



INTERVIEW GUIDE 04

LBOs and Private Equity

How buyouts work, the returns maths, debt and capital structure, fund economics, diligence and value creation.

How to use this guide

Private equity interviews test two things: whether you understand how a buyout makes money, and whether you can reason about a business the way an investor does. This guide covers the first and gives you the tools for the second.

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 private equity works

Before the modelling questions, interviewers check that you understand the business you want to join: who provides the money, how the firm gets paid and what the job actually involves.

1.1 What is private equity?

What to say

Private equity firms raise money from institutional investors, use it to buy stakes in private companies, work to make those companies more valuable over several years, and then sell them. Most of the large firms focus on buyouts, where they take control of the company and finance part of the price with debt.

Private equity is a family of strategies, not one. Buyouts take majority control. Growth equity buys minority stakes in companies that are already profitable or close to it. Venture capital backs early-stage companies. Interviews at buyout funds focus on the first, but you should know where the others sit.

1.2 How is a private equity fund structured, and how does the firm get paid?

What to say

The firm is the general partner. It raises a fund from limited partners such as pension funds, endowments, insurers, sovereign funds and development finance institutions. The firm earns a management fee on the capital, commonly around 2% a year, and carried interest, commonly around 20% of the profits, but usually only after investors have received their money back plus a preferred return.

- **Fund life.** Typically about ten years: roughly five to invest, then the remainder to grow and sell the companies.
- **Preferred return.** The minimum annual return investors receive before carry is paid, often around 8%. This is what the fund documents call the hurdle rate.

- **Waterfall.** A whole-fund (European) waterfall pays carry only after investors have received back all contributed capital across the fund. A deal-by-deal (American) waterfall can pay carry on individual exits sooner, usually with clawback protection.

Common mix-up: the preferred return (around 8%) is not the same thing as the IRR a deal team targets when it underwrites a deal (often 20% or more for buyouts). Keep the two separate.

1.3 How is private equity different from a hedge fund?

What to say

Private equity buys whole companies or large stakes, holds them for years and gets involved in running them. Hedge funds mostly trade liquid securities, hold them for anywhere from minutes to years, and rarely take control. Private equity carry is paid when investments are sold; hedge fund performance fees are usually calculated annually.

	Private equity (buyout)	Hedge fund
What it owns	Control stakes in private companies	Public equities, credit, rates, FX, derivatives
Holding period	Typically 3 to 7 years	Minutes to years
Liquidity	Illiquid; capital locked up for the fund life	Periodic redemptions
How it adds value	Operations, strategy, capital structure, M&A	Security selection and trading
Performance fee	Carry paid on realised exits	Usually crystallised annually

1.4 What does a private equity associate actually do?

What to say

Associates screen new opportunities, build the financial model, run diligence workstreams with advisors, and write the investment committee memo. After a deal closes, they help monitor the portfolio company and support add-on acquisitions and refinancings.

Show that you understand the deal lifecycle: sourcing, screening, first-round bid, diligence, final bid and financing, signing and closing, ownership, and exit. Be ready to say which part of that you find most interesting and why.

1.5 What is a good framework for an investment memo?

What to say

Lead with the recommendation and the three to five reasons behind it. Then cover the key risks and how you would mitigate them, the industry, the company, the financial case and deal structure, returns under different scenarios, and the questions you still need diligence to answer.

A memo that does not take a position is not a memo. The strongest candidates say "I would invest, because" or "I would pass, because" and then defend it.

In African markets

Development finance institutions such as IFC, BII and Proparco are among the most important limited partners for Africa-focused funds, and local pension funds are a growing but still small source of capital. Many African deals are minority or growth investments rather than leveraged control buyouts, because debt is harder to raise and currency risk is higher. Expect interviewers at Africa-focused funds to test growth equity reasoning as much as LBO mechanics.

Anatomy of a leveraged buyout

An LBO is the purchase of a company using a significant amount of borrowed money, repaid from the company's own cash flow. If you can explain this section clearly, you can handle most technical rounds.

2.1 Walk me through an LBO.

What to say

A sponsor buys a company for a price set by a multiple of EBITDA. It funds that price with a mix of debt and its own equity. Over the holding period, the company uses its free cash flow to pay interest and reduce the debt, while the sponsor works to grow EBITDA. At exit, the company is sold at a multiple of the higher EBITDA, the remaining debt is repaid, and what is left belongs to the equity holders. The return is that exit equity compared with the equity originally invested.

