

Private Equity Laid Bare: An Interview with Ludovic Phalippou

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Introduction

As interest in the field of private equity has grown, so too have publications about the industry, from textbooks that outline the principles of financial accounting and term sheets to case studies, war stories, and blow by blow descriptions of deals from heaven or, more dramatically deals from hell. After surveying the existing literature and having taught private equity courses at Oxford for over 15 years, Ludovic Phalippou felt there was a gap in knowledge and room for improvement in how the basics of PE were taught to students and represented to the outside world. He has recently published a book that addresses some of the shortcomings and provides an intriguing and creative addition to the private equity industry. We spoke with Ludovic recently to learn more about *Private Equity Laid Bare*.

The Bare Bones

The book is an outgrowth of the course that Ludovic has developed at Oxford over the past fifteen years. The course itself takes a comprehensive approach to what is essentially a hands-on subject and includes contributions from an array of industry practitioners who are involved as guest lecturers and tutors throughout the semester. *Private Equity Laid Bare* captures the sense of engagement and practice, combining concise descriptions, dialogues, and short pithy case studies to illustrate key points. “I came to private equity by luck,” says Ludovic, “and my research received a lot of attention. People had hardly ever seen such data and analysis. Clearly there was a headwind when it came to really understanding the essence of private equity and what makes deals tick. Ever since then I have gathered data, worked closely with practitioners, and followed the latest developments, which all create a better base for teaching students and executives about the industry.”

As heavy as the subject of finance can be, Ludovic kept the writing style accessible and fun; he made use of the tale Alice in Wonderland to explain the nature of the deal,

from points of failure to highlights of success. Staying current with themes that are running through the industry these days, he addresses the topic of fees and expenses through a vibrant dialogue between Alice (a GP) and the Hatter (an LP), which conveys the various tensions in a humorous way.

Readers will come away with a strong sense of what is at stake in every deal and fund, and four key points deserve particular attention.

Four Key Points

Leverage – In Ludovic’s words, “The amount of debt in an LBO will only affect the value-added positively if the target was purchased below its competitive value.” This means that when asset prices are at all-time highs, as they have been, firms should use less leverage in LBOs, not more. Viewed at a deeper level, he notes, “The usual decomposition of value-added into leverage, multiple arbitrage, and earnings growth does not make sense conceptually and the practical implementation, through a so-called ‘value bridge,’ only exaggerates the contribution of earnings growth.” Financial engineers take note!

Financial Bankruptcy – Looking out over the history of private equity deals, Ludovic observes that most of the controversies around LBOs arise when companies end up financially bankrupt. “A financial bankruptcy is one that would not have happened without the extra debt that has been added due to the LBO,” he says, “and indeed, most bankruptcies in private equity are in this category.” As an interesting counterpoint he adds, “Actually these bankruptcies should not be that controversial, since a purely financial bankruptcy should not, in principle, disrupt the underlying business. Naturally there should be a change of ownership to some of the debt claimants, and if there is actually a disruption of the business, then people should turn to bankruptcy laws, rather than focusing on the private equity side of the situation.”

Fees – In an era where the high fees of many

forms of alternative investment have come under fire, private equity is no exception. Ludovic takes a strong stance on this issue and offers some concrete advice. “When we hear of fees of 2 and 20, it may seem high, but it is also misleading,” he says. “The headline fees are only remotely related to the fee bill because the actual fees will depend on minute details in the term of the contract, a document that is notoriously difficult to read and understand.” One of the critical elements of the ultimate fee structure lies in portfolio company fees and expenses; until recently, this topic was not out in the open and had the potential to create substantial conflicts of interest for GPs.

Education – Following from the discussion of leverage, bankruptcy and fees, one might be discouraged from considering investment in private equity at all. However, the picture is not as bleak as it may seem. The role of private investment in firms is a critical feature of a healthy financial landscape and education, not avoidance, is the key to unlocking its potential.

Advice for CAIA Members

For those who are interested in breaking into private equity, Ludovic offers the following advice: “Many people, early in their careers, start off thinking that they want to work for a big GP – a KKR or a Blackstone, but it is helpful to consider what opportunities exist with smaller funds as well. There are funds that focus on emerging markets and niche funds where the ability to have an impact and develop a very strong area of expertise will come quickly. You may be able to execute deals faster, develop an excellent Rolodex, and do a lot of exciting things in a smaller firm.” In addition, he recommends that potential candidates consider roles at pension funds, sovereign wealth funds, and endowments. These institutions may be involved as LPs and some do deals themselves. “By working on the LP side of the industry, you can develop insights and connections that will carry across if you eventually want to make the move to a GP,” Ludovic notes. Legal and accounting jobs also provide opportunities to learn deal mechanics and comprise valuable skill sets on both sides of the industry. And finally, consulting can be an avenue into this intriguing area of finance. “Whatever you do,” says Ludovic, “you need to read, question, and don’t trust anyone; the sharpest business minds are drawn to fields like private equity and it is one of the most challenging and exciting areas in the financial world.”

One excellent way to start will be to read *Private Equity Laid Bare* this year.

On Amazon: <https://www.amazon.com/Private-Equity-Laid-Ludovic-Phalippou/dp/1973918927>

You can also follow the book on Twitter: @PELaidbare and on Facebook at PE Laid Bare <https://www.facebook.com/PElaidbare/>

If you are interested in further details, feel free to contact Ludovic at ludovic.phalippou@sbs.ox.ac.uk.

Bios



Barbara J. Mack
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Barbara J. Mack is founder and president of the consulting firm Pingry Hill Enterprises, Inc. For over fifteen years, she has worked as a consultant, editor, writer, and researcher on projects involving alternative investments, international economics, and technological innovation. Her previous work experience

includes appointments as a case writer at Harvard Business School and a research affiliate at the Computer Science and Artificial Intelligence Lab (CSAIL) at MIT.

Barbara has a Masters degree from Harvard University’s Kennedy School of Government, with a focus on law and policy in the European Union. She also has a Bachelor of Arts from Tufts University, where she focused on English Literature, Anthropology, and Fine Art.



Ludovic Phalippou, PhD
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Author of the best-seller *Private Equity Laid Bare*, Ludovic is a tenured faculty member of the Saïd Business School at the University of Oxford. He specializes in the areas of private equity that are of interest to investors in that asset class, such as fee tracking, interest alignment, and return benchmarking.

Named as one of “The 40 Most Outstanding Business School Professors Under 40 In The World” in 2014, and as one of the 20 most influential individuals in private equity in Europe in 2016, Ludovic has strong links with senior practitioners in the industry, routinely speaks at practitioner conferences, and appears in the media internationally.

Ludovic’s research papers have been widely cited in academia, in the press, and in regulatory circles. He worked with a number of large institutional investors on their private equity investment decisions and benchmarking systems.

At Oxford, Ludovic teaches ‘Asset Management’ and ‘Private Equity’. He achieved a degree in Economics from Toulouse School of Economics; a Master in Economics and a Master in Mathematical Finance both from the University of Southern California; and a PhD in Finance from INSEAD. Ludovic has two main hobbies: tasting great wines and racing road bikes.