A Private Equity Course

Currently, there is a widespread and strong demand for courses covering private equity funds. This pressure is understandable given that most students in business schools are seeking jobs in the private equity industry, and plenty of students in other fields also want to join. Private equity funds grew from managing about $5 billion in 1980, to about $500 billion in 2000, to about $5 trillion in 2016, and are nearing $10 trillion as of 2020. This growth has exceeded that of any other financial products. In addition, in the US alone, nearly 10 million people work for a company controlled by a private equity fund. Finally, this industry is home to a stockpile of mythologies, war-stories and fantasies, all shrouded in complex jargon, making the need for education yet more pressing.

This private equity course attempts to assist students on their quest to become fluent in the private market language and techniques. This up-to-date, authoritative, and non-complacent course builds on twenty years of academic research and teaching in this field, with the contribution of practitioners who intervene as guest speakers and tutors. The course textbook, "**Private Equity Laid Bare"** (v3.0, 381 pages) is affordable, especially as it includes five case studies, of which two role plays, and a specialised dictionary (Alternative Oxford Private Equity Dictionary). A companion podcast series also provide a body of asynchronous material free of charge.

Overview

This document describes the content of the private equity courses I developed at the University of Oxford, using the textbook "**Private Equity Laid Bare"**. Oxford was one of the first universities to introduce a private equity courses for MBA students in the early 2000s – at the initiative of Tim Jenkinson. Since then the school has developed a wide range of related courses: Venture Capital, Real Estate, Valuation of Private Assets, *etc*. This textbook is used at the University of Oxford in the course *'Private Equity & Debt'*, covering Chapters 1-7, and the course *'Investing in Private Markets'*, covering Chapters 8-17.

Each chapter corresponds to a lecture, each taking between one and three hours. Thus, in principle, the textbook could cover 50 hours of face-to-face teaching. The podcast series, as well as some videos, complement the book and offer an additional 50 hours of asynchronous material.

The book can be divided into three parts. These three parts can constitute an entire course, or represent three different courses. As mentioned above, in the course offering for the MBAs at Said Business School, the full book is used across two separate courses for the MBAs and is used for a single course for the EMBAs.

The first part of the course primarily focuses on Leveraged Buy-Outs (Chapter 1-7). Within the LBO space, the content is slightly tilted towards real estate LBOs (*i.e.,* value-add/opportunistic real estate). Yet, some of the content is also relevant for other private markets (*e.g.,* venture capital). In addition, as LBO transactions are most common in North America, Western Europe and Australia, the content is most relevant in these regions. However, as LBOs are growing in developing markets, the content is also relevant for other regions.

Specifically, we begin by covering valuation, with a focus on mature companies (Chapter 2). We study the provision of leverage finance in Chapter 3; there we cover capital structure theory and practice, including the fast-growing world of private debt funds. Chapter 4 contains a case study on Hilton Hotels; *i.e.,* a private equity real estate case. This case study enables to cover valuation, financial modelling, debt restructuring, capital structure, and exit strategies – which were discussed in the previous three chapters. Therefore, this case study is a tool to consolidate the first three lectures. Chapter 5 discusses value creation channels in LBOs. The two main areas of focus are management incentives and multiple arbitrage (buy and build strategies), but other channels are discussed as well as issues with the standard decomposition of value creation. Another case study is found in Chapter 6. It is set up as a role play. This case study can also be done after Chapter 3. The role play has been updated to include post-Covid factors and features transactions in the retail sector and has a strong real estate angle. This case also captures the co-existence and competition between banks and private debt funds, a hot topic worldwide.

The second part of the course focuses on stakeholders (ESG/Impact) and Developing Markets. It is natural to integrate discussions of PE in developing markets and ESG/Impact because the latter theme is central in the investment thesis of the former. There is less emphasis on ESG/Impact in developed markets, but it is now growing quickly. This part of the book begins at Chapter 7, overlapping with LBO content: most controversies around private equity focus on the impact of LBOs on stakeholders, especially employees, and this is what is covered in Chapter 7. Chapter 8 covers private equity in developing markets where private equity is not as controversial, but certainly challenging. Chapter 9 discusses ESG/Impact and focuses on providing clear definitions and a sense of what is measured.

Chapter 10 is a case study showing why and how finance acumen is essential to promote investment with positive social impact. The case study in Chapter 10 is the redevelopment of a building in a low-income neighbourhood in New York City and enables students to think about how impact considerations play a role in financial modelling and asset valuation, and vice versa.

The third part of the course is basically an '*Asset Management*' or '*Investment*' course. Such courses are standard in any school curriculum, but most investment textbooks are focused on public markets. Over the years, as private markets have developed, these textbooks increased their coverage of private markets but are limited to a couple of chapters at best, versus ten to twenty chapters on public markets. At Oxford, we have split the standard *Investment* course into several pieces: *'Investing in Public Equity'*, '*Fixed Income and Derivatives*', '*Hedge Funds*', and '*Investing in Private Markets' (*the latter being covered by this textbook). These chapters are valid for any type of private market funds, from venture capital to private debt funds.

Chapter 11 covers the different fund structures used in private markets. This section would be the equivalent of chapters in standard Investment textbooks that would describe the working of mutual funds, and ETFs. Chapter 12 discusses the complex fee structures used in private market funds. This content is a combination of Law and Finance (as is Chapter 11). Chapter 13 is a case study, set up as a role play, where student negotiate a typical private market fund contract (called limited partnership agreement). Chapter 14 is a bit niche and advanced and could be covered only briefly as an add-on to Chapter 12. It discusses the potential for conflicts of interest that are unique to private market funds. This section is basically the standard principal-agent problem applied to private markets. Chapter 15 is more focused on asset pricing. It covers the measurement issues for risk and return of private market funds. The techniques used in public markets cannot be used in private markets because assets are not continuously traded. As a result, all the material in investment textbooks on this topic: rate of return, beta, alpha, mean-variance…, are not usable. Chapter 16 covers asset owners who invest in private markets. It provides a landscape of the primary investors as well as their motivations. It goes over the increasing reliance on secondary markets and co-investments. Finally, Chapter 17 is a case study that focuses on a single asset owner (an Oxford college endowment) and illustrates the type of discussions that asset owners have when it comes to asset allocation in general and allocating capital to private markets in particular.