In a model, that becomes five steps:

- **Transaction assumptions.** Purchase price, fees, and the debt and equity that fund them (sources and uses).
- **Pro forma balance sheet.** The company's balance sheet adjusted for the new capital structure.
- **Operating projections.** Revenue, margins, capex and working capital, giving free cash flow each year.
- **Debt schedule.** Interest, mandatory repayments and optional paydown from excess cash.
- **Exit and returns.** Exit value, less net debt, gives exit equity. Calculate IRR and multiple of money, then sensitise the key assumptions.

2.2 Why use leverage at all?

What to say

Debt reduces the equity the sponsor has to put in. If the company's value grows, all of that growth accrues to a smaller equity cheque, so the percentage return is higher. Interest is also usually tax deductible, which lowers the effective cost of the debt.

Leverage cuts both ways. It magnifies losses as well as gains, and fixed interest payments raise the chance of default if the business weakens. Leverage only helps equity returns when the business earns more on its capital than the after-tax cost of the debt.

2.3 Strategic buyers often pay cash. Why do sponsors prefer debt?

What to say

The sponsor's goal is to maximise the return on a limited equity fund over a fixed period, so reducing the equity cheque matters more to it than to a corporate buyer. The acquisition debt is raised by the acquisition vehicle that merges with or owns the target, secured on the target's assets and serviced by the target's cash flow, not guaranteed by the fund.

2.4 Walk me through sources and uses.

What to say

Uses are everything the deal has to pay for: the equity purchase price, refinancing the target's existing debt, and transaction and financing fees. Sources are how it is funded: new debt tranches, any cash taken from the target's balance sheet, any rollover equity from management, and the sponsor's equity, which is the plug. The two sides must match.

Uses	\$m	Sources	\$m
Purchase equity	700	Term loan	350
Refinance existing debt	300	Senior notes	150
Transaction fees	20	Management rollover	30
Financing fees	10	Sponsor equity (plug)	500
Total uses	1,030	Total sources	1,030

Illustrative. Enterprise value here is \$1,000m: \$700m of equity plus \$300m of debt refinanced.

2.5 How does the balance sheet change at close?

What to say

The target's old shareholders' equity is eliminated and replaced with the sponsor's new equity. Old debt is repaid and new acquisition debt is added. Assets are written up to fair value, new identifiable intangibles are recognised, and goodwill is the residual. Cash falls by whatever was used in the deal.

- **Goodwill** is the purchase price less the fair value of net identifiable assets.
- **Financing fees** on term debt are generally netted against the debt and amortised over its life under U.S. GAAP and IFRS. Fees on an undrawn revolver are usually still shown as an asset. Older guides show all financing fees as a separate asset.
- **Transaction fees** such as advisory and legal costs are expensed, which reduces equity rather than being capitalised.
- **Deferred tax liabilities** can arise when book values are written up but tax bases are not.

2.6 Where do returns come from?

What to say

Three places. EBITDA growth, because the company is sold at a multiple of a bigger number. Debt paydown, because every dollar of debt repaid is a dollar more for equity at exit. And multiple expansion, if the company is sold at a higher multiple than it was bought for. Sponsors underwrite the first two and treat the third as upside.

EBITDA growth can come from revenue growth (organic or through acquisitions) or from margin improvement. Debt paydown depends on free cash flow, so working capital discipline and capex efficiency matter too. Section 3 shows how to split a return across the three drivers.

2.7 Your model shows returns below the target. What can you change?

What to say

Pay less, which is the most direct lever. Add more debt, if the business can support it. Improve the operating case through faster growth or better margins. Improve cash conversion so debt is repaid faster. Assume a higher exit multiple, though I would be careful relying on that. Or change the timing, since the same gain over a shorter hold produces a higher IRR.

The honest follow-up: most of these are assumptions, not actions. If the only way to reach the target return is a higher exit multiple or a more aggressive plan than management's, the right answer may be to lower the bid or walk away.

2.8 How could a company exit at a higher multiple than it was bought for?

What to say

By becoming a less risky or faster-growing business. Examples include reaching greater scale, reducing customer concentration, shifting towards recurring or contracted revenue, entering faster-growing markets, and professionalising management and reporting. Buyers pay more for earnings they trust.

Buying a smaller company cheaply and building it into a larger platform through add-ons is a deliberate version of this, often called multiple arbitrage.

