DRAFT

FIRMNAME & LOGO

Private Placement Memorandum

PRIVATE & CONFIDENTIAL

FIRM NAME LLC
_____________ (contact)
_____________ (tel.)
____

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EXECUTIVE SUMMARY

FIRMNAME is a search fund formed to identify, acquire and operate an existing private company with initial enterprise value between $[7.5 and $20.0] million. This summary provides an overview of FIRMNAME'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 100 search funds have been raised, primarily by recent graduates of Harvard Business School and Stanford Graduate School of Business. A [2007] study conducted by Stanford concluded that a portfolio of first time search funds produced annual returns of [52]%[1].

Principal Background

[INSERT]

Investment Structure

FIRMNAME is raising $________ through the sale of _______ ( ) investment units ("Units") priced at $________ each. This initial capital is intended to sustain a dedicated search for up to __ 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 $______ to $______ 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.

[1] *Search Funds – 2007: Selected Observations*, Stanford Graduate School of Business

Investment Step-Up. All Units will be converted to securities in the acquired company and stepped-up by 50%, structured as a combination of equity and subordinated debt on terms pari pasu with the investor capital provided in the acquisition round of financing (i.e., for every $1.00 invested in FIRMNAME 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.

FIRMNAME intends to finance the acquisition through a combination of bank debt, subordinated debt, seller financing and investor capital, which may include subordinated debt, preferred stock and common stock. Subordinated debt securities can provide attractive returns through interest and tax-free principal repayments, while preferred equity provides the benefit of capital gains tax rates rather than ordinary income. The common equity allows the investor to participate in the expected upside upon sale or recapitalization of the acquired company.

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 opportunity to earn between [_____________] of the common equity, depending on the ultimate size and structure of the acquisition. 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

[INSERT]

Prospective companies must possess the following minimum attributes and will be evaluated against the following quality dimensions:

Minimum Attributes	Quality Dimensions
• Niche mfg or service business	• Quality of people
• Mgmt transition / absentee owner	• Quality of industry
• Privately held, U.S. Based	• Quality of cash flows
• 3 year history of profitability	• Quality of market position

- Minimum EBITDA margin of 10%
- Minimum EBITDA of $1.5 million
- Quality of operations
- Quality of liquidity options

INVESTMENT HIGHLIGHTS

FIRM NAME represents a compelling investment opportunity for the following reasons:

[Relevant Personal Experience].

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[2]. 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 [2007] study of 61 "first time" search funds by the Stanford Center for Entrepreneurial Studies shows average investor returns of [52]% per year[3].

Committed Principal. [INSERT].

Opportunity for Value Creation. The Principal's experience investing in and building lower middle market companies has convinced him of the opportunity that exists to build value in small businesses. As a first step, the Principal anticipates assembling an experienced Board of Directors and management team who embrace his traditional values of hard work, integrity, humility and team work. Second, the Principal and management team will work to add rigor to existing business processes and upgrade the information systems at the acquired company to

[2] "*The Ten Trillion Dollar Question: A Philanthropic Gameplan*," *Initiatives*, Robert Avery, Cornell University
[3] *Search Funds – 2007: Selected Observations*, Stanford Graduate School of Business

serve as a foundation for growth. Finally, the team will look to prudently pursue underexploited growth initiatives organically and potentially through select "tuck-in" acquisitions.

PRINCIPAL BACKGROUND

[INSERT].

Professional Experience

[INSERT].

Relevant Investment Experience
• [INSERT IF RELEVANT] • • • • •

Education

[INSERT].

Personal

[INSERT].

Please see Appendix A for a complete copy of ____________'s resume.

INVESTMENT OPPORTUNITY

FIRMNAME is a search fund formed to identify, acquire and operate an existing private company with initial enterprise value between $7.5 and $20.0 million. The fund will allow the Principal to conduct a full-time search for a period of up to __ 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. Over 100 search funds have been raised to date, predominantly by recent graduates of Harvard Business School and Stanford Graduate School of Business.

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., FIRMNAME) to cover operating expenses and allow the Principal to draw a modest 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%, structured as a combination of equity and subordinated debt (i.e., for every $1.00 invested in FIRMNAME the investor will receive $1.50 of securities of the acquired company).

A [2007] study of 61 "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 [52]% per year (full text provided in Appendix D)[4].

[4] *Search Funds – 2007: Selected Observations*, Stanford Graduate School of Business

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 to 6 years
Stage 5: Exit the Business	4 – 6 months

Stage 1: Raise the Search Fund

FIRMNAME is raising $___________ through the sale of _________ (__) Units priced at $__________ each. This initial capital is intended to sustain a search for up to 30 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 are expected to 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 equity and subordinated debt on terms pari pasu with the investor capital provided in the acquisition round of financing (i.e., for every $1.00 invested in FIRMNAME 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.

Upon completion of a transaction, any funds remaining in the search fund will be returned to investors on a pro-rata basis. Cash returned to investors will not be converted to securities in the acquired company (i.e., only capital consumed in the search process will be converted and stepped-up). Investors will be released from any remaining capital commitments once the acquisition has been completed.

