

## COURSE SYLLABUS

### COURSE DETAILS

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**Course** Finance 394.2 – Financial Strategies in Private Equity

**Semester** Fall 2011

**Instructor** William T. Charlton, Jr., Ph.D., CFA

**Office** CBA 6.304D

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**Office Hours** MW 2-3pm. Others by appointment

**Class** MW 9:30-10:45, UTC 1.104, 03635

**Meetings** MW 11:00-12:15, UTC 1.104, 03640

### COURSE OBJECTIVES

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This course examines the application of advanced corporate finance concepts in the private equity markets. Private equity is a major source of capital for new and established private and public firms. The size of the organized private equity market has grown dramatically since the early 1990s. For example, capital committed to traditional private equity funds in the U.S. increased from \$8 billion in 1991 to over \$250 billion in 2007. The amount of capital that has been committed to traditional private equity funds worldwide, but remains un-invested as of mid-2010, is estimated to be over \$750 billion.

As investors have been attracted to private equity markets, private equity funds have developed specialized strategies and targeted specific market segments. In addition to the original LBO funds from the 1980's and the venture funds of the late 1990's, growth, mezzanine, middle market buyout, infrastructure, and energy funds, among others, have been popular investment vehicles for institutional investors.

The objectives of this course are to provide students with an understanding of the nature of the private equity markets, the principal participants in these markets and their activities, and the financial strategies that they employ. Topics covered include: How private equity funds are raised, structured, and financed; contracting in the private equity markets; financing investments; valuation of business interests; corporate restructuring and reorganization; M&A, and exit strategies.

## COURSE MATERIALS

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- Required Materials** 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, you may find the following books to be useful references at various times during the course.
- The *Wall Street Journal* should be read on a daily basis.  
To subscribe: <http://subscribe.wsj.com/semester>
- General Reference** Berk, Jonathan and Peter DeMarzo, 2007, *Corporate Finance*, Pearson/Addison-Wesley, Boston, MA (*your BA385T Text*).
- Private equity references** Bartlett, Joseph W., 1995 & 2009, *Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations* (2nd 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.
- Valuation and mergers and acquisitions references** Koller, Tim, Marc Goedhart, and David Wessels, 2010, *McKinsey Valuation* (5th ed.), John Wiley & Sons, Inc., Hoboken, NJ.
- Bruner, Robert F., 2002, *Applied Mergers and Acquisitions*, John Wiley & Sons, Inc., Hoboken, NJ.
- Gaughan, Patrick A., 2006, *Mergers, Acquisitions, and Corporate Restructurings* (4th ed.), John Wiley & Sons, Inc., Hoboken, NJ.
- Prerequisites** BA 285T, FIN 286, FIN 397.1, and FIN 394.1.

## COURSE POLICIES

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- Students With Disabilities** Upon request, the University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located on the fourth floor of the [Student Services Building](#). [Information on how to register](#), [downloadable forms](#), including [guidelines for documentation](#), accommodation request letters, and releases of information are available [online](#). Please do not hesitate to contact SSD at (512) 471-6259 or via [e-mail](#) if you have any questions.

**Religious Holidays** UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

**BlackBoard** Students should check Blackboard regularly. I will post any announcements, changes to the course schedule, as well as other useful information on that site.

**Feedback** I am open to and encourage students to offer suggestions on how to improve the course both for the existing semester and future ones. My goal is to optimize my approach to helping students understand the important topics that we will be covering this semester. Any suggestions for improvements will be much appreciated.

**Honor Code** The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the Policy Statement on Scholastic Dishonesty for the McCombs School of Business:

By teaching this course, I have agreed to observe all of the faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all of the student responsibilities described in that document. If the application of that Policy Statement to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification. Policy on Scholastic Dishonesty: Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, and the integrity of the University, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> or the General Information Catalog to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty.

You are expected to abide by the University Honor Code at all times. All violations will be handled according to University procedures and referred to proper authorities. I will pursue any violations to the fullest extent of the code. If you are ever in doubt about a particular issue, please ask!

The course is intentionally structured to give students multiple opportunities to achieve an appropriate grade. No single test will determine a student's grade (see discussion of the optional final below). It is my hope that this structure will minimize the incentives to violate the Honor Code.

## MCCOMBS CLASSROOM PROFESSIONALISM POLICY

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The highest professional standards are expected of all members of the McCombs community. The collective class reputation and the value of the Texas BBA experience hinges on this. Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects.