Returns maths and the paper LBO

Expect at least one question you have to solve in your head or on paper. Speed comes from knowing a few reference points by heart.

3.1 What are IRR and MOIC, and how do they differ?

What to say

MOIC, the multiple of invested capital, is total value returned divided by equity invested. It ignores time. IRR is the annualised return: the discount rate that makes the net present value of all the equity cash flows zero. A 2x over three years and a 2x over seven years have the same MOIC but very different IRRs.

With a single investment and a single exit, $IRR = MOIC^{1/\text{years}} - 1$. Investors look at both. A high IRR on a quick flip may return little actual money; a high MOIC over a long hold may barely beat the market.

Reference table: MOIC to IRR

MOIC	3 years	4 years	5 years
2.0x	26%	19%	15%
2.5x	36%	26%	20%
3.0x	44%	32%	25%

Memorise the five-year column. A 2x over five years is about 15%, 2.5x about 20% and 3x about 25%.

3.2 What is the rule of 72?

What to say

Divide 72 by the annual return to get roughly how many years it takes to double your money. At 12%, money doubles in about six years. Working backwards, doubling in five years implies about $72 \div 5 = 14.4\%$; the exact answer is 14.9%.

3.3 You invest \$100m of equity, hold for five years and want a 25% IRR. If you exit at 15x EBITDA with no debt remaining, what EBITDA do you need at exit?

What to say

A 25% IRR over five years is about 3x, so I need roughly \$300m of equity at exit. With no debt, that is also the enterprise value. \$300m divided by 15 is \$20m of EBITDA.

Precisely, $1.25^5 = 3.05$, so exit equity is \$305m and EBITDA is about \$20.3m. If the interviewer adds remaining debt, add it to the required enterprise value before dividing by the multiple.

3.4 EBITDA is flat and you exit at the same multiple you paid. Can you still make money?

What to say

Yes, through debt paydown. Enterprise value is unchanged, but the company has used its free cash flow to repay debt, so a larger share of the same enterprise value belongs to equity. Any dividends paid along the way add to the return as well.

3.5 Would you rather have an extra dollar of EBITDA or an extra dollar of debt paydown?

What to say

An extra dollar of EBITDA, in almost every case. At exit it is worth a dollar times the exit multiple, say \$8 at 8x, plus the extra cash it generates along the way. A dollar of debt paydown is worth about a dollar at exit, plus the interest it saves.

The exception is a very low exit multiple or an EBITDA gain that arrives too late to be capitalised by a buyer, but that is rare.

3.6 If debt costs 10%, what return does the business need for leverage to help equity?

What to say

The unlevered return on the business has to exceed the after-tax cost of debt. With a 25% tax rate, 10% debt costs 7.5% after tax. If the business earns more than that on its capital, borrowing increases the equity return; if it earns less, borrowing reduces it.

WORKED EXAMPLE

A five-year paper LBO

A sponsor buys a company with \$100m of EBITDA at 10x, so enterprise value is \$1,000m. It raises \$500m of debt at 8% and puts in \$500m of equity. Ignore fees and cash.

EBITDA grows 5% a year. Depreciation and capex are each \$20m a year, working capital is flat, the tax rate is 25%, and all free cash flow repays debt. Interest is charged on the opening debt balance each year. The sponsor exits after five years at 10x.

\$m	Year 1	Year 2	Year 3	Year 4	Year 5
EBITDA	105.0	110.3	115.8	121.6	127.6
Less: interest	(40.0)	(37.3)	(34.1)	(30.4)	(26.2)
Less: cash taxes	(11.3)	(13.2)	(15.4)	(17.8)	(20.4)
Less: capex	(20.0)	(20.0)	(20.0)	(20.0)	(20.0)
Free cash flow to repay debt	33.8	39.7	46.2	53.3	61.1
Closing debt	466.2	426.5	380.3	327.0	265.9

Taxes are 25% of (EBITDA – depreciation – interest). Figures may not sum exactly due to rounding.

The exit

Exit EBITDA × 10x	1,276.3
Less: remaining debt	(265.9)
Exit equity	1,010.4
MOIC	2.0x
IRR	~15%

Where it came from

EBITDA growth (\$27.6m × 10)	276.3
Debt paydown (\$500m – \$265.9m)	234.1
Multiple expansion	0.0
Total equity gain	510.4

The follow-up: getting to 20%

A 15% return would miss most buyout funds' targets. Two ways the interviewer might push you:

- **Buy for less.** At 9x, enterprise value is \$900m and equity falls to \$400m with the same \$500m of debt. Exit equity is unchanged at \$1,010m, so MOIC is 2.5x and IRR is about 20%.
- **Sell for more.** Exiting at 11x instead gives exit equity of about \$1,138m, a 2.3x and roughly 18%. Multiple expansion helps, but paying a turn less does more because it also shrinks the cheque.

