**Value Investing in Private Credit**

**Syllabus**

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Communications from the professors will take place through Canvas.

Students should regularly check for announcements and messaging notifications.

**COURSE DESCRIPTION**

This course will focus on investing in private credit up and down the capital structure including senior secured, mezzanine, unsecured, and convertible debt from both an origination and secondary market perspective. In addition, there will be an introduction to portfolio construction and management including workouts and loan sales.

**RECOMMENDED COURSE MATERIALS**

* Distressed Debt Analysis by Stephen G. Moyer (DDA)
* Bankruptcy and Debtor/ Creditor by Brian Blum (BDC)
* Business Organization and Finance (Legal and Economic Principals) by William Klein, John Coffee Jr., Frank Partnoy (BOF)

**REQUIRED PREREQUISITES**

* Capital Markets
* Corporate Finance
* Accounting

**CONNECTION TO THE CORE**

* Corporate Finance:
  1. Risk and Return
  2. Firm Valuation Model
  3. Capital Return Policy
* Strategic Formulation: Competitive analysis
* Global Economic Environment I:
  1. Causes of business cycle
  2. Role of financial markets in the economy
* Financial Accounting
  1. The accounting model
  2. Revenue and expense recognition
  3. Resources and obligations-measurement and disclosure

**CLASSROOM NORMS AND EXPECTATIONS**

Students are expected to adhere to CBS Core Culture in this class by being Present, Prepared, and Participating.

**COURSE ROADMAP/SCHEDULE**

**Class One: What is Private Credit and How Does it Compare to Other Asset Classes?**

In this class we will explore private credit as an asset class; how it compares to other asset classes; why and how investors think about incorporating it into their investment portfolios; and where different flavors and varieties of private credit fit in the capital structure and on the risk/return (yield) curve.

1. Compare private credit to other assets classes (returns, volatility, beta, upside (cap), downside (protection), and strategies (public equity, private equity, public debt, real estate etc.).
2. Examine how private credit fits into a value investing framework.

Homework (to be done after class and submitted prior to the next class):

* + - 1. Based on the class case and discussion determine the yield to maturity and yield to worst on the proposed new loan using the model template provided.

Reading for next class:

1. BOF- Chapter 3
2. BDC- Chapter 1
3. DDA- Chapters 2/3 (pages 22-49), Chapter 5

**Class Two: Fundamentals of Evaluating a Company**

In this class we will introduce the “5 C’s of Credit,” a framework for conducting a bottom-up evaluation of a company. Key topics will include how the business strategy and financials tie together, the concept of margin of safety from a lender’s perspective and how it changes over the life of a loan, and how to evaluate management in the context of loan underwriting.

1. Understanding what the financial statements, in particular the balance sheet, tell you about the business strategy.
2. Determining enterprise value of the firm (replacement cost vs. going concern value) and how that value flows (or does not flow) to lenders.
3. Deep dive into balance sheet assets (categories, turns, liquidity) and how they affect the enterprise value of the firm.
4. What to look for when interviewing management teams.

Homework (to be done after class and submitted prior to the next class):

* + - 1. Case Study - finding comparative advantage in competitive markets.

Reading for next class:

1. BDC- Chapters 2, 3, 15
2. DDA- Chapters 6, 7

**Class Three: Investing in Different Parts of the Capital Structure**

In this class we will introduce various debt structures and analyze where each sits on the risk / return curve.

We will start to incorporate the 5 C’s of Credit framework from the previous class to identify the key drivers a lender would want to focus on when proposing a debt structure. Finally, we will explore steps a lender can take to mitigate the risks associated with various debt structures.

1. The pros and cons of different debt structures in different situations.
2. Thinking through the diligence process for different debt structures.
3. Evaluating assets and cash flows to determine the optimal debt structure.

Homework (to be done after class and submitted prior to the next class):

* + - 1. Case Study - Creating value through balance sheet optimization.

Reading for next class:

1. BOF- Chapters 5, 6 (pgs. 422-447)
2. BDC- Chapters 4, 17

**Class Four: Unsecured Debt Structures**

In this class we will undertake a deep dive into various secured and unsecured debt structures (e.g., senior, subordinated, mezzanine, convertible, and venture notes) with a focus on where each sit on the risk / return curve. We will also discuss how lenders can use covenant structures to protect their capital and equity-like features to enhance returns. The first half of class will feature a case study on how lenders can deploy capital into various parts of the capital structure in a competitive process, while satisfying the yield requirements and risk appetites of different constituents.

Homework (to be done after class and submitted prior to the next class):

* + - 1. Case Study – Propose a new unsecured loan structure to address the company’s liquidity needs based on the case discussed in class.

Reading for next class:

* 1. DDA- Chapter 9

**Class Five: Portfolio Construction**

The first half of class we will discuss portfolio construction, including how to manage concentrations, how to segment a portfolio by vintage, and how to identify favorable and unfavorable characteristics of vintages to inform risk management. In the second half of the class, we will review questions on the homework assignment, discuss best practices when building models, and introduce the homework assignment on pricing a portfolio of whole loans.

