



Building Success. Together.

ABA Commercial Lending Schools

Deep Dive into C&I Lending

Michael Wear, CRC

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3 Steps to Risk Management

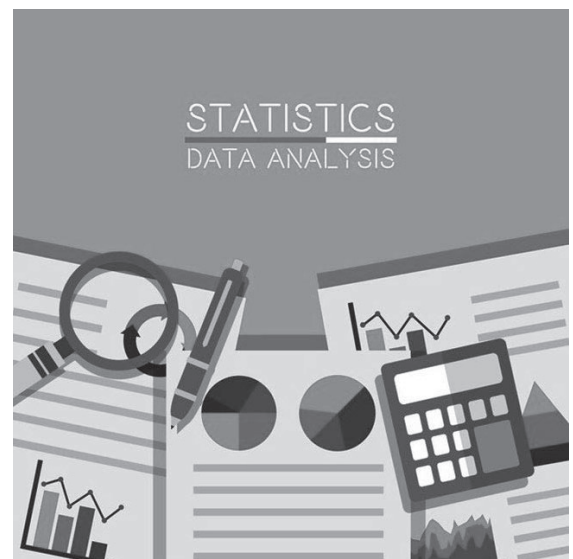
RISK IDENTIFICATION

RISK QUANTIFICATION

RISK MITIGATION

Typical Credit Risk Indicators: Leading or Lagging?

- Failure to Submit Timely Financials
- Loan Covenant Default
- Overdraft Report
- Past Due Report
- Risk Rating
- Problem Loan Report
- Annual Review
- Loan Review (internal)
- Loan Review (external)
- Regulatory Exam



EARLY Warning Signs

- Decreased Liquidity
 - Lower Deposit Balances
 - Increased Reliance on Debt (CC, RLOC)
 - “Riding the Trade” (A/P)
- Cut Expenses
 - Owner Salary/Distribution, Reduced Repairs & Ma
 - Cut Capital Expenditures
 - Layoffs
- Financial Management Problems
 - Higher-cost Creditors
 - Loan Covenant Defaults



NOT SO EARLY Warning Signs

- Employee Management Problems
 - Overwhelmed / Infighting
 - Key Employee Turnover
 - Board Resignations
- Operating Management Problems
 - Sale of Assets
 - Sale of Revenue Sources
 - Vendor Cram-downs
 - Decline in Quality, Loss of Customers
- Cash Crisis
 - Overdrafts, Past-due, Payroll Tax Delinquency, Vendor Collections, Lawsuits



