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[Logo of your fund]

[Logo of your fund]

# **Private Placement Memorandum**

[MONTH, YEAR]

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## EXECUTIVE SUMMARY

[Name of your fund] is a search fund formed to identify, acquire and operate an existing private company with initial enterprise value between [\$5.0 and \$30.0]<sup>1</sup> million. This summary provides an overview of [name of your fund]’s Principal, the financial structure of the search fund, and the strategy to identify and acquire an existing private company.

The purpose of the search fund is to provide investors with the opportunity to participate in the staged financing of the search for and acquisition of an existing private company. Search funds have been in existence since 1984 and have been structured to mitigate many of the risks associated with purchasing a small business. To date, over 325 search funds have been raised. A 2018 study conducted by Stanford concluded that a portfolio of first time search funds produced annual returns of 33.7% and an average multiple on invested capital of 6.9x<sup>2</sup>.

### Principal Background

[To be updated according to “Principal Background” section]

### Investment Structure

[Name of your fund] is raising \$[ ] through the sale of [ ] investment units (“Unit(s)”) priced at \$[ ] each. This initial capital is intended to sustain a dedicated search for up to 24 months. For each Unit purchased, investors will receive:

***Right of First Refusal.*** Investors will have the right, but not the obligation, to participate in financing the acquisition. Depending on the size and structure of the acquisition, investors are expected to have the opportunity to invest another [\$100,000 to \$1,250,000]<sup>3</sup> per unit at the time of acquisition. Investors will be given the opportunity to provide 100% of the required equity capital in order to prevent dilution from outside investors.

***Investment Step-Up.*** All Units will be converted to securities in the acquired company and stepped-up by 50%, structured as a combination of redeemable preferred equity and participating preferred equity on terms pari passu with the investor capital provided in the acquisition round of financing (i.e., for every \$1.00 invested in [name of your fund] the investor will receive \$1.50 of securities of the acquired company). This 50% step-up is meant to compensate the initial investors for the increased risk of investing in the first round of financing.

[Name of your fund] intends to finance the acquisition through a combination of bank debt, subordinated debt, seller financing and investor capital, which may include redeemable preferred equity and participating preferred equity.

The Principal will earn an equity interest in return for identifying and acquiring the target company, and for achieving agreed upon operating results. The Principal will have the

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<sup>1</sup> This represents our view of the historic range in size of traditional funded search transactions.

<sup>2</sup> *Search Funds – 2018: Selected Observations*, Stanford Graduate School of Business

<sup>3</sup> While there are many variables that could drive these numbers, it is most common to assume that the debt/equity split will be 50/50 for the purpose of filling in these blanks.

opportunity to earn [25][30]% of the common equity. A portion of this equity will be subject to meeting pre-established performance benchmarks. Neither the investors' nor the Principal's upside is limited in any way.

**Search Strategy**

[Name of your fund] is exclusively focused on finding a single, high quality company that has a motivated seller and the potential to achieve meaningful growth. Although [your name] initially intends to target industries such as life sciences and computing services where his technical expertise gives [him][her] an edge, [your name] does not plan to limit his search exclusively to these industries.

[Your name] believes the optimal search strategy consists of [ ]% of time dedicated to targeted proprietary outreach to qualified companies in a select set of industries, and the remaining [ ]% of time dedicated to opportunistic lead sourcing through intermediaries. [Your relevant experience] has taught [him][her] that brokered deals often result in acquisition prices too high to yield an acceptable return to a search fund, but that brokers can be an invaluable resource for learning about and identifying new industries to target. [Your name] also intends to leverage his personal network to identify leads, which will include the use of financial rewards for productive lead referrals.

[Name of your fund] will target opportunities located in industries that are currently experiencing a trajectory of growth and ideally possess the following attributes:

Financial	Business
Recurring and contractual revenue streams Annual revenues over \$5.0 million Annual EBITDA over \$1.0 million Cash flow positive for three years Low cyclicalilty Low ongoing capital expenditure needs	Strong middle management Private and concentrated ownership Motivated sellers Opportunity for [your name] to add value High operating leverage Low customer concentration and churn Business to business services
Industry	Geography
High organic growth potential Large, fragmented market Low risk of adverse regulatory changes Low risk of technological obsolescence Non-commoditized product or service offering High competitive barriers	USA

Currently [your name] has identified the following sub-industries of interest that will fit well with [name of your fund]'s outlined criteria; however, in no way is this list meant to be exhaustive.