Operating expenses for FIRMNAME are projected to be $________ for a __ 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:

Estimated Budget	Year 1	Year 2	Year 3	Total
Principal Draw				
Benefits & Insurance				
Travel				
Rent & Office Expenses				
Marketing				
Diligence	___________	___________	___________	_______________
TOTAL				

FIRMNAME is interested in assembling a diverse investor base with expertise in successfully sourcing, investing, financing, operating, growing and exiting private companies. FIRMNAME 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 participation in an Advisory Board during the search stage and Board of Directors during the operating stage. FIRMNAME 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

FIRMNAME will be based out of _______, ____________ and will perform an opportunistic nationwide search to generate deals that meet FIRMNAME's acquisition criteria. At a minimum, companies must possess the following characteristics:

Minimum Company Attributes
• Niche manufacturing or service business • Management transition or absentee owner • Privately-held and based in the U.S. • Three year history of profitable operations • Minimum EBITDA margin of 10% • Minimum annual EBITDA of $1.5 million

In addition to these minimum requirements, companies will be evaluated against the following dimensions:

Quality of People	Quality of Industry
• Honest, respected seller(s) • Talented middle management and dedicated employee base • Existence of sophisticated customers and suppliers	• Size, growth and stability of primary demand • Fragmented competitive landscape • Low threat of external shocks – technological, regulatory, legal, environmental, fashion, etc.
Quality of Cash Flows	**Quality of Market Position**
• Recurring • High margin, growing • Diverse (by customers, products and markets)	• Defensibility • High switching costs • Clarity of competitive advantage
Quality of Operations	**Quality of Liquidity Options**
• Simple, understandable • High returns on invested capital • Identifiable areas of improvement	• Ability to generate 30% compound annual return on investor capital • Identifiable set of future buyers • Intermediate liquidity events

Rather than focus on a select set of industries, FIRMNAME will opportunistically search for acquisition candidates. The Principal feels an opportunistic search, rather than an industry specific search, is appropriate for the following reasons[5]:

Opportunistic Search
• The Principal has significant direct experience with opportunistic deal sourcing and evaluation in his prior job at ___________ • Most of the companies invested in by ________ were sufficiently unique such that they would have been difficult to uncover using traditional database tools

[5] Notwithstanding his commitment to an opportunistic search, the Principal will selectively contact companies operating in desirable industries that have been uncovered during the search process.

- The Principal has limited industry-specific expertise
- A focused search unnecessarily limits the universe of potential opportunities
- Encourages deal sources to show a broad array of investment opportunities

While a variety of sourcing alternatives exist for the opportunistic searcher, each alternative requires a different level of time and financial commitment to generate a specific volume and quality of deal flow. The Principal believes the key to a successful opportunistic search is to balance the use of these sourcing alternatives in a focused manner while also factoring in his professional experience and personal preferences. It is important to remember that the ultimate goal of the search strategy is to generate enough high-quality deal flow to close a transaction in not more than __ months.

In order to add focus to the search, FIRMNAME has divided the country into three regions, as defined in Appendix B. The Principal will invest roughly 60% of his time canvassing the primary region, 30% the secondary region and 10% the tertiary region. The Principal believes that this resource allocation represents the appropriate balance for developing both a breadth and depth of deal flow contacts. The primary and secondary regions were selected due to the Principal's existing professional network as well as personal considerations.

The specific sources FIRMNAME will use to generate deal flow are as follows:

Business Brokers	
Deal Flow Type:	• High volume, high quality
Positives:	• Owners are committed sellers and less sophisticated
	• Opportunity for less efficient auction processes
Negatives:	• Wide disparity of broker quality
	• High quality brokers run a process, which equates to more competition for deals and higher purchase multiples
FIRMNAME Strategy:	• Compile database of brokers located in primary, secondary and tertiary regions
	• Mail marketing materials to brokers with information on firm background, investment focus and deal criteria
	• Establish contact with relevant brokers, using network to gain introductions and establish credibility (_______, ___________)

	• Contact brokers on a monthly basis to stay on deal radar; meet with brokers in primary and secondary regions

Small Investment Banks	
Deal Flow Type:	• High volume, variable quality
Positives:	• Owners are committed sellers
	• Companies vetted by investment bank
Negatives:	• Auction process leads to higher purchase multiples
	• FIRMNAME is a less attractive buyer than both strategic buyers and financial buyers with captive funds
FIRMNAME Strategy:	• Compile database of small investment banks located in primary, secondary and tertiary regions
	• Mail marketing materials to bankers with information on firm background, investment focus and deal criteria
	• Establish contact with relevant bankers, using network to gain introductions and establish credibility (_____________,________, _________)
	• Contact on a monthly basis to stay on deal radar; meet with bankers in primary and secondary regions

Direct Marketing & Cold Calling	
Deal Flow Type:	• Medium volume, high quality
Positives:	• Best source of proprietary deal flow
	• Uncover companies not previously for sale
Negatives:	• Can be time intensive to weed through opportunities due to low response rate
	• Owners are not always committed sellers
FIRMNAME Strategy	• Initially focus direct marketing efforts on primary region

