



INTERVIEW GUIDE 08

Credit and Private Credit

How lenders think, the instruments in a capital structure, credit analysis, and the yield maths that direct lending and distressed interviews test.

How to use this guide

Credit funds and DFIs deploy more capital in Africa than equity sponsors. This guide covers the lender's mindset and the analysis behind it.

Most questions have two layers. **What to say** is a short answer you could give in an interview. The notes underneath explain why it is right, so you can handle the follow-up.

Do not memorise answers word for word. Learn the logic, then practise saying it out loud.

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A note on conventions

Worked examples use a 25% tax rate unless the question states otherwise. Where U.S. GAAP and IFRS differ in a way interviewers ask about, the guide says so. Most African markets report under IFRS; U.S. firms will expect U.S. GAAP. Say which you are assuming.

How credit investing works

Credit funds now employ as many junior investors as buyout funds, and in Africa lenders and DFIs deploy more capital than equity sponsors. The mindset is different: you are paid to avoid losses, not to find upside.

1.1 How does a credit investor think differently from an equity investor?

What to say

An equity investor asks how much a company could be worth. A credit investor asks how likely it is to pay back the loan, and what I recover if it does not. My upside is capped at the interest and principal, so I care about downside protection: stable cash flow, asset coverage, seniority, covenants and the equity cushion beneath me. Growth is only useful to me if it makes repayment more certain.

1.2 What are the main types of credit investing?

Strategy	What it does	Return target (indicative)
Direct lending	Senior secured loans, often unitranche, made directly to mid-market companies, frequently sponsor-owned	High single digits to low teens, mostly cash interest
Mezzanine	Subordinated debt, often with PIK interest and warrants, filling the gap between senior debt and equity	Low to mid teens

Distressed and special situations	Buying debt of troubled companies at a discount, sometimes to take control through a restructuring	Mid teens and above
Leveraged finance (banks)	Arranging and syndicating loans and high-yield bonds for buyouts and acquisitions	Fee-based; the bank does not usually hold the risk
Structured credit	CLOs and asset-backed securities that pool loans and slice the cash flows into tranches	Varies by tranche
Development finance	DFIs such as IFC, BII, AfDB and Proparco lending to companies and projects in emerging markets, often alongside commercial lenders	Below commercial rates, with a development mandate

1.3 Why has private credit grown so much?

What to say

After 2008, regulation made it more expensive for banks to hold leveraged loans, so non-bank lenders stepped in. Borrowers, especially private equity sponsors, value the speed, certainty and flexibility of a single lender over a syndicated process. Investors value the yield and the floating rates. The result is that direct lenders now finance a large share of mid-market buyouts.

1.4 What does a credit analyst actually do?

What to say

Build a model focused on cash flow available for debt service under base and downside cases, size the debt, analyse the collateral and the capital structure, negotiate the term sheet and covenants, write the credit memo, and monitor the loan after closing, especially covenant compliance.

The capital structure and instruments

Instrument	Ranking and security	Pricing and terms
Revolver	Senior secured, usually first lien	Floating; commitment fee on undrawn amount; drawn for working capital
Term loan A	Senior secured, bank-held	Floating; amortises meaningfully; maintenance covenants
Term loan B	Senior secured, institutional	Floating; about 1% a year amortisation, bullet at maturity; often covenant-lite; usually prepayable
Unitranche	Single senior secured loan replacing first and second lien	Blended floating rate; from a direct lender; often with maintenance covenants
Second lien	Secured, but paid after first lien from the same collateral	Higher spread; bullet
High-yield bonds	Secured or unsecured; below bank debt if unsecured	Fixed coupon; bullet; incurrence covenants; call protection
Mezzanine	Subordinated, often unsecured	Cash plus PIK interest; warrants; bullet
Holdco / PIK notes	Issued by the parent, structurally subordinated to all operating company debt	PIK; highest cost debt

Preferred and common equity

Residual claim

Absorbs first losses

2.1 What is the difference between contractual and structural subordination?

What to say

Contractual subordination is an agreement that one creditor is paid after another, set out in an intercreditor agreement. Structural subordination arises from where the debt sits: debt at a holding company is paid only from what the holding company receives after the operating company's own creditors are satisfied, even without any agreement.

