



PROMETHEUS HEALTH PARTNERS

INTRODUCTION TO SEARCH FUNDS

A “Search Fund” is a two-stage private equity investment vehicle in which the GPs raise funds from LPs in two rounds:

- The first round covers expenses to find a suitable acquisition target and;
- The second round facilitates the acquisition financing

Typically, a search fund makes one acquisition and the GPs take active roles in managing the day-to-day operations of the acquired company.

In the first round, LPs purchase units in the fund. A unit will typically cost between \$20,000 and \$50,000. The GPs will look to include 10 to 20 LPs and in this first round, raise a total of \$400,000 to \$700,000 in capital. The funds are then used to cover the expenses of the GPs as they search for an acquisition. Expenses include such things as salaries for the GPs, deal sourcing costs, rent, administrative costs and due diligence expenses. Typically, the GPs will have up to 24 months to locate an acquisition target.

Once an acquisition target has been identified, each LP receives: (1) conversion of the capital they contributed for the search phase into equity of the acquired company and (2) the right, but not the obligation, to provide additional capital for the acquisition. In terms of the conversion of their initial capital, the LPs receive a step-up in basis, generally 50%, regardless of whether they invest in the second round. So, for example, if a LP purchased a unit at \$20,000, they would receive an equity stake in the acquired company equivalent to \$30,000 in value. LPs also receive the right of first refusal to elect to invest in the acquisition on a pro-rata share (meaning, if the LP held one unit and the GP sold 10 units, that LP would have the right of first refusal to fund 10% of the total investment amount). Essentially, the first round investment by the LPs are call options. If some of the LPs from the first round chose not to invest in acquisition or more capital is required, the GPs can bring additional investors into the deal.

The investment focus of search funds can vary from generalist funds to industry focused to geographic region focused. On average, search funds will target service-based companies and will typically look for companies with EBITDA between \$1 million and \$5 million.