Practise this example on paper until you can do it in under ten minutes. Interviewers often use almost exactly this setup with different numbers.

Debt and capital structure

Buyout returns depend on the financing, so interviewers expect you to know the main debt instruments, what lenders care about and how covenants work.

The capital structure, from safest to riskiest

Instrument	Security and ranking	Pricing	Repayment
Revolving credit facility	Senior secured	Floating; fee on undrawn amount	Drawn and repaid as needed
Term loan A	Senior secured, usually bank-held	Floating, lowest spread	Significant scheduled amortisation
Term loan B	Senior secured, sold to institutional investors	Floating, higher spread	Minimal amortisation (often 1% a year); bullet at maturity
Senior or high-yield notes	Secured or unsecured bonds	Usually fixed	Bullet; call protection limits early repayment
Mezzanine / subordinated	Junior to senior debt	Higher; often part PIK, sometimes with warrants	Bullet
Preferred and common equity	Residual claim	Highest expected return	At exit

4.1 What is a revolver, and why does a buyout company need one?

What to say

A revolver is a committed credit line the company can draw and repay as needed, like a corporate credit card. It covers swings in working capital and gives a liquidity buffer. The company pays interest on what it draws and a smaller commitment fee on the undrawn amount.

4.2 What is PIK interest?

What to say

Payment in kind: instead of paying interest in cash, the borrower adds it to the principal. It preserves cash in the near term but the debt balance compounds, so the claim ahead of equity grows every year. It shows up most often in mezzanine and holding company debt.

Accounting: PIK interest is an expense on the income statement, added back as a non-cash item on the cash flow statement, and increases debt on the balance sheet. Choosing to switch to PIK when cash interest is an option can signal that a company is under pressure.

4.3 What are maintenance and incurrence covenants?

What to say

Maintenance covenants must be met at regular test dates, usually quarterly, for example keeping leverage below a set level. Incurrence covenants are only tested when the company wants to do something specific, such as borrow more, pay a dividend or make an acquisition. Bank loans have traditionally carried maintenance covenants; high-yield bonds carry incurrence covenants.

Many institutional term loans are now "covenant-lite", with no maintenance tests on the term loan, often keeping only a springing test on the revolver. Private credit lenders are more likely to insist on maintenance covenants.

4.4 Why do lenders need covenants, and which matter most?

What to say

Covenants protect lenders from the borrower taking on more risk after the loan is made, and they give lenders an early warning and a seat at the table if performance slips. The most important are usually maximum leverage, minimum interest or fixed-charge coverage, and limits on extra debt, dividends and asset sales.

4.5 What credit statistics do lenders look at, and what is typical?

What to say

Total leverage (debt to EBITDA), senior leverage, interest coverage (EBITDA to interest), and a cash-flow coverage measure such as (EBITDA – capex) to interest. Acceptable levels depend on the business and the credit market; stable, cash-generative companies can carry more.

Leverage levels move with credit conditions, so avoid quoting a single "normal" number. Explain the logic instead: lenders size debt to what the business can service and repay in a downside case, not the base case.

4.6 How do you decide how much debt to put on a company?

What to say

Enough to lift returns, but not so much that a realistic downturn breaches covenants or leaves the company unable to pay interest and invest. I would size it from cash flow: how much the business can service at a sensible coverage ratio, how much it can repay over the hold, and what happens to both in a downside case. The market sets the ceiling; the business's cash flow should set the actual number.

4.7 What is a seller note?

What to say

Debt the seller provides by accepting part of the purchase price as a loan to the buyer, repaid later. It bridges a valuation gap, is usually subordinated to the senior lenders, and signals the seller's confidence in the business.

4.8 What is private credit, and why does it matter for buyouts?

What to say

Private credit funds lend directly to companies instead of arranging loans for banks or bond investors. They often provide a single "unitranche" loan in place of senior and junior layers. Execution is faster and more certain, at a higher interest cost. Direct lending has become a major source of buyout financing, especially for mid-market deals.

