

**Finance 6434 Mod 4 Spring 2009**  
**Private Equity**

**Stuzin 104, Mon Wed 7:30am-9:20am**

**Course Objective:** Over the past two decades there has been a tremendous growth in the private equity market, composed of buyout funds and venture capital funds. In the past year private equity has taken a beating, probably worse than even the public equity markets. The size (capital invested) of the private equity market in the U.S. is estimated to have increased from about \$5 billion in 1980 to over \$300 billion at the start of 2001. Over time the composition of the private equity market has changed. For example, as the internet bubble burst so did the venture capital market. This course explores the private equity industry and particularly the venture capital market. This course focuses on the organized private equity market, which involves professionally managed equity investments in unregistered securities of private and public companies. Professional management is provided by specialized intermediaries and institutional investors. These intermediaries typically acquire large ownership stakes in the companies they invest in and take an active role in monitoring and advising these firms. Exit strategies, in particular initial public offerings (IPOs) will also be focused on.

The course has three primary objectives. First, the course seeks to deepen students' understanding of corporate finance by applying the intellectual frameworks used in corporate finance to analyze activities and institutions in the private equity market. Thus, one goal is to review and apply the key concepts and tools of corporate finance in a new and interesting environment.

Second, the course seeks to familiarize students with the key institutional features of the private equity industry. This involves examining how institutions and contracts are structured to mitigate agency costs and information problems that are endemic to private equity investments. While there will be a focus on the structure of contracts and institutions in the venture capital market, we will also examine private equity investments in mature and distressed companies.

Finally, a crucial objective of the course is to build an appreciation of the valuation process in a private equity setting. Valuation issues are often an issue of intense negotiations and contentious disputes. The goal is to familiarize students with the valuation techniques used by private equity investors and to demonstrate how the value of private equity investments is inextricably linked to the cash flow and control rights provided to investors and entrepreneur/manager of the firms.

Each program at the Warrington College of Business Administration has developed goals and objectives that express the most valued skills and knowledge that students should be able to demonstrate upon completion of the total learning experiences in that program. The following goals and objectives are specifically mapped to FIN6434. The MSF program goals and objectives that apply to this course include the following: Our graduates will be technically competent in their area of specialization in finance: Equities and Portfolio Management, Fixed Income,

Corporate Finance, or Real Estate Finance. Students will be prepared to apply appropriate financial theory and technique as analysts in the Corporate Finance field.

**Text:** *Venture Capital and the Finance of Innovation* by Andrew Metrick (Wiley 2007) will be used. In addition, there is a packet of readings and cases that can be purchased at Target Copy, 1412 W University Ave, 352- 376-3826. It is absolutely essential that you read the cases and assigned readings before class. I will expect that you have read these materials before class and will question you in class about the cases and readings...so beware.

**Course Evaluation:** There will be weekly assignments and a final exam. The written assignments are to be done in groups of three to four students. The course grade will be determined as follows:

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|---------------------|-----|
| Final               | 60% |
| Assignments         | 30% |
| Class Participation | 10% |

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Office hours: I am usually in the office throughout the business day, except at lunchtime.

**Class Outline:**

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| <b>March 2<br/>Monday</b>     | Metrick, <i>Chapter 1: The VC Industry</i> and <i>Chapter 2: VC Players</i>   |
| <b>March 4<br/>Wednesday</b>  | William Sahlman, “Aspects of Financial Contracting” (1988 <i>Journal of Applied Corporate Finance</i> )   |
| <b>March 16<br/>Monday</b>    | Metrick, <i>Chapter 3: VC Returns</i> and <i>Yale Investments Office</i> case   |
| <b>March 18<br/>Wednesday</b> | Metrick, <i>Chapter 4: The Cost of Venture Capital</i> and <i>Chapter 5: The Best VCs</i>   |
| <b>March 23<br/>Monday</b>    | Metrick, <i>Chapter 6: VC around the World</i> and <i>Chapter 7: The Analysis of VC Investments</i>   |
| <b>March 25<br/>Wednesday</b> | GP compensation: Andrew Metrick and Ayako Yasuda “The Economics of Private Equity Funds” and CEO compensation: Steven Kaplan and Joshua Rauh “Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes? (both will be published in the <i>Review of Financial Studies</i> ) |
| <b>March 30<br/>Monday</b>    | Metrick, <i>Chapter 8: Term Sheets</i> and <i>Chapter 9: Preferred Stock</i>  |
| <b>April 1<br/>Wednesday</b>  | Metrick, <i>Chapter 10: The VC Method</i> and <i>Chapter 11: DCF Analysis of Growth Companies</i>   |

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| <b>April 6<br/>Monday</b>     | <i>In-fusion case and Metrick, Chapter 12: Comparables Analysis</i>   |
| <b>April 8<br/>Wednesday</b>  | Hsuan-Chi Chen and Jay Ritter “The Seven Percent Solution”<br>(June 2000 <i>Journal of Finance</i> )                          |
| <b>April 13<br/>Monday</b>    | <i>Preparing for the Google IPO: A Revolution in the Making?</i> case   |
| <b>April 15<br/>Wednesday</b> | Tim Loughran and Jay Ritter “Why Has IPO Underpricing Changed Over Time?” (2004 <i>Financial Management</i> )                 |
| <b>April 20<br/>Monday</b>    | <i>Altoona State Investment case</i>  |
| <b>April 22<br/>Wednesday</b> | Steven Kaplan and Per Stromberg “Leveraged Buyouts and Private Equity” (Winter 2009 <i>Journal of Economic Perspectives</i> ) |
| <b>April 27<br/>Monday</b>    | <b>Final Exam 7:30-9:20am in Stuzin104</b>  |