STANFORD
GRADUATE SCHOOL OF BUSINESS

CASE: E-446
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SEARCH FUNDS—2011: SELECTED OBSERVATIONS

Since 1996, the Center for Entrepreneurial Studies (CES) at the Stanford Graduate School of Business has conducted a series of studies on the performance of search funds. This study, as well as its predecessors in 1996, 1998, 2001, 2003, 2005, 2007, and 2009, has endeavored to gather data about and gain insight into all known search funds.[1] Each of these studies portrays the aggregate characteristics of search funds and their principals, and evaluates the investment returns generated by first-time search funds to their original investors. Together, this series of studies reflects changes in the characteristics of search fund entrepreneurs and the performance of their funds over time.[2] Using conservative assumptions, the aggregate pre-tax internal rate of return of the search fund asset class through year-end 2011 is 34.4 percent. The aggregate pre-tax return on invested capital is 11.1x.

For the uninitiated, the opening sections of this note describe in detail what a search fund is and how search capital is used. Those already familiar with search funds may move forward to the section called "Search Fund Asset Class" on page five.

[1] "Known search funds" refers to those of which the CES is aware. Despite the tightly knit network of search fund principals, investors and advisors, it is possible that search funds have existed that are not known to the CES.
[2] The data in this study is as of December 31, 2011.

Arar Han (MBA '09) and Sara Rosenthal (MBA '04) prepared this study under the direction of MBA Class of 1980 Consulting Professor of Management H. Irving Grousbeck and Lisa Sweeney, Program Director of the Center for Entrepreneurial Studies (CES) as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

The CES would like to thank the Searchers who elected to participate in this study. Additional thanks goes to Doug Wells (1996 study), Josh Hannah (1998 study), Chris Flanagan (2001 study), Mu Y. Li (2003 study), Mike Harkey (2005 study), Sean Harrington (2007 study), and Aimee LaFont Leifer and Tjarko Leifer (2009 study) for pioneering and updating earlier versions of this study.

WHAT IS A SEARCH FUND?

A search fund is a pool of capital raised to financially support the efforts of an entrepreneur, or a pair of entrepreneurs, to locate and acquire a privately-held company for the purpose of operating and growing it. The lifecycle of a search fund tends to include four stages:

- **Fundraising**: The *initial search capital* is raised to finance the search stage: the identification, evaluation, and negotiation of an acquisition. Principals often need to tap a wide network of potential investors to raise initial search capital, including friends and family, business associates, business school faculty, angel investors, business owners and executives, and institutional search fund investors.
- **Search and acquisition**: There are multiple steps in this stage: generating deal flow, screening potential candidates, assessing seller interest, performing due diligence on the target company, negotiating the terms of the acquisition, raising debt and/or equity capital, and closing the deal. When a target is identified, contributors of search capital are given the right of first refusal on their pro-rata share of new *acquisition capital*. Initial search capital is commonly stepped up by a certain percentage (e.g., 50 percent) in the acquisition round, whether or not investors of search capital decide to participate. In addition to follow-on investment, acquisition capital can come from a combination of other sources: seller's debt, bank loans, and equity financing from new investors. Investor debt, commonly in the form of subordinated debt, may also be added to the capital structure.
- **Operation**: After completing the acquisition, principals will recruit a board of directors for the company, which often includes substantial representation from the initial search fund investors. In the first 12 to 18 months after the acquisition, principals typically make few radical changes to the existing business, opting instead to gain management familiarity. After becoming comfortable operating the business, principals then begin to make changes to grow the business.
- **Exit**: Most search funds are established with a long-term outlook, often no less than five to seven years. A typical search fund entrepreneur may spend on average nine years from the beginning of the search to an exit. Liquidity events for investors and principals can occur in a number of ways, similar to exit opportunities for equity holders in a privately held company.

Since the first known search fund was formed in 1984, aspiring entrepreneurs have been drawn to search funds for two main reasons: first, they offer relatively inexperienced professionals with limited capital resources a direct path to owning and managing a small business. Second, search funds have generated significant financial returns for a small but growing number of principals.

Notwithstanding these benefits, few recent business school graduates raise search funds each year. The narrow appeal may be explained in part by the non-traditional financial outlook for search fund principals. While many post-MBA compensation packages include a high starting salary and a signing bonus, the principal of a search fund commands a relatively low income through most of the process. The financial upside to the principal typically occurs upon exit.

SEARCH FUND LIFECYCLE

The following is an overview of the four stages in the search fund lifecycle. A detailed analysis of principals and fund performance is found in "Search Fund Asset Class" on page five.

Stage One: Fundraising

Principals begin the process of raising initial search capital by writing a formal private placement memorandum. This document can serve as an initial point of contact with potential investors and can signal the principals' commitment and professionalism. The memorandum typically includes the following sections:

- Executive summary and overview of the search fund process
- List of specific criteria that will be used in the acquisition search and screening process
- Detailed timeline with expected completion dates for specific activities
- Explanation of financing sought and the structure of the search fund vehicle
- Detailed breakdown of expected use of proceeds
- Outline of potential exit alternatives
- Summary of personal backgrounds of principal(s) and allocation of future responsibilities

Given that most principals lack significant management experience, they commonly look for investors who also can serve as high-quality advisors. The best investors offer expert guidance, assist in generating deal flow, and provide leverage with lawyers, accountants, and bankers. In many cases, the investors are drawn to search funds not only by the potential financial returns of an investment, but also by the psychic rewards of advising and mentoring young entrepreneurs.

In a typical search fund, investors purchase one or several units of initial search capital, at about $20,000 to $35,000 per unit. A small community of institutional investors and funds has grown up around the search fund investment vehicle, helping to facilitate principals' fundraising efforts. In recent years, some individual investors have purchased a half unit of initial search capital, effectively increasing the number of investors per fund. The median in this study was 19.

