Structuring, Terms and Documentation

Interview preparation summary · PC track

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INT.CX.1.a · Pricing and terms

Calculate the all-in yield of a floating-rate private loan from its margin, base rate, floor, original issue discount and fees, and show when a floor starts to matter.

A private loan is priced as a floating base rate plus a fixed margin, so the cash coupon moves with rates while the margin stays put. Three features sit on top. A floor sets a minimum for the base rate (often somewhere between zero and 1%) and pays only when the benchmark falls below it. Original issue discount (OID) means the lender funds less than par, say 98, and an upfront or arrangement fee adds more; both are earned on day one, so lenders spread them over an assumed life, often three years to reflect a typical early takeout. Rough all-in yield is base rate plus margin plus upfront points divided by that life. The usual mistakes are quoting the margin as the yield, forgetting that a shorter life lifts the annualised value of the upfront points, and counting a floor as valuable when the base rate is far above it. Interviewers want the life assumption said aloud, because the answer changes with it.

WORKED EXAMPLE: ALL-IN YIELD ON A UNITRANCHE FOR KESTREL PRINT

Kestrel Print is an invented printing group borrowing a 100m unitranche. Terms: margin 6.00% over a base rate, base-rate floor 1.00%, issued at 98.0 (so 2.0 points of OID) and a 1.0% arrangement fee paid to the lender. The base rate is 4.00% today. Assume a 3-year life, straight-line spreading of upfront points, yield measured on the par amount and no tax. What is the all-in yield, and what is it if the base rate falls to 0.50%?

Answer: All-in yield is 11.00% at a 4.00% base rate and 8.00% if the base rate falls to 0.50%, because the floor lifts the coupon by 0.50 points.

> **Interview tip:** Say the life assumption first, then give coupon plus upfront points per year, and mention that the floor only earns its keep when the base rate is below it.

INT.CX.1.b · Pricing and terms

Explain how PIK interest, call protection and make-whole provisions change a lender's return and a borrower's cost, and compute their effect.

Payment-in-kind (PIK) interest is added to the loan balance instead of paid in cash, so the lender's claim compounds while the borrower keeps cash. It raises the lender's return but also its risk, because the debt grows while earnings may not, and nothing is received until repayment. Mezzanine often combines cash interest with a PIK element, and a PIK toggle lets the borrower choose, usually at a higher price. Call protection stops the borrower refinancing cheaply once spreads tighten: a non-call period when early repayment is not allowed or triggers a make-whole, then soft-call premiums such as 102 and 101 before par. A make-whole replaces the interest the lender loses, typically the present value of coupons to the first call date plus the premium due then. Interviewers test two things: that PIK is compounded rather than added in a straight line, and that you can say who pays when a borrower refinances early.

WORKED EXAMPLE: PIK AND SOFT CALL ON A DUNMORE FOODS MEZZANINE LOAN

Dunmore Foods is an invented food manufacturer. A fund lends 40m of mezzanine as a five-year bullet. Interest is 9% in cash plus 4% PIK, both charged on the opening balance, with PIK added at each year end. The loan is callable at 102 if repaid in year three, 101 in year four and par after. Ignore fees and tax and assume year-end flows. Find the balance at maturity, the total cash interest, and the lender's return if the borrower repays at the end of year three.

Answer: The balance reaches 48.67m at maturity with 19.50m of cash interest; repayment at year three costs the borrower 45.89m and gives the lender 13.63% against 13.00% if held.

> **Interview tip:** Say that PIK compounds, then say who benefits from the premium: the lender is compensated for early repayment but must find a new loan.

INT.CX.1.c · Pricing and terms

Compare delayed-draw term loans and revolving facilities with funded term loans, including commitment fees, utilisation and where each sits in the structure.

Not every facility is fully drawn at closing. A term loan is funded on day one and earns the margin on the whole amount. A delayed-draw term loan (DDTL) is committed but drawn later, usually for acquisitions or capex within an availability period of perhaps 12 to 24 months; until then the lender earns only a ticking fee, often around half the margin, while holding capital ready. A revolving credit facility (RCF) can be drawn, repaid and redrawn: the lender earns the margin on the drawn part and a commitment fee, often around 35% of the margin, on the undrawn part. Revolvers are usually priced lower and often rank super senior or are supplied by banks. Analytic points: judge return on committed capital, not funded capital; assume the revolver is drawn in a downturn, when credit is weakest; and read the draw conditions, such as pro forma leverage tests, as the lender's protection.

WORKED EXAMPLE: REVOLVER AND DELAYED-DRAW ECONOMICS FOR A LENDER

A fund provides two facilities to Larchmont Pumps, an invented engineering group. Facility A is a 20m revolver at a margin of 4.5% over a 4.0% base rate, with a commitment fee of 35% of the margin on the undrawn part and average utilisation of 30%. Facility B is a 30m DDTL at 6.0% over the same base rate, with a ticking fee of half the margin, drawn after nine months of a twelve-month year. Ignore OID, upfront fees and tax. Find each facility's year-one income and its yield on committed capital.

Answer: The revolver earns 0.73m, 3.65% on commitment; the DDTL earns 1.425m, 4.75% on commitment, against 10.0% on a fully funded term loan.

