Private Equity: The Asset Class, Its Investments & Its Markets
Course B8394

Fall 2015
Class Session Times: Mondays 4:00PM-7:15PM
Class Location: TBD

Professor: H. Marshall Sonenshine
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Office hours: Upon request

Course Overview

This course surveys the private equity asset class emphasizing primarily corporate buyouts and secondarily growth capital. Over the past three decades, private equity has evolved into a global industry approximately $3 trillion of capital commitments. The industry includes hundreds of well-established private equity firms with differentiated strategies many of which have produced meaningful returns for institutional investors and extraordinary returns for the entrepreneurs who started these companies and invested alongside investors. The characteristics of their strategies and underlying investments have spawned an asset class that has become a requisite portfolio allocation for a broad range of institutional investors. While the financial crisis has inevitably taken its toll on current investments and on the industry, and we will discuss that as well, the industry remains a highly important constituency in financial and corporate markets and one that will continue to evolve as financial markets and macroeconomic change. This course will provide a framework for understanding the industry's evolution to date, its impact on and implications for corporate and financial dynamics, and the trends that will shape its future role.

We will explore the evolution of the private equity market and its players as well as the characteristics that have contributed to its sustainability. We will delve into its impact on other markets – M&A, financing, equity, investor and labor – and its general implications for issues of business strategy, corporate governance and the management of corporations. We will also discuss the complex relationships that private equity firms typically conduct with the portfolio companies they invest in, the management teams with which they partner, the banking, capital markets and financial services industry on which they rely, and other constituencies. We will examine the unique relationship between general partners and limited partners on one side, and between general partners and portfolio companies on the other side, and the perspectives and motivations of each such constituency. Through case analysis, class discussion and role playing, students will develop a comprehensive understanding of each perspective. The building blocks of a private equity firm and the financial environment affecting firms will be evaluated in detail:

- Players, including investors and managers (capital providers) -- focusing on how the modern private equity firm raises capital, aligns interests, builds a track record, reports and communicates with investors, manages conflicts and regulatory issues, and creates an ongoing institutional brand
- Investments (deals) – understanding a company’s fundamentals, conducting due diligence, developing an investment thesis, creating a capital structure, assessing and securing leverage, forming a valuation, negotiating, executing on the investment plan and exiting
- Managing the business (people) – creating competitive advantages (team, strategy, deal sourcing), designing economic incentives that are sustainable, managing human capital (deal professionals, operating partners, portfolio company management teams), creating franchise value
- Current Topics – we will discuss how the private equity industry has evolved and changed over time, how financial markets generally and the financial crisis in particular have shaped and affected the industry, and how the current era of portfolio rebalancing and enhanced financial regulation may affect the industry.
It is recommended that students taking this course will have previously completed B6001, B6300 and B6102. Taking B8306 prior to or with this class is also advised. This class will not focus on financial modeling techniques, but it is expected that students will be comfortable evaluating financial statements and developing projections and working with and discussing capital structures used in private equity transactions.

**Faculty**

The faculty for this course is Professor Marshall Sonenshine (BA, Brown; JD, Harvard). Professor Sonenshine is a career investment banker who is highly experienced in representing, negotiating with and otherwise working with private equity investors. He has served on Columbia’s adjunct faculty since 2009. Prof. Sonenshine has also been a Teaching Fellow in Government at Harvard, a Legal Methods and LLM Instructor at Harvard Law School, and a frequent guest lecturer at Wharton and at Fordham and Brown Universities. He has also been a frequent Global Affairs commentator on CNBC and Bloomberg Television, and contributor to the NY Times, Financial Times, Institutional Investor, CNN, Harvard Law Review and other publications.

A typical class will include some lecture style introduction to the topic for the day followed by an active and spirited discussion of the case and other readings and the underlying issues and dynamics.

Students are recommended to purchase the three text books and required to obtain the casebook.

**Key Course Topics**

The course includes five key components as follows:

I. **Overview of the Private Equity Industry**: We will explore the history, terminology, and categories within the asset class, participants, anatomy of funds and partnership agreements, key terms, economics, GP and LP perspectives and negotiations and perspectives of companies (approximately 3 classes).

II. **The Fundamentals of Private Equity Investing (aka Doing Deals)**: We will examine key elements of understanding a business from a private equity investment perspective, financing, structuring and negotiating buyout and growth capital transactions, and managing the portfolio company over the life of the investment up to and including an exit or value realization transaction.