Contributors to initial search capital receive the right but not the obligation to participate in the following round of acquisition capital, if any. As compensation for taking on early-stage risk, all initial search capital is stepped up in the acquisition round, regardless of participation.

Stage Two: Search and Acquisition

Creating a stream of potential deals can be difficult for principals, many of whom have little buyout experience. Principals typically focus their search by geography or by industry, although many also review deals opportunistically (e.g., deals sourced from third parties such as brokers, bankers, and professionals that may be outside of the principals' primary scopes of interest).

Having a geographic focus can help a principal home in more quickly on an acquisition target by narrowing the search area. On the other hand, finding a deal is partly a numbers game. Applying geographic limits on the world of opportunities may be imprudent given that 21 percent of funds failed to make an acquisition, and that potential investors may view such limits unfavorably.

Industry-based searches generally target two to four industries. Searching by industry can help principals build credibility with sellers and intermediaries, and allow principals to screen potential acquisitions more efficiently. Conversely, principals run the risk of spending too much time trying to identify the perfect industry. One former principal reported that a thoughtful industry screen, including preliminary research, identification of target companies, and outreach, requires as much as four to eight months of nearly full-time effort.

By adhering to a strict list of acquisition guidelines, search fund principals have been able to greatly reduce the risks typically associated with investing in individuals having little operating experience. To further mitigate operating and investment risk, search fund principals generally target industries that have high growth and high margins. They may also favor industries that are not subject to rapid technology change and are fairly easy to understand. Some might target fragmented industries, as they may offer enhanced opportunities for growth through acquisition, or product or market extension.

Within the preferred industries, companies are targeted based on their sustainable market position, their history of positive, stable cash flows, and opportunities for improvement and growth. Search fund principals and their investors tend to prefer healthy, profitable companies with a proven second-tier management team versus turnaround situations. Ideally, the acquired company would provide adequate cash flow and be without significant debt service, so that the short-term survival of the company does not rely on immediate, significant improvement in company performance.

If the target is a sustainable business with modest growth, its purchase price will often be a multiple equivalent of four to eight times EBITDA.[3] Purchase prices generally range from $5 million to $20 million. The equity portion of the acquisition tends to range between $1 million and $7 million, representing 10 percent to 75 percent of the total purchase price. The purchase is expected to be at fair market value.

Searching for a target acquisition and completing a transaction is a time-consuming process. The general economic environment, industry characteristics, sellers' willingness to sell, and regulatory issues are among the factors that can prolong or derail the process. Depending on the complexity of the deal, six months or more can elapse between a signed letter of intent and the close of deal. If the initial search capital is exhausted before a target can be identified, principals may choose either to close the fund or to raise additional funding to continue the search.

Stages Three and Four: Operation and Exit

After a company is purchased, search fund principals assume the role of top management and may create value through one or more ways: revenue growth, improvements in operating efficiency, appropriate use of leverage, and expansion. Revenue growth may result from internal growth initiatives, pricing improvements, or scale attained from acquiring similar businesses. If additional funds are required for acquisitions or other growth initiatives, original search fund investors may be invited to participate.

After a growth plan has been executed, the resulting company can be expected to gain value, even if sold at the same multiple at which it was purchased. In addition to revenue growth, improvements in operating efficiency can make a business more profitable. If an acquired

[3] EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization.

company is leveraged, the equity in the business can grow as the debt is paid off successfully.

In addition to annual salary and other compensation, successful searchers generally earn 20 percent to 40 percent of the upside on the investment. The upside is typically structured to vest upon achievement of specific hurdles, e.g., a common vesting schedule vests one third when the acquisition closes, one third over time and one third upon hitting defined growth targets.[4]

Principals evaluate exit alternatives throughout the life of the business: companies can be sold or taken public, investor equity may be sold to other investors or bought by the company, or dividends may be issued.

SEARCH FUND ASSET CLASS

The demographic sample in this study includes 150 first-time search funds formed since 1983. Keeping with precedent, we excluded funds raised by principals who had previously raised a search fund. The focus of this study is to understand the returns from investing with a new entrepreneur in an industry in which she or he has limited prior experience. "Serial" search fund entrepreneurs have a track record that may imply different fundraising techniques, management and operational capabilities, and an established network of investors, intermediaries, and sellers.

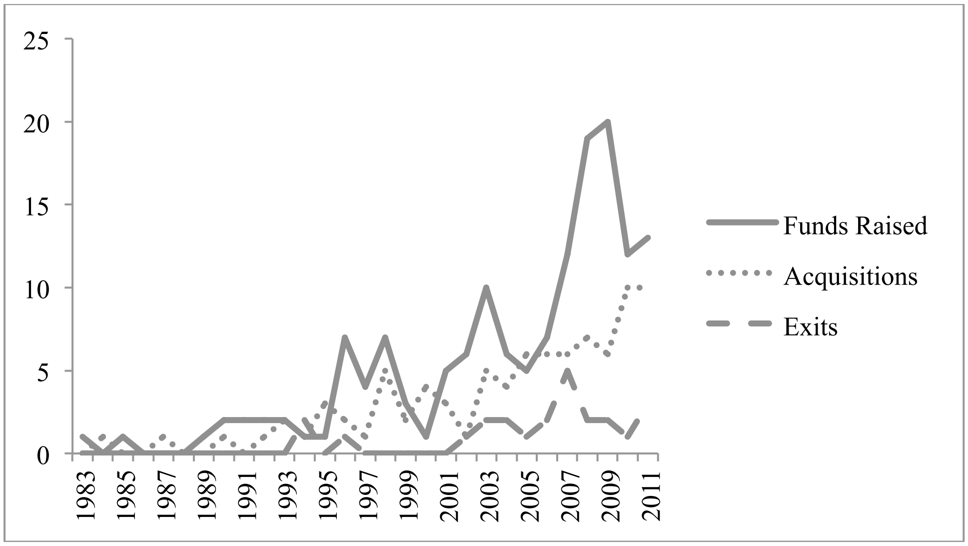
For each search fund, we collected information on the demographic characteristics of the principal(s) as well as key metrics relating to fundraising, the acquisition, company operations, and liquidity events. We have made every effort to include all known search funds.[5]

Many more search funds have been raised in recent years than in the past. The first time more than 10 funds were raised in one year was 2003. Since 2007, the annual figure has been 12 or more. Similarly, the first time there were 10 search fund acquisitions was 2010. The following year also saw 10 acquisitions. Exits are relatively rare in any given year. The year 2007 had five exits, a high in the overall record, but the years leading to and from 2007 had one or two. The year 2011 was slightly higher, at three exits. (**Graph 1** shows fund activity by year.)

