

Found by a Search Fund: Good Fortune for a Seller

By Peter J. Schaefer



NEW DIRECTION
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The entrepreneurs riding these well-financed acquisition vehicles are single-minded about finding, buying, and running profitable printing and packaging businesses.

Could the right buyer for your printing or packaging business be a search fund? Quite possibly, yes. That's why it's essential to understand who these buyers are, how they operate, and what motivates them as they search for acquisition targets in this industry.

Our first encounter with search funds took place about three years ago when we were approached by a former executive of a Fortune 500 company who wanted to buy and operate a business of her own. She had lined up investors and was on the lookout for a print-based company that also would let her exercise her considerable skills in logistics, marketing, and advertising.

After introducing her to several candidates, we helped her acquire a business in the \$10 million sales range that continues to do very well under her management. Not long after that, when we brought a seller doing twice that volume to market, three of the four best offers the seller received came from search funds. Lately, well over half of the deals we have marketed on behalf of sellers have attracted interest from this special breed of buyer.

Eyes on the Prize

In a search fund, one or a pair of entrepreneurs raise a pool of capital from investors to acquire a privately held business that they intend to manage as full-time owner/operators. While this concept has been around since the mid-1980s, only recently have we seen these buyers show significant interest in the printing industry.

Well over 500 investment vehicles of this type have been formed since the first ones appeared, focused mostly on purchasing companies in the \$5 million to \$30 million revenue range. The Stanford Graduate School of Business estimates that \$2.3 billion of equity capital was invested in search funds and their acquired companies from 1986 through 2021.

Perhaps the key thing to know about search fund-backed entrepreneurs is that once they acquire a company, they don't necessarily have a timed exit strategy – they see themselves in the management role over the long haul.

Some are young MBA graduates looking for their first ownership ventures. Others, like our initial search fund buyer, are corporate veterans ready for a career change. Also drawn to the opportunity are retired military personnel with business backgrounds and private equity specialists who know the ropes of financing business acquisitions, but who now want to buy and operate a business of their own.

Their investors are friends, family members, wealthy individuals, and family offices that manage the resources of the latter group. They may also seek investment capital from banks. When they search for companies to acquire, they typically are business agnostic and may or may not be well acquainted with the industries they are searching in.

What they prioritize are well-run, profitable, and growing companies that promise them and their investors the kinds of solid returns they want – a description that fits the “haves” of the printing and packaging industry. Strategic buyers and financial buyers, the other two principal types of acquirers in printing and packaging M&As, seek companies with the same attributes, but search funds differ from them in a number of ways when it comes to planning and executing the deal.

Somewhere in the Middle

Strategic buyers typically are printing and packaging companies that want to grow their sales, capabilities, and footprints by acquiring other printing and packaging companies. Financial buyers use private equity (PE) funding to build platforms of related companies in anticipation of selling them for profit after a set period of time. The tables on page 00 summarize how search funds compare with them in terms of business objectives.

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For instance, unlike a strategic buyer, a search fund will not be concerned with integrating the company it has acquired into an existing business, or with cutting costs by eliminating redundancies. As a newcomer to the industry, the search fund may be more likely to retain employees and operations than a strategic buyer – an advantage for a seller who wants to preserve the legacy of what he or she has created.

In our experience, search funds have been prepared to make very competitive offers for the companies they want. However, because they lack the post-sale opportunities to cut costs that strategic buyers can sometimes take advantage of, they may not be willing to pay absolute top dollar in a bidding war. Selling owners also should keep in mind that if they are asked to stay on in management roles, it won't be for long – running the company as CEO is, after all, the search fund buyer's main ambition.

As a result, search fund entrepreneurs don't have the timetable for exiting ownership that characterizes financial buyers. Unlike hands-off PE investors, they will be actively involved in management from day one. They can be similar to PE in the way they structure the seller's compensation, providing most of the cash at closing with the seller holding a note for the balance.

Here to Stay

Although they're relatively new, search funds are well established as vehicles for M&As. According to Stanford, 66% of their searches since 1984 have resulted in an acquisition and of those, 73% resulted in gains. We expect their interest in printing and packaging companies to continue, and that's good news for sellers.

In many cases, search funds can offer selling owners an attractive alternative to strategic and financial acquisition. The financing is securely in place, and the buyer's commitment is deeply personal – reassurances that go a long way towards making it a success for both parties to the deal.

Differences Between Types of Buyers

Question	Strategic Buyer	Financial Buyer	Search Funds
Will leverage (debt) be used?	Possibly, but not always.	Almost always. Sometimes up to 80% of the purchase price.	Almost always. Sometimes up to 80% of the purchase price.
Will the seller remain after the transaction?	Possibly, but not always. One-to-two-year standard transition period.	Yes. Financial buyers are investing in the management team, and they will need to remain with the company; 2-3 years at minimum is normal.	Possibly, but not always. One-to-two-year standard transition period.
How long will the buyer own the acquired business?	Long-term to indefinitely.	Typically 3-7 years before seeking an exit to realize a return.	Long-term to indefinitely.
What is buyer's approach to valuation?	Look at return on investment (ROI) and synergy. Take into consideration if you are gaining access to a new market or buying a competitor.	Analyze free cash flow and EBITDA. Also consider the amount of leverage that can be used and resulting debt ratios.	Analyze free cash flow and EBITDA. Also consider the amount of leverage that can be used and resulting debt ratios.

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Differences Between Types of Buyers (cont.)

Question	Strategic Buyer	Financial Buyer	Search Funds
Will buyer be involved on a day-to-day basis?	Yes. Depending on the size of the acquired entity, buyer may integrate into its existing business promptly after close.	Typically no, as most are not interested in running day-to-day operations. Will take a seat on the Board of Directors and help guide growth plans.	Yes. Likely running this company will become the buyer's long-term career.
Will buyer retain the employees?	Possibly. Eliminating redundancies may be part of strategy and may result in some positions being consolidated or eliminated.	Yes, unless buyer decides to eliminate specific employees.	Yes, unless buyer decides to eliminate specific employees.
Will buyer relocate the business?	Possibly. This will depend on whether buyer has a central headquarters or a desire to consolidate businesses.	No, unless a very strong business case can be made for the relocation.	No, unless a very strong business case can be made for the relocation.
Will the seller retain ownership?	Typically not. Some key members of management may be awarded equity in the parent company.	Generally yes. This allows management to retain an interest in the business and provides motivation for them to grow the company.	Typically not, however some key members of management may be offered the opportunity to invest in the business.

New Direction Partners is an investment banking and financial advisory services formed by Peter Schaefer, Paul Reilly, Jim Russell and Tom Williams to serve the printing and related industries. Services include merger advisory services through the representation of selling shareholders as well as buy side representation, valuation services, financing and refinancing efforts, turnaround and restructuring services, and temporary/interim management consulting. To learn more about New Direction Partners, visit New Direction Partners' website at www.newdirectionpartners.com.