The Search Fund

A Unique Funding Mechanism for the Aspiring Entrepreneur
What’s A Search Fund?

• A partnership between young promising managers/operators and experienced investors looking to back them

• A novel way to buy an existing business that has good bones but is in need of fresh management and strategic direction

• Give the manager/operator a chance to earn substantial equity (20-30%) in the business through both time-vesting and overall deal performance (*tied to growth of company*)

• Origins from Harvard and Stanford Schools of Business
Aspiring entrepreneurs and savvy investors have been drawn to search funds for two main reasons:

1. They offer relatively inexperienced professionals with limited capital resources a direct path to owning and managing a small business.

2. Search funds have generated good financial returns.
   
   a. Aggregate pre-tax IRR of the search fund asset class is 34.4%
   
   b. Returns driven by a few big winners, relatively small losses
Symmetry of the Search Fund

**Searcher/Manager**
* (1 or 2 individuals)*
- Incented to find “best” deal
- Able to be patient in their search
- Frugal with initial search capital

**Investor Group**
* (10-15 High Net worth Individuals)*
- Small upfront capital commitment
- Direct deal investment (low cost)
- Decide at deal time if they want in

**Deal Advisor Group**
- Act as advisors during the search
- Willing to review deals, provide guidance
- End up on your board when deal is done

**Aligned Interests:**
Searcher and Investor are aligned at all phases of the process
Who does Search Funds?

- Predominately post MBA managers and operators
- Want to run a business and earn equity
- Believe they have what it takes to lead and grow a business
- Have honed a certain skill set that can be leveraged
- Don’t have capital, only sweat equity and tenacity
- Adverse to the “start up thing”
- Are willing to take risk and have entrepreneurial zeal
The Search Fund Cycle

**“Search Phase”**

2-3 Years

3-6 Months
- Initial Funding for Search

12-24 Months
- Searching For A Business

4-6 Months
- Acquiring A Business

3-5 Years
- Running The Business

Initial Funding 300-500k provides:

- Small salary for the managers during search
- Office space and misc. business expenses
- Travel expenses associated with visiting businesses
- Diligence costs (accountants, consultants, etc)
- Most legal costs are carried into the deal
Our Odyssey (Headland Partners)

- Raised 425k from 15 investors
- 600 Companies Reviewed
- 10 LOI’s written
- 2 Purchase Agreements
- 1 Acquisition
  
Purchased ProService in Fall 2005

Search for 2 ½ Years

Left our jobs

Refinancing / liquidity
Stats On Search Funds

Source: Stanford Graduate School of Business 1984-2011 Study

Majority of funds buy a business

Majority continue to run business
## Stats On Search Funds

<table>
<thead>
<tr>
<th>Medians</th>
<th>All Acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of Search (months)</td>
<td>19</td>
</tr>
<tr>
<td>Purchase Price</td>
<td>$8.5 M</td>
</tr>
<tr>
<td>Equity Invested at Purchase</td>
<td>$2.6 M</td>
</tr>
<tr>
<td>Investors' Debt</td>
<td>$0.0 M</td>
</tr>
<tr>
<td>Company Revenues at Purchase</td>
<td>$7.5 M</td>
</tr>
<tr>
<td>Company EBITDA at Purchase</td>
<td>$1.6 M</td>
</tr>
<tr>
<td>EBITDA Margin</td>
<td>21.6%</td>
</tr>
<tr>
<td>EBITDA growth rate at purchase</td>
<td>12.0%</td>
</tr>
<tr>
<td>Purchase Price / EBITDA Multiple</td>
<td>5.1x</td>
</tr>
<tr>
<td>Purchase Price / Revenue Multiple</td>
<td>1.1x</td>
</tr>
<tr>
<td>Company Employees at Purchase</td>
<td>50</td>
</tr>
</tbody>
</table>
Navigating the Search Process

There is an ocean of businesses to consider. You must have a process.

1. Most important – Know your search criteria
   - Recurring revenue
   - Stable margins / profitable
   - Growing or clear growth potential
   - Understandable – we aren’t rocket scientists
   - Benefitting from big trends – outsourcing, demographics, computing power, mobile

2. Turn over lots of rocks in lots of ways
   - Quarterly newsletter
   - Brokers
   - Lawyers, accountants and business organizations in key locales
   - Primary research of industries we liked
   - Industry Conferences
• Spring 2004: introduced to ProService on response to a blast email
  – Tried and failed (quickly) to negotiate a deal
  – Left on good terms with owner (stay in touch)
• Rest of 2004: 3 other deals fell through
• Early 2005: retouched multiple old leads
  – Negotiations in spring
  – Diligence through the spring and summer
  – Raised capital from investors in June - August
  – Managed attorneys to get to close
• Successful close – Oct 2005
The Transition to Leading ProService

• From deal to running a company
  – Climbing Everest to Scuba Diving = very different

• Everything diligenced was worse than we thought

• Grit, hard decisions, prioritization were critical
  – litigation, accounting, bad clients, culture
  – Establishing a base to grow from.
    • Only looking forward: New team, new values, new partners.
Lessons learned

• The search is hard
• Seek a great opportunity, not a job
• Be disciplined / follow your process
• Deals die – need multiple “shots on goal”
• Buying the business brought different challenges
• As long as we worked hard at the process, no outcome was a failure