[4] In most search funds, principals' equity was subordinate to investors' preferred shares. As such, principals would only earn equity once investors had been paid back their original capital, often with a preferred return.

[5] This study includes all but one known search fund, which did not participate.

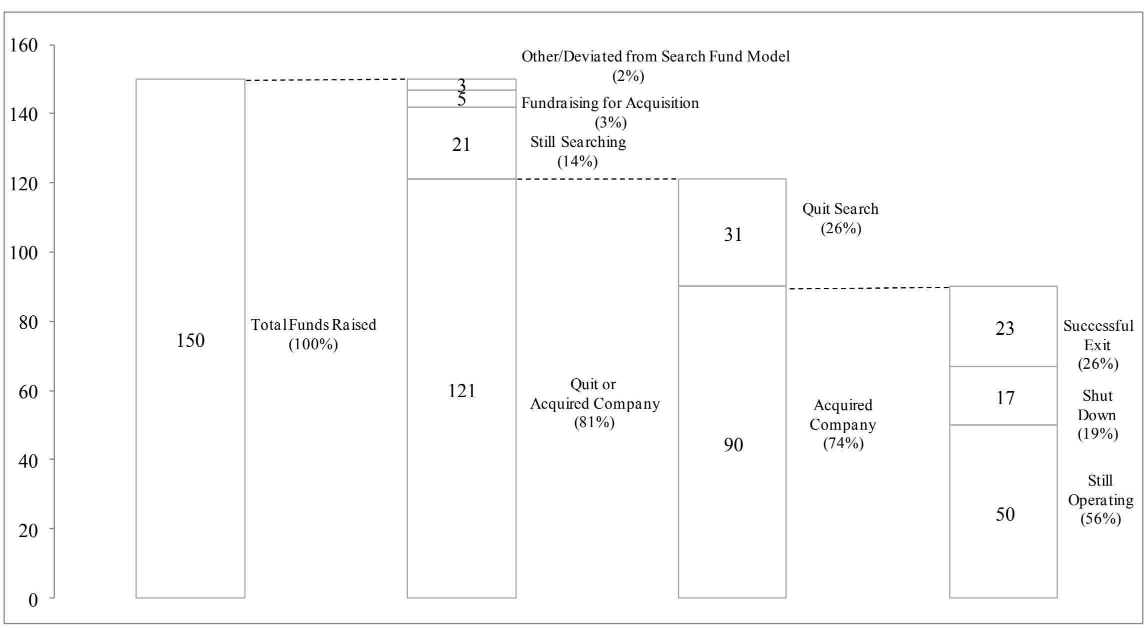
Graph 1: Search Fund Activity by Year



Source: Case writer surveys, data from previous search fund studies.

As of December 2011, 26 principals or partnerships were either looking for a company to buy or raising funds for acquisition, 50 had acquired companies that were still in operation, 3 had deviated from the search fund model, and 71 were classified as "terminal." Of the 71 terminal search funds, 23 acquired and exited a business, 17 acquired then shut down a company, and 31 concluded without an acquisition. **(Graph 2** shows the distribution of funds by stage.)

Graph 2: Distribution of All Search Funds by Status



Source: Case writer surveys, data from previous search fund studies.

Readers should not attempt to directly compare the above with the figures reported in the 2009 study, as several modifications have been made to the sample:

- International funds have been removed from this sample. Going forward, the analysis for this growing cohort of funds located throughout Latin America, Western Europe and India will be conducted separately by our counterparts at the IESE Business School in Barcelona, Spain. International searchers remain part of the historical record retained herein, but new reporting on the 2010 and 2011 classes includes U.S. domestic funds and Canadian funds only.
- We added two historical funds that were not part of the 2009 study.
- This study maintains the tradition of excluding search funds that later deviated from the model to pursue a materially different end, such as putting the initial capital toward a start-up business or purchasing multiple companies. This classification applies to three funds.

Profile of Principals

In 2011, most search fund entrepreneurs conformed to the profile of a relatively young, recent business school graduate. Of the 36 new principals in 26 new funds raised in 2010 and 2011, 42 percent had graduated from an MBA program within a year of raising their fund, and 70 percent were under 36 years old. Only three new funds were raised by principals without an MBA. The number of funds headed by a single principal (as opposed to a pair) increased from 36 percent in the previous study to 62 percent in this study, a mix that has tended to fluctuate from study to study.

The cohort of principals over the age of 36 suggests the search fund model may retain its appeal beyond those just out of an MBA program. Moreover, one notable departure from recent studies was a new fund raised by two female principals in 2011, currently searching for an acquisition. (See **Exhibit 1** for more information on the profiles of search fund principals.)

A few investors have reported that they have no preference for one background or another of the principals in which they invest. Indeed, there continues to be diversity in the professional backgrounds of search fund entrepreneurs. As in the previous survey, about one quarter of all search fund principals listed management consulting or investment banking as their primary professional background. Those with a background in line or general management rose from 11 to 19 percent, and those with an entrepreneurial background dropped from 13 to 6 percent. Searchers from the private equity industry remained at just over a quarter of all new searchers. (See **Exhibit 2** for more information on search fund principals' professional backgrounds.)