2.2 Why is bank debt cheaper and shorter-dated than bonds?

What to say

Bank loans are senior, secured and amortising, and come with tighter covenants, so lenders take less risk and accept a lower rate. Shorter maturities, typically five to seven years, further limit risk and match banks' own funding. High-yield bonds are usually unsecured or junior, longer-dated and fixed-rate, and give the borrower more freedom, so investors demand more.

2.3 Explain floating-rate pricing.

What to say

Loan interest is quoted as a spread over a benchmark: SOFR for dollars, EURIBOR for euros, SONIA for sterling. A loan at SOFR + 500 with SOFR at 4% pays 9%. Many loans include a floor on the benchmark, so lenders are protected if rates fall to zero. Floating rates mean a borrower's interest cost rises when central banks tighten, which is why coverage must be tested under higher rates.

LIBOR is gone. Anyone still quoting "L + 500" in an interview is reading old notes.

2.4 What is an intercreditor agreement?

What to say

The contract between different classes of lenders that sets out who gets paid first, who controls the collateral and enforcement, and what junior lenders can and cannot do if the borrower defaults. In a unitranche, an agreement among lenders splits the single loan into first-out and last-out pieces behind the scenes.

Credit analysis

THE QUESTIONS

Five things every credit memo answers

1. **Cash flow.** How stable is EBITDA, and how much of it becomes cash after capex, working capital and tax?
2. **Leverage and coverage.** How much debt relative to earnings, and how comfortably is interest covered, in the base case and the downside?
3. **Collateral and recovery.** What do we recover if the company fails: enterprise value in a distressed sale, or asset values?
4. **Structure.** Where do we rank, what covenants protect us, and how big is the equity cushion below us?
5. **Sponsor and management.** Who owns this, will they support it with more equity if needed, and how have they behaved with lenders before?

Key metrics

Metric	Formula	Use
Total leverage	Total debt ÷ EBITDA	How much debt relative to earnings
Net leverage	(Total debt – cash) ÷ EBITDA	Same, giving credit for cash on hand
Senior / first-lien leverage	Senior debt ÷ EBITDA	Risk of the senior tranche alone
Interest coverage	EBITDA ÷ cash interest	Ability to pay interest

Cash-flow coverage	$(\text{EBITDA} - \text{capex}) \div \text{cash interest}$	Ability to pay interest and still reinvest
Fixed charge coverage	$(\text{EBITDA} - \text{capex} - \text{cash taxes}) \div (\text{interest} + \text{scheduled principal})$	Ability to meet all fixed obligations
Loan to value	Debt through your tranche $\div$ enterprise value	Equity cushion beneath you
Debt service coverage	Cash flow available for debt service $\div$ (interest + principal)	Standard in project and real-estate lending

3.1 Worked example: sizing and stress-testing a loan.

A sponsor is buying a company with \$50m of EBITDA and \$10m of annual capex for \$500m, 10x. A direct lender offers a \$250m unitranche, 5.0x leverage, at an all-in rate of 10%.

	Base case	Downside: EBITDA -20%
EBITDA	\$50m	\$40m
Cash interest (\$250m $\times$ 10%)	\$25m	\$25m
Leverage	5.0x	6.25x
Interest coverage	2.0x	1.6x
$(\text{EBITDA} - \text{capex}) \div \text{interest}$	1.6x	1.2x
Loan to value at entry (250 $\div$ 500)	50%	
Recovery if sold at 6x in distress (6 $\times$ \$40m = \$240m)		96% of \$250m

Reading it. The loan works in the base case with a 50% equity cushion. In the downside, coverage after capex falls to 1.2x, which leaves little room for higher rates or a working capital outflow, and a distressed sale at 6x would not quite repay the loan in full. A lender might respond by sizing at 4.5x, requiring a leverage covenant set with 25% to 30% headroom to the base case, or asking for more equity.

3.2 How do you set covenant levels?

What to say

Start from the base case projection and set the test with headroom, typically 25% to 35% on EBITDA, so that a normal miss does not trigger a default but a serious deterioration does. The purpose is an early warning that brings the borrower back to the table while there is still value to protect.

3.3 What happens when a covenant is breached?

What to say

Technically it is an event of default, which lets lenders accelerate the loan. In practice, lenders usually agree a waiver or amendment in exchange for a fee, a higher margin, tighter terms, or an equity injection from the sponsor, sometimes called an equity cure. Acceleration is the last resort, because forcing a sale often destroys value for everyone.

