

# **B7399-067: Private Equity**

Columbia Business School: Executive MBA Program

## **Professor**

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## **Course Overview**

This seminar is designed as a survey of private equity. In addition to looking at the industry's dynamics, it will introduce the processes private equity professionals use to evaluate investments. It will also cover the way firms monitor and manage their portfolio companies. Over the course of the semester we will look at cases related to five types of transactions (i.e., venture capital deals, growth equity investments, middle market buyouts, LBOs and distressed debt/turnarounds).

The structure of the class will include lectures, cases and guest speakers. You will get the most out of the course by completing the required reading and coming to class prepared to participate and ask questions. Each week, a short quiz will be sent to you about **one** of the two cases you were asked to read. You must complete and submit it prior to class. Your participation will count towards your final grade. In addition to the cases, there are required texts for this course. However, there is no timetable for reading them. They were chosen to provide you with additional resources and perspective for this semester, and down the road.

You will be asked to form teams that will analyze and present one case in class. You will either be the deal team asking for approval to do the deal or will be the investment committee that should challenge the investment thesis and identify the investment's risks. The case presentations will be limited to 20 minutes. Each team member's performance will be evaluated during the presentations so it is important that everyone plays an active role on his/her respective teams. Each group will also write a 10-15 page "deal memo" (i.e., paper) arguing their respective positions on the cases they present in class. **The write-ups are your opportunity to analyze the case and take a position on the investment's merits. A summary of the facts of the case is not necessary. In fact, it will negatively impact your grade.**

## **Course Goals**

This course is designed to expose you to the analytical processes used to evaluate venture-stage, growth equity, buyout and distressed debt transactions. It will combine many of the fundamental skills you have acquired in the EMBA Program (e.g., financial statement analysis, valuation, industry analysis, microeconomics, macroeconomics, operations, strategic management and organizational dynamics). You should apply your knowledge in these areas to the presentations and papers. When selecting teams, be sure to gather a diverse set of skills (e.g., financial modeling, industry analysis, marketing, business writing, etc.). In addition to providing you with an understanding of how these skills can be applied in the private equity process, the course will also concentrate on how

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private equity professionals communicate their findings to their colleagues and influence their firm's investment decisions.

Another goal of the course is to emphasize the importance of monitoring and managing investments. An overlooked aspect of the private equity business is that a substantial portion of the value is created after an investment closes and before an exit occurs. This is especially true in the wake of the meltdown in the private equity, debt and stock markets. Investors can no longer assume they will be able to exit a deal and create value for their general and limited partners through an IPO, sale to a financial sponsor or benefit from the multiple expansion that typically accompanies a sale to a strategic buyer. As a result, it is very important for professionals to play a role in the growth and evolution of the businesses they have invested in.

Aside from these practical goals, the course lectures will cover topics ranging from technical items (e.g., how to value companies, how to use financial analysis techniques, etc.) to investment process related items (e.g., how to draft and read term sheets, stock purchase agreements and loan documents, how to conduct due diligence, etc.) to strategic items (e.g., how to assess a company's industry position, how to use macroeconomic factors when making investment decisions, etc.). The slides from each lecture will be posted on BOLD **after** they have been presented in class.

### **Preparation and Assignments**

Most weeks you will be required to read two HBS cases, which will be presented by you or your peers. In order to participate in the classroom discussions (note: class participation is one determinant of your final grade), you will need to be familiar with every case.

On occasion, you will also have assignments (other than the weekly surveys) to complete. I expect each of you to turn in your own work on these exercises (i.e., individuals, not groups, must submit answers).

### **Required Texts**

There are several required texts for this course. I believe each is a good business book and contains ideas you can use in a variety of careers. The required titles are:

*Execution* – Larry Bossidy

*Valuation for M&A* – Frank Evans and David Bishop

*Frenzy* – Carl Haacke

*Mastering the Merger* – David Harding, Sam Rovit

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*Buyouts* – Rick Rickertson

## **Required Cases**

These can be found in the casebook you received from the EMBA Office.

During the semester I will hand out additional articles. Unless otherwise noted, these are not required reading. However, they will cover topics we discuss in class and it is recommended that you look them over at some point.

## **Other Recommended Reading**

These books should be read at your leisure – assuming you are interested. Some of you may have already encountered a few of these titles in other classes.

