What’s Next?
Search fund entrepreneurs reflect on life after an exit

A. J. Wasserstein

During his time at the Yale School of Management, Matt Dittrich (Yale SOM ‘18) became interested in how recent MBA students gathered search funds, structured small acquisitions, propelled themselves into being a CEO, and then participated in a liquidity event only a few years after acquisition and graduation.

Dittrich wanted to find out more. He enrolled in MGT 671, Entrepreneurship Through Acquisition, in Spring 2017. He appreciated the case studies about entrepreneurs facing acquisition, strategy, and financing issues. He also spent the summer between his first and second year, working at Trilogy Search Partners (http://trilogy-search.com), a prolific search fund investment firm in Seattle, Washington. While at Trilogy, Dittrich further immersed himself in the search fund space and absorbed more information about what makes a company a good search fund target and how entrepreneurs successfully transition from searcher to CEO.

However, Dittrich believed there was a gap in his knowledge. In MGT 671, there were a few cases which examined search fund exits with a focus on valuation, the mechanics and choices around the exit. But what did entrepreneurs do after their exits? Dittrich noted that many entrepreneurs who exited were still young, in their 30s or 40s, and had lots of professional runway ahead of them. He was considering being part of the search fund world after graduation, possibly as a CEO or an investor. Before making that commitment, Dittrich wanted to learn more about the entire career arc.

Dittrich asked his teacher from Entrepreneurship Through Acquisition, A. J. Wasserstein, what happened to the entrepreneurs after they sold. Wasserstein suggested connecting with some former search fund entrepreneurs who had experienced an exit to learn what exactly they chose to do, and why.

Wasserstein advised Dittrich to examine the many different afterlives the conversations revealed. Both psychological and economic factors played a role in determining what entrepreneurs did next and how they evaluated their experiences. The type of exit also made a difference. For example, did the acquirer necessitate the entrepreneur to roll equity into the deal to make the acquisition work, and would the CEO be required to continue on with the firm?

Overcome by curiosity, Dittrich was excited to begin his informational interviews (summaries below). However, he had no idea what he would do with the data once he got it.
Ravi Dhavale (disguised)

Ravi Dhavale (Harvard Business School MBA 2008) raised a search fund, Rhythm Capital Partners (disguised), during his second year in graduate school. Commencing work immediately after graduation, he found himself searching just as the economy plunged into the Great Recession.

Despite the formidable economic conditions, Dhavale identified multiple acquisition opportunities during the two-year search process. Nonetheless, the search proved taxing:

It was such a challenging time. When the market is so turbulent, the emotional ups and downs are heightened. I think it was compounded by the fact that I was doing the search by myself. I still don’t know whether going solo was a good decision overall, but it certainly made it more difficult to stay on an even keel. Between the recession and the emotional difficulty of it, it felt like I was running into a brick wall. Later, I found out there were people in my vintage year who did find companies and have done well. I suppose it highlights how anything entrepreneurial always has an element of luck.

One deal did progress into a Letter of Intent (LOI) and Dhavale dove into diligence on the project.

I found a medical massage school. I really liked the investment thesis and there was broad investor support. I was in diligence for five or six months before a legal issue popped up relating to one of the sellers, who was slated to stay on and work with me after the deal closed. The issue brought into question the seller’s integrity. I was concerned about the worst possible scenario – running a business for five years and still having the asset go sideways.

About a week before we were scheduled to close, I killed the deal after trying to reprice and renegotiate. Part of what drove my decision making was thinking about whether I wanted to be known as a failed operator, buying and running a limping asset and seeing my equity underwater, or being known as a failed searcher. The broken deal occurred towards the end of my search period. I was pretty worn down from walking away from this deal, so I hung it up and closed down my search. I realized searching was more reliant on luck than I had anticipated.

Even though a decade has passed, Dhavale notes,

Oh, I would say it still haunts me in some ways. I felt like a failure. I thought I had wasted three of the most important years of my career - the time right after you graduate from Harvard Business School. You’re not supposed to have a flame out! It seemed like I wasted that launching pad. I saw that my peers who had taken a more conservative approach and ended up with something to show for it. And I had nothing to show for my time. It was disappointing. Then just to add insult to injury, I tore my ACL. I was in a bad place. One bright spot was the arrival of my first child, but that added some pressure to my professional situation too.

After Dhavale administratively wrapped up Rhythm Capital Partners, he paused and reflected.

It took me probably a good month or two of just really feeling down in the dumps. The fact that I had a young child at home and needed to start thinking practically really provided a kick in the pants. So, I started a process, thinking about what I wanted to do, gauging how my experience will be perceived by people in the market and deciding on my next move.
Dhavale wound up joining M, J & L Capital Investments (disguised), a New Jersey-based middle market private equity firm after networking and conducting a focused job search. Now a principal, Dhavale hopes to become a partner in the next year or two.

Time has offered Dhavale some perspective. He has come to realize that his broken search was just a setback and life goes on,

It is not as bad as I thought. The only thing that bothers me a little bit is whether I made the right decision to begin with. I lost a little bit of time. I look at my peer group and a lot of them went into private equity right away and now have been a partner for a couple of years. So, I feel a bit behind.

On some level, Dhavale is happy that he flexed his entrepreneurial muscles.