Human Influences on the Numbers

5 6 C's of Credit

Character
Capacity
Collateral
Capital
Conditions
Cash Flow

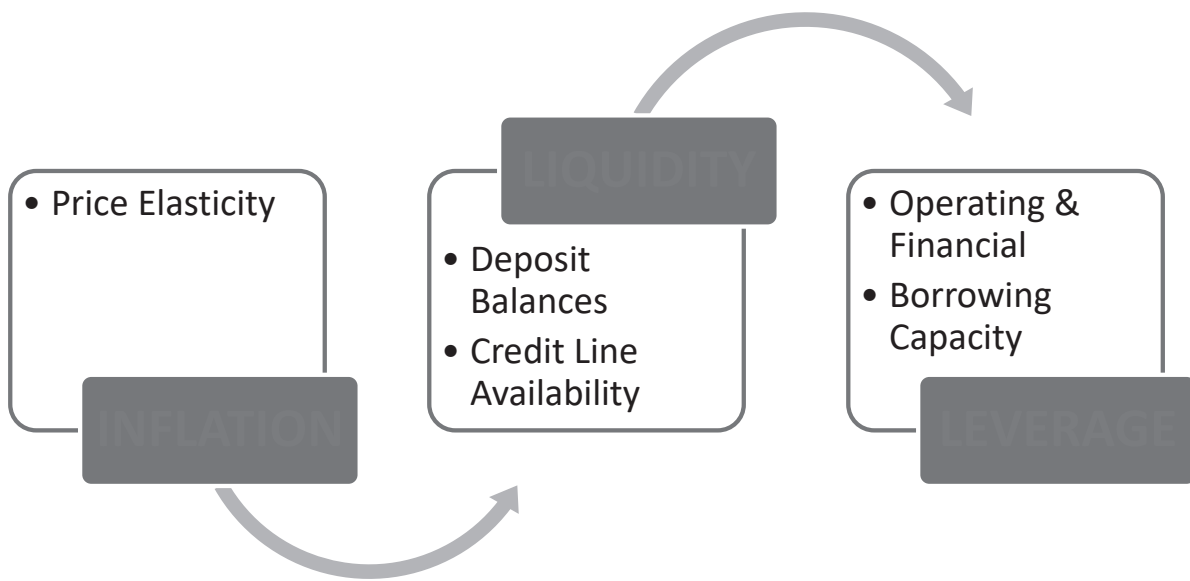


6 D's of Bad Credit

Death
Disability
Divorce
Dice
Drugs
Deceit (Fraud)

Bad things happen to good people. Desperate people do desperate things.

Current Concerns & Tools



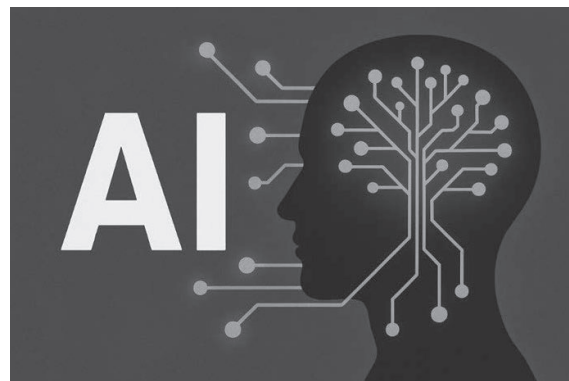
External Influences on the Numbers

You are Lending in a Different World.

New Deals → Opportunity Analysis Renewals/Reviews → Situation Analysis

- **Use of AI**

- Pertinent macro-economic and industry information can be sourced from AI / Internet
- Key information is often
 - Private, Internal, or Proprietary to Borrower
- Authenticate, Validate, and Reference Source(s)



New Deals → Opportunity Analysis Renewals/Reviews → Situation Analysis

“Take a step BACK before you take a step IN.”

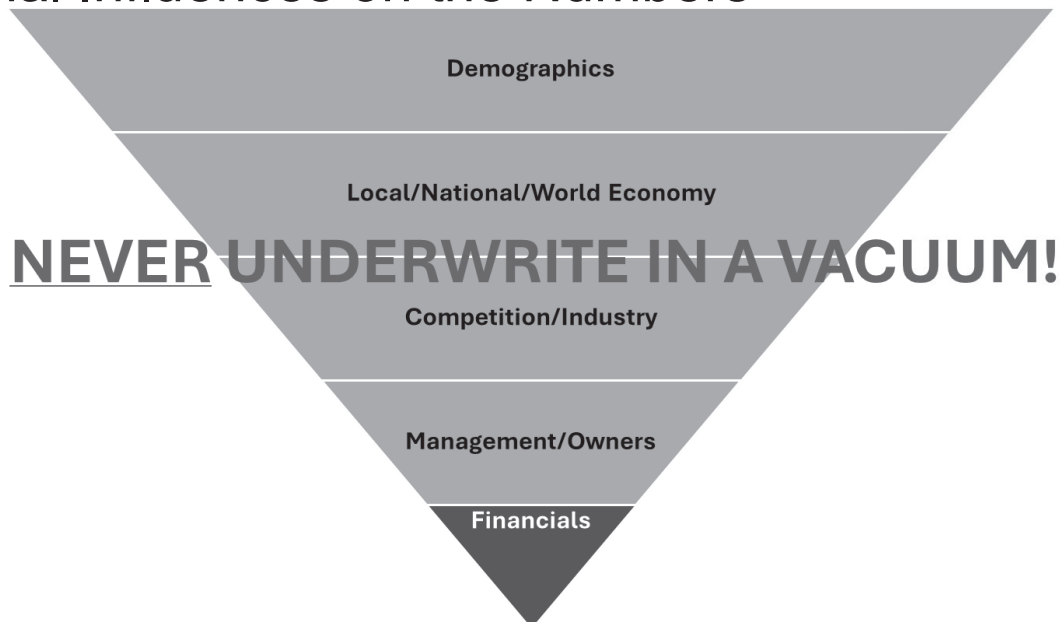
- Check your Personal Bias (+/-) at the door
- Be Objective and Observant
- Review Entire Relationship (usage, trends)