*Valuation* – McKinsey & Company, Inc., Tom Copeland, Tim Koller, Jack Murrin

*Value Investing* – Bruce Greenwald, Judd Kahn, Paul Sonkin, Michael van Biema

*Manias, Panics, and Crashes* – Charles Poor Kindleberger

*The Art of M&A Due Diligence* – Alexandra Reed Lajoux, Charles Elson

*Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions* – Jack Levin, Martin Ginsburg (Editor), Donald Rocard (Editor)

*Valuing a Business* – Shannon Pratt

*Due Diligence for Global Deal Making* – Arthur Rosenbloom (Editor)

*Trading Up* – Michael Silverstein, Neil Fiske

*Economic Nature of the Firm* – Louis Putterman (Editor), Randall Kroszner (Editor)

*Expectations Investing* – Alfred Rappaport and Michael Mauboussin

*The Art of M&A* – Stanley Foster Reed, Alexandra Reed Lajoux

*The Synergy Trap* – Mark Sirower

*Deal Terms* – Alex Wilmerding

*Confessions of a Venture Capitalist* – Ruthann Quindlen

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*Done Deals* – Udayan Gupta

*Financial Shenanigans* – Howard Schilit

*How to Run a Company* – Dennis C. Carey

## **Course Requirements**

Each team will be responsible for analyzing one case and presenting its findings and recommendations to the class. In order to complete this task successfully, you will need to address a number of business issues.

Some of the topics you will need to cover in your presentations include, but are not limited to:

- Overview of business/investment opportunity
- Summary of industry, market, macroeconomic factors
- Competitive analysis
- Financial analysis/credit analysis
- Critique of the company's business and/or operating strategy
- Discussion of the marketing plan
- Unit economics
- Potential financial scenarios (e.g., management's case, a realistic case and, of course, a downside case)
- Valuation
- Analysis of milestones to monitor as the company executes its business plan and a description of what will drive growth
- Commentary on management team, strengths, weaknesses, needs, etc.
- Recommendation (i.e., should you invest, would you change the strategy, etc.)
- Deal structure
- Assessment of exit strategies and sponsor returns
- Listing of issues to cover during due diligence (besides the obvious stuff)

At the end of each presentation your peers will pose questions about the deal and, more importantly, your recommendation. Please give me a copy of your slides at least 24-hours before presenting. If you make last minute edits, please give me a clean copy before you begin speaking.

Your presentations **must** include slides that cover the topics listed below. However, it is up to you to decide how many slides to devote to each area.

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<b>Topic</b>	<b>Suggested # of Slides</b>
Deal/Company Overview	2 Slides
Transaction Description	1 Slide
Valuation	3-4 Slides
Due Diligence Process	2-3 Slides
Performance Metrics	1-2 Slides
Ways to Add Value	1-3 Slides
Exit	1 Slide

You can also cover the following topics:

Management	1 Slide
Important Secular Trends	1 Slide
Deal Risks	1 Slide

Your papers should be 10-15 pages, excluding exhibits. Margins should be 1", the text should be double-spaced and the font should be 12 point. Summary financial tables may be placed in the text if they help illustrate a point, but do not abuse this. One of the most important practical skills you can develop in business school is an ability to write clearly, concisely and persuasively. It is also important that you become comfortable using numbers to support your investment recommendation. If you fail to develop your argument logically and fully, I may send the paper back to you for revision.

### **Grading**

The case will be worth 30% of your grade. Papers are due one week after you present in-class. **Please note that one week after you present in-class does not mean the next time our class meets, which usually is two weeks after your group has presented. Late papers will not be accepted.**

Twenty percent (20%) of your grade will be based on class participation and the weekly surveys. You will be evaluated on your contribution to discussions and the questions you ask other teams. As always, quality is more important than quantity. Make every effort to pose thought provoking questions. Try to determine what factors are most important and incorporate these ideas into your comments. In other words, determine which aspects of the business being studied are essential to generating an attractive rate of return and be prepared to ask about them.

In addition, you will be asked to **write a two-page essay summarizing what you have learned this semester**. You may hand this paper in at any point during the semester. However, you should incorporate some of the ideas and arguments found in at least one of the books on the required reading list. This document and the homework exercises

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(e.g., the Boston Associates write-up, the free cash flow exercise, the IRR and multiple of capital analysis) will be worth 20% of your grade.