Fundraising and Search Statistics

The median amount of initial search capital raised by the 26 new search funds in this study was \$446,250, or approximately equal to \$450,000, the figure for funds new to the 2009 study. Average capital raised per principal (rather than per fund) rose by 15 percent, from \$262,500 to \$302,500. The median number of search fund investors increased from 15 to 18.5, and the median number of months to raise a fund dropped slightly from 4 to 3.8. (See **Exhibit 3** for additional comparisons of search fund metrics.)

From 2001 to 2009, search funds increasingly chose to target services firms over all other types. In 2009, almost three-quarters of new searchers aimed to acquire companies that provided some suite of services, up from 69 percent in the 2007 study and 35 percent in the 2005 study. This was likely due to the fact that the best-known and most successful search funds had acquired service-oriented firms, and new principals may have been attempting to model themselves after these exemplary cases.

In the 2011 study, service businesses fell to 20 percent of targeted industries. This was, by and large, due to the addition of three new categories to the 2011 survey: internet/IT, healthcare, and education. Internet/IT was selected by 14 percent of respondents, while healthcare was chosen by 13 percent, and education, 11 percent.

Acquisition Metrics

Twenty-one percent of all search funds have closed without making an acquisition. Those that successfully complete an acquisition tend to buy relatively small companies with profitable business models. Some 32 percent of all acquisitions tracked were purchased for $4 million to $8 million, 22 percent for $8 million to $12 million, and 30 percent for $12 million or more. However, at $71 million, the size of the largest acquisition in this study was much greater than the largest acquisition of all previous years, which was $30.6 million. Acquisitions consummated since the 2009 study had a median purchase price of $7.9 million, in line with $8 million for those occurring up to the 2009 study.

Since 1984, search fund acquisitions have tended to have positive EBITDA margins. The two exceptions have been an acquisition reported in the 2009 study, and one newly reported in this study. The median search fund acquisition has the following characteristics: $7.5 million in revenues, EBITDA margin of 21.6 percent, purchase price to EBITDA multiple of 5.1x, trailing annual EBITDA growth rate of 12 percent, and 50 employees. (See **Exhibits 4 and 5** for more search fund acquisition statistics.)

Calculation of Returns

This study calculated financial returns from the perspective of investors of *initial search capital*. Two measures of return were used: return on investment[6] (ROI) and internal rate of return[7] (IRR). Both ROIs and IRRs were calculated on a cash flow basis, including both equity and debt that was invested as initial search capital and as acquisition capital. As in prior years' studies, the timing of the cash flows for each search fund was adjusted to a common start date.[8]

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6 Return on investment (ROI) represents the multiple of initial cash invested that is returned to investors. For example, if the group of initial investors invested $5 million and received back $10 million, this would be described as a 2.0x ROI. A return of $1 million would be a 0.2x and so forth. A complete loss of capital is an ROI of 0.0x.

7 Internal rate of return (IRR) represents the annual compounding rate derived from the adjusted dates and actual amounts of search and acquisition capital invested and returned by an investment. For investments returning nothing, or only a fraction of the investors' original investment, IRR is not a meaningful metric.

8 The IRR for search funds as an asset class was calculated by shifting the dates of all cash flows such that all funds appear to have raised initial search capital on the same "day one." Subsequent infusions from, and distributions to, search fund investors occurred at the same intervals reported by each fund. Thus the asset class IRR is a hypothetical

All returns were calculated on a pre-tax basis using data provided by the principals of the funds. We assumed that the searchers' share of equity had fully vested,[9] that all debt was repaid, and that funds were distributed in proportion to the investors' share of equity and subordinated debt.

Of the 121 funds classified as "Quit or Acquired Company," 100 were included in the calculations of returns.[10] The calculation of enterprise value was straightforward for the 64 terminal funds included; the capital table as of the terminal event, e.g., closure, exit, sale, recapitalization, etc., was applied. For the remaining 36 funds, the enterprise value as of December 31, 2011 was based on principals' estimates of market value, or conservatively estimated as the most recent annual EBITDA (or EBITDA run-rate, if more appropriate) times the original multiple paid at acquisition.[11]

We have made every effort to provide accurate returns. It is also important to note that precise information for all cash infusions and distributions over the life of each fund is difficult to obtain, especially for funds with long operating histories and complex capital structures. Readers should keep this in mind when considering the ROI and IRR figures presented in this study.

Financial Returns

As an asset class, search funds have achieved an ROI of 11.1x and an IRR of 34.4 percent. The median fund returned 0.8x of initial search fund investors' capital, whereas the top-performing fund returned well over 500x. ROI, which has been calculated since the 2009 study, declined from 13.5x in 2009 to 11.1x in 2011. Since the 2001 study, the blended IRR has mostly fluctuated between 32 and 38 percent. The exception was the 2007 study, where IRR rose to 52 percent. (See **Exhibit 6A and Exhibit 6B** for more ROI and IRR information, respectively.)

The performance of individual search funds has varied widely over the years. Distribution by ROI ranges from greater than 10x for a highly successful company to a total loss of capital. Distribution by IRR ranges from upwards of 100 percent to negative; in cases of a total loss of capital, IRR cannot be calculated. (For a histogram of funds by ROI, see **Exhibit 7A**; for a histogram by IRR, see **Exhibit 7B**.)

