b>	<b>Score</b>
<b>Operating Profit Margin</b>	
<b>Losses</b>	<b>-5</b>
<b>Less than 5%</b>	<b>0</b>
<b>5% and above but less than 10%</b>	<b>5</b>
<b>10% and above but less than 20%</b>	<b>10</b>
<b>20% and above</b>	<b>20</b>
<b>Interest Cover</b>	
<b>No cover</b>	<b>-30</b>
<b>Less than 1</b>	<b>-20</b>
<b>More than 1 but less than 2</b>	<b>-10</b>
<b>More than 2 but less than 4</b>	<b>0</b>
<b>4 and above</b>	<b>10</b>
<b>Current Ratio</b>	
<b>Less than 1</b>	<b>-20</b>
<b>Between 1 and 1.25</b>	<b>-10</b>
<b>Between 1.26 and 1.5</b>	<b>0</b>
<b>Above 1.5</b>	<b>10</b>
<b>Gearing (total debt / (total debt plus equity))</b>	
<b>Less than 25%</b>	<b>20</b>
<b>25% and above but less than 50%</b>	<b>10</b>
<b>More than 50% but less than 65%</b>	<b>0</b>
<b>Between 65% and 75%</b>	<b>-20</b>
<b>Between 76% and 80%</b>	<b>-40</b>
<b>Above 80%</b>	<b>-100</b>
<b>Risk</b>	<b>Aggregate Score</b>
<b>Very low risk</b>	<b>Between 60 and 21</b>
<b>Low risk</b>	<b>Between 20 and 1</b>
<b>Medium risk</b>	<b>Between 0 and -24</b>
<b>High risk</b>	<b>Between -25 and -50</b>
<b>Very high risk</b>	<b>Above -50</b>