There will also be a take-home final exam/project worth 30% of your grade. Your group should identify a public company with an enterprise value of less than \$1 billion that it thinks is a prime candidate to be taken private and evaluate the transaction. I will distribute a list of potential targets in a couple of weeks. Your recommendation should be 5-10 pages. It should cover the same points as your case presentations and should inform the reader why the company you are choosing is (or is not) a viable “going private” transaction.

**The final exams will be due on Friday August 26, 2005. You can e-mail your papers to me. I WILL NOT ACCEPT LATE PAPERS.**

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As a graduate of the EMBA Program, I recognize the demands it places on you and will do everything in my power to keep your workload reasonable.

### **Guest Speakers**

I plan to have guest speakers this semester. Ideally, a venture capitalist will speak when we are looking at venture stage investing, someone specializing in growth equity financings will address the class when we are focused on that topic, etc. Unfortunately, we are at the mercy of our guests' schedules, so please be flexible and understanding if the guest lectures do not correspond perfectly with the topics we are covering in class.

In order to get the most from the speakers I would recommend reviewing their firm's Web site to gain an understanding of where they invest. It will also be helpful to know something about the types of transactions their firms execute and the businesses in their portfolios. Come to class prepared to ask challenging questions

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## **Class Schedule**

### **Friday May 20th, Sessions 1 & 2**

#### Topics

- Course Introduction
- Industry Overview
- Deal Evaluation Process

#### Required Reading

- Fed Study on Private Equity (Distributed via BOLD)
- Boston Associates

#### **Assignment (Due May 27<sup>th</sup> via e-mail)**

- 3 half-page summaries of the investment opportunities in the **Boston Associates case**

### **Friday June 3rd, Sessions 3 & 4**

#### Topics

- The “Private Equity Process”
- Roles within Private Equity Firms
- Deal Evaluation (continued)
- Deal Terms & Structuring

#### Required Reading

- Martin Smith May 2002
- Hotmail

### **Saturday June 4th, Sessions 5 & 6**

#### Topics

- Return on Invested Capital
- Valuation

#### Required Reading

- The Knot
- Pet Doctors

### **Friday June 10<sup>th</sup>, Sessions 7 & 8**

#### Topics

- Structuring Equity Investments
- Venture Capital Due Diligence

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## Required Reading

- Sigma Networks
- **Honest Tea**
- Anasazi Exclusive Salon Products

## **Saturday June 11th, Sessions 9 & 10**

### Topics

- Innovation
- Investing Philosophies
- Industrial Organization

### Required Reading

- Apax/Dialog Semiconductor
- Sirona

### **Assignment (Due June 17<sup>st</sup> via e-mail)**

#### **Free Cash Flow Exercise**

## **Friday July 8th, Sessions 11 & 12**

### Topics

- Investing in Consolidations
- The Synergy Trap

### Required Reading

- Hamilton Test Systems
- Record Masters

## **Saturday July 9th, Sessions 13& 14**

### Topics

- Buyout Deal Terms
- Important Market Dynamics
  - Supply Chain/RFID
  - Private Label vs. Branded Products
  - Foreign Sourcing, Manufacturing and Service Sector Outsourcing
  - Trading Up
  - Changing Face of the Market

### Required Reading

- BCI Growth
- Project Dialtone

### **Assignment (Due July 15<sup>th</sup> via e-mail)**

#### **IRR and Multiple of Capital Returned Analysis**

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**Friday July 22nd, Sessions 15, 16 & 17**

Topics

- Leveraged Buyouts
- Structuring Debt Agreements
- Exiting Buyouts

Required Reading

- Regal Cinemas
- Dressen

**Saturday August 6th, Sessions 18 & 19**

Topics

- Due Diligence in LBOs
- Financial Analysis/Portfolio Monitoring

Required Reading

- The Fojtasek Companies and Heritage Partners
- K-III: A Leveraged Build-Up

**Saturday August 20th, Sessions 20 & 21**

Topics

- Expectations Investing
- Distressed Debt
- Restructurings and Turnarounds

Required Reading

- Loewen Group
- National Convenience Stores

**Assignment (Due August 20<sup>th</sup> in-class or via e-mail)**

**Two-page write-up on “What You’ve Learned this Semester”**