A small number of highly successful search funds positively affects the blended returns, much as principal returns for all risk capital portfolios come from top performers. (For adjusted returns when the top three and five performers by ROI and IRR are removed, see **Graphs 3A and 3B.**)

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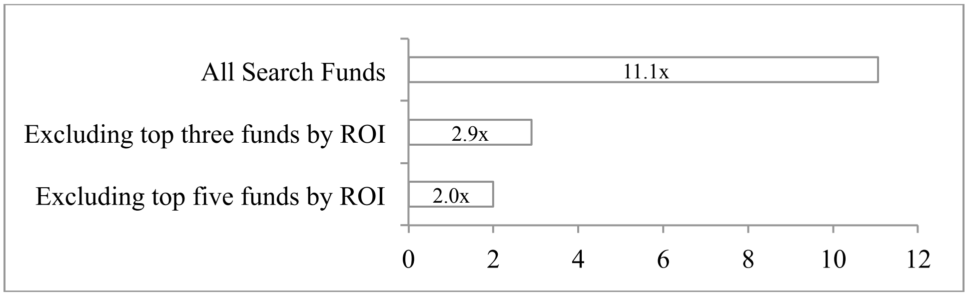
return an investor would have realized if all funds had started at the same time and the investor had participated in each fund in proportion to the amount of capital raised by each fund.

[9] This results in a more conservative IRR to investors since funds typically include both time-based vesting and performance hurdle rates which must be exceeded before the searchers vest at least a portion of their equity.

[10] Ten funds were removed from the sample because the principals had operated the acquisition for less than one year, and eleven were removed due to insufficient data, unresponsiveness, or personnel change resulting in the principals' exits. The impact of removing these older funds is slightly, but not significantly beneficial to the overall calculations of returns.

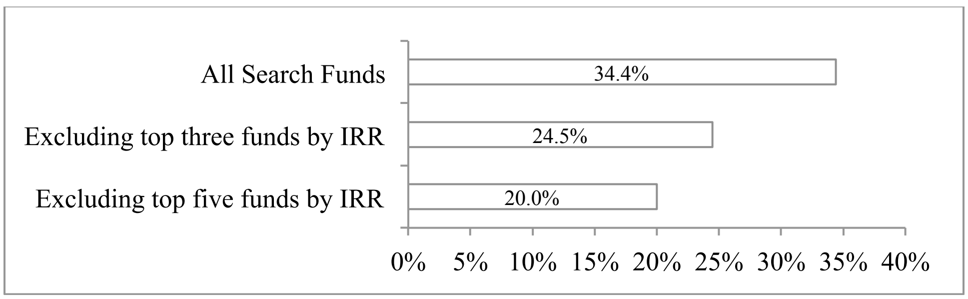
[11] This estimation returns to the more conservative enterprise valuation method used in the 2007 study. The 2009 study asked principals to independently estimate enterprise value and to justify their calculation.

Graph 3A: Search Fund Asset Class ROI



Source: Case writer surveys, data from previous search fund studies.

Graph 3B: Search Fund Asset Class IRR

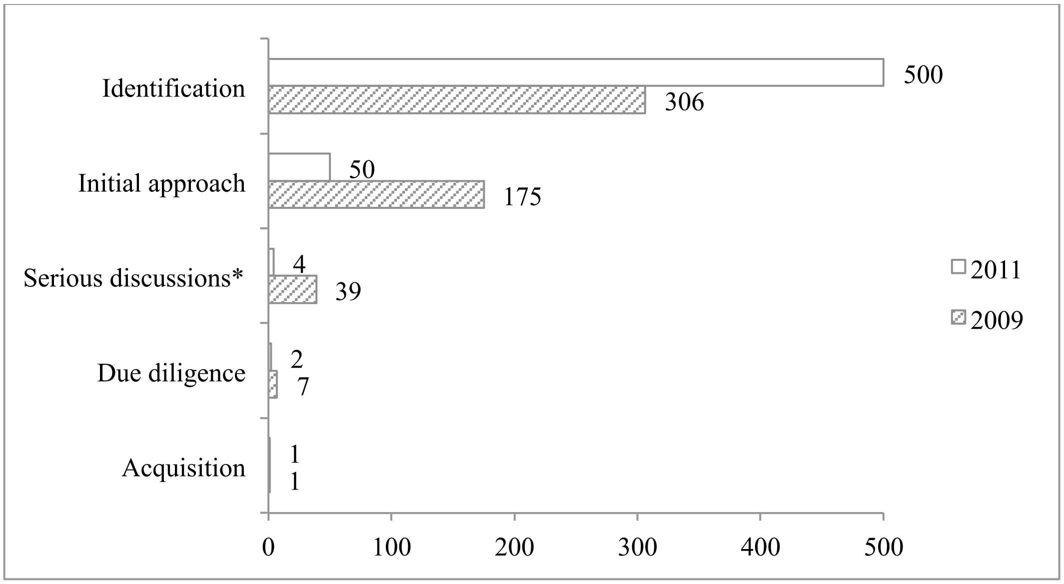


Source: Case writer surveys, data from previous search fund studies.

CURRENT OUTLOOK

Anecdotally, the most desirable search fund target acquisitions are larger, faster-growing companies with better EBITDA margins. Therefore, it is the primary work of principals during the search phase to discover fruitful sources of such targets. Surveys from 2011 suggest that as compared to the two years ending in December 2009, search fund principals who completed an acquisition in the two years ending December 2011 focused more on researching business opportunities to identify possible targets. They tended to approach potential targets less frequently than previous searchers did by a factor of 3.5, and entered into serious discussions less frequently than previous searchers did by a factor of almost 10. (**Graph 4** shows the acquisition funnel in 2009 and 2011.)

Graph 4
Acquisition Funnel of Successful Acquisitions (2009 vs. 2011)



* "Serious discussions" was asked as "Number of Companies under LOI" in the 2011 survey, which may account for the delta between 2009 and 2011.

Source: Case writer surveys, data from previous search fund studies.

It is unclear why the acquisition funnel has shifted as it has from 2009 to 2011, or what the implications for search fund principals will be, if any. One contributing factor to the shift may be a heavier reliance on business brokers. In the 2007 study, only four percent of all searchers reported relying on business brokers. That figure rose to 30 percent in the 2009 study and has remained high in 2011. Business brokers may increase the volume of opportunities reviewed by search fund principals, and decrease the need to contact businesses directly in the early stages of learning about a potential acquisition. However, they are unlikely to replace the high quality deals to be discovered outside of the open market.

