New York University
Leonard N. Stern School of Business
Prof. Robert Semmens

Summer 2015
(Draft May 4, 2015)

FINC-GB.3165.30 2015S

Topics in Private Equity Finance

Tuesdays 6:00 to 9:00 pm
KMC 4-120

Robert F. Semmens
Office Hours: By appointment only
Email: rsemmens@stern.nyu.edu
Website: http://www.stern.nyu.edu/~rsemmens

Introduction

This course examines the private equity marketplace. Private equity is a significant source of capital for both new ventures and established firms. Private equity is the investment of capital in the equity of private companies to fund growth or in public companies to take them private.

Private equity is segregated into several sub-markets of which the principal focus of this class is on the leveraged buyout markets. Since its origins after World War II, the size of the private equity market has grown substantially and has become institutionalized. For example, annual capital commitments to private equity funds have grown from $8 billion in 1991 to a peak of more than $500 billion in 2007. Since the financial crisis began in late 2007, private equity commitments and deal volumes have declined substantially but by 2013 commitments had risen to $450 billion. At year-end 2013, there was approximately $1.1 trillion of private equity "dry powder" available for sponsors to call for private investments.

The objective of this course is to provide an overview of the private equity market from the differing perspectives of private equity investors (limited partners), private equity fund sponsors (general partners) and the managers of portfolio companies by focusing on the nature of the market and the strategies employed.

The "private equity cycle" will be explored and developed in the course. The private equity cycle includes:

1. Private equity fundraising and structure;
2. Investment origination, valuation, value creation and investment management;
3. Exit strategies.

Topics expected to be covered include:

1. Fundraising and Structure
    i. Private equity risk and return
    ii. Private equity manager selection
    iii. Asset allocation
    iv. Structure of private equity funds
    v. Analyzing a fund investment opportunity
    vi. Raising a first time fund

2. Investment Origination, Valuation, Value Creation and Management
    i. Valuation
    ii. Leveraged investments
    iii. Value creation
    iv. Debt securities
    v. Bad investments & restructuring
    vi. Private Equity securities
    vii. Investment management

3. Investment Exit
    i. Initial public offerings
    ii. Sale of portfolio companies
    iii. Leveraged recapitalizations
    iv. Distributions of portfolio investments

4. The Institutionalization of Private Equity

5. Other topics (as time permits)
    i. Secondary trading of fund investments
    ii. Monetization of general partnership interests
    iii. Discerning and developing opportunities
    iv. Portfolio management issues
    v. Corporate venture capital
    vi. Private equity in emerging markets
    vii. The impact of the financial crisis

The teaching method will employ extensive reading, discussion and lecture based principally on case studies. Since this is a mini-course, we will cover topics quickly, touching on the highlights rather than studying issues in depth. We will not discuss every topic or case in class but reading will be assigned on most topics. Students will be expected to actively participate in classroom discussion.

Class Prerequisites

*Foundations of Finance (*COR-GB.2311) are a prerequisite. It is also suggested (but not required) that students have completed or are taking concurrently *Corporate Finance*

(FINC-GB.2302). Working knowledge of finance, including investments and investment banking, and management policy is quite helpful.

Students who have taken similar courses such as Entrepreneurial Finance, Venture Capital Financing and New Venture Financing should only take this class with the Instructor's permission. Students who have taken Private Equity Finance may not take this course.

Schedule

Class will be held every Tuesday from May 12th to June 23rd except for May 19th, which is a Stern holiday from 6 pm to 9 pm. We will take one 10 to 15-minute break during each class.

A mid-term written assignment will be distributed at the end of the class on June 2nd and will be due on June 9th at the beginning of class. The final written assignment will be distributed on the last day of class, June 23rd, and will be due no later than 6 pm on Tuesday June 30th.

For every class, including the first class, students will prepare and hand in a short written analysis of a question the instructor distributes the previous week tied to the current reading assignment. Students are expected to work individually on all the weekly assignments and on the two major written papers.

Primary Materials

Harvard Business School cases and notes will constitute the primary course materials. The course packet as individual cases and materials can be downloaded at the HBS Publishing website.

Course Outline

<u>See Excel Spread Sheet in NYU Classes</u>

Unlike many finance courses this course is not an overly quantitative course. While the section discussing valuation contains quantitative work as does one of the major papers, the main focus will be on analytics, especially qualitative factors. This course places a strong emphasis on presentation and discussion skills. Students will need to explain their thinking about an issue to the class and the Instructor. Participation will be an important element of the final grade as described below. Participation will be judged primarily on the quality of the insight provided in the classroom comments rather than on the quantity of the participation. Students will participate either by volunteering or by being selected to participate by the Instructor. Relatively frequent contributions to the discussion that demonstrate logical and complete analysis will be required to excel in the participation portion of the grade. Name cards are highly recommended. The Instructor cannot properly evaluate your classroom participation if the Instructor does not know who you are.

Assessment

The instructor will follow the suggested grade distribution standards of the Stern Department of Finance for upper division graduate courses. These guidelines suggest the following grade distribution: "A" 15%, "A-" 20%, "B+" 10%, "B" 45-55% and "C" 0-10%.