III. **Understanding and Evaluating Private Equity Firms In Financial Markets Today**: We will consider how the financial community assesses firms and chooses which funds to invest in and how funds assemble portfolios of companies and how LP investors assemble their portfolios of LP interests. Other topics will include understanding and managing LP liquidity options; the rise and role of other alternative investment vehicles, most notably hedge funds and sovereign wealth funds; the publicly traded private equity firm; the impact of the financial crisis and current issues under discussion in the area of financial regulation (approximately 3 classes)

**Prerequisites**

Prerequisites for taking Private Equity include a general understanding of finance, the capital markets and basic financial accounting. It is recommended that students considering this course have completed B6001, B6300 and B6102. Taking B8306 prior or with this class also is advised.
### Course Requirements

This course will comprise lectures and class discussion. Course materials will be a combination of selected text materials, cases, private equity firm source material (fund offering documents, partnership agreements and investment material) and articles. There will be a case packet as well as material posted on the course web site. See attached course bibliography for readings. Students are recommended to purchase the three text books and obtain the casebook.

### Class Participation

Class participation is essential and students are expected to participate meaningfully including when called on. Students will be expected to attend classes and to come prepared and to participate in discussions actively and thoughtfully. Preparation includes reading materials, specific session cases and questions, role playing exercises and team projects. **Readings flagged with the word “case” will be quite specifically analyzed in class, so students should read those especially thoroughly.**

<table>
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<tr>
<th>Required readings for each class are in boxes in the syllabus and provided in the Course Case Books.</th>
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For students wishing to do additional reading on the class topic there are also optional readings from three (3) textbooks students may purchase and in some cases the case book.

### Case Prep

All students are expected to be fully prepared for Case discussion and ready to be called on. In addition, each class will have a dedicated small team of Case Prep Leaders who will have submitted CASE PREP SLIDES prior to class and will present and open discussion of key topics for that day's case. The Case Prep should be approximately 3 or 4 PowerPoint slides to be prepared and presented by a small group as part of the Case Prep and Discussion for a given day. On the first day of Class, students will form small groups and in consultation with the TA each such group will sign up for a day to prepare and present the Case for that day choosing from the following list (each group to choose one of eight classes at which to present). Each group will prepare and deliver to the TA and Professor by Noon before Class 4 great discussion slides on point. Here are the available dates and suggested topics:

**Class 2  Yale University Case: What’s a Nice School Like Yale Doing in a Place Like Private Equity?** – What Allocation to Private Equity is Appropriate for a University Endowment and Why? How does such allocation fit within in broader paradigm of Global Asset Allocation (and related financial needs and return objectives) for the Institutional Investor?

**Class 3  Bear Stearns Case: What Happens Inside a Bank Sponsoring Private Equity Funds?** – What are the Key Things to Understand about Bear Stearns’ (1) competitive advantage and internal relationship between the investment bank and the Private Equity business, (2) LP Agreement Terms defining the relationship between GP and LP; and (3) Bear’s Deal Experience To Date as of the time of the case fund offering?

**Class 4  InvestCorp and the Moneybookers Bid: Understanding Growth Capital as Part of Private Equity** -- Please provide a simple 3 to 5 Year financial model for a Base Case, Upside Case and Downside Case for Moneybookers and explain how this model might affect your judgment about how to structure a deal including growth capital investment into the company?

**Class 5  Doing Deals: Go Shops and No Shops** Please explain (1) the difference between Conventional Sales Processes and Go Shop Deals; (2) the theory and data associated with Go Shops; and (3) how the theory might relate to 1-800 Contacts Case in which the Company was “well shopped” prior to the announced deal (ie would a go shop process have worked better or worse and why?)
Class 6 – Inside Leveraged Finance: The Lion Capital Case: please provide a simple but clear base case model (3 financial statements, showing 3 years of history and 5 years of forecast) for Lion capital and explain your assumptions for drivers and financing (use and show current financing rates on a separate slide). Add a 4th slide for how you would finance the buyout and whether you think the returns might or might not work.

Class 8 – Francisco Partners and the (then) Brave New World of Tech Buyouts – Please present the Case from the perspective of (1) what was new and different in Francisco Partners’ investment thesis as a PE firm; (2) what is meant and not meant by “Technology Companies” for this purpose; (3) why is this definition of Tech sensible / attractive or not sensible / attractive for this form of PE (i.e. what are the risks and rewards associated with the investment strategy at least at that time, and perhaps today); and (4) take a peek forward in the syllabus and comment on silver lake and the Dell Deal.

Class 9 – The Curious Case of Dell – Why Was This 8,000 Pound Gorilla Going Private, Why Was this such a Food Fight and What Was this Company Really Worth? – Please break apart this case in 4 slides: (1) what is really going on inside Dell as a company in Case A? (2) what is really going on transactionally at the Board level and among the deal participants (PE firms, strategic suitors, board of directors, CEO) in Case B; (3) what roles were provided and what guidance on value was given by the company’s investment banks in the deal; and (4) was Dell fairly, fully or underpriced in the deal and how are you thinking about that question?