3.4 What warning signs do you watch after closing?

- Revenue growing but cash flow falling: working capital is absorbing cash.
- EBITDA "adjustments" growing each quarter.
- Revolver drawn and not repaid.
- Requests to switch to PIK or to defer amortisation.
- Management or sponsor team changes, delayed financials, auditor changes.

Pricing, yields and returns

4.1 How is a credit spread related to default risk?

What to say

Roughly, the spread compensates for expected loss, which is the probability of default multiplied by the loss given default, plus a premium for illiquidity and uncertainty. A loan with a 4% annual default probability and a 40% loss in default has an expected loss of 1.6% a year, so a spread well above 1.6% is needed to make money over time.

The same logic explains why junior debt pays more than senior debt from the same borrower: the default probability is the same, but the loss given default is higher.

4.2 What is the difference between coupon, current yield and yield to maturity?

What to say

The coupon is the fixed interest paid on face value. Current yield is the annual coupon divided by the current price. Yield to maturity is the total annual return if held to maturity, including the pull to par: the gain if bought below 100 or the loss if bought above.

Example. A five-year bond with an 8% coupon trades at 90. Current yield is $8 \div 90 = 8.9\%$. Yield to maturity is roughly $(8 + 10 \div 5) \div 95 \approx 10.5\%$, since the holder also earns 10 points of price appreciation over five years.

4.3 How does a direct lender earn its return?

What to say

Cash interest, usually floating; an upfront fee or original issue discount of one to three points, which lifts the yield when the loan is repaid early; sometimes a prepayment penalty; and, in mezzanine, PIK interest and warrants. Funds often add modest leverage at the fund level to lift returns to equity investors.

4.4 Why would you buy a loan trading at 70?

What to say

Because I believe recovery will be higher than 70, whether through repayment at par, a restructuring in which I receive new debt and equity worth more, or a sale of the company. Distressed investors buy the "fulcrum security", the tranche that will be converted into equity in a restructuring, when they want to end up owning the company.

4.5 What is a CLO?

What to say

A collateralised loan obligation buys a portfolio of leveraged loans and funds itself by issuing tranches of notes with different priority: AAA at the top, taking the first cash flows and lowest yield, down to an equity tranche that takes first losses and the residual return. CLOs are the largest buyers of institutional term loans.

In African markets

Local-currency lending is expensive because policy rates and inflation are high, so many corporate borrowers take hard-currency loans, creating a mismatch if their revenue is local. Lenders address this with currency hedges, dollar-linked revenue, shorter tenors, or DFI guarantees and first-loss tranches. Sovereign risk and convertibility, the ability to actually move dollars out of the country, are part of every credit memo. Be ready to explain how you would structure around them.

Documentation and terms

In credit, the document is the investment. Two loans with identical pricing can have very different outcomes depending on what the borrower is allowed to do.

5.1 Why does the definition of EBITDA matter so much?

What to say

Because every covenant, every leverage test and every debt basket is calculated off it. Credit agreements define EBITDA with a list of permitted add-backs: one-off costs, restructuring, run-rate synergies from acquisitions, and sometimes pro forma cost savings that have not happened yet. Generous add-backs, often capped at a percentage of EBITDA, let a borrower report leverage well below the true figure.

Example. Reported EBITDA of \$80m with \$20m of add-backs gives covenant EBITDA of \$100m. At \$500m of debt, leverage is 5.0x on the covenant definition and 6.25x on reported numbers. Always ask which definition a leverage figure uses.

5.2 What are baskets, and which ones matter?

Provision	What it permits	Why a lender cares
Incremental / accordion facility	Additional debt up to a fixed amount or a leverage level	Dilutes your claim; look for an MFN clause that forces the new debt to be priced fairly relative to yours
Permitted debt basket	Other borrowings the company may take on, including at subsidiaries	Debt raised at a subsidiary can rank ahead of you structurally

Restricted payments	Dividends and distributions to the sponsor	Cash leaving the business is cash not repaying you
Permitted investments	Acquisitions, joint ventures, transfers of assets to unrestricted subsidiaries	The route by which collateral can leave the credit group
Asset sale provisions	Whether proceeds must repay debt or can be reinvested	Determines whether a disposal de-levers
Portability	Allows the debt to survive a change of control	You may end up lending to a sponsor you never underwrote

5.3 What is a liability management exercise?

What to say

A borrower using flexibility in loose documents to raise new money on terms that disadvantage existing lenders. The two well-known patterns are moving valuable collateral into a subsidiary outside the credit group and borrowing against it, and issuing new debt that ranks ahead of existing lenders, sometimes with the consent of a majority who are offered better terms for agreeing. The defence is tighter documentation and a large enough position to block amendments.