<b>Initial Industries of Interest<sup>4</sup></b>	
[	]
[	]
[	]
[	]

\* Please see Appendix C for Industry Summaries and Investment Theses

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<sup>4</sup> It is typical to have 3-4 industries or sub-industries listed. It is useful to be more specific than, for example, saying “software” or “healthcare”.

## INVESTMENT HIGHLIGHTS

[Name of your fund] represents a compelling investment opportunity for the following reasons:

***Underserved Acquisition Niche.*** Approximately \$4.8 trillion of net worth, representing the largest intergenerational shift of wealth in U.S. history, will be transferred over the next 20 years, as virtually all closely held and family-owned businesses will lose their primary owner to death or retirement.<sup>5</sup> Opportunities to acquire lower middle market businesses will be greater than demand, as these businesses typically fall below the investment parameters of most buyout firms and are often too large for private buyers. Furthermore, direct sourcing of these opportunities requires a significant time investment that is oftentimes not feasible for private equity firms due to their limited professional staffs. As a result, acquisition multiples in the lower middle market are lower than those found up-market.

***Tested Investment Vehicle.*** Search funds have been in existence since 1984 and have been used by over 100 entrepreneur teams primarily from Harvard Business School and Stanford Graduate School of Business to support efforts to locate, acquire and manage an existing private company. A 2018 study of “first time” U.S. and Canadian search funds by the Stanford Center for Entrepreneurial Studies shows average investor returns of 33.7% per year.<sup>6</sup>

[Note: the categories below are illustrative only. You will want to personalize this section with categories relevant to your own skills and experience. The symbol \* refers to experiences discussed in more detail in the PRINCIPAL BACKGROUND section.]

***Domain Expertise of Principal Allows Targeting of Firms in Various Industries.*** [Your name]’s deep expertise in [your expertise] allows [him][her] to target firms in the highly fragmented and growing [life sciences and pharmaceutical] services niches that searchers from more conventional backgrounds typically avoid. Anecdotally, [your name] knows of several searchers who have stumbled upon acquisition prospects they “had no idea how to run” in the life sciences industry and chose not to pursue those companies further even if they were excellent from a financial standpoint. [Your name] believes that his technical background will give [him][her] a level of credibility with sellers, future employees and future customers that few searchers possess.

***Committed and Resilient Principal.*** [To be personalized.]

***Talent for Thriving in New Situations.*** [Your name] recognizes the enormous value of developing orthogonal technical and business skills, and [he][she] has actively sought out mentors and learning experiences. [Describe the efforts you have made to get yourself familiar with the industries you intend to focus on for the search fund, including but not limited to extra-curriculum activities, full time working experience, and internship.]

***Experience of Principal with Searching Best Practices*** [To be personalized.]

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<sup>5</sup> “The Ten Trillion Dollar Question: A Philanthropic Gameplan,” *Initiatives*, Robert Avery, Cornell University

<sup>6</sup> *Search Funds – 2018: Selected Observations*, Stanford Graduate School of Business

## **PRINCIPAL BACKGROUND**

### **Professional Experience**

[\*]

[Use paragraphs to describe your professional experience, including your relevant prior working experience, your primary business interest, and how you become interested in search fund business etc.]

### **Education**

[\*]

[Use this paragraph to describe your education background. The information may include but not limited to your major, areas of studies, and honors earned.]

### **Personal**

[\*]

[Use this paragraph to describe your personal information, including your place of birth and growth, your hobbies, and some other interesting personal experience you may have.]

**Please see Appendix A for a complete copy of [your name]'s resume.**

## INVESTMENT OPPORTUNITY

[Name of your fund] is a search fund formed to identify, acquire and operate an existing private company with initial enterprise value between [\$5.0 and \$30.0] million. The fund will allow the Principal to conduct a full-time search for a period of up to 24 months.

### Overview of Search Fund Model

Conceived in 1984, the search fund is an investment vehicle in which investors financially support a manager's efforts to locate, acquire and manage an existing private company. To date, over 325 search funds have been raised.