A lot of time has passed, and I don’t know that I have a definitive answer on whether I should have done the search fund or not. I think I would have been an unhappy person today had I not tried something entrepreneurial. While the search fund was unsuccessful, I still contemplate investing in a search fund type opportunity. Whether that is solely as an investor where I can play a hands-on chairman role, or perhaps as a full-time operator further down the road in my career when I can fund equity needed for the acquisition myself. I think raising a search fund and having a finite amount of time to pull it off and then being behind a bunch of senior equity is a difficult proposition and I would avoid those circumstances if I tried again. I would rather always be searching and then opportunistically jump at the diamond in the rough, which may not be visible in a 24-month search. I think that says I believe in the opportunity, just not sure it is a great match for the stage in one’s career where most searchers start (post MBA).

Brian O’Connor

Brian O’Connor (University of Chicago Booth MBA 2008) was involved with private equity before deciding to do something more entrepreneurial. In 2010, he launched a search fund, Fellowship Capital Partners, with a partner. O’Connor and his partner acquired Innflux, a hospitality focused IT company. They had been running the company for three and a half years, experiencing rapid growth, when they received an unsolicited buyout offer from an undisclosed strategic buyer.

After O’Connor disclosed the surprise solicitation to his board, it catalyzed hiring an investment bank and exploring a formal sale process. O’Connor commented,

I’m sort of embarrassed that I was so naïve. We talked about it with the board as “testing the market.” But our board was constructed of experienced investors, and we all knew, and probably them more so than me, that once we went down the path, we weren’t turning back. It’s like they say - if you go window shopping for an engagement ring with your girlfriend, you might as well start booking the church.

When O’Connor thought about exiting, a range of emotions came to the forefront,

I was a combination of excited and scared. Based on what we knew from the unsolicited bids that we had received, a sale would constitute a win for our investors. That was exciting for me because it was the first deal that my partner and I had done out on our own and we wanted to generate an attractive win for our investor base. We weren’t overly concerned about being the next Asurion
[an extremely successful search fund]. We realized that our company didn’t have that ability to be an Asurion, but we could generate an interesting return for our investors.

The fear was around one primary question - what does life look like next? I was only 34 years old with a young family and had to decide what to do with the rest of my career.

While the potential sale to a handful of interested suitors was being negotiated, O’Connor thought about whether he individually wanted a complete personal exit from the business or whether he wanted to remain in the business and help after the sale,

I was open with the board and had some flexibility, depending on the buyer and the situation, I could stick around, or I could be done. I wanted to do what was in the best interest of our limited partners and not something that was uncomfortable for me. If the buyer said that I needed to move my family away from Chicago that would be something that I would not be overly excited about doing. It turned out that the private equity-backed strategic buyer that ultimately purchased the company wanted to maintain a hub in Chicago. I wound up staying with the company for about a year after the sale.

When reflecting on the deal, O’Connor elaborated,

I felt OK about moving forward with the transaction slightly earlier than anticipated because my original motivation for doing this was to own a business and get a win for the people that entrusted their capital with me. We had done that. The exit allowed me the flexibility to pursue new career goals and challenges. It built a track record. I had been a good steward of my investors’ capital. While we made a few mistakes, we did a lot of things right along the way with the business. I never intended to retire. So, as long as I had some flexibility and the first notch on my belt, I was good with that.

When contemplating what to do after his exit, O’Connor thought through many choices. He wanted to do something that engaged him financially, intellectually and personally.

I thought about going back into private equity because that’s where I came from before doing the search fund. I thought about operating in some way, now that I had some good experience. I thought about partnering in the private equity world - several firms approached me about companies that were in their portfolio that might be looking for C-level or even CEO-level positions.

Upon reflection, he knew he did not want to be an operator again,

This is probably something that search funders don’t want to admit, but the idea of starting a new operational role was not something that I was excited about doing. It had been a wonderful experience. I learned a ton. I had my good days and bad days. And now, I can draw upon those experiences as a small business operator.

After leaving the company, O’Connor launched a private equity firm, NextGen Growth Partners (http://nextgengp.com/). “NGP” partners with early-career entrepreneurial-operators to acquire and grow great businesses, a strategy that incorporates many elements of the “Entrepreneurship through Acquisition” course he’d begun teaching at his alma mater, the University of Chicago Booth School of Business.
I realized when we exited that I am a better investor than I am an operator. Now I’m able to leverage some of the experiences and the learnings than I’ve accumulated in two really interesting arenas (operating and investing) in an investment capacity - which is what I love doing. Furthermore, our strategy at NGP satisfies another passion of mine in teaching and mentoring promising early-career CEOs.

When asked whether he would make the same decisions again about exiting, O’Connor unequivocally answered, “Yes!” But he did learn from the experience and might have done some things differently,

I was probably a little bit too quick to accept what was being asked of me from an equity roll standpoint. In retrospect, I probably bore a little more risk than I needed to. While I knew the pressure to roll was coming from myself, I really should have said ‘Wait a minute.’ After all, I was rolling equity into a relatively unknown security in a relatively unknown asset. That aspect of the deal gave me some indigestion at the time.

Jeff Dietzel (disguised)

Jeff Dietzel (University of Chicago Booth MBA 1993) initiated a search fund, with a partner, immediately after graduation from Chicago. The fund acquired Industrial Maintenance Services (IMS) a Seattle-based business (disguised) that helped sell and grow post installation maintenance contracts for large manufacturing companies. Customers included Boeing, General Electric and United Technologies. Under Dietzel and his partner’s leadership, IMS grew rapidly.

The firm’s growth presented Dietzel and his investors multiple opportunities for liquidity and an exit through a series of dividends and recapitalizations over an approximately six year period. This series of events came as investment firms, looking to invest in the enterprise, approached IMS. Dietzel, in collaboration with his original investors made the decision to take the additional investment capital, facilitating the process of new investors diluting, or buying out, ownership interests of existing investors at different periods of time. This allowed a return capital to initial search fund investors, de-risking their initial investment.