Answer These 2 Questions *before* your analysis:

- What do you *expect* to see in the Financials and why?
- What can affect (+/-) our Sources of Repayment?

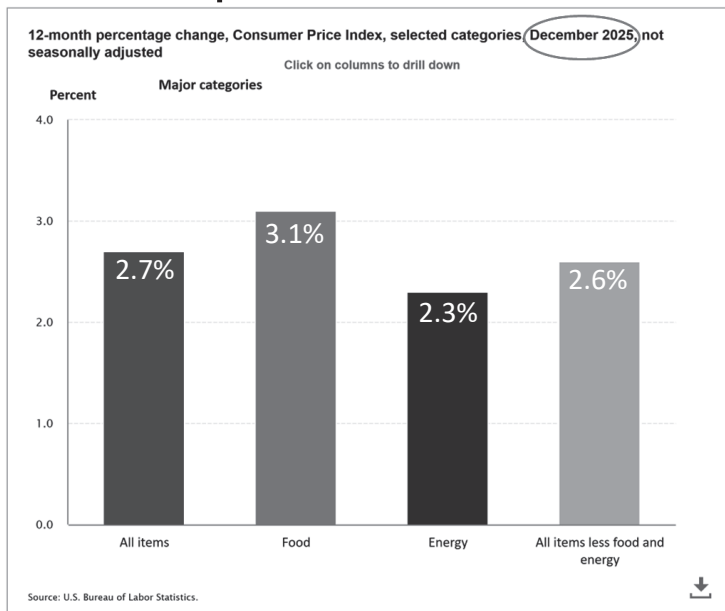
External Influences on the Numbers



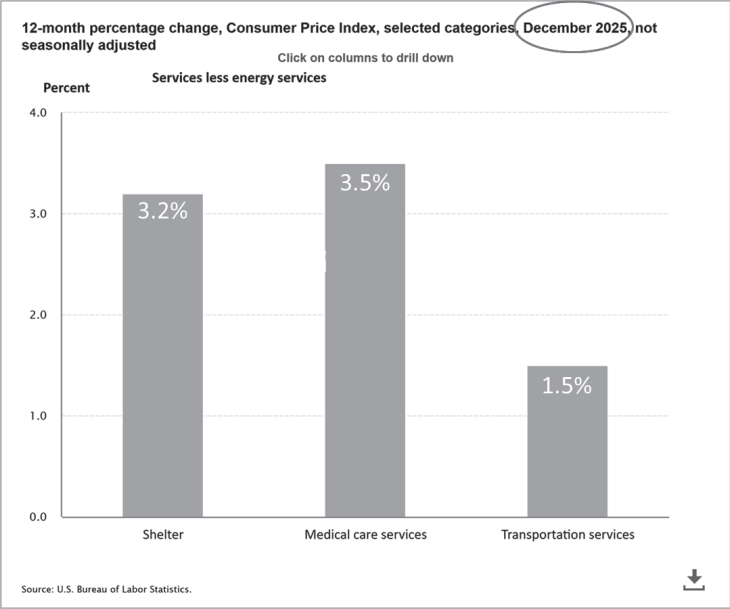
Recognizing Economic Cycles

Plentiful Labor / General Skill Sets	→	Demographic Constraints / Specialty Skill Sets
Excess Savings	→	Liquidity Constraints
Globalization of Supply Chain	→	Shortening Supply Chains / Digital Transformation
Low Inflation	→	Higher Inflation
Low Interest Rates	→	Higher Interest Rates

Not all Inflation is created equal...