The Texas BBA classroom experience is enhanced when:

- Students arrive on time** On time arrival ensures that classes are able to start and finish at the scheduled time. On time arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
- Students are fully prepared for each class** Much of the learning in the Texas BBA program takes place during classroom discussions. When students are not prepared they cannot contribute to the overall learning process. This affects not only the individual, but their peers who count on them, as well.
- Students attend the class section to which they are registered** Learning is enhanced when class sizes are optimized. Limits are set to ensure a quality experience. When section hopping takes place some classes become too large and it becomes difficult to contribute. When they are too small, the breadth of experience and opinion suffers.
- Students respect the views and opinions of their colleagues** Disagreement and debate are encouraged. Intolerance for the views of others is unacceptable.
- Laptops are closed and put away** When students are surfing the web, responding to e-mail, instant messaging each other, and otherwise not devoting their full attention to the topic at hand they are doing themselves and their peers a major disservice. Those around them face additional distraction. Fellow students cannot benefit from the insights of the students who are not engaged. Faculty office hours are spent going over class material with students who chose not to pay attention, rather than truly adding value by helping students who want a better understanding of the material or want to explore the issues in more depth. Students with real needs may not be able to obtain adequate help if faculty time is spent repeating what was said in class. There are often cases where learning is enhanced by the use of laptops in class. Faculty will let you know when it is appropriate to use them. In such cases, professional behavior is exhibited when misuse does not take place.
- Phones and wireless devices are turned off** We've all heard the annoying ringing in the middle of a meeting. Not only is it not professional, it cuts off the flow of discussion when the search for the offender begins. When a true need to communicate with someone outside of class exists (e.g., for some medical need) please inform the professor prior to class.

**EVALUATION**

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<b>Weighting</b>	Midterm Exam	20%
	Final Case	40%
	Class Participation	35%
	Peer Evaluation	<u>5%</u>
	<b>Total</b>	<b>100%</b>

Plus/minus grades will be assigned for the final course grades.

**Distribution** The MBA Programs Committee approved the following target grade distribution for all Core and Flex Core courses:

A (4.0)	25%
A- (3.67)	20%
B+ (3.33)	15%
B (3.0)	35%
B- & below (2.67)	5%

This course uses that target distribution as a guideline for establishing final grades.

**Midterm Exam** There will be an in-class exam on October 12. Students are responsible for all course material covered up through October 10.

**Final Case** 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, November 30, 2010, and the analysis will be due by 9:00 a.m. on Wednesday, December 7, 2010. The report will not exceed six pages (including exhibits). See the last page of this syllabus for additional details.

**Class Participation** 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** 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.

## TENTATIVE COURSE OUTLINE

### Introduction

**8/24 Lecture 1:** Course introduction and overview

**Reading(s):**

How Firms Raise Capital, Chapter 15 in *Fundamentals of Corporate Finance* by Robert Parrino and David S. Kidwell, John Wiley & Sons, Inc., Hoboken, NJ, 2009.

Technical Note: The Private Equity Industry

**8/29 Lecture 2:** Private equity markets

**Reading(s):**

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, Steven N., Private Equity: Past, Present, and Future, *Journal of Applied Corporate Finance* (Summer 2007), pp. 8 – 16.

Kaplan, Steven N. and Josh Lerner, It Ain't Broke: The Past, Present, and Future of Venture Capital, *Journal of Applied Corporate Finance* (Spring 2010), pp. 36 – 47.

### How Private Equity Funds Are Raised, Structured, And Managed

**8/31 Lecture 3:** How private equity funds are raised, structured, and managed

**Reading(s):**

An Introduction to Private Equity Funds, Chapter 1 in Private Equity Funds: Business Structure and Operations.

Structuring Formation of Private Equity Fund, Chapter 10 in Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions.

**9/7 Case 1:** Yale University Investments Office: August 2006 (investing in private equity)

**9/12 Case 2:** Acme Investment Trust (analyzing an investment in a private equity fund)

### Relationships Between Private Equity Funds And Entrepreneurs/Managers

**9/14 Lecture 4:** Relationships between private equity funds and entrepreneurs

**Reading(s):**

Term Sheet: The Substance of The Deal Between the Founder and Investors, Chapter 9 in Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (pp 187-210) and pp 73-93 from 2009 Cumulative Supplement.