Besides making the investment less risky, Dietzel found that these events reduced stress on him and the company.

There is a ton of risk, a ton of nervousness - what will this project and business be? Every time I got liquidity that allowed the figurative release valve to open and reduce the pressure cooker a bit. I personally found it very helpful. I was not inclined to relax or hit the beach after the serial exits. Rather, I was energized, recharged, and wanted to drive ahead.

The exits also allowed Dietzel and his partner to achieve their financial objectives within three years of the acquisition. Each took a low eight-figure dividend.

It was a wow moment –a life-changing event. We were able to realize what we set out to do with the search fund overall. I remember we were running a company meeting when the money got wired in. My partner and I just looked at each other and shook hands. That’s a cool moment that you fantasize about. When it comes true you think, wow, that was really, really spectacular.

Eventually Dietzel’s business partner used one of the liquidity events to exit the firm and pursue different opportunities. This left Dietzel to lead the company into an IPO - an experience he considered to be equally as extraordinary,
Post-IPO, I have an amazing memory of Morgan Sachs (disguised) paying for a Gulfstream V private jet to fly home from New York to Seattle. With me was my wife and a couple of my teammates. You get on a G5 and fly direct. It was surreal. We had a big party on board.

After the IPO, Dietzel faced the demanding and high-profile job of being the CEO of a public company. As he led the company, Dietzel also used the public markets to reduce his stake in the firm, “The stock was up, and I took a lot of money off the table,” he observed. “My net worth had change pretty meaningfully on a realized and unrealized basis.”

Ultimately, Dietzel enjoyed cash proceeds of approximately $50 million from IMS after all of his transactions. Dietzel’s original investors received 80x their initial investment.

A few years after the IPO, Dietzel began to feel tired and wanted a change. He had been running the business for 18 years. He had responsibility for over 4,000 employees around the world and all the other duties that come with being the leader of a public company. At home, a third child had just arrived. Dietzel began to discuss how to exit gracefully from the business with his board members.

Unfortunately, the business began to struggle before Dietzel could exit. He agreed to remain at his post while the company considered an opportunity to go private. However, the chance to go private fell through. Dietzel left soon after, but as the chief of a company whose stock price was plunging.

In my mind, the movie ended with us selling the company in the IPO. But in reality, the movie didn’t end that way, and it took me almost two years to reconcile all the noise that went on in my head. Unlike most entrepreneurs who ask themselves “what do I do now?” I was asking myself “How the heck did this happen?” I had written this great story in my own mind and then the end of the movie changed, and not for the better.”

In the wake of his exit, Dietzel experienced a rush emotions, feeling both vulnerable and confused.

As he was slowly coming to grips with the way he left IMS, Dietzel also was grappling with his plans. He had more money than he ever dreamed about, while still in his mid-40s.

The hardest part is that, after the exit, you now must reenter and fit into your family’s life. I woke up in the morning, and listened to my kids and wife running their normal play, getting ready for school. I can still remember vividly thinking, what do I do today?

I’m not a beach kind of guy. I don’t deal well with just doing nothing. I felt there was more for me to contribute. Also, I knew a lot of guys in my neighborhood who really didn’t work, and I always thought it would be a weird thing for my kids to see me sitting around every day or playing golf. So those are some of the factors that went into figuring out what to do next.
Dietzel was counseled to pause and reflect, to figure out where he was in life and how his professional decisions would impact his personal life and vice versa. He would now offer the same advice to any entrepreneur who exits. The key, Dietzel advocates, is to recognize that there are many doors to open (even some you don’t realize exist) when you initially sell a business. Dietzel checked in with a mentor after exiting who told him that for advice to sink in, he had to relax and be in a state of mind to be “present”. Dietzel encourages exiting entrepreneurs to completely punch out and take a year or two off and “move down to Argentina,” so they can untether from their current context.

For his part, Dietzel did not entirely take his own advice. He relocated from Seattle to New York City and started a private equity investment fund, GHB Investments (named for the first three letters of his children’s names). GHB invests in mid-stage services businesses. Dietzel also occasionally invests in search funds, but has largely eschewed the asset class. He wonders,

I find myself now, three years later, thinking that I’m happy with what I’m doing. I enjoy it. But had I had the full state of mind would I have chosen what I’m doing now? I don’t know. Sometimes I also wonder if I actually have enough money which seems irrational in the abstract, but I wrestle with that feeling.

Another challenge Dietzel encountered was finding how to manage his newfound wealth. Shifting from being a wealth creator to a wealth manager proved to be an unexpected transition. He found that the skills and mindset that bring success in one, does not ensure success in the other.

I probably made some mistakes with fancy stuff in the 2007, 2008 timeframe. I lost some money, but not a ton. Now, I’m going plain vanilla. I have a guy that basically manages all the public equities and bonds and I oversee it, so I understand what he’s doing. It’s very simple index funds, and I have a small real estate portfolio where I make all the decisions. So, I think of myself as the fund manager of my portfolio.

Tom Bird & Ken Saxon

Tom Bird (Stanford Business School MBA 1988) and Ken Saxon (Stanford Business School MBA 1988) met in 1987 at Stanford Business School. Bird and Saxon enjoyed each other’s company and a friendship formed while they trained together for a marathon.

During their second year of business school, Bird and Saxon took a course on entrepreneurship and loved listening to the impresarios who visited class. The two decided that they too could be entrepreneurs. They formed a partnership and devised a plan to pursue an acquisition in the records management industry after graduation. At the time, it was not referred to as a self-funded search, but that is exactly what it was.