Not all Inflation is created equal...



Local Living Wage and Cost of Living Tool

- Takes into Account
 - Local Food and Housing
 - Childcare and Taxes
- livingwage.mit.edu

	1 ADULT				2 ADULTS (1 WORKING)				2 ADULTS (BOTH WORK)		
	0 Children	1 Child	2 Children	3 Children	0 Children	1 Child	2 Children	3 Children	0 Children	1 Child	2 Children
Living Wage	\$24.21	\$37.86	\$47.81	\$56.59	\$31.72	\$37.35	\$40.00	\$45.63	\$15.86	\$21.63	\$25.79
Poverty Wage	\$7.67	\$10.40	\$13.13	\$15.87	\$10.40	\$13.13	\$15.87	\$18.60	\$5.20	\$6.57	\$7.93
Minimum Wage	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25	\$7.25

State of Georgia (FEB 2025)

Shift Happens...

YoY CHANGE COMPARISON	March 2022		March 2023		March 2024		March 2025	
	Non-Current	Net Charge-Offs	Non-Current	Net Charge-Offs	Non-Current	Net Charge-Offs	Non-Current	Net Charge-Offs
Construction & Development	0.42%	-0.02%	0.38%	0.01%	0.60%	0.04%	0.81%	0.07%
Farmland	1.05%	0.04%	0.66%	0.02%	0.65%	0.00%	0.82%	0.00%
Ag Production	0.92%	0.05%	0.62%	0.10%	0.72%	0.11%	0.75%	0.17%
1-4 Family Residential	1.84%	-0.02%	1.35%	-0.01%	1.22%	0.00%	1.27%	0.00%
1st Lien - Closed End	1.80%	0.01%	1.31%	0.00%	1.17%	0.00%	1.23%	0.00%
HELOC	2.06%	-0.19%	1.73%	-0.07%	1.73%	-0.04%	1.67%	-0.03%
Multifamily	0.22%	0.00%	0.20%	0.03%	0.38%	0.05%	1.05%	0.12%
Commercial Real Estate	0.66%	0.01%	0.70%	0.09%	1.24%	0.27%	1.36%	0.21%
Owner-occupied	0.67%	0.00%	0.55%	0.01%	0.62%	0.02%	0.76%	0.03%
Investment	0.66%	0.02%	0.79%	0.13%	1.59%	0.40%	1.70%	0.31%
Commercial & Industrial	0.68%	0.11%	0.65%	0.26%	0.83%	0.40%	0.97%	0.51%
Credit Cards	0.91%	1.85%	1.35%	3.09%	1.80%	4.70%	1.72%	4.71%
Loans to Individuals	0.45%	0.44%	0.49%	0.84%	0.48%	1.23%	0.55%	1.31%
Auto Loans	0.48%	0.38%	0.56%	0.84%	0.60%	1.20%	0.64%	1.09%
Lease Financing	0.47%	0.23%	0.35%	0.10%	0.40%	0.22%	0.44%	0.25%
TOTAL LOANS & LEASES	0.84%	0.22%	0.75%	0.41%	0.91%	0.65%	0.98%	0.67%

Least Risky U.S. Industries for 2026 (IBISWorld)

1. Solar Power
2. Solar Panel Manufacturing
3. Guns & Ammunition Manufacturing
4. 3D Printer Manufacturing
5. Independent Label Music Production
6. Wind Power
7. Space Vehicle & Missile Manufacturing
8. Virtual Reality Software
9. Residential Intellectual Disability Facilities
10. Unmanned Aerial Vehicle (UAV) Manufacturing