Once an acquisition has been made, principals must grow the businesses they have acquired. Given their relative lack of experience operating a business, they will likely benefit from a depth of operating guidance on their boards of directors. While this study does not survey board composition, anecdotal data suggests that search funds with thoughtful board composition comprising both financial interests and operating talent will be able to generate the best returns. Of these, operating talent is reportedly the harder to find, given that financial oversight has become more readily available through institutional search fund investors.

Exhibit 1
Profiles of Search Fund Principals

	Pre-2002	2002-2003	2004-2005	2006-2007	2008-2009	2010-2011
Age at Start of Search						
Minimum	26	28	28	27	26	25
Median	30	31	32	32	30	30
Maximum	35	60	47	50	51	51
Under-30	N/A	12%	30%	33%	35%	39%
30-35	N/A	65%	53%	47%	40%	31%
36-40	N/A	12%	10%	10%	16%	14%
Over-40	N/A	12%	7%	10%	9%	17%
Number of Post-MBA Years before Search Fund						
Minimum	N/A	0	0	0	0	0
Median	N/A	2	1	1	4	2
Maximum	N/A	10	18	16	20	17
No MBA	N/A	N/A	0%	13%	16%	14%
<1 year post-MBA	N/A	N/A	47%	33%	18%	42%
1-3 years post-MBA	N/A	N/A	17%	27%	20%	17%
4-7 years post-MBA	N/A	N/A	23%	20%	22%	17%
>8 years post-MBA	N/A	N/A	13%	7%	24%	11%
Gender						
Male	96%	100%	100%	100%	100%	94%
Female	4%	0%	0%	0%	0%	6%

Source: Case writer surveys, data from previous search fund studies.

Exhibit 2
Search Fund Principals' Professional Backgrounds

Professional Background	Pre-2002	2002-2003	2004-2005	2006-2007	2008-2009	2010-2011
Management Consulting	26%	23%	10%	26%	7%	14%
Investment Banking / Finance	23%	10%	16%	27%	20%	11%
Sales	12%	1%	3%	7%	4%	6%
Venture Capital	8%	3%	5%	1%	0%	0%
Line/General Management	5%	27%	7%	15%	11%	19%
Marketing	5%	2%	4%	0%	4%	0%
Law	4%	0%	2%	0%	0%	0%
Operations	4%	7%	16%	1%	7%	8%
Entrepreneur	2%	13%	8%	7%	13%	6%
Accounting	2%	0%	3%	0%	0%	0%
Engineering	2%	0%	5%	2%	0%	6%
Military	2%	1%	8%	1%	0%	0%
Insurance	2%	1%	0%	2%	0%	0%
Private Equity	1%	5%	11%	4%	27%	28%
Others	0%	7%	2%	8%	7%	3%

Source: Case writer surveys, data from previous search fund studies.

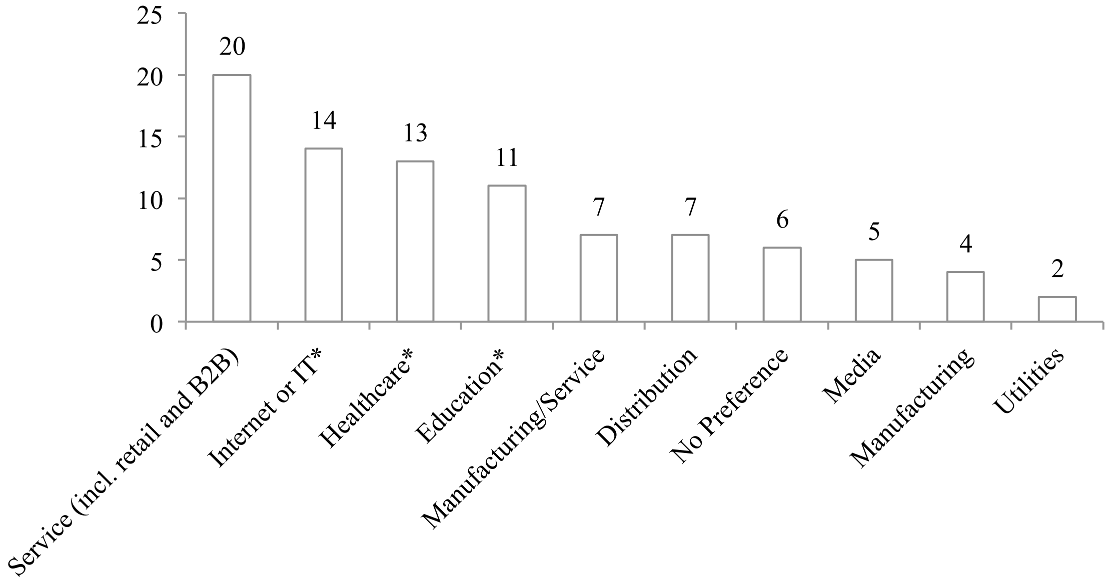
Exhibit 3
Comparison of Search Fund Metrics