The partners acquired First American Records Management (FARM), a small California based concern, and began building the business. The company grew rapidly through organic sales and an acquisition. Bird and Saxon relished their opportunity to use the skills and experiences they had acquired at Stanford in their own business. Sharing the leadership role at a young age was fun, satisfying and rewarding.

After running the business for about five years, Bird approached Saxon about potentially exiting the business and moving on. Bird remembered,

After four or five years of running the business I approached Ken and said, 'I think we've done pretty much what we set out to do. What are we going to do now?' I wasn’t feeling the full motivation to keep doing the entrepreneurial gig anymore. Being an entrepreneur is glamorized,
but the reality is that it is grinding and difficult. Being an entrepreneur means you must be prepared to be staring at the ceiling at 3:00 in the morning. I had young kids and now that I had achieved what I set out to do – It didn’t occur to me that I wanted to keep doing this indefinitely.

Bird and Saxon discussed where they were and what they each wanted. They explored having Bird leave and Saxon stay, and they considered a complete exit. However with guidance and advice from their lawyer, they landed on a transition which involved both Bird and Saxon leaving the business as operating leaders, but remaining affiliated with the enterprise as board members and investors. The two entrepreneurs were happy with the financial performance of the business, Bird just wanted to shed his operating obligations.

Bird and Saxon went about the transition with the help of a coach – facilitator, Rick Eigenbrod. In addition, Saxon read the book *Transitions* by William Bridges. Saxon stated,

> Tom came to me and I had a choice. I could stay and run the place on my own by building a team around me, or I could leave with him. That began a bunch of conversations and we really used Rick Eigenbrod a lot. Rick worked with us individually and together to talk about what our goals were, what makes us happy, and what gives us energy.

At the end of that process, I decided to leave with Tom. We set up a structure to accommodate that. Because at that point our whole net worth was in this company, we did a deal with Housatonic Partners, selling a minority interest in the business and allowing each of us to take out a meaningful amount. If we weren’t there day-to-day, we just didn’t feel it made sense for us to have a hundred percent of our net worth tied up in the business.

So, how did I feel? I’m not someone who gets nervous. There were definitely things I wanted to explore. I felt that this would give me the space to do that. But the transition required a change in attitude because I was a very hands-on guy. Part of that was resolved by Tom and Rick both suggesting that I take a sabbatical. I went away for three months. I think one of the interesting parts of my story is that within weeks of me deciding to leave the business, I met my wife! And that’s not a coincidence. Basically, I had my head down for a bunch of years. Suddenly, I stepped into some open space and I looked up and there was somebody there.

I was not nervous about the business very much. You know how stable these businesses are. I was excited about this new life I was building. It was an opportunity for me to grow. That was the number one thing.

FARM promoted an existing executive and recruited a new executive to be co-CEOs. Initially, Saxon took a sabbatical in Santa Fe and Bird became the board chair. Bird and Saxon physically removed themselves from the FARM offices they previously occupied and set up working space in Menlo Park.

At first, Bird and Saxon spent part of their newfound free time by investing in small startup companies - what we would now refer to as angel investing. The two had access to this asset class through their Stanford affiliation and network. Bird revealed,

> I can’t remember exactly how this occurred, but we became intrigued with venture capital investing. That was the beginning of the dot com boom era, and it was very exciting. We were hyperventilating on University Avenue in Palo Alto because of the opportunities that were coming up. We took some of the money that we got from Housatonic, and began to put it in other early stage companies.
Saxon soon had mixed feelings about angel investing and his interest waned.

I liked it at first. What I most liked was working with the entrepreneurs and doing informal coaching, but I didn’t love it after a few years. I began to try to explore other things that I might do. I started getting on non-profit boards.

Saxon devoted more and more time to social service organizations and philanthropic activities. He relocated to Santa Barbara with his wife and two children where he established Leading from Within (http://leading-from-within.org/). The organization worked with regional social service organizations to develop and improve leadership in these organizations. Lead from Within allowed Saxon to tap into his entrepreneurial interest, his social service interest and his desire to teach and coach organizations making an impact in the community.

Meanwhile, Bird relocated to Concord, Massachusetts and enrolled at Harvard Divinity School. His attention started to shift towards impact investing, helping business with a social mission. He explained,

The whole secret to impact investing is finding the right blend. Impact investing is all about trying to get three things: financial returns, and impact on the world, and then impact on the investor. Impact on the investor is important, because that’s what makes it sustainable. It is what keeps you getting out of bed and doing it, staying motivated and committed. The impact on the world is the real pursuit, and the financial returns are a part of the puzzle.

Even as Bird and Saxon pursued other interests, FARM continued to grow and thrive. Bird and Saxon made the decision to completely exit the business by selling to Iron Mountain, a large industry operator. From a financial perspective, the two entrepreneurs, walked away with “enough.” People define “enough” differently, and Bird and Saxon exceeded their relatively modest expectations when years earlier each invested to buy the business.

Bird and Saxon shared some of the proceeds from their sale with their team members to express appreciation. The two also donated 10% of their proceeds to their respective donor-advised charitable funds. With the balance of their cash proceeds, Bird and Saxon invested their cash in a balanced portfolio of Vanguard index funds managed by Vanguard’s advisory service for a small fee. They also continued to do a small amount of direct private investing which their networks provided unique access.

Looking back, Bird and Saxon had no regrets about how they managed their exit. They loved their entrepreneurial project, which they thought of as a laboratory to explore their ideas and philosophies, but were happy to move on to new projects. They felt particularly grateful and lucky that their exit took place in stages, with a transition away from management and then a complete exit. This allowed them to avoid the fate of most entrepreneurs – going full speed with a hard stop at the exit.