Class 10 – Smart Institutions Foolish Choices and Why Some Folks are a Tad Cynical About the Private Equity Business – Please analyze the findings and data set in this seminal article and explain in 3 cogent slides what the study tells us about how PE performs as an asset class and how institutions behave as investors within the asset class. (Note: this question sounds deceptively simple but it is actually quite complex; your goal is to get to the bottom of what is really going on in the data.)

Class 11 – Blackstone IPO: Inside the World’s Largest Private Equity Firm and Why It is Not Even Private Anymore – In 4 slides explain (1) why Blackstone wanted to be public; (2) what investing activities were inside Blackstone as a business at that time; (3) what were the hardest issues associated with this IPO, which was a watershed event in global finance; and (4) how investors today should approach the subject of valuation of a Private Equity firm as a public equity matter.

There will be an in-class midterm examination.

In lieu of a final examination, there will be a final paper, to be prepared in groups, in the form of an Investment Memorandum analyzing the merits of an acquisition of one of three prepared potential private equity case opportunities. The suggested length of team final paper 15 pages, double spaced including charts. Students will be expected to do their own research and preparation of their recommendation, from the perspectives of company analysis, valuation, potential structuring or financing issues, potential exit or realization issues, and other relevant considerations.

Method of Evaluation

| Class Participation                          | 30% |
| Brief Reading Presentation Assignment (1)   | 10% |
| Midterm Exam                                | 20% |
| Final Investment Memorandum                 | 40% |

*The teaching assistants for the class will keep your record of thoughtful comments.
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PART I: THE INDUSTRY
An Overview of the Strategies, the Players and the Dynamics

Session #1: Industry Overview - The Terminology, the Strategies, the Participants
Class: Monday, September 14, 2015
Time: 4:00PM – 7:15PM

Introductions, course overview and expectations of class participants
Terminology
History of the industry
Overview of private equity strategies
Introduction to the key documents, and the "anatomy" of these materials
Private Equity from the Perspective of Companies

Required Readings:
Case: Joseph Calandro, Jr., “Taking Burlington Northern Railroad Private,” Journal of Private Equity, Fall 2010, p.8-16


Session #2: The Investors' Perspective
Class: Monday, September 21, 2015
Time: 4:00PM-7:15PM

The limited partner (LP) universe
Portfolio management approaches and asset allocation
Introduction to performance assessment
Introduction to fund selection
Alignment of incentives and the Limited Partnership Agreement (LPA)
Liquidity and the secondary market for private equity

Required Readings:
Case: Harvard Business School "Yale University Investments office: February 2011"
Sonenshine, Valuation Slides
**Optional Extra Material**: Fraser-Sampson, Private Equity as an Asset Class (Wiley 2007), Chapters 1-3.

**Session #3: The General Partners' Perspective to the GP**
Class: Monday, September 28, 2015
Time: 4:00PM-7:15PM

The general partner (GP) universe
The components of the firm
Introduction to firms' competitive advantage and sources of alpha
Introduction to capital raising
Negotiating the LPA, from the perspective of the GP
“Partner to Management” – What Does it Mean?

**Required Readings:**
Tuck, Note on Exits, Case #5-0022 (Dec 15, 2004)
Case: Bear Stearns Merchant Banking Partners III (private placement memorandum).

**Optional Extra Material:**
**Optional Extra Material:**

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**Part II: Transaction Fundamentals – (aka “Doing Deals”)**
An Overview of Due Diligence, Capital Structure and Company Valuation

**Session #4: Conducting Due Diligence, Analyzing the Company and Considering the Capital Structure**
Class: Monday, October 5, 2015
Time: 4:00PM-7:15PM

The deal process and the participants
Conducting due diligence on companies
The Financial Model -identifying key variables and value drivers
Analyzing comparables
Capital Structure and Introduction to leveraged finance
Valuation

**Required Readings:**
Case: Tuck School Case Study #5-0004 (Note on Leveraged Buyouts) (2003).
Case: Growth and Buyout: Sonenshine, BevMo case (short case)

**Optional Extra Material:**
Session #5: Valuation and Negotiation  
Class: Monday, October 12, 2015  
Time: 4:00PM-7:15PM  
Discussion of valuation approaches  
Identifying components of strategic plan and operating improvements  
Potential Exit or Realization Strategies  
Implications of the New Construct for Management and Governance of the Corporation  

Required Readings:  
Case: Sonenshine, 1-800 Contacts Case (Columbia Caseworks and Appendix)  


Session #6: Perspectives on Leveraged Finance  
Class: Monday, October 19, 2015  
Time: 4:00PM-7:15PM  
Leveraged finance market  
Financing buyout transactions  