Grades will be based 28% on the first written major assignment, 40% on the second written major assignment, 12% on the six weekly assignments and 20% on class participation. If you wish to take an Incomplete you must request it prior to the end of our class.

Other Comments

The Stern Default Policies shall be followed except as otherwise indicated. See http://www.stern.nyu.edu/portal-partners/academic-affairs-advising/policies-procedures/default-policies-stern-courses

Please not notify me in advance for any excused absence. If you are called on and are not present without an excused absence it will affect your participation grade.

If you miss a class, you are responsible for any material that you miss, including any weekly assignments and administrative announcements. The Instructor will ask Stern IT to employ Class Capture for later viewing.

Given the relatively small size of our class, I expect that every student will volunteer or be called on in each class.

To be fair to other students, there will be no extra-credit assignments.

Your final grade will be determined solely by the system described above.

The written assignments will be available from the instructor.

Students shall adhere to the MBA Honor Code. Every student is obligated to report to the Instructor any suspected violation of the code that he or she has observed.

Upon request, the Instructor will re-grade the student's work but only at the end of the term and only by reviewing each and every assignment of the term. The Instructor will not re-grade single assignments. The student will then receive the grade arising from the re-grade even if it is lower than the original grade.

In general, students will not receive direct feedback on the two major assignments in order to preserve future grading integrity. However following the submission of the first major assignment the instructor will present a model answer to the assignment. Students may contact the instructor after the final case for feedback on the final assignment if desired.

In the past, students have complained about the volume of reading for this course. However it is not possible to cover our survey materials in the mini-course format without a significant level of reading. The instructor assigns about 25 pages of reading (not including exhibits) each week.

Some students have complained about "cold calling." While I completely understand the issue, each student will be cold called at some point in our class. Being unprepared when cold called will affect your participation grade. Faking a response when cold called because you are unprepared will also affect your grade.

Laptops are permitted for note taking only. All other electronic devices are not permitted in class.

Instructor

Robert Semmens was a Co-Founder and General Partner of the Beacon Group, a Private Equity and M&A Advisory firm formed in 1993. At Beacon, he raised and managed the $650 million Beacon Group Energy Investment Fund, L.P and the $950 million Beacon Group Energy Investment Fund II, L.P. The Beacon Group Energy Investment Funds were private equity funds focused on making investments in the global energy business. In addition, he also managed a hedge fund of fund invested in a variety of market neutral strategies. JP Morgan Chase acquired the Beacon Group in the summer of 2000 and until 2001 he was a consultant to JP Morgan Chase. Prior to co-founding Beacon, he was a Vice-President at Goldman, Sachs & Co. in the Investment Banking Division where he concentrated on corporate financings, mergers & acquisitions and private investments, all in the energy area. He also worked at J. Aron, the commodity and currency trading division of Goldman Sachs, in oil and gas derivatives. He has a BA from the University of Arizona (Economics), a Masters of Business Administration (Finance) from the J.L. Kellogg Graduate School of Management at Northwestern University and a Juris Doctor from the Northwestern University School of Law. He is currently a private investor in early stage companies and buyouts in life sciences, medical devices, information technology and energy related companies, serves on the Board of four companies and is a member of NY Angels, a NYC based early stage-investing group.

Instructions for Preparing Written Case Analyses

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 if possible. If the information is not possible to obtain, note the information you would like to obtain.

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 written analyses will be written as reports to senior management. The first page should provide a short summary that is no more than one paragraph long. The detailed analysis should be presented on the following pages. The written text should not exceed 5 pages. All pages should be numbered and the document typed with one-inch margins and double spacing. Use a 12 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.

The weekly assignments can be written in whatever format the student finds most useful but cannot exceed one written page (although analytics may comprise additional pages.) The Instructor recommends an outline format for the weekly assignments.

Useful References

The course packet consists of the notes 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:

Brealey, Richard A. and Stewart C. Myers, *Principles of Corporate Finance (6th ed.),* (New York: McGraw-Hill, 2000).

Private equity references:

Fenn, Liang, and Prowse, "The Economics of the Private Equity Market", *Board of Governors of the Federal Reserve System*, Release 168, December 1995. Available for download at:
http://www.federalreserve.gov/pubs/staffstudies/1990-99/default.htm

Bartlett, Joseph W., *Equity Finance: Venture Capital, Buyouts, Restructurings, and Reorganizations (2nd ed.)*, (Frederick, MD: Panel division of Aspen Law & Business, 1995).

Lake, Rick and Ronald A. Lake, *Private Equity and Venture Capital: A Practical Guide for Investors and Practitioners*, (London: Euromoney Books, 2000)

Levin, Jack S., *Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions*, (Frederick, MD: Panel division of Aspen Law & Business, 2000).

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

Valuation references:

Copeland, Tom, Tim Koller, and Jack Murrin, *Valuation: Measuring and Managing the Value of Companies (2nd ed.),* (New York: John Wiley & Sons, 1994).

Damodaran, Aswath, *Damodaran on Valuation*, (New York: John Wiley & Sons, 1994).

Pratt, Shannon P., Robert F. Reilly, and Robert P. Schweihs, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies (4th ed.),* (Burr Ridge, IL: Richard D. Irwin, 2000).