This is now a standard interview topic in credit and distressed. Know the concept and that lenders respond with co-operation agreements, tighter transfer and investment covenants, and blocking positions.

5.4 How does an equity cure work?

What to say

The sponsor is allowed to inject equity to fix a covenant breach, usually a limited number of times and often with the cash treated either as an addition to EBITDA or as debt repayment. It is a genuine benefit to lenders when the sponsor is committed, but a cure that only inflates covenant EBITDA can mask a deteriorating business.

Example. The covenant caps leverage at 5.0x. EBITDA is \$50m and net debt is \$270m, so leverage is 5.4x. A cure of \$20m applied to repay debt brings net debt to \$250m and leverage to exactly 5.0x.

5.5 What is the difference between a loan and a bond from a documentation view?

What to say

Loans are agreements with identifiable lenders who can be assembled to amend terms, usually with maintenance covenants and prepayment at par. Bonds have dispersed holders, an indenture with incurrence covenants, call protection, and are harder to amend quickly. That makes loans more flexible for a borrower in trouble and bonds more expensive to refinance early.

Markets, ratings and syndication

6.1 How do credit ratings work?

What to say

Agencies rate issuers and individual instruments on a scale from AAA down. Investment grade runs to BBB- at S&P and Fitch, or Baa3 at Moody's; anything below is high yield, sometimes called speculative grade or junk. Ratings drive who can buy the paper, and a downgrade can force selling and raise the borrower's cost of funds. Most sponsor-backed borrowers sit in the B range.

6.2 How does a leveraged loan get syndicated?

What to say

The arranging bank commits to provide the debt, usually as part of a bid, then sells it to institutional investors. It prepares a lender presentation and a model, runs a bank meeting, builds a book at a proposed spread and discount, and then flexes the terms: if demand is weak, the spread or the original issue discount rises; if demand is strong, pricing tightens. If the loan cannot be sold, the bank is left holding it, which is why commitment letters contain flex language.

6.3 What is original issue discount, and how does it affect yield?

What to say

The loan is issued below par, so the lender advances less than the face amount it is repaid. Two points of discount on a five-year loan adds roughly 0.4% a year to the yield, and more if the loan repays early. Direct lenders use upfront fees for the same effect.

6.4 What is the difference between a bank's leveraged finance role and a credit fund's?

What to say

The bank underwrites and distributes, earning fees and holding little risk if the syndication works. The fund holds the loan to maturity and earns the interest, so it cares far more about documentation, monitoring and workout capability. Interviews at banks test structuring and market knowledge; interviews at funds test credit judgement.

6.5 What is fund finance, and what is a NAV loan?

What to say

Lending to funds rather than companies. A subscription line is secured on investors' uncalled commitments and used to bridge capital calls. A NAV loan is secured on the fund's portfolio of investments and used to fund follow-ons or generate distributions before exits. Both have grown quickly, and both raise the question of whether reported fund returns are being flattered by leverage.

6.6 What is asset-based lending, and how do you size a borrowing base?

What to say

Lending against specific assets rather than cash flow, with availability recalculated regularly from a borrowing base: a percentage of eligible receivables and inventory, less reserves. Advance rates are typically around 85% on good receivables and much lower on inventory.

Borrowing base	Eligible	Advance rate	Availability
Accounts receivable	\$100m	85%	\$85m
Inventory	\$60m	50%	\$30m
Total availability			\$115m

Eligibility rules do the real work: receivables over 90 days past due, from related parties, or from concentrated or foreign customers are usually excluded. This structure suits distributors,

commodity traders and other working-capital-heavy businesses, and is widely used in African trade finance.

