

FIN 394.2

MW 8:00 a.m. – 9:30 a.m. (03320)

MW 9:30 a.m. – 11:00 a.m. (03325)

MW 11:00 a.m. – 12:30 p.m. (03330)

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Fall 2009

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Office hours:

MW 12:30 p.m. – 1:30 p.m.

and by appointment

## **Financial Strategies In Private Equity**

### **Course Objective**

This course examines the market for private equity. Private equity is a major source of capital for new and established private firms. The size of the organized private equity market has grown dramatically since the early 1990s. For example, capital committed to U.S. private equity firms increased from \$8 billion in 1991 to over \$250 billion in 2007. Even with the much-publicized decline in private equity investment, commitments to private equity funds totaled over \$175 billion in 2008. Despite the recent decline in capital commitments, the organized private equity market remains, and will continue to be a major component of the capital markets.

The objective of this course is to provide students with an understanding of the nature of the private equity market, the principal participants in this market, and the financial strategies that they employ. Topics covered include: How private equity funds are raised, structured, and financed; contracting in private equity markets; valuation of private equity interests; sources of capital for private companies; strategies for value creation; mergers and acquisitions, and exit strategies.

Prerequisites for this course are BA 385T, FIN 397.1, and FIN 394.1.

### **Course Packet and Useful References**

The course packet, which is available at the University COOP, contains daily assignments, readings, and the cases that will be discussed during the course. **The course packet is the only required text.** However, students may find the following books to be useful references at various times during the course.

#### **General references:**

Berk, Jonathan and Peter DeMarzo, 2007, Corporate Finance, Pearson/Addison-Wesley, Boston, MA.

#### **Private equity references:**

Bartlett, Joseph W., 1995 & 2009, Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (2<sup>nd</sup> ed., 2009 Cumulative Supplement), Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY.

Levin, Jack S., 2009, Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions, Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY.

Metrick, Andrew, 2007, Venture Capital and the Finance of Innovation, John Wiley & Sons, Inc., Hoboken, NJ.

Schell, James M., 1999, Private Equity Funds: Business Structure and Operations, Law Journal Press, New York, NY.

**Mergers and acquisitions references:**

Bruner, Robert F., 2002, Applied Mergers and Acquisitions, John Wiley & Sons, Inc., Hoboken, NJ.

Gaughan, Patrick A., 2006, Mergers, Acquisitions, and Corporate Restructurings (4<sup>th</sup> ed.), John Wiley & Sons, Inc., Hoboken, NJ.

**Course-related information, including the syllabus and handouts, will be posted on Blackboard.**

**Grading**

Final grades will be determined as follows:

Weight

**Midterm case**

20%

Each student will individually prepare a written analysis of a case. The case will be distributed in class on October 12, 2009 and the analysis will be due in class on October 26, 2009. The report will not exceed six pages, including exhibits. See page 8 of this syllabus for additional details.

**Final case**

40%

The final assignment in this course will consist of a written case analysis (individually prepared). The case will be distributed on the last day of class, December 2, 2009, and the analysis will be due by 9:00 a.m. on Wednesday, December 9, 2009. The report will not exceed six pages (including exhibits). See page 8 of this syllabus for additional details.

**Class participation**

35%

This portion of the grade will be based on the contribution of each individual student to the class discussion throughout the term. It will be based on the quality and quantity of class participation. Quality will be the far more important of the two dimensions. While each comment will be judged on its merits, worrying about each comment is counterproductive. What is important is your overall contribution to moving the class forward during the semester. Relatively frequent contributions to the discussion that demonstrate logical and thorough analysis will be required to earn 35%.

**Peer evaluation**

5%

At the end of the semester, I will ask each member of the class to evaluate the contribution of other class members to the quality of the class discussion throughout the semester.

Plus/minus grades will be assigned for each assignment and for final course grades.

### **Other Comments**

- All students are expected to be seated and ready at the beginning of class. I reserve the right to refuse admission to any student who does not make it to class on time. If you miss a class, you are responsible for any material that you miss, including any administrative announcements.
- To be fair to other students, I will not give any extra-credit assignments. Your final grade will be determined solely by the system described on the previous page.
- Students with disabilities may request appropriate academic accommodations from the Division of Diversity and Community Engagement, Services for Students with Disabilities, 471-6259.
- I expect every student to abide by the Honor System.

## Class Schedule/Readings

### I. Introduction

- Aug. 26 Lecture 1: Course introduction and overview  
 Reading: Technical Note: The Private Equity Industry
- Aug. 31 Lecture 2: Private equity markets  
 Readings:  
 Prowse, Stephen D., The Economics of the Private Equity Market, *Economic Review*, Federal Reserve Bank of Dallas (Third Quarter 1998), pp. 21 – 34.  
 Acharya, Viral V., Julian Franks, and Henri Servaes, Private Equity: Boom or Bust, *Journal of Applied Corporate Finance* (Fall 2007), pp. 44 – 53.  
 Kaplan, Steve, Private Equity: Past, Present, and Future, *Journal of Applied Corporate Finance* (Summer 2007), pp. 8 – 16.

