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CREDIT INVESTING

TOP SKILLS & STRATEGIES



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Overview

Historically, private credit funds had played a limited role prior to the global financial crisis, often as the provider of the final portion of financing, taking the highest level of credit risk in typical tiered capital structures.

Following the global financial crisis of 2007-2008, **private credit funds have increased their activity significantly**. These funds are now often the sole provider of debt financing on a transaction, playing the role that banks played before the crisis (also called direct lending). They also actively purchase distressed debt from banks, by acquiring portfolio of non-performing loans (NPLs).

Today, **private credit is growing at a rapid pace**. In fact, the private credit market has grown enormously over the past decade, and as demand from institutional investors continues to increase, it is set to expand even further.

This has been evidenced by Preqin, which claims that not only the total assets allocated by investors in this category nearly doubled since 2020 to \$1.6 trillion, but it's also expected to reach \$2.3 trillion total assets by 2027.

Private Credit Skills

Private credit is a fast-growing sector that demands a strong technical skillset for investment success. From credit analysis to risk management, mastering these skills is crucial for assessing borrower risk and structuring deals.

Legal and regulatory knowledge also plays a key role in navigating this complex landscape. We've split the essential skills into the categories below to help you understand what's needed to excel in private credit.

Credit Analysis

Involves evaluating borrower creditworthiness, identifying risks and determining suitable debt terms by assessing financial statements and cashflow projections.

Modelling Skills

Financial modelling skills are key for predicting investment outcomes, performing scenario analysis and supporting strategic decisions through cashflow projections and economic assessments.

Risk & Legal

Knowledge of legal frameworks and compliance in private credit is vital, enabling professionals to deal with regulatory changes and assess transaction documents efficiently.

Sector Expertise

In-depth industry knowledge allows professionals to identify risks and opportunities, tailoring lending strategies to specific sectors like real estate, banking and technology.

Credit Analysis

Credit analysis entails a thorough examination of financial documents, cash flow patterns and broader industry factors. Here's what a robust credit analysis involves:

- Analyzing financial statements for accuracy and trends
- Analyzing cash flow to gauge repayment potential
- Assessing both macro and micro risks of a portfolio
- Evaluating collateral value to support loan security

In practice, successful credit analysis hinges on understanding how several key elements will influence returns such as:

- **Gross cash flows:** How much income can the borrower realistically generate?
- **Costs:** What are the expected operational, financial, legal and capital expenses under different scenarios?
- **Time:** Does the timeline align with the expected results? What is the base, up and downside scenario?

In summary, a good credit analysis ensures that the investment's net present value (NPV) is positive, considering the required rate of return, potential defaults and the strength of the collateral backing the loans.

Modelling Skills

Private credit professionals use financial models to conduct scenario analyses, assess cash flow projections, and analyze the impact of various economic factors on loan performance.

Strong financial modelling skills enhance decision-making capabilities and support strategic investments and portfolio management. Following the previous point on credit analysis, this is essentially where you **put together your assumptions and test them on the data you have**. Ultimately, your goal is to be confident in your analysis so that the investment yields positive results.

Nevertheless, note that you might be very good at credit analysis but not so good at financial modelling. Therefore, you need to **ensure that the model is well conceived**, for which you might require not only checks to confirm cashflows, etc. but also follow the **four-eyes principle** to assure that the model is on point.

In the end, that model will be used as a basis of an analysis that will be **presented to the investment committee (IC)** and, if all goes well, you will have the green light to pursue the investment.

Risk & Legal

Private credit professionals must possess **robust risk assessment and management skills** to navigate the complexities of the debt markets. This includes evaluating credit risk to determine the likelihood of default, analyzing default rates across different asset classes, and understanding the challenges associated with illiquidity and secondary market transactions.

Effective risk management strategies help **mitigate potential losses and optimize portfolio performance**. One has to constantly stay up-to-date with news and events that might require changes in assumptions used in models for investments, as well as portfolio management (past investments that are currently being managed/monitored by the portfolio management team).

Being actively involved in the credit world is essential to becoming a solid investment professional and is praised in any top-tier credit investing team. Engaging with industry networks, analyzing market data, and participating in ongoing education are critical to maintaining a competitive edge. The ability to anticipate and manage risks effectively not only safeguards returns but also enhances credibility and trust among stakeholders, positioning professionals as valuable assets within their organizations.

Sector Expertise

Having a broad understanding of diverse industry sectors is essential for private credit professionals. This knowledge enables them to identify unique investment opportunities and potential risks, providing a competitive edge in the market.

Examples of sectors that are particularly relevant to the private credit industry today include **banking, real estate, energy and consumer goods**. Each industry has its own dynamics, market trends, and regulatory considerations that impact investment decisions and risk assessments.

Professionals with sector-specific expertise can effectively **identify opportunities and risks** (and sometimes get jobs more easily), **assess market conditions, and evaluate the financial health of companies within these sectors**. This insight guides strategic lending decisions and supports effective investments and portfolio management.

Moreover, a deep understanding of industry sectors allows private credit professionals to offer tailored financing solutions that meet the specific needs of businesses, enhancing their competitiveness and value proposition in the market.

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