Jake Berkman (disguised)

Jake Berkman (Yale School of Management MBA 2010) (disguised) formed a search fund immediately upon graduation from his MBA program. Berkman, a funded solo searcher, purchased Employee Screening Services (ESS), a multi-site employee background check operator in the St. Louis area (disguised). Berkman liked the fact that the business had relatively low CapEx with recurring cash flows. The business grew steadily under Berkman’s guidance and experienced organic growth and acquired growth.
After approximately two and a half years of operation, Berkman reported to the board about recent transactions that had taken place in the industry. After the meeting, a board observer pulled Berkman aside and commented, “I think we should try to get one of these high multiples people are paying in the industry. They seem ridiculous.”

Berkman recalls,

That conversation promoted a whole lot of soul searching and analysis. It was with trepidation and some mixed emotions that I recommended to the board at the next meeting that we hire investment bankers and hit the market to see what we could get. Importantly, I did not characterize it as, 'I recommend that we sell the company.' But I did say that we should see if we could get one of those high multiples.

After some debate and opposition, Berkman’s board decided to pursue this course of action. One board member was vehemently opposed to an exit believing that the timing was off, and the company would be leaving lots of value on the table. Despite some opposing views on the board, the process moved forward.

Berkman approached the sale process with a certain amount of apprehension. While Berkman was keen to post a win for himself and his investors, he was concerned about how selling would be interpreted by his employees and coworkers. Berkman had worked diligently to build a positive culture of inclusion and transparency. He had stressed his own long-term commitment to building an excellent company. Berkman noted, “I just greatly valued my team professionally and personally. I worried that they would deem this decision to be an indictment of the company’s long-term potential or my signal of waning commitment.”

Berkman and his financial advisors ran a competitive auction process for the sale of ESS. Eight definitive LOIs were offered, all from private equity companies. Given the similar value to shareholders, the board gave Berkman the opportunity to select the prevailing buyer amongst three that bids that were nearly identical. Berkman selected a Miami-based private equity company that he thought was the best overall partner, including valuation.

When the deal was ultimately completed, Berkman experienced an overwhelming sense of relief.

There were countless times during the process where it could have gone off the rails. Getting it done and getting across the finish line was a huge relief and exceeded my expectations. I remember pulling into my driveway the night that the deal closed. It was December 23rd. I was talking to my Dad, who had always been a big mentor. He is a guy I looked up to tremendously. They were tears of happiness and relief.

Berkman generated a 40% IRR for investors over more than a three-year period. Berkman himself walked away with approximately $3.3 million before tax, not an amount that would allow him to responsibly retire. To facilitate the transaction, Berkman committed to roll $1 million of his $3.3 million proceeds, an amount that he considered at the very high end of the range that he was prepared to invest. After taxes and the roll, Berkman netted approximately $1.8 million in cash.

Although Berkman was asked to roll into the new deal, he was not explicitly required to stay on as an employee. However, he remained as CEO with the new owner in exchange for some additional option incentives. He wanted to stay on as CEO for several reasons, one of which was to ensure a smooth
transition for his employees. Additionally, Berkman wanted to see how working with a new, sophisticated owner would play out.

As the company was being sold, Berkman was intensely aware of the unusual situation. Once he committed to roll equity, he was both a buyer and a seller. He wondered how to balance his allegiance to his departing shareholders and his entering investors. At points, he clearly felt conflicted and tried to do the right thing with all parties in mind, including himself.

Berkman had some misgivings about the equity roll.

By virtue of the fact that I was recommending that we accept the offer, I obviously believed that the PE firm was paying a full price for the assets. As a function of that, I basically rolled, not because I wanted to, but because I felt like I needed to. I felt that I owed that to my shareholders. So, I struggled then, and I continue to struggle now, to see how equity value is going to be created.

I probably should have thought differently about the roll over and advocated more for myself. I wonder how much of the needing to invest a million dollars was truth versus my interpretation of the matter. If I hadn’t been willing to roll what kind of value erosion would really take place? I might not have put a meaningful portion of my net worth into a company that I thought had been purchased at a peak in the M&A market.

Still, Berkman remained extremely grateful and happy. When thinking about his cash proceeds, Berkman initially felt rich, but then upon further contemplation and analysis, knew he had to keep generating wealth for himself and his family. Additionally, he realized that he was now a wealth manager in addition to being a wealth creator. He thought about what to do with his recent riches.

I would really like to actively manage it. What I found is I’m just very risk averse. The horrifying part is, I kept most of it in cash which I totally realize how absurd and silly that is. I just kept thinking the markets have peaked and I have not invested yet, and now is not the right time.

Matt Estep

Matt Estep (Harvard Business School MBA 2008) formed a solo funded search, Bosworth Capital Partners (http://bosworthcapital.com/), immediately after graduating from the Harvard Business School. In his second year of searching for a business to buy, he joined up with another solo searcher and purchased Midwest Supplies (https://www.midwestsupplies.com/), a home brewing business. Midwest was growing at a heady pace with year over year growth rates in the 30 to 35% range. This niche hobbyist space was popular - customers purchased materials online to brew beer and ferment wine at home. Estep completed the acquisition in the 27th month of search.