Distress, recovery and workout

7.1 How do you value a company in distress and allocate the value?

What to say

Estimate enterprise value, usually with a conservative multiple of stressed EBITDA or a liquidation analysis, then pay it down the capital structure in order of priority. The tranche where the value runs out, the one that is partly paid and therefore gets converted into equity, is the fulcrum security. Distressed investors buy it to end up owning the reorganised company.

Claim	Amount	Value received	Recovery
Enterprise value in a restructuring		\$500m	
First lien	\$400m	\$400m	100%
Second lien	\$150m	\$100m	67%
Unsecured notes	\$100m	nil	0%
Existing equity		nil	0%

The second lien is the fulcrum: it is impaired, so it negotiates the plan and takes the new equity. Buying it at 50 cents when you believe recovery is 67 is the classic distressed trade.

7.2 What is the order of priority?

What to say

Broadly: administrative and court costs, then super-priority financing such as DIP loans, then secured claims to the extent of their collateral, then priority unsecured claims such as certain taxes and employee entitlements, then general unsecured creditors including trade and bond claims, then subordinated debt, then preferred and common equity. The details differ by jurisdiction, and secured lenders whose collateral is worth less than their claim become unsecured for the shortfall.

7.3 What options does a struggling borrower have?

Option	What it involves
Amend and extend	Lenders push out maturities and reset covenants in exchange for fees, higher margin and tighter terms
New money from the sponsor	Equity cure or a shareholder loan, often in exchange for lenders relaxing terms
Debt exchange	Bondholders swap into new debt with a longer maturity, lower principal or worse ranking; coercive if the alternative is worse
Out-of-court restructuring	A negotiated deal among the main creditors; faster and cheaper, but needs near-unanimity
Formal process	Chapter 11 in the U.S., business rescue in South Africa, administration elsewhere; binds dissenting creditors but is expensive and public
Sale of the business	Through a court process or a lender-led sale; secured lenders can sometimes credit bid, using their claim as currency

7.4 What does a workout look like from the lender's side?

What to say

Get current information and an independent business review. Decide whether the problem is liquidity or solvency: a liquidity problem can be bridged, a solvency problem needs the capital structure fixed. Assess your leverage: collateral, covenants, maturities and your share of the debt. Then choose between supporting the company with new money and concessions, or enforcing. The decision usually rests on whether the business is viable at a lower debt level and whether management should stay.

7.5 Why is recovery analysis different for asset-heavy and asset-light businesses?

What to say

An asset-heavy borrower has hard collateral whose value survives the business failing, so recovery is anchored by asset values. An asset-light borrower's value is its contracts, people and brand, which can evaporate in distress, so recovery depends on selling the business as a going concern. That is why lenders accept lower leverage on asset-light borrowers despite better margins.

Emerging market and Africa credit

8.1 What is the sovereign ceiling, and why does it matter for corporate credit?

What to say

A company is rarely rated far above the government of the country it operates in, because the sovereign controls taxes, currency and the ability to move money out. So a strong company in a weak country still borrows expensively. Structures that pierce the ceiling rely on hard-currency revenue held offshore, collateral outside the country, or guarantees from a DFI or insurer.

8.2 What are the main currency structures?

Structure	Trade-off
Hard-currency debt, local revenue	Cheapest coupon, largest risk; a 30% devaluation can raise effective leverage by half
Local-currency debt	No mismatch, but high nominal rates and short tenors; often unavailable in size
Hard-currency debt with revenue indexed to it	The standard compromise; shifts currency risk to the customer or offtaker, if they can bear it
Hedged hard-currency debt	Forwards or cross-currency swaps through specialist providers; cost can approach the local rate for long tenors
Guarantees and risk cover	Partial credit guarantees and political risk insurance lower the effective cost and lengthen tenor

8.3 What is convertibility and transfer risk?

What to say

The risk that a borrower has local currency but cannot buy dollars or move them out because of central bank restrictions or a shortage of reserves. It is separate from credit risk: a profitable company can miss a payment because the currency queue is long. Mitigations include offshore collection accounts for export revenue, liquidity buffers, and insurance that covers non-transfer.

8.4 How do sovereign restructurings differ from corporate ones?

What to say

There is no bankruptcy court for a country. Restructuring happens through negotiation with bondholders, often using collective action clauses to bind holdouts, alongside official creditors and multilateral programmes. Recoveries depend on debt sustainability analysis rather than asset values. Several African sovereigns have restructured Eurobonds in recent years, which has consequences for the banks and companies in those countries.