In a search fund model, capital is raised in two distinct rounds of financing. In the first round, funds are invested into the search fund entity (e.g. [name of your fund]) to cover operating expenses and allow the Principal to draw a salary while conducting a professional search to acquire an existing private company. In return, search fund investors obtain the right, but not the obligation, to invest in the second round of financing, the acquisition round. All funds invested in the first round will automatically be converted to securities in the acquired company and stepped-up by 50% (i.e., for every \$1.00 invested in [name of your fund] the investor will receive \$1.50 of securities of the acquired company) and structured as a combination of redeemable equity and participating preferred equity.

A 2018 study of 325 "first time" search funds (funds raised by management teams without prior search fund experience) by the Stanford Center for Entrepreneurial Studies shows average investor returns of 33.7% per year and an average multiple on invested capital of 6.9x. (full text provided in Appendix D).<sup>7</sup>

### Five Stages of the Search Fund

The search fund model is executed over five distinct stages, the entirety of which can last anywhere from five to eight years.

Search Fund Timeline	Stage Time
Stage 1: Raise the Search Fund	2 – 4 months
Stage 2: Source & Evaluate Opportunities	1 – 24 months
Stage 3: Finance & Close a Transaction	2 – 6 months
Stage 4: Operate the Business	4 – 6 years
Stage 5: Exit the Business	4 – 6 months

<sup>7</sup> *Search Funds – 2018: Selected Observations*, Stanford Graduate School of Business

**Stage 1: Raise the Search Fund**

[Name of your fund] is raising \$[ ] through the sale of [ ] Units priced at \$[ ] each. This initial capital is intended to sustain a search for up to 24 months. For each Unit purchased, investors will receive:

**Right of First Refusal.** Investors will have the right to participate in financing the acquisition, but are not obligated to do so. Depending on the size and structure of the acquisition, investors have the opportunity to invest another \$[ ] to \$[ ] per unit at the time of acquisition. Investors will be given the opportunity to provide 100% of the required equity in order to prevent dilution from outside investors.

**Investment Step-Up.** All Units will be converted to securities in the acquired company and stepped-up by 50%, structured as a combination of redeemable equity and participating preferred equity on terms pari passu with the investor capital provided in the acquisition round of financing (i.e., for every \$1.00 invested in [name of your fund] the investor will receive \$1.50 of securities of the acquired company). This 50% step-up is meant to compensate the initial investors for the increased risk of investing in the first round of financing.

Operating expenses for [name of your fund] are projected to be \$[ ] for a 24-month search. These costs include salaries and benefits for the Principal, office space, travel, communications, research, and deal expenses. Specific expenses incurred during diligence and documentation of the acquired company will be included as part of the transaction’s purchase price. A detailed search budget is as follows:

**[Name of Your Fund] Representative Search Budget**

<b>Expense</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Total</b>
Principal Draw	\$[ ]	\$[ ]	\$[ ]
Benefits & Insurance	\$[ ]	\$[ ]	\$[ ]
Legal	\$[ ]	\$[ ]	\$[ ]
Rent, Office & Admin.	\$[ ]	\$[ ]	\$[ ]
Travel	\$[ ]	\$[ ]	\$[ ]
Diligence	\$[ ]	\$[ ]	\$[ ]
<b>Total</b>	\$[ ]	\$[ ]	\$[ ]

[Name of your fund] is interested in assembling a diverse investor base with expertise in successfully sourcing, investing, financing, operating, growing and exiting private companies. [Name of your fund] is also interested in identifying investors who have the time and interest to provide mentoring and advice throughout the search fund process, especially in the form of Board of Directors during the operating stage. [Name of your fund] welcomes any level of investor participation and believes the credibility associated with a distinguished investor group will aid in approaching and negotiating with business owners.