During Estep’s first year of operating Midwest Supplies, its largest competitor become available for sale. Estep and his partner attempted to purchase this competitor, but ultimately lost the deal to a private equity firm. He recalled,

We tried to buy our largest competitor, but a private equity firm managed to make the acquisition. After that transaction closed, I stayed in touch with the private equity firm. About a year later, they came to us and they said, we want to buy your business. Our initial response was that our business isn’t for sale. They came back to us and said, how much do you think it’s worth? We worked with the board, came up with a very optimistic number that the board said would cause
us to sell. We were seeing some things in the industry that gave us some concern and we went back to them with the number and they said OK.

Estep was concerned that growth rates would diminish from the double-digit rates the business initially garnered. He started to back the sale because it was the right thing to do for himself and his investors.

The business would still have been a fine business and it would have generated cash. We would have paid down our debt, but I think we would have been in for very different outcomes for ourselves than we ultimately achieved.

Estep anticipated cashing out part of his proceeds from the exit and then joining forces with the acquiring private equity firm as an executive, similar to the role he had been playing at Midwest. That was not meant to be.

Halfway through diligence the operating partner from the private equity firm and I went to dinner. The PE investor shared that the firm had made some difficult decisions. I was told that my search fund partner was going to be the CEO. That was the first punch. The second punch was that I was going to report to him and not have a board seat. I just said no, actually I’m not going to do that. It’s not what I signed up for.

Despite the surprising news that Estep received at the dinner, he was still keenly focused on getting a deal done. He realized it was the right business decision to make and the financial outcome would be a win for him personally and his investors. Estep decided not to roll any equity proceeds into the new deal. His partner, who was now the CEO, rolled a significant amount of equity into the new structure. Seventy-two days after the private equity firm agreed to the board’s number, the deal closed

Estep and his partner generated an 85% IRR for investors and their common equity was worth approximately $3 million each.

Estep was thrilled with where the deal landed. He did not have excessive expectations around what his first venture could be. Rather, he was focused on learning and proving himself to investors.

I focused on the professional experience I got from figuring out how to buy a business and run it. The day the wire cleared I remember calling my wife saying, we just came into $3 million never expecting anything. I just went to work every day and I thought I’m just going to work hard and hopefully this turns into something. I was certainly thrilled with the outcome from that perspective and I was never looking to have $50 million put in the bank in one transaction such that I wouldn’t have to do anything again. From my perspective, I thought it was a wonderful outcome for me and my family. Graduating from HBS, I had $147,000 in loans and so, looking at it from that perspective, it was a delightful result.

After the deal closed, Estep took his after-tax proceeds and placed all the funds in an E*TRADE account. He invested 50% of the money in an S&P index fund and used the balance for direct investing in search funds where he can be on the board and actively mentor future entrepreneurs.

Estep spent some time deciding what he wanted to do professionally. To help think about his choices and options, he spoke with about 35 former successful search funders and one consistent theme he heard was not to be in a rush – to resist the temptation to dive into something too quickly. Pausing was acceptable and even helpful.
One thing that became clear, Estep knew that he wanted to operate a business again. He really enjoyed that part of his experience.

I had no idea what I was going to do next. I loved running the business. I spent six or seven months talking to people and figuring it out. I spoke to people who had been successful - defined as a broad range between making $500,000 and $50 million as operators, on how they decided their next move.

After trying to figure out what I really enjoyed, I concluded that what excited me were some periods of extreme and intense work that ultimately wanes as you get through the work and stabilize the situation. I finally landed on the goal, it was going to be to acquire a business, or multiple businesses, where I would be extremely active in the business for a period but then turn the running of that business over to someone for the longer tenure.

Estep initiated a self-funded search to acquire a business. He chose this structure because he wanted the ultimate flexibility in deciding what to acquire and how it would impact his family personally – specifically around relocation. Estep wound up purchasing a $10 million revenue business that was advertising based and is “pretty typical and classic search fund.”

Despite his fresh wealth, Estep used investors’ capital to purchase his new business and described his only regret being that he self-funded his search, which cost him about $600,000. He believes that with his experience and track record he could have raised search capital and still had a high degree of flexibility on which deal to do.

Reflecting on being a CEO for the second time, Estep notes,

I’m more confident in the decision making. If we need the accounting cleaned up or if we need to install a CRM, I say let’s go find a good one and just put it in. I’m more confident from the perspective of investing, whereas in the first time around I was extremely frugal to our detriment. I’m making decisions quicker. Does that mean I’m always getting them right? No, absolutely not. We probably changed a lot more staff in this business in the first eight months than I would have done as a rookie CEO. The board has been a much more positive experience this time, just given where I’m at professionally and knowing how to deal with them.

As for his first business, Midwest’s growth did significantly slow down, as Estep prognosticated. His former partner was pushed out from his CEO role.

Leah Michaels (disguised)

Leah Michaels (University of Pennsylvania Wharton MBA 2003) initiated a solo search fund after she completed her MBA degree. At the end of her search, Michaels purchased a company, Rocky Mountain HVAC (RM), a Denver based super-regional operator of residential HVAC services (disguised).

Under Michaels’ guidance, RM operated successfully for several years growing organically as well as by acquiring other proximate HVAC operators and converting these operations to RM based locations. Michaels enjoyed being a CEO and did not specifically have immediate intentions to sell the business. Yet, she notes,

We started to get inbound interest from some private equity groups, then maybe a strategic or two. At the same time, there were concerning competitive dynamics on the horizon. That
combination led the board to suggest that I should engage an intermediary to follow-up on these inquiries. Of course, that added momentum to the discussions. And then we quickly slipped into a mode of moving towards a sale.

Since Michaels did not actively initiate the sale process, she had conflicting sentiments about the exit strategy.