### II. How private equity funds are raised, structured, and managed

- Sept. 2 Lecture 3: How private equity funds are raised, structured, and managed  
 Readings:  
 An Introduction to Private Equity Funds, Chapter 1 in Private Equity Funds: Business Structure and Operations by James M. Schell, Law Journal Press, New York, NY, 1999.  
 Structuring Formation of Private Equity Fund, Chapter 10 in Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions by Jack S. Levin, pp 10-1 to 10-62, Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY, 2009.
- 9 Case 1: Yale University Investments Office: August 2006 (investing in private equity)
- 14 Case 2: Acme Investment Trust (analyzing an investment in a private equity fund)
- 16 Case 3: 3i Group plc: May 2006 (managing a private equity firm)

### III. Relationships between private equity partnerships and entrepreneurs/managers

- 21 Lecture 4: Relationships between private equity partnerships and entrepreneurs  
 Readings:  
 Term Sheet: The Substance of The Deal Between the Founder and Investors, Chapter 9 in Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (2<sup>nd</sup> ed.) by Joseph W. Bartlett (pp 187-210) and pp 73-93 from 2009 Cumulative Supplement, Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY, 1995 & 2009.

Form 26-1: Sample Term Sheet, in Volume 3 of Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (2<sup>nd</sup> ed.) by Joseph W. Bartlett (pp 86-98) and 557-562 from 2009 Cumulative Supplement, Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY, 1995 & 2009.

Key Agreements: Stock Purchase, Stockholders, Employment, Chapter 10 in Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (2<sup>nd</sup> ed.) by Joseph W. Bartlett (pp 211-252), Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY, 1995.

23 Case 4: DermaCare: Zapping Zits Directly (evaluating alternative sources of capital)

28 Lecture 5: Compensation: Motivating entrepreneurs/managers

Readings:

Executive Compensation, Stephen F. O'Byrne, Chapter E9 in Handbook of Modern Finance, edited by Dennis Logue and James Seward, Warren, Gorham & Lamont RIA Group, Boston, MA, 1999.

Wruck, Karen H., Private Equity, Corporate Governance, and the Reinvention of the Market for Corporate Control, *Journal of Applied Corporate Finance* (Summer 2008), pp. 8 – 21.

28 Speaker: Guhan Swaminathan, Managing Director, Virgo Capital

Time: 6:00 p.m. – 7:30 p.m.

Location: GSB 2.124

#### **IV. Valuing private equity interests**

30 Case 5: Berg Electronics Corporation (capital cash flows approach to valuation)

Reading: Ruback, Richard S., Capital Cash Flows: A Simple Approach to Valuing Risky Cash Flows, *Financial Management* (Summer 2002), pp. 85-103.

Oct. 5 Case 6: IBP (valuing an investment)

Readings:

Dillon, Nancy, DLJ Knows Where the Beef Is, *New York Daily News* (October 3, 2000)

Mehring, Jaine I., Analyst Report on IBP, Inc., SalomonSmithBarney, October 2, 2000, pp. 1– 4.

McMillin, John. M. and Jeffrey G. Kanter, Analyst Report on IBP, Inc., Prudential Securities, October 3, 2000, pp. 1– 5.

Mehring, Jaine I., Analyst Report on IBP, Inc., SalomonSmithBarney, October 2, 2000, pp. 1– 9.

7 Case 7: Palamon Capital Partners/TeamSystem S.P.A. (valuing an investment)

- 12 Case 8: Sprigg Lane (A) (evaluating risk)  
 Reading: Monte Carlo Simulation, Section 10.2 in Chapter 10 of Principles of Corporate Finance (6<sup>th</sup> ed.) by Richard A. Brealey, Stewart C. Myers, and Franklin Allen, New York, NY, McGraw Hill/Irwin, 2000, pp. 268 - 275.

