

Paul Robbins training and consultancy

Credit Management

Credit Scoring

Exercise 1

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

	Year 1 (£000)	Year 2 (£000)
<i>Sales Revenue</i>	<i>654</i>	<i>703</i>
<i>Cost of Sales</i>	<i>479</i>	<i>515</i>
<i>Current Assets</i>	<i>368</i>	<i>377</i>
<i>Current Liabilities</i>	<i>312</i>	<i>325</i>
<i>Inventory</i>	<i>127</i>	<i>141</i>
<i>Trade Receivables</i>	<i>133</i>	<i>152</i>
<i>Trade Payables</i>	<i>164</i>	<i>159</i>
<i>Profit from Operations</i>	<i>47</i>	<i>50</i>
<i>Interest Paid</i>	<i>24</i>	<i>24</i>
<i>Net Profit</i>	<i>23</i>	<i>26</i>
<i>Long Term Debt</i>	<i>100</i>	<i>100</i>
<i>Equity</i>	<i>230</i>	<i>230</i>

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 Tennis Supplies Ltd.*

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

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