Abstract:
Private equity firms are blamed for quickly extracting all of a target company's cash, and sometimes for going even further by requesting a target company to incur additional debts (in order to be able to pay investors an additional dividend) and thus driving it into bankruptcy. Consequently, there is always a trade-off between the benefit of high extra dividends and the associated risk, due to higher debt obligations, which may cause bankruptcy. In this paper, we apply real-options theory and capital-budgeting techniques to the problem of assessing a private investor's risk. We propose a new continuous time DCF model, which incorporates the four fundamental value drivers, among others a high debt to equity ratio, and typical characteristics for private investments like a high probability to default. We also introduce different risk measures by proposing a new measurement model that is based on the cash flow process, the associated multiple process as well as on the implied IRR of the transaction. Finally, we give some details of how such a model is implemented to provide investors as well as debt lenders with a decision support regarding different investments or investments strategies.

Stichworte:
Private Equity, Risk Return, Business Valuation, Leveraged Finance, Risk Assessment, Credit Risk, DCF Default Model