	<p>Form 26-1: Sample Term Sheet, in Volume 3 of <u>Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations</u> (pp 86- 98) and (pp557-562) from 2009 Cumulative Supplement.</p> <p>Key Agreements: Stock Purchase, Stockholders, Employment, Chapter 10 in <u>Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations</u> (pp 211-252).</p>
<b>9/19</b>	<p><b>Lecture 5:</b> Motivating managers</p> <p><b>Reading(s):</b></p> <p>Executive Compensation, Stephen F. O’Byrne, Chapter E9 in <u>Handbook of Modern Finance</u>, edited by Dennis Logue and James Seward, Warren, Gorham &amp; Lamont RIA Group, Boston, MA, 1999.</p> <p>O’Byrne, Stephen F. and S. David Young, Six Factors That Explain Executive Pay (and its Problems), <i>Journal of Applied Corporate Finance</i> (Spring 2010), pp. 109 – 117.</p> <p>Wruck, Karen H., Private Equity, Corporate Governance, and the Reinvention of the Market for Corporate Control, <i>Journal of Applied Corporate Finance</i> (Summer 2008), pp. 8 – 21.</p>
<b>9/21</b>	<p><b>Case 3:</b> Donald Salter Communications, Inc. (structuring compensation in a private firm)</p>
<b>Financing</b>	
<b>9/26</b>	<p><b>Case 4:</b> Coleco Industries, Inc. (choosing the appropriate financial policy)</p> <p><b>Reading(s):</b></p> <p>Scan Chapters 14-16 on Capital Structure in <u>Corporate Finance</u></p>
<b>9/28</b>	<p><b>Case 5:</b> Noble Group (financing a business)</p>
<b>10/3</b>	<p><b>Case 6:</b> Petrolera Zuata, Petrozuata C.A. (project finance)</p>
<b>10/5</b>	<p><b>Case 7:</b> Athens Ring Road (Attiki Odos) (project finance and infrastructure projects)</p>
<b>10/10</b>	<p><b>Lecture 6:</b> Leasing Policy</p> <p><b>Reading(s):</b></p> <p>Note on leasing policy</p>
<b>10/12</b>	<p><b>Midterm exam (Time and location TBD)</b></p>
<b>Valuation</b>	
<b>10/17</b>	<p><b>Case 8:</b> Berg Electronics Corporation (general valuation methods)</p> <p><b>Reading(s):</b></p>

	Ruback, Richard S., Capital Cash Flows: A Simple Approach to Valuing Risky Cash Flows, <i>Financial Management</i> (Summer 2002), pp. 85-103.
<b>10/19</b>	<b>Case 9:</b> IBP (LBO valuation) <b>Reading(s):</b> Dillon, Nancy, DLJ Knows Where the Beef Is, <i>New York Daily News</i> (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.
<b>10/24</b>	<b>Case 10:</b> Bidding for Hertz: Leveraged Buyout (LBO valuation)
<b>10/26</b>	<b>Case 11:</b> Comerica Incorporated: The Valuation Dilemma (valuing a financial institution)
<b>10/31</b>	<b>Case 12:</b> Sprigg Lane (A) (evaluating risk) <b>Reading(s):</b> Monte Carlo Simulation, Section 10.2 in Chapter 10 of <u>Principles of Corporate Finance</u> (6th ed.) by Richard A. Brealey, Stewart C. Myers, and Franklin Allen, New York, NY, McGraw Hill/Irwin, 2000, pp. 268 - 275.
<b>Strategies For Creating Value</b>	
<b>11/2</b>	<b>Lecture 7:</b> Corporate restructuring and reorganization <b>Reading(s):</b> Corporate restructuring and Reorganization, James K. Seward, Chapter E8, E9 in <u>Handbook of Modern Finance</u> , edited by Dennis Logue and James Seward, Warren, Gorham & Lamont RIA Group, Boston, MA, 1999.
<b>11/7</b>	<b>Case 13:</b> Ford Motor Company's Value Enhancement Plan (A) (recapitalization)
<b>11/9</b>	<b>Case 14:</b> Cumberland Worldwide Corporation (A) (financial restructuring in distress)
<b>11/14</b>	<b>Case 15:</b> WL Ross and Plascar (restructuring a business)
<b>11/16</b>	<b>Case 16:</b> NEC Electronics (restructuring a business)
<b>11/21</b>	<b>Case 17:</b> Service Corp. International (mergers and acquisitions and value drivers)

<b>Exit Strategies</b>	
<b>11/23</b>	<p><b>Lecture 8:</b> Exit strategies</p> <p><b>Reading(s):</b></p> <p>Exit Strategies: Structuring IPO or Sale of VC-Financed Portfolio Company, Chapter 9 in <u>Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions</u> (pp 9-1 to 9-49).</p> <p>Initial Public Offerings, Jay Ritter, Chapter D11, E9 in <u>Handbook of Modern Finance</u>, edited by Dennis Logue and James Seward, Warren, Gorham &amp; Lamont RIA Group, Boston, MA, 1999.</p> <p>Lazard, Robert Berger, SPACs: An Alternative Way to Access the Public Markets, <u>Journal of Applied Corporate Finance</u> (Summer 2008), pp. 68 – 75.</p>
<b>11/28</b>	<p><b>Case 18:</b> Transportation Displays Incorporated (C) (alternative exit strategies following a successful corporate turnaround)</p>
<b>Conclusion</b>	
<b>11/30</b>	<p><b>Lecture 9:</b> Summary and course wrap-up</p>
<b>12/7</b>	<p>Final case due by 9:00 a.m.</p>

*Note:* This is a tentative course outline. Topics may be re-sequenced, dropped or added depending on our progress throughout the semester. I will inform you of any changes as they are made and post any changes on BlackBoard.

**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 Organization**

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.