

Is it true that searchers seem to gravitate towards larger companies than before?

How does this trend impact the multiple range, and are we going to see searchers competing with private equity players targeting small SMEs?

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One of the key advantages of the Search Fund model is its focus on acquiring companies with an EBITDA between 1 and 3 €M, which reduces competition and enhances direct relationships between entrepreneurs and sellers. However, at Arada Capital Partners, we've recently noticed a growing number of transactions exceeding this range.

Each acquisition is unique, and rather than making premature judgments, we prefer to thoroughly analyze these situations to understand what drives some entrepreneurs to pursue larger deals. While most of the transactions we analyze fall within the 1-3 €M EBITDA range, we have pinpointed several dynamics fueling appearance of these atypical larger transactions:

The Solo and Partnered Search

Historically, one of the driving factors behind a Search Fund's inclination to acquire larger companies has been the composition of its team.

Search Funds comprised of dual entrepreneurs typically sought out larger entities than those pursued by solo searchers. This trend is often attributed to the financial dynamics of the operation: a larger firm can more comfortably accommodate the salary framework for two CEOs. Moreover, the financial returns following a sale or exit tend to be more substantial and appealing when distributed among the team members.

This factor is not a recent development, and as such, while it has an impact, it should not significantly alter the overall size of deals. It becomes crucial to delve into the trends surrounding solo-searchers and partnered searches to fully grasp their implications.

According to the IESE International Search Fund 2022 Study, from 2016 to 2021, solo-searcher funds maintained a lead over partnered funds, even with a marginal drop in the last measured period. Partnered

funds saw a significant decrease in 2018-2019, with a slight recovery by 2020-2021. Throughout 2023 and 2024, we have not seen a significant shift, but a subtle trend appears to be emerging in favor of partnered Search Funds.

Mature markets

The maturation of the Search Fund model in certain regions has expanded the range of potential acquisitions. Search Funds are now more willing to consider deals that may fall outside the traditional size range, aiming to navigate the increasingly competitive

landscape. In these geographies, Search Funds place great importance on having a differentiating angle to position themselves in front of the company seller.

This openness to a wider range of transaction sizes and types underscores a strategic evolution within the Search Fund model, where the emphasis shifts from strictly defined deal parameters to a more nuanced assessment of potential value creation. Deals that might have been overlooked in the past due to their size or complexity are now being embraced as viable opportunities, provided they present an interesting angle or strategic fit. This trend is indicative of a sophisticated approach to deal selection, where the criteria for consideration extend beyond size, embracing the complexity and potential of each unique opportunity to drive growth and generate returns.

Raise of institutional investors

We highlight the growth of institutional investors in the ecosystem as a driving factor behind Search Funds seeking out slightly larger companies than usual. There is a significant influx of capital into the Search Fund ecosystem, mirroring trends seen in the United States, with numerous new institutional funds entering the scene with deep pockets.

It's no coincidence that historically, the usual investors in the ecosystem were small funds or private investors. Considering the Search Fund as an asset class, it is undoubtedly a type of investment where capital deployment is complex. The checks issued are relatively small for institutional investors, and therefore large institutional funds seek for larger tickets, which can be achieved in two ways: acquiring multiple units during the search phase and purchasing larger companies at the time of acquisition. This factor is paving the way for larger deals that, in the past, would have been overlooked.

Entry multiple

In certain European geographies, traditional private equity funds are

targeting increasingly larger deals, leaving an opening for Search Funds at the upper end of the 3-4x EBITDA range. This shift offers Search Funds opportunities, but caution is advised, especially regarding entry multiples. High entry multiples can limit potential returns and increase risk if the economy falters, potentially reducing a company's valuation and affecting expected returns. A strategic approach, weighing growth potential against risks and avoiding overpayment, is crucial to achieve the Search Fund expected returns.

This dynamic is partly driven by traditional private equity funds expanding their investments to support larger and more complex structures, prompting them to explore new markets and larger deals. However, this trend varies by region, underscoring the need for Search Funds to carefully consider entry multiples and market conditions.

Debt Dynamics

The ability to raise debt varies significantly by geography and sector, directly impacting the size of acquisitions that Search Funds can pursue in specific areas or industries. In some countries, regulatory conditions, economic stability, or the maturity of the financial market may limit the availability of debt financing, making it more challenging for Search Funds to leverage their acquisitions substantially. Similarly, certain sectors may present higher perceived risks or volatilities, leading lenders to be more cautious in providing financing.

Conversely, in some countries or industries, Search Funds are gaining access to bank financing or private lenders who are increasingly understanding the Search Fund model, thereby facilitating the emergence of larger deals. This growing familiarity with and confidence in the Search Fund approach by lenders is broadening the scope for more significant acquisitions, allowing Search Funds to capitalize on opportunities that were previously beyond their reach due to financing constraints. This shift is creating a more favorable

environment for the realization of larger-scale operations within the Search Fund community.

Shaping Search Fund larger deals

The adoption of complex deal structures plays a pivotal role in facilitating the movement towards larger acquisitions within the Search Fund ecosystem. The prevalent use of seller notes, earn-outs, or a combination thereof, marks a significant development in these expanded deals. By linking a portion of the payment to the company's future performance, these financial tools adeptly synchronize the objectives of buyers and sellers, paving the way for larger-scale acquisitions.

Moreover, the deliberate incorporation of roll-over equity, usually ranging from 5-10%, marks a strategic evolution. This not only ensures that sellers maintain an interest in the company's ongoing success—providing buyers with both continuity and invaluable insights from the sellers' continued involvement—but also plays a crucial role in the financial structuring of the deal. This progression towards intricate, thoughtful transaction designs represents a sophisticated approach in the Search Fund model, facilitating bigger acquisitions.

In summary, the Search Fund ecosystem is evolving and opening to new opportunities presented by larger acquisitions, driven by more intricate deal structures, increased investor and lender understanding of the model, and the maturity of specific regions. As the trend towards larger deals gains momentum, there's a need to assess operational risks and the challenges of managing larger enterprises.

In Search Funds, entrepreneurs always come first. They must grasp the intricacies of larger deals, navigate complexities, and steer their acquired businesses towards success. Their experience, adaptability, and strategic planning are crucial to seize opportunities within the changing landscape of Search Funds.