**Stage 2: Source & Evaluate Opportunities**

[Name of your fund] will be based out of [ ] and will perform a highly targeted and yet opportunistic nationwide search to generate deals that meet [name of your fund]’s acquisition criteria. Companies will be evaluated against the following dimensions:

Financial	Business
Recurring and contractual revenue streams Annual revenues over \$5.0 million Annual EBITDA over \$1.0 million Cash flow positive for three years Low cyclicalilty Low ongoing capital expenditure needs	Strong middle management Private and concentrated ownership Motivated sellers Opportunity for [your name] to add value High operating leverage Low customer concentration and churn Business to business services
Industry	Geography
High organic growth potential Large, fragmented market Low risk of adverse regulatory changes Low risk of technological obsolescence Non-commoditized product or service offering High competitive barriers	USA

Experience has taught [your name] that, in a competitive marketplace, very rarely do companies fit all the characteristics listed above *and* are available on terms capable of generating attractive returns to search fund investors. [Your name] believes that efficient searching is an exercise in holistically evaluating companies based on limited data and learning quickly which of the above attributes are worth compromising on.

At a minimum however, companies must possess the following characteristics:

Minimum Company Attributes
Business to business service Privately-held and based in the U.S. Ownership stake above 70% for sale Three-year history of profitable operations Minimum EBITDA margin of 15% Minimum annual EBITDA of \$1.0 million

[Your name] believes the optimal search strategy consists of [ ]% of time dedicated to targeted proprietary outreach to qualified companies in a select set of industries, and the remaining [ ]% of time dedicated to opportunistic lead sourcing through intermediaries. [Your name]’s past experience [interning/working with a search fund] has taught [him][her] that brokered deals often result in acquisition prices too high to yield an acceptable return to a search fund, but that brokers can be an invaluable resource for learning about and identifying new industries to target.

[Your name]'s [prior search fund experience] has also taught [him][her] that, particularly in deals generated through proprietary outreach, the willingness of the seller to accept terms capable of generating attractive returns to investors is often the biggest barrier to deals, rather than any of the terms listed above. To this end, [your name] believes that a key component of searching best practice is to rapidly send non-binding indications of interest for purchase at a 4-5x EBITDA multiple to sellers after one or two phone calls with business owners to determine if the business fits the minimum attributes. Sending an indication of interest early in the owner interaction process both shows the seller that [name of your fund] is serious about completing an acquisition but also anchors a price in the seller's mind and acts as a filter to prevent wasting of valuable and finite search resources on sellers with incompatible price expectations.

[Your name] intends to utilize his network of [life sciences and biotechnology] professionals as well as hire part time interns over the summer to help build up his database for proprietary outreach, so that [he][she] can minimize the amount of time on lead generation when [he][she] starts searching full-time. [Your name] also intends to leverage his personal network to identify leads, which will include the use of a financial reward for productive lead referrals.

### ***Stage 3: Finance & Close a Transaction***

[Name of your fund] intends to finance the acquisition through a variety of sources, including:

***Bank Debt.*** Bank debt will constitute a significant portion of the acquisition financing. Typical revolving credit facilities provide advances against a negotiated borrowing base, such as 80% of accounts receivable and 50% of inventory. Senior term debt can be either asset-based or cash flow-based. Asset-based loans are determined primarily on the liquidation value of the company's fixed assets. Cash flow loans are predicated on the company's earnings. While search funds in the past have been able to secure bank debt for a substantial portion of the overall purchase price, the availability, interest rate and other terms for such debt will depend on the quality of the company's assets and cash flow and on the general lending environment at the time of purchase. [Name of your fund] will build on the Principal's and Investors' existing senior lender relationships and cultivate new relationships throughout the search process.

***Institutional Subordinated Debt.*** Institutional subordinated debt, also referred to as mezzanine debt, may constitute a portion of the eventual capital structure. Mezzanine debt is structurally subordinate in priority of payment to senior debt but typically ranks senior to seller financing and investor capital. As with the senior lender market, the availability, interest rate and other terms for mezzanine debt will depend on the quality of the company's cash flow and on the general lending environment at the time of purchase. [Name of your fund] will build on the Principal's and Investors' existing mezzanine lender relationships and cultivate new relationships throughout the search process.

***Seller Financing.*** Owners of companies in [Name of your fund]'s target range are often willing to accept a stream of future payments as part of the acquisition. Typical structures include seller paper and/or earn-out provisions. The availability and extent of seller financing is influenced by several criteria, including the seller's need for immediate liquidity, his/her tax situation and his/her desire to remain involved with the business. Previous search funds have shown that if the

external lending environment is poor then seller financing is a convenient way to close the funding gap.