Required Readings:  
Case: Standard & Poor's, "The Leveraging Of America: LBOs -The Good, the Bad, and the Ugly"(2007):1-22  


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Session #7: Midterm Examination  
Class: Monday, October 26, 2015  
Time: 4:00PM-7:15PM  
The exam is 2 hours.  
There will be a 1 hour modeling tutorial after the exam  

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Session #8: The Company Experience and the New Partnership -- Executing the Plan, Monitoring, Governance and Managing the Exit Process  
Class: Monday, November 9, 2015
Time:  4:00PM-7:15PM

Backing management
Monitoring the investment and board composition
Implementing strategy and the role of operating partners
Assessing the exit strategy

Required Readings:
Case: Cohn, Mills & Towery, “The Evolution of Capital Structure and Operating Performance after Leveraged Buyouts” (University of Texas, August 2011)

**Optional Extra Material:** Sonenshine, “The Business of Politics, The Debate Over Romney at Bain is Wholly Irrelevant”

PART III: THE PRIVATE EQUITY FIRM
Identifying Top Tier Performance, Raising Capital, Managing the Firm and Evolving the Business Model

Session #9: The Search for Alpha - Evaluating Private Equity Firms
Class:  Monday, November 16, 2015
Time:   4:00PM-7:15PM

Sources of alpha
Fund investment strategy and competitive advantage
Analyzing track record - assessing the realized and unrealized performance
Alignment of incentives

Required Readings:
Case: Sonenshine, “The Curious Case of Dell”. (Case and Appendices)
Case: Harris, Jenkinson, Kaplan & Stucke, “Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds” (February 2014).


Session #10: Raising Capital and Managing the Business
Class:  Monday, November 23, 2015
Time:   4:00PM-7:15PM

The Firm as an Operating Business: Mission, Core Competencies, Ops
Human capital management and structuring economic incentives
Reporting, monitoring and the management of investor relations
Brand Management: What does the Firm Stand For?

Required Readings:


**Session #11: Current Topics In Private Equity: Bubble and Crisis Period**
Class: Monday, November 30, 2015
Time: 4:00PM-7:15PM

Secondary market for private equity  
Emerging markets and sovereign wealth funds  
Tax and Data Regulatory Issues Affecting or Potentially Affecting the Industry  
The Financial Crisis and Implications for Private Equity

**Required Readings:**  
Case: “Paul Capital Partners: Secondary LP Investing”.


**Session #12: Financial Reform and Current Outlook**
Class: Monday, December 7, 2015
Time: 4:00PM-7:15PM

Continuation of Current Topics  
- PE in Changing Global Markets  
- Financial Reform  
Review and Discussion of Final Papers

**Required Readings:**  
Case: Fang, Ivashina, and Lerner, “Combining Banking with Private Equity Investing” (This Draft, April 16, 2012).  
Bain & Co., Global Private Equity Report 2014 (please skim)

I. **Recommended Course Textbooks** *(Students are recommended to purchase the first three books for optional readings):*

Fraser-Sampson, Guy *Private Equity as an Asset Class*. West Sussex: John Wiley & Sons, 2007.


II. **Articles** *(to be included in the case book):*


Joseph Calandro, Jr., “Taking Burlington Northern Railroad Private,” Journal of Private Equity, Fall 2010, p.8-16


Harvard Business School: "Yale University Investments office: February 2011"

Tuck, Note on Exits, Case #5-0022 (Dec 15, 2004)

Private Placement Memorandum for Bear Stearns Merchant Banking Partners III.

Tuck School of Business Case: “Note on Leveraged Buyouts” (Prepared by John Olsen and updated by Salvatore Gagliano under the supervision of Adjunct Assistant Professor Colin Blaydon, 2003)


Cohn, Mills & Towery, “The Evolution of Capital Structure and Operating Performance after Leveraged Buyouts” (University of Texas, August 2011)


Sonenshine, Marshall, “The Business of Politics: The Debate Over Romney at Bain Is Wholly Irrelevant”

Sonenshine, Marshall, “The Curious Case of Dell (A) and (B)”, Columbia Caseworks, published March 6, 2014


Harris, Jenkinson, Kaplan & Stucke, “Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds” (February 2014).


Degeorge, Martin & Phalippou, “Performance of Secondary Buyouts” (October 10, 2013)


David S. Scharfstein “Paul Capital Partners: Secondary LP Investing” (Case)


Bain & Co., global Private Equity Report 2014 (please skim)

III. **Additional Bibliography Items for Reference** *(Not required):*


Selected ancillary articles and other material will be posted on Angel throughout the course.


Interesting research papers at: [http://www.privateequitycouncil.org/research-library/](http://www.privateequitycouncil.org/research-library/)