Most Risky U.S. Industries for 2026 (IBISWorld)

1. Polystyrene Foam Manufacturing
2. Printing
3. Oil & Gas Field Services
4. Oil & Gas Drilling Equipment Manufacturing
5. Fuel Dealers
6. Billboard & Outdoor Advertising
7. Vending Machine Operators
8. Regional Banks
9. Copper Rolling, Drawing & Extruding
10. Restaurant Construction



Industry Analysis Tool

- **Porter's Five Forces**

- hbr.org/video/3590615226001/the-explainer-porters-five-forces

- **Other Considerations:**

- Government Regulation/Deregulation
- Technology
- Demographics
- Social Change

- **Market Disrupter List:**

- cnbc.com/cnbc-disruptors/



Improving Credit Underwriting

More Forward-looking. More Meaningful.

Timeliness and Sources of Financial Information

- Self- or Company-Prepared
 - Bookkeeping Service
 - CPA Compiled
 - CPA Reviewed
 - CPA Audited
 - Tax Return
-
- Tax/Legal Entity Type (Sole Prop, S-Corp, C-Corp, LLC)
 - Influences on Numbers



How to Strengthen your Credit Analytics

1. Identify

- Trends, Sudden/Significant Changes, Aberrations

2. Discuss

- Never say a “What” without a “Why”
- Include Borrower’s Voice

3. Explain

- Causality & Implications on Cash Flow

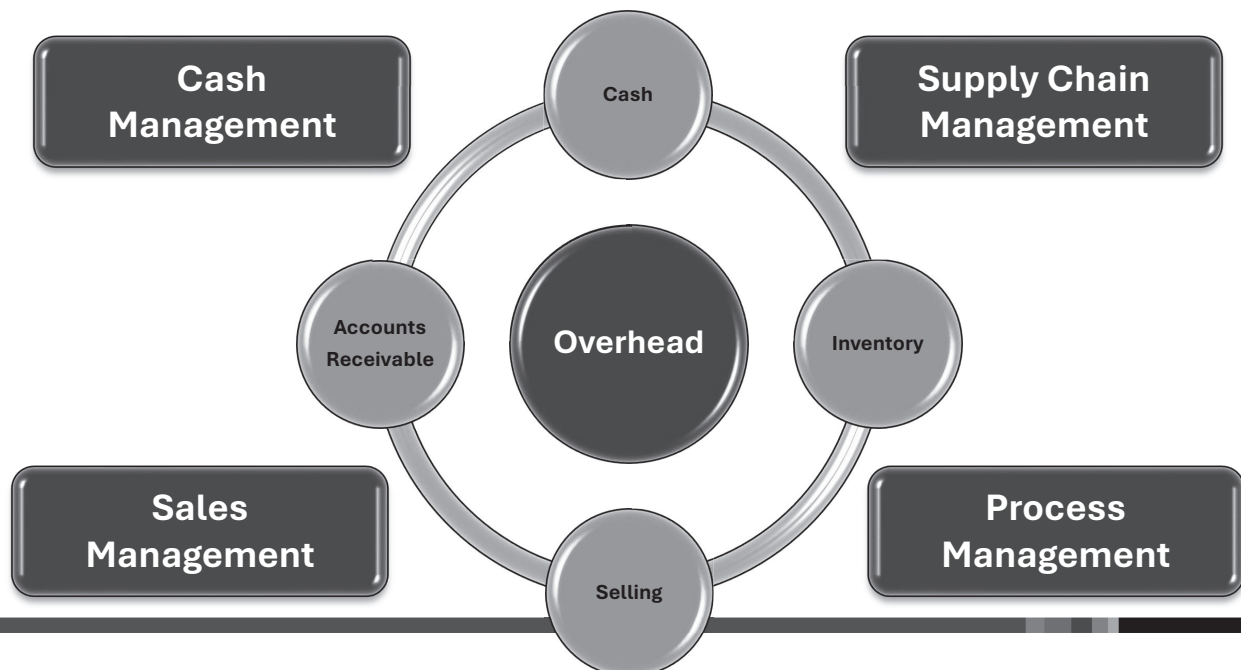


Avoid:

- “Elevator Analysis”
- Longer is not typically better

Perform a “Self-check” on your bank’s loan memo content

Cash Conversion Cycle Tool



Working Investment Tool

(\$000)	Year 1	Year 2
Accounts Receivable (net*)	\$1,614	\$2,471
Inventory	\$3,634	\$7,079
Accounts Payable	(\$1,666)	(\$4,512)
Accrued Expenses	(\$327)	(\$568)
= Working Investment	\$3,055	\$4,470
YoY Change (Δ)		\$1,415

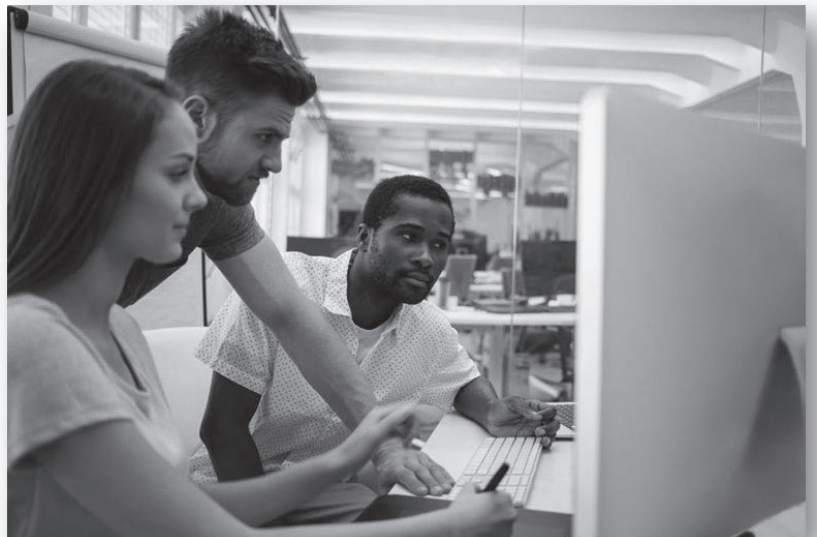
Example Discussion:

Causality of Cash Sources and Cash Uses
Implications on Liquidity and Leverage

*Less Allowance for Doubtful Accounts / Provision for Bad Debts

CASE STUDY

- MFG, Inc.
 - Big Company (\$33M Sales)
 - “The Power of 1”
 - 1 day in Turns
 - 1% in Margins
- You are Loan Committee
 - Assign Risk Rating
- Cash Flow Swings
 - Causality and Implications



CASE STUDY - Overview



- Request: Increase Revolving Credit Line
- Reason: “Sales are growing each year. We need a bank to grow WITH us.”
- Quick Risk Assessment (latest FYE):
 - DSCR = 1.22x (Policy = 1.20x for a Manufacturer)
 - Debt/TNW = 2.26x
 - Discounted Collateral covers credit line with 14% cushion (Borrowing Base - monthly)
 - Net Fixed Assets = \$4.6M vs. \$1.4M of LT Debt

CASE STUDY – Collateral Coverage



	2022	2023	2024	2025
Accts Receivable	\$2,359	\$2,557	\$3,210	\$4,338
x 80% [A]	\$1,887	\$2,046	\$2,568	\$3,470
Inventory	\$2,824	\$3,308	\$4,117	\$4,359
x 50% [B]	\$1,412	\$1,654	\$2,059	\$2,180
Collateral [A+B]	\$3,299	\$3,700	\$4,627	\$5,650
Bank RLOC & OD	\$1,401	\$1,673	\$3,712	\$4,841
Collateral Margin	\$1,898	\$2,027	\$915	\$809
DLTV	42%	45%	80%	86%

CASE STUDY – Lender's Introduction

- Sales have increased each of the last 4 years and 55% growth over the 4-year review period.
- Sales growth has been supported by the Bank's revolving credit line, with interest income of nearly \$500M paid to the Bank in the last fiscal year.
- With the increased investment in plant & equipment, higher depreciation has caused Net Income to decline the last 2 years; however, debt service coverage remains above policy guideline.
- Even with the increased use of credit, overall leverage is considered moderate.