I had mixed feelings because I loved the organization and the people that worked there. But the reality was the industry was evolving. Both the regional and national competitive dynamics were changing. We did not know what was going to happen and how we would adjust to it. So, the risk went up significantly. At that point, we had had a very good run. I had mixed feelings.

We ran a full sale process. The investment bank Filbertson McDonald (disguised) represented us and they were a machine. They went out to a lot of buyers and ran a very structured process. It was important to me that the buyer understood and matched our culture. RM was a storied service organization with a big employee culture and being employee minded was a significant part of who we were. I remember we had a lot of interest which is great. The buyers had very different cultures. There was also a strategic buyer looming that may have come in for slightly more money, but we decided that the timing was best to go with a financial buyer that had a good culture that seemed to fit with the organization.

Michaels and her shareholders wound up selling RM to a Los Angeles based private equity firm, West Coast Capital (disguised). Investors realized a 34% IRR and Michaels received approximately $8 million before taxes for her efforts.

Michaels rolled 20% of her equity into the acquiring company and stayed on as CEO. She was passionate about the team and business, wanting to continue to grow. Her enthusiasm was soon dampened as dealing with the private equity firm who purchased RM proved dispiriting.

I had assumed that private equity meant that they were going to have discipline and be good at running an organization. I figured out quickly that they may not be the greatest operators, particularly when tough decisions needed to be made. That was a little bit frustrating, as an operator, to be on a team with 20% of my eggs in the basket and to watch as decisions that needed to be made, weren’t made. This was a tumultuous time in that industry. Decisions would take a year or longer to make, and real value was being destroyed in the interim.

One thing I did, which I would recommend to anyone that is in that situation: go to the buyer a year from the time of acquisition and offer to sell half your rolled equity back at the same valuation as the deal. That’s kind of a win-win because they get the time value of that year and you reduce some risk. So, I did that and that turned out to be a great thing. Half of what I rolled at the time of the sale, or 10% of my proceeds, was now at risk versus the full 20%. This transaction proved important as, within a few years, the equity had lost 60% of its value.

Michaels stayed on as CEO for about six months and then shifted into a non-executive board role.

During her transition out of RM, Michaels had mixed feelings,

I focused on running the organization, convincing myself that a transaction would not happen. When it did happen, I didn’t internalize it for six or seven months. My first reaction was, ‘OK my family isn’t going to starve.’ The deal took a lot of risk off the table. I was very excited about
that. On the other side – I felt vulnerable after many months of being out as a CEO. It was like being a ship without a keel -- a weird and not great feeling. But overall, I was satisfied. As a kid, I didn't have a lot. I distinctly remember hoping one day I could make a $100,000. As a kid, that was the most I could conceive of. So, I felt gratitude, but I was not hugely celebratory.

Michaels was used to the daily demands of being an active CEO, having time scheduled, meetings and lots of people interaction. Life after the transition was a challenge,

At the time of the sale, I was exhausted from running the company while also running a full sale process, so I knew that any of my initial thoughts would be cluttered. I took time off and I spent time doing household tasks and taking my kids to school – just being and thinking. My friends made fun of me because I knew all of specials in the grocery store. I goofed off with a consulting project and then figured out pretty quickly that it wasn't that satisfying. Although selling the business was rewarding professionally and financially, I was unprepared for the aftermath.

After engaging a financial advisor and understanding how much money she would have left after taxes, she and her husband came to the quick realization that as fortunate as they were, Michaels' share of the RM sale was not a windfall that would allow her to retire. Her financial advisor recommended Michaels do nothing with the proceeds for at least one year - avoid buying a car, house, or making a large investment, to just tread water and let the situation become real.

I agreed with that. So, I didn’t do anything except make asset protection my overarching goal. It’s ironic because I always joked that I gamble with my professional life. Now it was all about the diversification and insurance, life planning and all that stuff. It was all about protection. It was about not taking any risk with the proceeds.

With the help of her advisor, Michaels invested his proceeds in a 60% equity, 40% fixed income portfolio focusing on broadly diversified funds.

As time went on, Michaels began to feel dull, like an athlete getting out of shape. She began to look for another business to acquire and operate. She wanted to be a CEO again and was anxious, even fearful, of being out of the game. Michaels had reflected on who she was and a theme that kept emerging was her desire to be a builder and a creator of companies.

When thinking back on her experience, Michaels reflected that it was the journey she enjoyed the most. Building the business, driving the initiatives and projects – the small wins. Exiting was certainly affirming and positive, but the real happiness was in the building.

Mario Sicilia

Mario Sicilia (Stanford University MBA 2009) and Jose Antonio Fernandez launched a search fund, Vestige Capital, after completing their MBAs at Stanford University. The partners focused their search on businesses in their native Mexico. A broker introduced them to a company called Bomí Mexico (now Medistik), a third-party logistics provider in the Mexican healthcare market. Fernandez and Sicilia tried to acquire the company, but they could not agree with the seller regarding a valuation gap generated by the loss of Bomí’s main client.

After looking at other opportunities with no success for over a year, Fernandez and Sicilia reopened conversations with Bomí. Before a deal was made, Fernandez had to move to the US to work at a business that his family controlled and disengage from the search due to security reasons. Nonetheless, both
Fernandez and Sicilia remained interested in the company. They liked the business because it was asset light, had recurring revenues and was growing rapidly. Bomi reported annual revenues of around $13 million and EBITDA margins of 32%.