As an add-on to the textbook, a specialized dictionary is offered. Given the importance of the jargon, an extensive dictionary is not a luxury. Also, as most definition are written to be entertaining, it should be less painful for students to check out specialized definitions.

Textbook content

Part 1: GP

Chapter 1: An Asset Class is Born
The different sources of capital to finance companies
Chapter 2: Valuation
Valuing private companies using a brain, Excel and comparable companies
Chapter 3: For the Love of Debt
Debt packages in PE transactions and impact on returns
Chapter 4: Room for Cash
Hilton Hotels: A Private Equity Real Estate case study
Chapter 5: Cash Generation
What is distinctive about how PE funds manage companies
Chapter 6: Debt Play
Role play: Negotiating a debt package for an LBO

Part 2: Society

Chapter 7: Dirty PE?
Discussion of controversial PE transactions and actions
Chapter 8: Flirting with Frontiers
Private markets in developing countries
Chapter 9: Full on Impact
Impact investing & ESG
Chapter 10: Can financial acumen supercharge positive social impact?
The case of the redevelopment of Spofford in the Bronx

Part 3: LP

Chapter 11: Fund structure
How PE funds are structured and staggered
Chapter 12: Fees
How are fees computed
Chapter 13: Contract Play
Role play: LPs vs GPs - negotiating an LPA
Chapter 14: Hide and Seek
Hidden fees, expenses, conflicts of interest
Chapter 15: Performance
How to measure fund returns properly & empirical evidence
Chapter 16: D.I.Y.
The evolving world of LPs
Chapter 17: To PE or not to PE
A Case Study on The Queen's College Endowment
The Dictionary

The website

www.pelaidbare.com contains videos, podcasts, Excel spreadsheet with all the data in the book, potential power point slides for each chapter, and much more.

Learning objectives

The Entire Book -- At the end of this course you should be able to:

- Demonstrate fluency in private equity jargon and techniques, and in particular, describe the key participants in private equity and the relationships between them.
- Understand the process of buying, managing, and selling a private equity sponsored asset, including being able to identify the most applicable valuation method, assess risk, and articulate an investment case using a financial model in Excel.
- Design a career path in private markets based on current industry trends and opportunities.
- Know the skills and governance requirements to implement private market strategies.

Overview by Chapter

<u>Chapter 1</u>

Recognise the key stakeholders and key mechanics in a leveraged buy-out.

Describe the key participants in private markets and the relationships between them.

<u>Chapter 2</u>

Evaluate and apply the most applicable valuation method for a specific asset.

Assess the assumptions that inform a private asset valuation model.

Create a financial model in Excel in order to determine asset value and assess risk.

<u>Chapter 3</u>

Understand Impact of Different Debt Packages on PE Transactions, learning how to structure debt to acquire a company in the PE world.

Determine the optimal capital structure for an asset.

Evaluate the rise of private debt funds.

Assess the repositioning of banks in the leverage finance market.

<u>Chapters 4 and 5</u>

Understanding incentive alignment between management and shareholders

Review the process of buying, managing, and selling a private market asset.

Assemble an investment memorandum.

<u>Chapter 6</u>

Determine the optimal capital structure for an asset.

<u>Chapter 7</u>

Understand the source of private equity investment controversies.

<u>Chapter 8</u>

Discuss the unique aspects of developing markets.

Understand the differing regional dynamics.

<u>Chapter 9</u>

Articulate the growing importance of environmental, social, and governance (ESG) issues.

<u>Chapter 10</u>

Understand how financial literacy can improve the social impact of private investments.

Chapter 11

Evaluate fund structures and terms for investing and setting up a private market fund.

How PE funds are structured and staggered.

Identify popular private market structures.

Outline key considerations when setting up a fund.

Chapter 12

Calculate the different types of fees based on their corresponding legal description.

Understand the issues investors face when deciding whether to make investments into a fund

Evaluate fees and alignment of interests.

Appreciate the interplay between Law and Economics in contracts

Chapter 13

Identify the most important elements of a limited partnership agreement.

Chapter 14

Evaluate potential conflicts of interest in fund terms and negotiation remedies available for them.

Chapter 15

Evaluate investment track records.

Calculate fund performance using the internal rate of return.

Investigate the issues with using internal rates of return as industry benchmarks in private equity.

Compute and understand the public market equivalent methodology as a performance measure.

Evaluate fund performance by using the appropriate benchmarks.

Empirical evidence on private equity fund returns.

Chapter 16

Analyse the role of private markets in modern portfolio construction.

Identify the characteristics of private market sources of capital.

Identify key private market participants and their roles in the private market ecosystem.

Interpret how private market return, risk and correlation assumptions are developed.

Review the impact of private markets on traditional asset allocation assumptions.

Outline the different asset allocation models of key asset owners.

Explain the rise, breadth, and growth potential of the secondary private market.

Explain two mega-trends in fund management – *e.g.m* rise of co-investments, and secondary markets

Chapter 17

Evaluate the suitability of the different models to the particularities of a given asset owner.

Describe the world of university endowments.

Evaluate the key differences between the yale model and the Canadian model of investing.