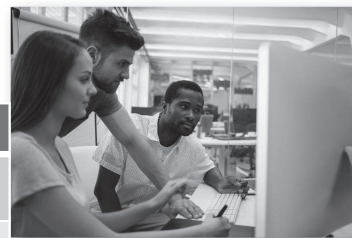


CASE STUDY – Initial Risk Rating

1. Substantially Risk Free
2. Minimal Risk
3. Modest Risk
4. Better Than Average Risk
5. Average Risk
6. Watch
7. Special Mention (potential weakness)
8. Substandard (definite weakness, loss unlikely)
9. Doubtful (partial loss probable)
10. Loss (definite loss)



CASE STUDY – Overall Leverage Tool



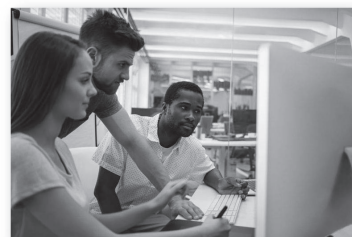
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x 80% [A]	\$1,887	\$2,046	\$2,568	\$3,470
Inventory	\$2,824	\$3,308	\$4,117	\$4,359
(Accts Payable)	\$(800)	\$(641)	\$(902)	\$(1,525)
x 50% [B]	\$1,012	\$1,334	\$1,608	\$1,417
Collateral [A+B]	\$2,899	\$3,380	\$4,176	\$4,887
Bank RLOC & OD	\$1,401	\$1,673	\$3,712	\$4,841
Collateral Margin	\$1,498	\$1,707	\$464	\$46
DLTV (incl. A/P)	48%	49%	89%	99%

aba.com | 1-800-BANKERS

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CASE STUDY – Change in Sales Tool



	2022	2023	2024	2025
Sales Δ		18%	28%	2%
A/R Δ		8%	26%	35%
Days A/R	39	35	34	45
Inv Δ		15%	24%	6%
Days Inv	75	78	71	73
A/P Δ		(20)%	41%	70%
Days A/P	21	15	15	25
COGS Δ		10%	38%	3%
GPM	36%	40%	36%	35%

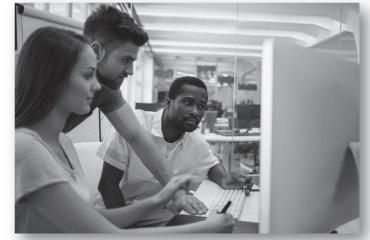
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CASE STUDY – CF Analysis Tool

- **5-minutes... or less!**
- **Works with ANY Cash Flow Statement format:**
 - UCA, Direct, Indirect



Train Stop Analogy

1. Net Cash After Operations [NCAO]
2. Cash After Debt Amortization [CADA]
3. Financing Surplus (Deficit)



CASE STUDY – Final Risk Rating

1. Substantially Risk Free
2. Minimal Risk
3. Modest Risk
4. Better Than Average Risk
5. Average Risk
6. Watch
7. Special Mention (potential weakness)
8. Substandard (definite weakness, loss unlikely)
9. Doubtful (partial loss probable)
10. Loss (definite loss)



Workshop Highlights

- 3 Steps: Risk Identification, Quantification, and Mitigation
- Early Warning Signs
- Living Wage – Cost of Living Tool
- Porter's Five Forces – Industry Analysis Tool
- Cash Conversion Analysis & Working Investment Tool
- Overall Leverage Tool
- Change in Sales Tool
- 5-minute Cash Flow Analysis Tool

Thank You!

Did you...

- Gain Knowledge
- Useful Tools
- Have Fun



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