CURRENT ASPECTS OF UNSECURED LENDING
FINANCIAL RATIOS

QUESTIONS AND ANSWERS

Comment - Don Argus:

I would like to respond to Richard Youard. I suggest that here in the Australia up until about ten years ago most ratios were not worth the paper they were written on. But I think that the degree of sophistication that has been forced on the banks, whilst we might scuffle and kick to get the quarterly reports that you speak of, at least we are getting half-yearly reports and I think from memory in the Bond brewery deal we argued for quarterly reports and they are meaningful to us.

Comment - John Cadell:

I guess there is just one comment from my experience in this field with these complex ratios and that is that very often one spends months and months debating them. Probably at the end of the day the lawyers and the bankers who have been sitting together for three months understand them. Goodness knows what happens when those people pass on and the documents are taken out of the bottom drawer many years later. It calls for very good drafting.

Comment - Diccon Loxton:

I agree with everything that Richard has said but I would not say that they were useless at all. My attitude to ratios is the same attitude that the president of an American manufacturer of latex products has to Aids - which is that they are the best thing since sliced bread! As soon as these things are put onto paper only lawyers can understand them so bankers and the borrowers keep on coming back to the lawyers and asking them to be analysed but what is even better, no sooner is the print dry on the paper than that borrower is approaching other bankers and asking those bankers to work out ways of providing further money without reaching the ratios. And it is there that the really complex and therefore the really legally intensive transactions come forward. So I would encourage every banker in this room to have more ratios!

Response - Richard Youard:

I think one reaction of mine is that some companies will enter into these covenants without having the machinery to do the monitoring. I think it is very important. I have sat at meetings when the banker has unexpectedly asked the key question - he said "Fred, how are you going to monitor these things?" and there was a dreadful silence and it appears that Fred, the finance director has got no machinery in place whatever for monitoring things. A lot of it is coming up through his operating subsidiaries, he is not properly integrated, his computer does not tell him (if he has got one) the right information. So again we should not kid ourselves. Of course you must be right but if everybody is doing their job right and can do their job right then it will be O.K. But those are generally the best credits who are going to pay back anyway.

Comment - John Cadell:

I think there is an interesting example of that in the Bond transaction. As I understand at the end of the transaction Rory Argyle was asked by his client to provide a summary of the ratios in a form which the company's financial officers could readily understand. Is that right Rory?

Response - Rory Argyle:

Yes. My brief was to prepare the working man's guide to the ratios that John Cadell had drafted. That, I am pleased to report to the banker at the end of the table here, is being closely attended to by my client. It is never far from his side, he assures me.

My experience (this particular client has had experience with these sorts of ratios in earlier borrowings) is that they are taken seriously and they do have a very great influence on the way the finances of the company are managed. Clearly if they don't then they are not much use to you. My impression is that they are accepted as an imposed policy restraint and are effective.

Question - David Frecker (Sydney):

In my experience the problem with maintenance ratios and particularly debt equity ratios for any company with a complex balance sheet is that it is virtually impossible except on balance date to determine whether the ratios have been complied with. Now perhaps you can also test them on dates when the quarterly accounts or when the half-yearly accounts are made up but I would just like to ask the banker's view as to whether the banker really expects the company to maintain the ratios 24 hours a day 365 days a year or whether the banker just expects the company to comply on balance dates or on quarterly account dates?

Response - Don Argus:

I think that banks realise today that with the treasury functions that have developed within conglomerates, it is impossible to maintain your ratios daily. But I would expect that the financial controller of a particular corporation would have control of his ratios at least on a monthly basis if their accounting and management reporting is up to standard and I would have thought that they would need to control that themselves, particularly if they are moving money around between their various entities associates and subsidiaries to ensure that their own cash flow and whatever other covenants we are looking at in a loan documentation, are maintained.