14 **There will be no class meetings on this day**

**V. Financing**

- 19 Case 9: Tax-Motivated Film Financing at Rexford Studios (raising capital)
- 21 Case 10: Coleco Industries, Inc. (choosing the appropriate financial policy)  
 Reading: Scan Chapters 14-16 on Capital Structure in Corporate Finance by Jonathan Berk and Peter DeMarzo, Boston, MA, Pearson/Addison-Wesley, 2007. (*in your BA385T Text*)
- 26 **Case 11: Midterm case (report due in class)**
- 28 Case 12: Aluminium Bahrain (Alba): The Pot Line 5 Expansion Project (large project financing)
- Nov. 2 Lecture 5a: Leasing Policy  
 Reading: None
- 2 Speaker: John Bass, Investment Manager, Chase Capital Corporation  
 Time: 6:00 p.m. – 7:30 p.m.  
 Location: GSB 2.124

**VI. Strategies for creating value**

- 4 Lecture 6: Corporate restructuring and reorganization  
 Reading: Corporate restructuring and Reorganization, James K. Seward, Chapter E8, E9 in Handbook of Modern Finance, edited by Dennis Logue and James Seward, Warren, Gorham & Lamont RIA Group, Boston, MA, 1999.
- 9 Case 13: Cumberland Worldwide Corporation (A) (financial restructuring in distress)
- 11 Case 14: NEC Electronics (restructuring a business to increase value)
- 16 Lecture 7: Mergers and acquisitions  
 Readings:  
 Mergers and Acquisitions, Chapter 28 in Corporate Finance by Jonathan Berk and Peter DeMarzo, Boston, MA, Pearson/Addison-Wesley, 2007. (*in your BA385T Text*)  
 University of Rochester Roundtable on Corporate M&A and Shareholder Value, Journal of Applied Corporate Finance (Fall 2005), pp. 64 – 84.  
 Zenner, Marc, and Matt Matthews, Jeff Marks, and Nishant Mago, The Era of Cross-Border M&A: How Current Market Dynamics are Changing the M&A Landscape, Journal of Applied Corporate Finance (Spring 2008), pp. 84 – 96.
- 18 Case 15: Service Corp. International (mergers and acquisitions and value drivers)

- 23 Speaker: John Muse, Chairman, HM Capital Partners  
Time: 6:00 p.m. – 7:30 p.m.  
Location: GSB 2.124

### **VII. Exit strategies**

- 23 Lecture 8: Exit strategies

Readings:

Exit Strategies: Structuring IPO or Sale of VC-Financed Portfolio Company, Chapter 9 in Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions by Jack S. Levin (pp 9-1 to 9-49), Aspen Publishers division of Wolters Kluwer Law & Business, New York, NY, 2009.

Initial Public Offerings, Jay Ritter, Chapter D11, E9 in Handbook of Modern Finance, edited by Dennis Logue and James Seward, Warren, Gorham & Lamont RIA Group, Boston, MA, 1999.

Lazard, Robert Berger, SPACs: An Alternative Way to Access the Public Markets, Journal of Applied Corporate Finance (Summer 2008), pp. 68 – 75.

- 25 **There will be no class meetings on this day**

- 30 Case 16: Transportation Displays Incorporated (C) (alternative exit strategies following a successful corporate turnaround)

### **VIII. Conclusion**

- Dec. 2 Lecture 9: Summary and course wrap-up  
9 Final case due by 9:00 a.m.

## Instructions for Preparing Written Case Analyses

### Case Analysis

1. Read the case carefully. Identify the significant points and relationships. Use the exhibits to help you understand and/or interpret the text.
2. Analyze the data presented in the case and evaluate it in light of the situation. Try to understand not only the present situation, but also its historical origin and how it developed.
3. Decide what the major problems are and, if appropriate, prioritize them.
4. With the problems in mind, identify the feasible alternative courses of action. Determine what additional information is necessary to evaluate the alternative courses of action. Obtain that additional information.
5. Decide what your specific recommendation is to be. In doing so, use your understanding of the alternatives to frame a solution to the problem(s), and predict and evaluate the probable consequences of your solution.
6. Decide how you will organize the presentation of your solution to the case.

### Document Organization

1. **Problem Statement:** Identify the problem(s) concisely, using whatever case facts are necessary to show significance and/or priority.
2. **Analysis:** Avoid generalities. Be as specific as possible. Express your ideas clearly, supporting them adequately with evidence, explanation, and references to appropriate exhibits. The strengths and weaknesses of alternative courses of action should be developed. The analysis should build to support your recommendation. Reasons for accepting or rejecting alternatives should be stated and, if necessary, defended.
3. **Recommendation:** State your recommendation clearly and in detail sufficient to guide implementation. Discuss both the positive and negative results of following your recommendation and why you think that it is the appropriate course of action. Make sure that the recommendation follows logically from your analysis.

### Document Format

The case solution will be written as a report to senior management. The first page should provide a short executive summary that is no more than one three or four sentence paragraph in length. The detailed analysis should be presented on the following pages. All pages should be numbered and the document typed with one-inch margins and double spacing. Use a 10 point font or larger. Tables, Charts, spreadsheets, or any other supporting materials may be attached as exhibits. Each exhibit must be referred to in the text and clearly labeled.