Update your terminology: U.S. dollar floating-rate loans are now priced off SOFR, not LIBOR. Regulators ended new LIBOR use after 2021 and the U.S. dollar panel was discontinued in June 2023. Older guides still say LIBOR.

In African markets

Local-currency debt is often expensive and short-dated, and hard-currency debt creates a mismatch if the company earns in naira, cedis or shillings. As a result, leverage in African deals is usually lower, and development finance institutions and mezzanine providers play a larger role in financing. When you discuss capital structure for an African company, raise currency risk early.

Picking the right company

Technical skill gets you through the first rounds. Judgement about businesses gets you the offer.

5.1 What makes a good LBO candidate?

What to say

Stable, predictable cash flow comes first, because that is what services the debt. Beyond that: a defensible market position, low capital and working capital needs, a strong management team, clear ways to improve the business, and a credible route to exit. A reasonable purchase price ties it together.

- **Cash flow.** Recurring or contracted revenue, diversified customers, limited cyclicity.
 - **Capital intensity.** Low maintenance capex and working capital leave more cash for debt paydown.
 - **Levers.** Pricing, cost efficiency, add-on acquisitions, new markets.
 - **Assets.** Tangible assets can support more borrowing, though cash flow matters more to lenders.
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5.2 How would you work through a CIM?

What to say

I would start with the business model: what it sells, to whom, and why customers choose it. Then the industry: growth, competition and what could disrupt it. Then the numbers: revenue quality, margins, capex, working capital and cash conversion. From there I would form a view on value, decide whether it fits an LBO, sketch a capital structure, and list the biggest risks and what diligence would need to prove.

5.3 What questions would you ask about the industry?

What to say

How fast is it growing and why? How concentrated is it, and on what do players compete: price, quality, service or brand? How much power do customers and suppliers have? What are the barriers to entry, and what could substitute for the product? What are the regulatory and macro exposures?

Porter's Five Forces is a reasonable scaffold, but interviewers are listening for the one or two forces that actually matter in this specific industry.

5.4 Would you rather invest in a business with high growth capex or high maintenance capex?

What to say

High growth capex, as long as it earns a good return. Maintenance capex just keeps the business where it is, so it is a permanent drag on free cash flow. Growth capex is discretionary and, if well spent, builds future EBITDA. The follow-up question is always what return that growth capex actually earns.

5.5 Would you rather own a shoe company or a utility in an LBO?

What to say

It depends on price and what I can change, but the utility offers far more predictable cash flow and supports more debt, while the shoe company has more cyclicity and fashion risk but more room to create value through brand, channel and cost improvements. Utilities are also regulated, which caps upside. I would lean towards whichever has the better risk-adjusted return at the price, and explain the trade-off rather than pick a side by reflex.

5.6 How do sponsors limit risk?

What to say

By not overpaying, using sensible leverage, doing thorough diligence, aligning management through equity ownership, structuring protections such as earn-outs or seller notes, and diversifying across the fund.

AWI CASE FRAMEWORK

Five questions for any business

Industry. Is this a market we want to be in?

Company. Why does this business win, and will it keep winning?

Levers. What can we change to make it more valuable?

Deal. Why is it for sale, and can we pay this price and still make our return in a downside case?

Exit. Who buys it from us, and why will they pay more?

Guide 05, The PE Case Interview, expands this framework.

Exits, recaps and add-ons

6.1 How do sponsors exit an investment?

What to say

A sale to a strategic buyer, a sale to another financial sponsor, an IPO, or a partial exit such as a dividend recapitalisation or a minority stake sale. More recently, continuation funds have become common: the sponsor sells the company from one of its funds to a new vehicle it also manages, giving existing investors the option to cash out.

6.2 What is a dividend recapitalisation, and why do one?

What to say

The company raises new debt and uses it to pay a dividend to its owners. The sponsor gets cash back before exit, which lifts IRR and reduces its capital at risk, while keeping ownership. The cost is higher leverage and more risk for the company.

Effect on the statements: the balance sheet shows more debt and lower shareholders' equity, with cash unchanged if all proceeds are paid out. The cash flow statement shows debt raised and dividends paid, both in financing. The income statement shows higher interest expense in later periods.

6.3 What is an add-on acquisition, and why do sponsors like them?

What to say

An add-on (or bolt-on) is a smaller company bought by an existing portfolio company. Sponsors like them because small companies often sell at lower multiples than the platform, so buying them lowers the blended entry multiple. They also bring cost savings, cross-selling and scale, which can support a higher exit multiple.