Homework (to be done after class and submitted prior to the next class):

* + - 1. Case study – Portfolio acquisition

Students will determine if they are willing to purchase a portfolio of whole loans, and if so, at what price using guidance from class discussion.

Reading for next class:

* + - 1. Read background information for the case Securing Equity through Distressed Debt

**Class Six: Equity through a distressed debt**

The first half of the class will discuss opportunities in the distressed debt market and how purchasing distressed debt can be used to acquire the equity of a reorganized business. In the second half of the class, we will walk through the homework case Securing Equity through Distressed Debt and discuss the final project.

Final project (to be done after class and submitted TBD):

* + - 1. Case Study- Financing a buy-out

Please draft a memo to your firm’s Investment Committee outlining a financing proposal you would like to make to finance the acquisition of the company referenced in the case study.

**METHOD OF EVALUATION-** *All assignments are type B2 (Individual with discussion of concepts only).*

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| Participation | 15% |
| Homework | 35% |
| Final Project | 50% |

**ASSIGNMENTS**

All of your assignment submissions are subject to the [CBS Honor Code](http://www8.gsb.columbia.edu/honor/definitions). Violations of the CBS Honor Code may lead to failing the assignment, failing the course, suspension, and/or dismissal. In order to avoid ambiguity that may lead to unintentional violations of the Honor Code, assignment description types have been standardized and specified below.

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| --- | --- | --- | --- | --- | --- |
| **Type** | **Designation** | **Grade** | **Preparation of submission** | **Discussion of Submission\*** | **Discussion of Concepts\*\*** |
| A | Group Work | Same grade for all group members | By the group | Permitted to discuss (within group) | Permitted |
| B1 | Individual w/ Discussions of  Concepts and Submission | Individual grade | Individual preparation | Permitted to discuss;  sharing solutions or submission files is not allowed | Permitted |
| B2 | Individual w/  Discussions of  Concepts Only | Individual grade | Individual preparation | Not permitted to share/discuss solutions or submission | Permitted |
| C | Individual | Individual grade | Individual preparation | Not permitted to share/discuss solutions or submission | Not permitted\*\*\* |

\* The designated group can be either an assigned study group or a self-selected one.

**ATTENDANCE POLICY**

Students are required to attend each class. Students should reach out to the [Office of Student Affairs (OSA)](https://www8.gsb.columbia.edu/mba-students/the-office-of-student-affairs) by using Core Absence Form on this course’s Canvas page regarding excused absences (for religious observances; personal, medical, and family emergencies; military service; court appearances such as jury duty). Unexcused absences will affect your course grade.

NOTE: The following is applicable for Core Courses:

* Students that miss more than **33%** of their classes (unexcused absences) will at most receive a **P** **for the course grade**
* Students that miss more than **50%** of their classes (unexcused absences) will receive a **F** **for the course grade**

NOTE: The following is applicable for Core Courses and for any electives with OSA-administered exams:

* Students that miss the exam for an **excused** reason but are unable to take the exam within the stated make-up period will receive a **zero for the final exam grade**
* Students that miss the exam without notifying OSA (**unexcused**), will receive an **F for the course grade**

**INCLUSION, ACCOMMODATIONS, AND SUPPORT FOR STUDENTS**

At Columbia Business School, we believe that diversity strengthens any community or business model and brings it greater success. Columbia Business School is committed to providing all students with the equal opportunity to thrive in the classroom by providing a learning, living, and working environment free from discrimination, harassment, and bias on the basis of gender, sexual orientation, race, ethnicity, socioeconomic status, or ability.

Columbia Business School will make reasonable accommodations for persons with documented disabilities.  Students are encouraged to contact the Columbia University’s Office of Disability Services for information about registration. Students seeking accommodation in the classroom may obtain information on the services offered by Columbia University’s Office of Disability Services online at [www.health.columbia.edu/docs/services/ods/index.html](http://www.health.columbia.edu/docs/services/ods/index.html) or by contacting (212) 854-2388.

Columbia Business School is committed to maintaining a safe environment for students, staff and faculty.  Because of this commitment and because of federal and state regulations, we must advise you that if you tell any of your instructors about sexual harassment or gender-based misconduct involving a member of the campus community, your instructor is required to report this information to a Title IX Coordinator.  They will treat this information as private, but will need to follow up with you and possibly look into the matter.  Counseling and Psychological Services, the Office of the University Chaplain, and the Ombuds Office for Gender-Based Misconduct are confidential resources available for students, staff and faculty. “Gender-based misconduct” includes sexual assault, stalking, sexual harassment, dating violence, domestic violence, sexual exploitation, and gender-based harassment.  For more information, see <http://sexualrespect.columbia.edu/gender-based-misconduct-policy-students>.