	Pre-2002	2002-2003	2004-2005	2006-2007	2008-2009	2010-2011
Number of Principals						
Single	68%	41%	42%	75%	36%	62%
Partners	32%	59%	58%	25%	64%	38%
Amount of Initial Capital Raised						
Minimum	$40,000	$125,000	$150,000	$200,000	$200,000	$140,000
Median	$290,000	$350,000	$395,000	$385,000	$450,000	$446,250
Maximum	$1,000,000	N/A	$750,000	$550,000	$750,000	$850,000
Amount of Initial Capital Raised per Principal						
Minimum	N/A	N/A	$106,250	$175,000	$143,750	$140,000
Median	N/A	N/A	$276,250	$350,000	$262,500	$302,500
Maximum	N/A	N/A	$750,000	$540,000	$450,000	$575,000
Number of Search Fund Investors						
Minimum	2	1	3	10	5	8
Median	12	13	12	14	15	19
Maximum	25	20	24	23	28	26
Number of Months Fundraising						
Minimum	N/A	1.0	2.0	0.8	0.0	1.5
Median	N/A	4.5	5.0	3.0	4.0	3.8
Maximum	N/A	9.0	12.0	10.0	20.0	28.4
Targeted Industries						
Service (incl. retail and B2B)	62%	33%	35%	69%	74%	New chart for 2010-2011 follows
Manufacturing	19%	30%	25%	14%	0%	
Manufacturing/Service	12%	0%	5%	0%	5%	
Distribution	8%	5%	3%	0%	0%	
Media	0%	13%	0%	0%	0%	
Utilities	0%	6%	0%	0%	0%	
Internet or IT*	N/A	N/A	N/A	N/A	N/A	
Education*	N/A	N/A	N/A	N/A	N/A	
Healthcare*	N/A	N/A	N/A	N/A	N/A	
No Preference	0%	13%	32%	17%	21%	

* Due to their increasing prevalence as search fund targets, Internet/IT, Education and Healthcare have been added to the 2011 study.

Source: Case writer surveys, data from previous search fund studies.

Exhibit 3, continued
Targeted Industries by Frequency (2010-2011)*



* In the 2011 study, principals were asked to choose all industries they targeted, rather than choosing only one. The above units represent the frequency of each response across all search funds newly surveyed for this study.

Source: Case writer surveys.

Exhibit 4
Median Statistics for Recent Search Fund Acquisitions

Medians	All Acquisitions	Acquisitions 2006-2007	Acquisitions 2008-2009	Acquisitions 2010-2011
Length of Search (months)	19	19	14	18
Purchase Price	$8.5 M	$9.4 M	$6.5 M	$7.9 M
Equity Invested at Purchase	$2.6 M	$4.2 M	$3.6 M	$5.3 M
Investors' Debt	$0.0 M	$0.0 M	$0.7 M	$0.1 M
Company Revenues at Purchase	$7.5 M	$9.1 M	$5.3 M	$6.0 M
Company EBITDA at Purchase	$1.6 M	$2.0 M	$1.3 M	$1.5 M
EBITDA Margin	21.6%	18.2%	20.5%	23.5%
EBITDA growth rate at purchase	12.0%	16.5%	9.3%	11.9%
Purchase Price / EBITDA Multiple	5.1x	5.2x	4.9x	5.2x
Purchase Price / Revenue Multiple	1.1x	0.9x	1.5x	1.3x
Company Employees at Purchase	50	60	38	38

Source: Case writer surveys, data from previous search fund studies.

Exhibit 5
Selected Statistics for All Search Fund Acquisitions

Total Number of Months From Start of Search to Deal Close	All Acquisitions
Minimum	3
Median	19
Maximum	74
<11 months	15%
11-20 months	39%
21-30 months	25%
31+ months	21%

Purchase Price Statistics	All Acquisitions
Minimum	$0.6 M
Median	$8.5 M
Maximum	$71.0 M
<$4 M	16%
$4 M to $8 M	32%
$8 M to $12 M	22%
>$12 M	30%

Additional Statistics for All Search Fund Acquisitions	Minimum	Median	Maximum
Company Revenues at Purchase	$0.4 M	$7.5 M	$45.0 M
Company EBITDA at Purchase	-$1.6 M	$1.6 M	$12.0 M
Company EBITDA Margin at Purchase	-18.5%	21.6%	60.0%
Purchase Price / Revenue Multiple	0.3x	1.1x	3.9x
Purchase Price / EBITDA Multiple	NM	5.1x	18.0x
Growth of EBITDA over 12 months leading up to acquisition	-20.0%	12.0%	300.0%
Company Employees at Purchase	4	50	740

Source: Case writer surveys, data from previous search fund studies.

Exhibit 6A
Search Fund ROIs[12] to Original Investors

	2009	2011
Individual ROIs		
Minimum	0.0 x	0.0 x
25th Percentile	0.0 x	0.0 x
Median	0.5 x	0.8 x
75th Percentile	1.9 x	2.1 x
Maximum	>200 x	>500 x
Distribution of individual ROIs		
0.0 x (total loss)	30%	29%
< 1.0 x (partial loss)	29%	27%
Exactly 1 x (return of capital)	3%	2%
1.0 x - 1.5 x	10%	10%
1.5 x - 2.0 x	3%	6%
2.0 x - 5.0 x	13%	14%
5.0 x - 10.0 x	5%	6%
>10.0 x	7%	6%
Asset Class ROI	13.5 x	11.1 x

Source: Case writer surveys, data from previous search fund studies.

[12] ROIs were calculated on a cash flow basis, including both debt and equity that was invested as initial search capital and as part of the acquisition. In all calculations of returns, we assumed that all debt was repaid, that the searchers' share of equity had fully vested and that funds were distributed in proportion to the investors' share of equity and subordinated debt. All returns were calculated on a pre-tax basis.