6.4 Which gives a higher valuation, a DCF or an LBO?

What to say

Usually the DCF. An LBO values the company at the price that delivers a target equity return, often 20% or more, while a DCF discounts cash flows at the weighted average cost of capital, which is much lower. A higher discount rate means a lower value, which is why an LBO analysis is often treated as a floor valuation.

6.5 What is a 338(h)(10) election?

What to say

A U.S. tax election that lets a stock purchase be treated as an asset purchase for tax purposes. The buyer gets a step-up in the tax basis of the assets, and therefore extra tax-deductible depreciation and amortisation, while the transaction is still legally a stock deal. It is available only when the target is an S corporation or a subsidiary of a corporate group, and the seller usually needs to be compensated for any extra tax it bears.

This is U.S.-specific. Mention that you would check the equivalent treatment for a non-U.S. target.

6.6 At the end of the day, what is private equity about?

What to say

Buying good businesses at sensible prices, making them better, and selling them to someone who values them more. The leverage and structuring help, but the returns that last come from picking the right companies and improving them.

Fund economics and deal structures

Beyond the model: how the fund makes money, and the structures that appear in real transactions.

7.1 Walk me through the fund waterfall with numbers.

Investors commit \$100m. The fund exits everything for \$250m after five years, with an 8% preferred return and 20% carry on a whole-fund basis with a full catch-up.

Step	\$m
Return of capital to investors	100.0
Preferred return: \$100m at 8% compounded for five years, less capital	46.9
GP catch-up until the GP holds 20% of total profit	30.0
Remainder split 80/20	73.1
Investors receive in total	220.0
GP carried interest	30.0

With a full catch-up the GP ends with exactly 20% of the \$150m profit. Under a hard hurdle, carry applies only to profit above the preferred return, so the GP would receive 20% of \$103.1m, about \$20.6m.

7.2 What is a clawback, and what is a management fee offset?

What to say

A clawback requires the GP to return carry already paid if later losses mean it received more than its share of total fund profits; it exists mainly in deal-by-deal waterfalls. A fee offset requires transaction, monitoring and other fees charged to portfolio companies to be credited against the management fee investors pay, usually at 80% to 100%. Both are standard investor protections and are worth knowing if a fund asks whether you understand its economics.

7.3 What is a subscription line, and how does it flatter IRR?

What to say

A credit facility secured on investors' uncalled commitments, used to fund investments before calling capital. Because IRR is time-weighted, delaying the capital call shortens the period between investors' cash going out and coming back, which raises reported IRR without changing the multiple of money. Sophisticated investors therefore look at multiple of money and at IRR calculated as if capital had been called on day one.

7.4 What is a continuation vehicle, and why have they grown?

What to say

A new fund, usually managed by the same sponsor, that buys an asset or a group of assets from an older fund. Existing investors choose to cash out or roll into the new vehicle. They have grown because they give liquidity when trade sales and IPOs are slow, let a sponsor hold a strong asset longer, and reset the value creation plan. The obvious conflict is that the sponsor sits on both sides, so the price is usually validated by new third-party investors and an independent fairness opinion.

7.5 What is a GP-led secondary, and what is an LP-led secondary?

What to say

A GP-led transaction is initiated by the manager, such as a continuation vehicle or a strip sale of several assets. An LP-led secondary is an investor selling its fund interest to another investor, usually at a discount or premium to the reported net asset value. Both are now routine and are a normal part of how private capital gets liquidity.

7.6 What is co-investment, and why do funds offer it?

What to say

Investing alongside the fund in a specific deal, usually with reduced or no fees and carry. Funds offer it to do deals larger than their concentration limits allow, to build relationships with investors ahead of the next raise, and to keep control of an asset they like. For the investor, it improves net returns but requires the capability to underwrite single assets quickly.

7.7 How do rollover equity and management incentive plans work?

What to say

Rollover equity is the seller, often a founder or the previous sponsor, reinvesting part of their proceeds into the new structure, which reduces the sponsor's cheque and aligns the seller with the next phase. A management incentive plan gives the team a share of equity value above a threshold, typically 8% to 12% of the equity in a mid-market deal, vesting over time and on exit, sometimes with tiers tied to multiple of money. Both dilute the sponsor's exit proceeds, so both belong in the returns model.