	• Use database tools to generate lists of companies that fall within specified deal criteria • Mail mass-customized letters with information on firm background, investment focus and deal criteria • Expected 1-2% response rate on mailings, of which 25% will result in "real" opportunities • Cold-call most interesting companies

Network with Deal Professionals and Service Providers (Lenders, Accountants, Lawyers, Financial Advisors, etc)	
Deal Flow Type:	• Low volume, variable quality
Positives:	• Source of semi-proprietary deal flow
Negatives:	• Serendipity required • Can have low return on time investment • Easy to fall off deal radar
FIRMNAME Strategy	• Secondary source of deal flow • Focus networking on primary region to maximize ROI • Establish contact with relevant professionals, using network to gain introductions and establish credibility (_________, _________, ________)

Personal Network	
Deal Flow Type:	• Low volume, high quality
Positives:	• Source of proprietary deal flow
Negatives:	• Serendipity required • Difficult to harness
FIRMNAME Strategy	• Secondary source of deal flow

	• Circulate a standing offer to pay a $_______ finders fee to friends, family, _________ classmates, ________ classmates, etc. who provide an introduction to any business which is ultimately acquired

Buy-Side Brokers	
Deal Flow Type:	• Low volume, variable quality
Positives:	• Provide extra feet on the street that are keyed into the deal environment
Negatives:	• Pay for what you get, qualified brokers require retainers
	• "Lehman formula" fee structure
FIRMNAME Strategy	• Secondary source of deal flow, if at all
	• Research market for brokers who do not require retainers

Advertising & Public Relations	
Deal Flow Type:	• Low volume, variable quality
Positives:	• Enhances credibility with owners
	• Introduces FIRMNAME story to wider audience
Negatives:	• Advertising can be cost prohibitive
	• Difficult to generate meaningful publicity
FIRMNAME Strategy	• Secondary source of deal flow
	• Cultivate press coverage in primary and secondary regions
	• Develop list of publications in primary and secondary regions and price out advertisement options

During Stage 2, the Principal anticipates forming an Advisory Board of between three to five investors with relevant experience in sourcing opportunities and investing in private companies. The Advisory Board will be used as a sounding board for prospective investment theses and as references that may be used to establish credibility with business owners.

[Personal Relevant Information].

Stage 3: Finance & Close a Transaction

FIRMNAME 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. FIRMNAME will build on the Principal's 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. FIRMNAME will build on the Principal's existing mezzanine lender relationships and cultivate new relationships throughout the search process.

Seller Financing. Owners of companies in FIRMNAME'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. FIRMNAME anticipates that investor capital will represent between 30% and 50% of the capital required to fund the acquisition. Based on a targeted transaction size of between $____ million and $____ million, investor capital will total between $____ and $____ million. This amount represents $______ to $______ per Unit. Investor capital may include a combination of subordinated debt, preferred equity and common equity. The ultimate capital structure will depend on specific acquisition and investor preferences.

Subordinated debt securities can provide attractive returns through interest and tax-free principal repayments, while preferred equity provides the benefit of capital gains tax rates rather than ordinary income. The common equity securities allow the investor to participate in the expected upside upon sale or recapitalization of the acquired business.

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

Stage 4: Operate the Business

Following completion of the acquisition the Principal will assume the role of President of the acquired company. For the first 180 days the Principal will be focused on acclimating himself 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. Based on his experience at ______, 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 team work 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 five and seven shareholders or 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 FIRMNAME should be viewed as a long-term investment. While interest payments and subordinated debt principal repayments could return a portion of investor's capital in the medium term, investor returns will primarily come from the Principal's ability to increase the value of the acquired company. FIRMNAME expects to provide investors with a liquidity event between four and six years after acquisition. 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, FIRMNAME 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, FIRMNAME targets a 30% compound annual return on investor capital. The overall return is a blend of the payments on the subordinated debt and equity portions of financing. This targeted internal rate of return, 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 between a [____________] share of the common equity, depending on the ultimate size and structure of the acquisition. 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 will be restricted equity, with restrictions that lift as investor IRR hurdles are met. [In addition, an employee option pool will be granted for between [5% and 10%] of the company's common equity. Options 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 option 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 FIRMNAME'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 the inability to complete an acquisition, poor performance of the acquired company, inability to meet debt service commitments and the lack of liquidity for investors. Additionally, the Principal is crucial to the success of the search fund, and therefore investors run the risk that he will not be able to complete the search process due to illness, accident or personal reasons.

While past performance of other search funds provide benchmarks for the type of returns the search fund is capable of generating, there is no guarantee that FIRMNAME will achieve the same results.

FIRMNAME 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.

APPENDICES

Appendix A: _________________ Resume

Appendix B: Geographic Segmentation

Appendix C: Illustrative Transaction Economics

Appendix D: Stanford GSB, Search Funds – 2007: Selected Observations