**Investor Capital.** [Name of your fund] anticipates that investor capital will represent between 25% and 80% of the capital required to fund the acquisition. Based on a targeted transaction size of between \$[5.0 million and \$30.0 million], investor capital will likely total between \$[ ] and \$[ ]. This amount represents roughly \$[ ] to \$[ ] per Unit. Investor capital may include a combination of redeemable equity and participating preferred equity. The ultimate capital structure will depend on specific acquisition and investor preferences.

Illustrative transaction economics can be found in Appendix B. **Please note the ultimate transaction size, structure and financial results may vary significantly from that which is depicted in Appendix B.**

#### ***Stage 4: Operate the Business***

Following completion of the acquisition, the Principal will assume the role of President and/or CEO of the acquired company. For the first 180 days, the Principal will be focused on acclimating [himself][herself] with the acquired business, without disrupting the status quo. The diligence process will provide an important foundation, however it is anticipated that significant time and energy will be required to gain a more thorough understanding of the business, to establish credibility with the existing management team and to formulate a strategy for the business.

Additionally, during the first 180 days, the Principal will evaluate the strength of the existing management team, paying careful attention to how the strengths and weaknesses of the existing team overlay the current and future risks and opportunities of the business. The Principal, with the help of the investor group, will include an assessment of his individual strengths, weaknesses, interests, and areas of relevant expertise in this analysis in order to paint a complete picture of the management situation at the acquired company. The Principal anticipates making additions to the management team in the first twelve to eighteen months after acquisition. Representative additions may include upgrading the finance and accounting team with the addition of a qualified Chief Financial Officer and/or hiring an experienced sales executive as a new Vice President of Sales. While change can be disruptive, the Principal believes that it is important to thoughtfully assemble a team that embrace traditional values of hard work, integrity, humility and teamwork and can accelerate the growth of the business.

The Principal will recruit a Board of Directors for the acquired business. The Board of Directors will consist of between three and five investors or other leaders in the company's industry. The Principal is interested in assembling a Board of Directors consisting of individuals with expertise in operating, growing and exiting private companies as well as those with an interest in coaching and mentoring the Principal throughout the life of the investment.

#### ***Stage 5: Exit the Business***

Investment in [name of your fund] should be viewed as a long-term investment, as investor returns will primarily come from the Principal's ability to increase the value of the acquired company. [Name of your fund] expects to grow the company so long as it remains attractive for

both the investors and the entrepreneur. Although no assurances can be given, the average holding period in the search fund universe is 7 years. Although liquidity will most likely come from a sale of the business, the Principal may in fact remain with the business following a sale, depending on the buyer and the continued growth prospects of the business. In certain situations investors with a longer-term investment horizon may be able to maintain their investment in the business. In addition to a liquidity event through sale, [name of your fund] will explore additional opportunities to maximize investor returns such as recapitalizations and share repurchases. As such, the duration of the investment could vary substantially from the initial expectations of five to eight years.

### **Investor Returns**

Through the acquisition and active management of its company, [name of your fund] targets a 35% internal rate of return on investor capital (IRR). This IRR target, which is comparable to the returns of previous search funds, will be used to evaluate all investment opportunities. Investor returns on equity will not be capped in any way.

### **Principal Carried Interest**

The Principal will earn common equity in the acquired company in return for identifying and acquiring the target company, and for achieving agreed upon operating results. The Principal expects to have the opportunity to earn up to a 25% share of the common equity. The earned equity is comprised of three parts: one third will be allocated at the close of the acquisition; one third will be based on management service and will vest evenly over a period of four years; and the final one third vest on a straight line basis as starting at 20% IRR and fully vesting at 35% IRR. In addition, an employee equity pool will be granted for up to 5% of the company's common equity. Employee will be used as a combination of time and performance-based incentives for employees, excluding the Principal, and must be approved by the Board of Directors prior to issuance. The Principal will suffer pro-rata dilution from the equity pool.

### **Investment Risks**

The search fund model attempts to minimize risk for investors via a staged financing structure, but it is not risk free. While [name of your fund]'s search, acquisition and management process will utilize best practices outlined in this document, the search fund has risks characteristic of investment vehicles that pursue superior returns. Significant risks include:

***Inability of [Name of Your Fund] to Find an Acquisition Target:*** There is no guarantee that [name of your fund] will be able to identify and then close a suitable transaction. If this were to occur investors would lose their initial search capital. Approximately one-third of all known first-time search funds fail to make an acquisition despite the best efforts of the search fund partners over a two-year time horizon. Even if a suitable target is found, there is no guarantee that a transaction can be completed at an acceptable price.