7.8 What is a buy-and-build, and where does it go wrong?

What to say

Acquiring a platform company and adding smaller businesses at lower multiples to build scale and re-rate the whole. It works when the platform has a management team and systems that can absorb acquisitions, when targets are genuinely cheaper, and when integration produces real savings. It goes wrong when the platform's own performance is neglected, when acquisitions are funded with expensive debt at rising multiples, when reported EBITDA is full of unrealised synergies, and when the enlarged group is still a collection of separate businesses at exit.

7.9 What is a take-private, and what makes one work?

What to say

A sponsor buying a listed company. It works when the market is undervaluing a business that needs investment, restructuring or a longer horizon than public shareholders will tolerate, when public company costs and short-term reporting pressure are a real burden, and when the sponsor can pay a control premium and still earn its return. The hard part is that the premium is paid on day one and the improvement takes years.

7.10 What is a minority or structured equity investment, and why would a sponsor do one?

What to say

Buying a stake without control, often with preferred terms: a liquidation preference, a coupon, board rights and protective provisions. Sponsors do it when the owner will not sell control, when the business needs growth capital rather than a change of ownership, or when the structure offers downside protection at a better risk-adjusted return than common equity. It is the dominant form of private capital in much of Africa, so be ready to discuss the governance rights that make a minority position investable.

Diligence and value creation

8.1 What does a quality of earnings report tell you that the audited accounts do not?

What to say

Whether reported EBITDA is sustainable. It tests revenue recognition and customer-level profitability, strips out one-off and owner-related costs, challenges management's adjustments, normalises working capital to set the peg, and identifies the real net debt items. The audited accounts confirm compliance; the QoE tells you what you are buying.

8.2 Which seller EBITDA adjustments would you push back on?

- Run-rate savings from actions not yet taken, or taken too recently to have been measured.
- Pro forma revenue from customers signed after the period end.
- "One-off" costs that appear in three consecutive years.
- Owner compensation removed without adding the cost of a professional replacement.
- Acquisition pro formas that add a full year of a target owned for two months, without its costs.
- Capitalised expenses presented as margin improvement.

The practical question in an interview: what would you accept? Genuine one-off legal settlements, closed-facility costs, transaction expenses, and above-market related-party rent, adjusted to a market rate.

8.3 What is a 100-day plan?

What to say

The list of actions agreed before closing and executed immediately after: install reporting and a KPI dashboard, fill gaps in the finance team, launch the pricing or procurement work, set the budget and the incentive plan, and start the acquisition pipeline if it is a buy-and-build. The point is that the value creation plan is underwritten in diligence and started in week one, not discovered in year two.

8.4 Which value creation levers are most reliable, in order?

Lever	Why it works, and what limits it
Pricing	Fastest and highest margin impact; limited by customer concentration and competitive response. Start with the price list, discount leakage and the last increase
Procurement and cost	Measurable and within management's control; limited by supplier concentration and quality risk
Working capital	Releases cash without affecting EBITDA, improving returns immediately; limited by customer and supplier power
Add-on acquisitions	Buys EBITDA below the platform multiple; limited by integration capacity and target availability
Professionalisation	Systems, reporting, management depth; slow but often what earns the exit multiple
Commercial expansion	New products, channels, geographies; highest upside, lowest predictability, so rarely underwritten in the base case

8.5 What makes a portfolio company exit-ready?

What to say

Two to three years of clean, auditable numbers with a credible management-reported EBITDA; a management team a buyer wants to back, including a CFO who can run a process; diversified customers; a documented growth plan a buyer can underwrite; no unresolved legal, tax or title issues; and a capital structure that can be refinanced or repaid. Sponsors start preparing 12 to 18 months before launching a sale.

8.6 How do you monitor a portfolio company?

What to say

Monthly management accounts against budget, a short KPI dashboard of the five or six operating drivers that actually move the business, cash and covenant headroom, the pipeline of value creation initiatives with owners and dates, and board meetings that address the two or three real issues rather than reviewing history. Associates usually own the reporting pack and the model update.

8.7 What do you do when a portfolio company misses badly?

What to say

Establish whether it is a timing issue or a structural one, get a 13-week cash flow forecast, test covenant headroom and talk to lenders early rather than late, decide whether management can fix it or needs strengthening, and re-underwrite the investment from today's facts: if I were buying this company now, would I? That question, honestly answered, drives whether the fund supports it with more equity or manages for value.