Interview tip: Always quote yield on committed capital and note that revolver exposure rises when credit quality falls, so you size the downside on the full commitment.

INT.CX.2.a · Protection

Distinguish maintenance, incurrence and covenant-lite packages and test covenant headroom, including the effect of baskets and EBITDA add-backs.

A maintenance covenant is tested on a schedule, usually quarterly, whatever the borrower does; a breach is an event of default and gives lenders a seat at the table. An incurrence covenant is tested only when the borrower acts, for example raising debt, paying a dividend or making an acquisition. Covenant-lite loans carry incurrence tests only, sometimes with a springing maintenance test on the revolver. Headroom is the fall in covenant EBITDA before the test breaks; for a covenant set at a level L from opening leverage of x, headroom is one minus x divided by L, and a target headroom h implies L equals x divided by one minus h. Definitions matter as much as levels: uncapped add-backs for cost savings and synergies, and grower baskets tied to EBITDA, inflate both headroom and debt capacity. Interviewers look for headroom measured on unadjusted EBITDA and for caps on add-backs.

WORKED EXAMPLE: SETTING AND TESTING A LEVERAGE COVENANT FOR ORRIN PACKAGING

Orrin Packaging is an invented sponsor-backed manufacturer with net debt of 80m and EBITDA of 20m, so opening leverage is 4.0x. The lender wants about 27% headroom. First, find the covenant level that gives it, then show what happens to headroom if the company later claims 3m of cost-saving add-backs in covenant EBITDA that are never realised. Ignore cash movements and tax.

Answer: A 27% headroom target implies about 5.5x, so a 5.5x covenant gives 27.3% headroom; unrealised add-backs of 3m lift covenant EBITDA to 23m and let real EBITDA fall 42.3% before a breach instead of 27.3%.

Interview tip: Quote headroom as the EBITDA fall to breach and say you would check it on unadjusted EBITDA, not the borrower's certificate.

INT.CX.2.b · Protection

Assess a security and guarantee package and an intercreditor structure by tracing who is paid first from which assets.

Security is a claim on specific assets: share pledges over the group, fixed and floating charges over operating assets, and pledges over bank accounts and intellectual property. Guarantees from subsidiaries give the lender a direct claim on the entity that owns the earnings. A test lenders use is guarantor coverage, often requiring guarantors to hold perhaps 80% or more of group EBITDA and assets. Anything held outside the guarantor group is only reached through a share pledge, and then behind that subsidiary's own creditors, which is structural subordination. The intercreditor agreement sets who is paid first

from the proceeds: a super senior revolver may rank ahead of term lenders, second lien usually accepts a standstill before enforcing, and junior creditors turn over recoveries until senior debt is paid. Interviewers want you to trace value from assets to claims and to name the leak, such as a non-guarantor subsidiary or a priming debt basket.

WORKED EXAMPLE: TRACING RECOVERIES FOR WEXCOMBE HOTELS

Wexcombe Hotels is an invented hotel group with a distressed enterprise value of 100m. Guarantor subsidiaries hold 80m of that value. A non-guarantor subsidiary holds the other 20m but has 6m of its own bank debt; its shares are pledged to the lenders. Claims are a 15m super senior revolver, a 60m first-lien term loan and a 25m second-lien loan. Ignore enforcement costs. What does each class recover?

Answer: The revolver and first lien recover 100%, the second lien recovers 76%, because only 94m of the 100m reaches the lenders once the non-guarantor's own debt is paid.

> **Interview tip:** Say you trace value up the structure first, then down the ranking, and name the first leak: value held outside the guarantor group.

INT.CX.2.c · Protection

Explain how amendments, waivers and consent thresholds work, price a covenant waiver and compare an equity cure with a debt paydown.

A waiver is a one-off agreement not to enforce a specific breach; an amendment changes the document for good. Most changes need the required lenders, often a majority or two thirds by commitments, while sacred rights such as reducing margin, extending maturity, changing pro rata sharing or releasing all security need every affected lender. A holder with more than a third of a two-thirds class can block. Lenders usually charge a waiver fee, often 25 to 50 basis points, and may add a margin step-up, tighter reporting, a cap on add-backs or an equity injection. Many sponsor deals allow an equity cure: cash from the sponsor treated as extra EBITDA or as debt repayment for the covenant test. An EBITDA cure is cheap for the sponsor but leaves real debt unchanged, so lenders limit the number of cures and refuse overcure. Interviewers ask what you would demand in return for relief.

WORKED EXAMPLE: WAIVER AND CURE FOR PELHAM LOGISTICS

Pelham Logistics is an invented transport group with a 120m term loan, net debt of 81m and EBITDA of 15m against a maximum net leverage covenant of 5.0x. The sponsor asks for a waiver of the breach. Compare an EBITDA cure (cash deemed to be extra EBITDA for the test, not netted against debt) with a debt paydown, and price a waiver of 25 basis points fee plus a 50 basis point margin step-up for twelve months on the 120m loan.

Answer: The breach is 5.4x against 5.0x; an EBITDA cure needs 1.2m but leaves real leverage unchanged, a paydown needs 6.0m and fixes it, and the waiver is worth 0.90m to the lenders.

> **Interview tip:** Say what you would ask for in return for relief: a paydown or equity, a fee and step-up, tighter reporting and a cap on add-backs.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.