***Unappealing Proposed Acquisition for Search Fund Investor:*** [Name of your fund] will work closely with investors throughout each stage of the acquisition process, communicating regularly regarding specific industries and companies. However, the possibility exists that a proposed acquisition may not fit with an investor's profile or personal taste. If this is the case, the investor

is not obligated to invest additional funds in the acquisition and will still receive an appreciated carried interest/step up related to his/her original investment.

***Inability of [Name of Your Fund] to Complete Acquisition Successfully:*** [Name of your fund]'s successful acquisition of a target company will be dependent on its ability to acquire debt financing, the willingness of investors to participate in the equity financing, and factors outside the Principal's control, such as seller willingness and market conditions. The Principal will attempt to assess seller willingness and market conditions as [he][she] pursues opportunities, but must be prepared for some uncertainty regarding these issues.

***Poor Performance of Acquired Company:*** The possibility exists that unidentified problems with the target company will surface after completing the transaction. [Name of your fund] will implement thorough and professional due diligence to reduce unforeseen risks and to ensure the financial health and operational performance of the company. The use of seller financing and earn outs will provide incentives for the selling party to provide full and open disclosure and to add value to ongoing operations after the acquisition. Nonetheless, despite aggressively pursuing operating targets and financial plans, there is no guarantee that the company performance will meet predetermined hurdles.

***Inability of [Name of Your Fund] to Manage Acquired Company:*** Because the future performance of the company is tied to the incoming and current management team's abilities, the Principal is committed to gathering the appropriate skills necessary to lead the company successfully. In addition to his own abilities, [he][she] will rely on industry partners, directors, advisers, consultants and new hires to bring requisite skills into the company.

***Illiquidity of Investment:*** Since the investor units will not be registered under the Securities Act of 1933, there will be no public market for them, and the ability to resell them will be limited. Investor returns may be realized through interest payments, unit redemption and possible equity liquidity events, such as the sale of the company, initial public offering, or recapitalization. An investment in a search fund is an illiquid investment and there is no guarantee that the investors can achieve liquidity within the projected timeframe.

***Limited Operating History:*** [Name of your fund] has no operating history. The determination to become a member must be made primarily on the basis of one's appraisal of the ability of the Principal of [name of your fund] to achieve the proposed objectives discussed in this Memorandum.

***Management Risks:*** [Name of your fund] will be substantially dependent upon the efforts of the Principal, with respect to the identification of the target company and the operation of such company post-acquisition. The death, disability or withdrawal of the Principal could have a material adverse effect on the ability [name of your fund] to locate a suitable acquisition target or operate such a company post-acquisition.

***Unknown Tax Impact:*** The operation of [name of your fund] and the tax consequences of an acquisition and future sale of the acquired company are substantially affected by an investor's

[Logo of your fund]

personal, legal and tax situation. Potential members are highly encouraged to consult their personal tax, legal and other advisors prior to making a decision to invest in [name of your fund].

[Name of your fund] will attempt to mitigate risk factors by aligning the interests of investors and management, conducting extensive due diligence and by reducing exogenous factors related to industry and company operations. Nevertheless, there can be no guarantee that investors will recover their initial investment or realize the projected returns. Investors may experience a substantial or complete loss of invested capital and therefore must be capable of bearing that risk.

[Logo of your fund]

## **APPENDICES**

### **Appendix A: [Your Full Name]'s Resume**

**[Insert one-to two-page resume here]**

## Appendix B: Illustrative Transaction Economics<sup>8</sup>

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<sup>8</sup> Searcher to insert a chart showing hypothetical returns to Investors and Principal in standard search fund investment.

## Appendix C: Industry Summaries & Investment Theses<sup>9</sup>

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<sup>9</sup> Searcher to include a discussion of the opportunity in 3-4 industries [he][she] or she is interested in.

[Logo of your fund]

## **Appendix D: Stanford GSB, Search Funds – 2018: Selected Observations**