Quick-fire bank

Question	Answer
Why does more leverage raise IRR?	A smaller equity cheque captures the same increase in enterprise value, provided the business earns more than the after-tax cost of debt.
Gross versus net leverage?	Gross uses total debt; net deducts cash. Lenders often cap the cash deduction.
Why do sponsors prefer EBITDA to net income?	It approximates cash generation before capital structure and accounting for capital, making businesses comparable and debt capacity measurable.
Why does working capital growth reduce debt paydown?	Cash tied up in receivables and inventory is not available to repay debt, so fast growth can slow deleveraging.
What is the danger of underwriting multiple expansion?	It is outside your control and depends on the market at exit. Sponsors underwrite EBITDA growth and paydown and treat re-rating as upside.
Why might 5x leverage be riskier for a company with \$50m EBITDA and \$30m capex than for one with \$5m capex?	Cash available for debt service is far lower, so coverage after capex is what matters, not the leverage multiple.
Why would a sponsor do a dividend recap before exit?	To take money off the table, de-risk the position and raise IRR, while keeping the upside.
What is a management fee at the portfolio company level?	A monitoring fee charged by the sponsor for its services; usually credited in part against the fund's management fee.
Why do funds have concentration limits?	To stop a single failure impairing the fund; typically no more than 10% to 20% of fund size in one investment.
What is dry powder?	Committed capital not yet invested. High industry dry powder tends to push entry multiples up.

What is a club deal?	Two or more sponsors investing together in one company, usually because of size; it requires a shareholders' agreement on governance and exit.
What is the difference between growth equity and buyout?	Growth equity buys minority stakes in expanding, usually profitable companies with little or no leverage; buyouts take control and use debt.
Why would a sponsor pass on a good company?	Price. A high-quality business at a price that cannot deliver the target return in a downside case is a pass, not a compromise.
What is the first thing you look at in a new CIM?	The revenue and EBITDA history and how much of the EBITDA is adjusted, then customer concentration and capex. Then the reason for sale.
What is the most common reason PE deals underperform?	Overpaying, usually by relying on an operating plan or exit multiple that the sponsor did not control.
What does a J-curve look like for a single deal?	Fees and early costs come first, so the marked value dips before value creation and paydown lift it; realised return only appears at exit.

Test yourself

Answer each one out loud before checking. Answers are on the next page.

#	Question
1	A sponsor doubles its money in four years. What is the approximate IRR?
2	A company has \$50m of EBITDA and is bought at 8x with 60% debt. How much equity does the sponsor invest?
3	Same deal. EBITDA grows to \$60m, the exit multiple is 8x and \$100m of debt has been repaid. What is exit equity and the MOIC?
4	Name the three sources of LBO returns. Which one do sponsors avoid relying on?
5	Why does a revolver charge a fee on money the company has not borrowed?
6	What happens to the debt balance of a \$100m PIK note at 10% after two years?
7	A term loan has no quarterly leverage test. What is that called, and who bears the extra risk?
8	Give two reasons a company with high customer concentration is a harder LBO.
9	Why can buying add-ons at 5x lift returns for a platform bought at 10x?
10	What is the difference between a fund's preferred return and a deal's target IRR?

Answers

#	Answer
1	About 19%. $2^{1/4} \approx 1.19$. The rule of 72 gives 18%.
2	Enterprise value is \$400m. Debt is \$240m, so equity is \$160m.
3	Exit enterprise value is \$480m. Remaining debt is \$140m, so exit equity is \$340m. MOIC is $\$340m \div \$160m \approx 2.1x$.
4	EBITDA growth, debt paydown and multiple expansion. Sponsors avoid underwriting multiple expansion because they cannot control it.
5	The bank has committed capital it must hold available, and it is paid for that commitment whether or not the company draws.
6	$\$100m \times 1.1 \times 1.1 = \$121m$. The interest compounds into principal.
7	Covenant-lite. Lenders bear more risk because they have no early trigger to renegotiate if performance weakens.
8	Losing one customer can wipe out a large share of EBITDA, which threatens debt service; and buyers and lenders value concentrated earnings at lower multiples and lend less against them.
9	Each add-on's EBITDA is bought at 5x but, once part of the platform, is valued at the platform's multiple at exit. The blended entry multiple falls while the exit multiple does not.
10	The preferred return (often around 8%) is the minimum investors must earn before the sponsor receives carry. The target IRR (often 20% or more) is the return a deal team underwrites when deciding what to pay.

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