The opportunity was presented to Vestige investors, but only 35% of the $18.5 million needed for the acquisition were sourced from the original group. Fernandez and Sicilia reached out to Michael Kahn, a friend they had met at Stanford who was working at Valiant Capital, a San Francisco based hedge fund, for advice. After reviewing the deal, Kahn decided that he wanted to invest. After some negotiations, Valiant contributed 65% of the equity for the acquisition. Fernandez joined as a very active board member and Sicilia became the CEO of Bomi Mexico.

Over the first three and a half years of Sicilia’s leadership, Bomi grew swiftly. Sicilia thought that it was time to consider selling the business despite the relatively short holding period. Although the business was stable and growing, Fernandez and Sicilia believed their initial investment thesis was changing as larger, multinational logistics companies like UPS and FedEx began targeting the Mexican healthcare market.

Additionally, Sicilia felt the burden of being CEO and running a business, especially one as operationally intensive as a logistics company. Sicilia noted,

> I loved being close to people and making decisions, but I was constantly stressed. As a CEO, you are playing defense all the time and that can be tiring. When running the business, you are facing problems all day long. I found it hard to feel comfortable as an operator because I am a pessimist. The logistics business is a business of “security and hygiene.” Clients only think about you when you make a mistake or when they need to reduce costs.

Fernandez and Sicilia consulted with their largest investor, the San Francisco-based hedge fund, and got support for pursuing a sale. An investment bank was engaged to manage the auction process. A key concern for the partners was the type of acquirer the investment bank would source. Sicilia was hoping that a strategic player would emerge because it would likely attract the best valuation and provide a graceful exit for Sicilia as CEO. Of most concern to Sicilia was a private equity buyer who would require Sicilia to remain onboard as the key operating executive for an indefinite time period. When one potential private equity investor inquired about Sicilia staying on for an additional five years as the CEO, Sicilia’s terse response was, “No thank you!”

Sicilia’s investors eventually found a Mexico-based family office who could meet their price expectations and only require Sicilia to stay as CEO for a transition period. Investors were excited with the deal the family office proposed, but Sicilia was willing to leave money on the table for the strategic player. Once the transaction closed, Bomi investors reaped 5.2x their initial capital investment and posted a 65% IRR. Fernandez and Sicilia personally grossed more money than they had projected in their best-case scenario.

To facilitate the transaction, Fernandez and Sicilia were required to reinvest 50% of their respective proceeds into Bomi under the family office’s ownership structure. The rollover equity requirement was not something Fernandez and Sicilia were excited about, but they felt that it was the right thing to do given that their investors had supported them during the search and management process. To mitigate some of the reinvestment risk, the partners negotiated a put option for their equity interest if there was not an exit within five years of the transaction.
Both Fernandez and Sicilia were excited with the transaction. They built a track record, wealth, and returned money to the investors who supported them. As Sicilia describes it, the outcome was almost too good to be true.

While money was never the primary reason to do this, the economic reward was much higher than what we expected. We never planned to receive such a big payout in that short period of time. We understand luck played a huge role in our success. However, the financial stability offered a new perspective to us when considering family and business issues.

After receiving the proceeds from the divestiture, I confirmed that money was not my motivation. I thought that money was going to make me feel a lot happier, but it didn’t really make a difference. What I was very happy about was the difference we had made to our stakeholders, mainly our employees, building a name for ourselves and upholding our fiduciary duty. It was gratifying to make money for those who invested their money and their trust with us. We were happier to return money to our investors than to receive money for ourselves. As we calculated the returns, we asked our investors to approve a special bonus for our top executives that changed their lives. It was gratifying to see them buying a house or getting out of debt given partially to our intervention.

When thinking about what to do next, Sicilia knew he did not want to be an operator again and wanted to get back to investing. He had worked in private equity before starting business school. Fernandez and Sicilia wanted to have exposure to many different industries and business models. Sicilia wanted to avoid being an expert in one industry where he was an inch wide and a mile deep. After transitioning out of his role as CEO at Bomi, Sicilia and Fernandez partnered with a couple of people close to them and raised $150 million to invest in large private and small public companies listed on the Mexican stock exchange. Their strategy was to provide stable capital and liquidity to businesses who were undergoing a generational transition, but had a compelling business model. Seven of Vestige’s investors invested in Fernandez and Sicilia’s new fund.

Besides seeding his new investment vehicle, Sicilia used his cash proceeds to purchase a house for his family, and make some real estate and search fund investments. When thinking back on his project, Sicilia reflected,

I am very glad that we exited when we did. It was a fun run, but we timed the exit right. That being said, I sometimes struggled with is the realization that the very best thing I might do professionally has happened during my early 30s. It will be difficult to repeat or exceed the success that Bomi had. However, we will do our best hoping that the stars align again.

Is this the right path?

After connecting with many entrepreneurs who had exited, Dittrich had a better understanding about how being a search fund entrepreneur can fit into a broader career. He had a sense of what people do, and do not do, after an exit. He also understood the potential array of choices an entrepreneur could make. Dittrich noted that a high investor IRR did not always result in a big financial win for the entrepreneur. He also observed that there was a difficult transition to make from wealth creator to wealth manager after an exit. Dittrich discerned that no entrepreneurs who acquired a company, and had a win, got a traditional job after the exit and wondered whether he would actually be less employable after executing a search fund – even a very successful one. Lastly, Dittrich learned that one chapter of your career could be about gathering and earning, and another about having a social impact and serving.
But Dittrich wondered how all of these new found perspectives should add up. All things considered, was forming a search fund the right choice? Are the likely cash proceeds consistent with the risk and the effort? And did what he knew about the post-exit life of entrepreneurs play a role in how he should go about shaping his own career?

Endnotes

1 Eugene F. Williams, Jr. Lecturer in the Practice of Management