8.5 Why do DFIs matter in credit?

What to say

They provide tenor no commercial lender will offer, they lend in local currency in some markets, they take first-loss or junior positions in blended structures that let commercial lenders participate, and their presence discourages governments from interfering. For a credit investor in Africa, understanding how to structure alongside them is a practical skill, not a footnote.

Quick-fire bank

One or two sentences each. These are the warm-up questions in most credit interviews.

Question	Answer
Which is riskier for a lender, high leverage or low interest coverage?	Coverage, because it measures the ability to pay now. High leverage with strong coverage can be refinanced; weak coverage defaults.
Why lend to a company with negative book equity?	Book equity is an accounting figure. What matters is cash flow and the market value of the business above your claim.
What is the difference between default and bankruptcy?	Default is a breach of the agreement, which may be technical. Bankruptcy is a legal process. Most defaults never become bankruptcies.
What is a springing covenant?	A test that only applies in certain conditions, typically a revolver leverage test that applies when the revolver is drawn beyond a threshold.
Why do lenders care about capex more than equity investors do?	Maintenance capex competes directly with debt service for the same cash, and cutting it to pay interest destroys the collateral.
What is a make-whole provision?	A payment that compensates lenders for interest they lose if the borrower repays early, common in bonds and some private credit.
What is the difference between secured and senior?	Secured means specific collateral is pledged. Senior means it ranks ahead of other claims. A loan can be senior and unsecured.
What happens to a floating-rate lender when rates rise?	Income rises, but the borrower's coverage falls, so credit risk rises. Net effect depends on how much cushion the borrower had.

Why might a lender prefer an amortising loan?	Principal is repaid while the business is healthy, reducing exposure over time rather than relying on a refinancing years out.
What is refinancing risk?	The risk that debt maturing cannot be replaced on acceptable terms. It is the most common cause of failure in otherwise profitable leveraged companies.
What is a first-out, last-out structure?	A unitranche split privately between lenders, where one takes a lower-yielding senior slice and another a higher-yielding junior slice, invisible to the borrower.
How does PIK affect your position?	It preserves borrower cash but grows the claim ahead of equity, so it only helps you if the delay buys a real recovery in the business.
Why is an unfunded revolver commitment still risk?	The borrower will draw it precisely when things go badly, so it is exposure you will have at the worst moment.
What is the equity cushion, and why does it matter?	The value below your claim: the sponsor's equity. It is the buffer between a fall in value and a loss for you, and it is why loan to value matters as much as leverage.

Test yourself

#	Question
1	EBITDA \$80m, total debt \$360m, cash \$40m. What are total and net leverage?
2	A loan is priced at SOFR + 475 with a 1% floor. SOFR is 3.5%. What is the all-in rate?
3	EBITDA \$60m, capex \$15m, cash interest \$30m. What are interest coverage and cash-flow coverage?
4	A bond with a 6% coupon and four years to maturity trades at 96. Approximate yield to maturity?
5	Default probability 5%, loss given default 60%. What is the annual expected loss?
6	A company owes \$300m of first-lien debt and \$100m of second lien. It is sold in distress for \$340m. What does each tranche recover?
7	Why does a maintenance covenant help the lender more than an incurrence covenant?
8	A holdco PIK note at 12% starts at \$100m. What is the balance after three years?

Answers

#	Answer
1	Total 4.5x. Net $(360 - 40) \div 80 = 4.0x$.
2	8.25%. SOFR is above the floor, so the floor does not apply.
3	Interest coverage 2.0x. Cash-flow coverage $(60 - 15) \div 30 = 1.5x$.
4	$(6 + 4 \div 4) \div 98 \approx 7.1\%$.
5	$5\% \times 60\% = 3.0\%$ a year.
6	First lien recovers \$300m, 100%. Second lien recovers \$40m, 40%.
7	It is tested regularly whether or not the borrower does anything, so deterioration triggers a conversation early. An incurrence covenant only bites when the borrower tries to act, so a company can decline for years without giving lenders a seat at the table.
8	$\$100m \times 1.12^3 \approx \$140.5m$.

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