Exhibit 6B
Search Fund IRRs[13] to Original Investors

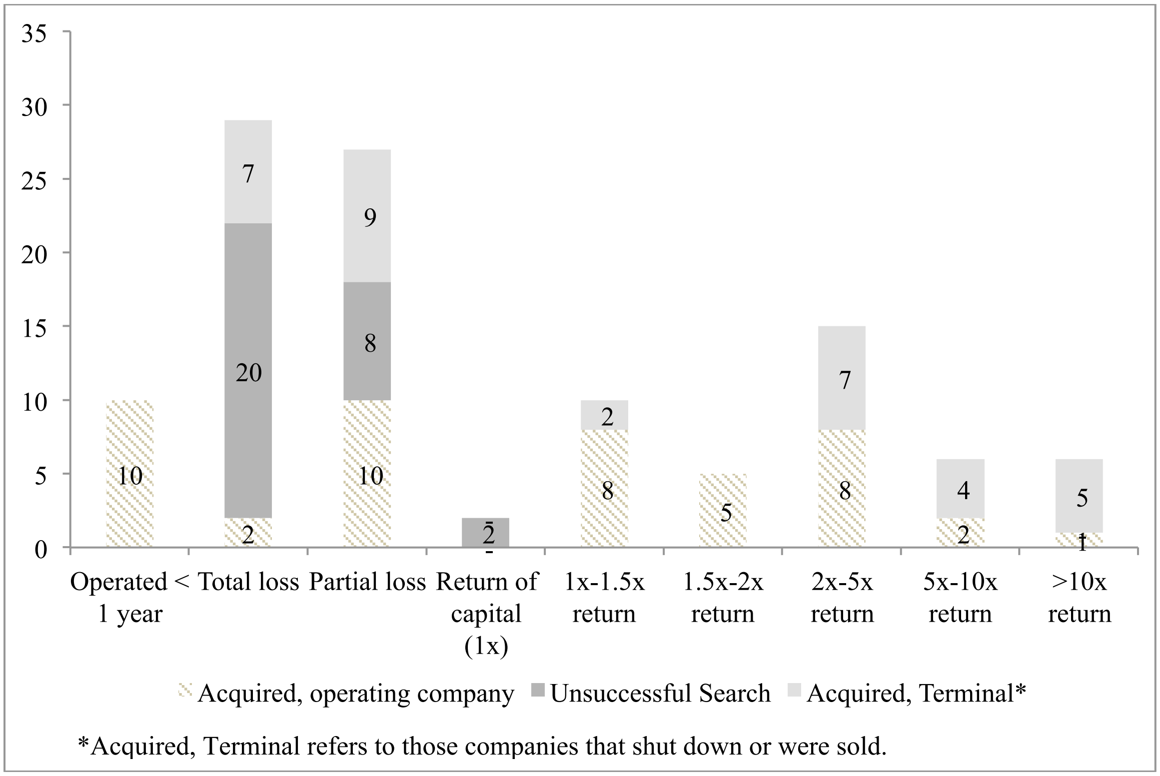
	2001	2003	2005	2007	2009	2011
Individual IRRs						
Minimum	NM*	NM*	NM*	NM*	NM*	NM*
25th Percentile		NM*	NM*	NM*	NM*	NM*
Median	18%	NM*	NM*	NM*	NM*	NM*
75th Percentile		22%	25%	25%	11%	26%
Maximum	98%	85%	215%	189%	189%	189%
Distribution of individual IRRs						
Not meaningful (NM)			53%	49%	60%	57%
0% to 25%			22%	25%	19%	17%
26% to 50%			14%	18%	14%	18%
51% to 75%			4%	2%	3%	4%
76% to 100%			2%	2%	2%	1%
>100%			4%	5%	2%	2%
Asset Class IRR	38%	32%	37%	52%	37%	34%

* Not meaningful (NM) is reported in situations of partial or complete loss of capital over a period of years where the IRR metric is not useful

Source: Case writer surveys, data from previous search fund studies.

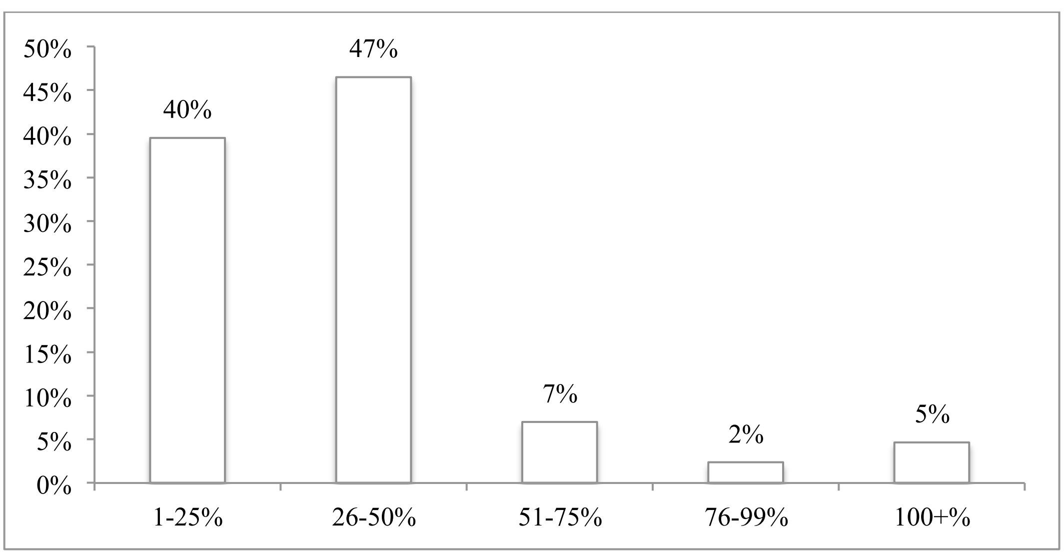
[13] IRRs were calculated on a cash flow basis, including both debt and equity that was invested as initial search capital and as part of the acquisition. As in prior years' studies, the timing of the cash flows for each search fund was adjusted to a common start date. In all calculations of returns, we assumed that all debt was repaid, that the searchers' share of equity had fully vested and that funds were distributed in proportion to the investors' share of equity and subordinated debt. All returns were calculated on a pre-tax basis.

Exhibit 7A
Histogram of Search Funds by ROI (n=100+10 operating for less than one year)



Source: Case writer surveys, data from previous search fund studies.

Exhibit 7B
Histogram of Search Funds with Positive IRRs (n=43)



Source: Case writer surveys, data from previous search fund studies.