

Entrepreneurship Through Acquisition: Buying and Building Small Businesses

Alex Schneider

Matt Littell

Northwestern | Kellogg

Today's Learning Objectives

- Overview & ETA trends
- What makes a good industry & company?
- How are acquisitions financed?
- How is value created?
- What's going on in ETA at Kellogg?
- How do I participate as an Alum?
- How do I learn more?

Who are we?



Alex Schneider

Adjunct Lecturer of Entrepreneurship

- Teach ETA, co-lead Zell Fellows ETA
- Investor at Clover Capital
- 20+ years of PE / investment banking experience



Matt Littell

Adjunct Lecturer of Entrepreneurship

- Teach ETA, co-lead Zell Fellows ETA
- Investor at Halstatt Legacy Partners
- Former searcher, 15+ years of ETA experience

STEVE JOBS



What is Entrepreneurship through Acquisition (ETA)?

An aspiring entrepreneur searches for and acquires a company they subsequently run.

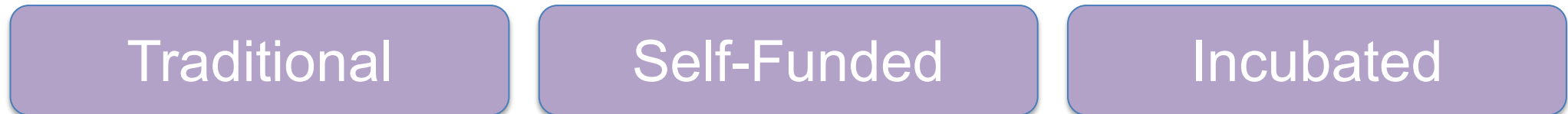
The most familiar form of ETA is a “Search Fund”

How Do Search Funds Work?

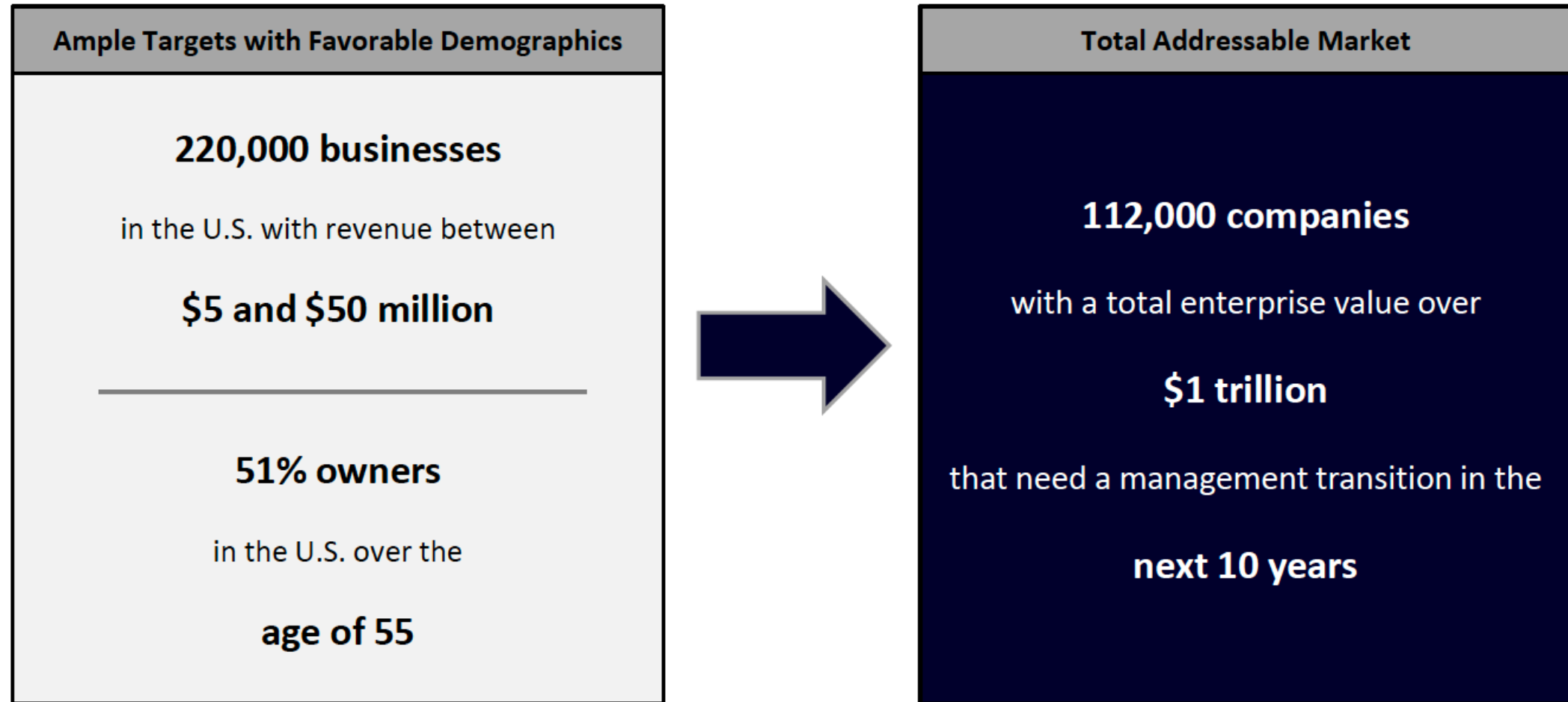
Phases of a Search Fund:



Styles of Search Funds:



What Problem Does Search Solve?



Source: NextGen Growth Partners Research

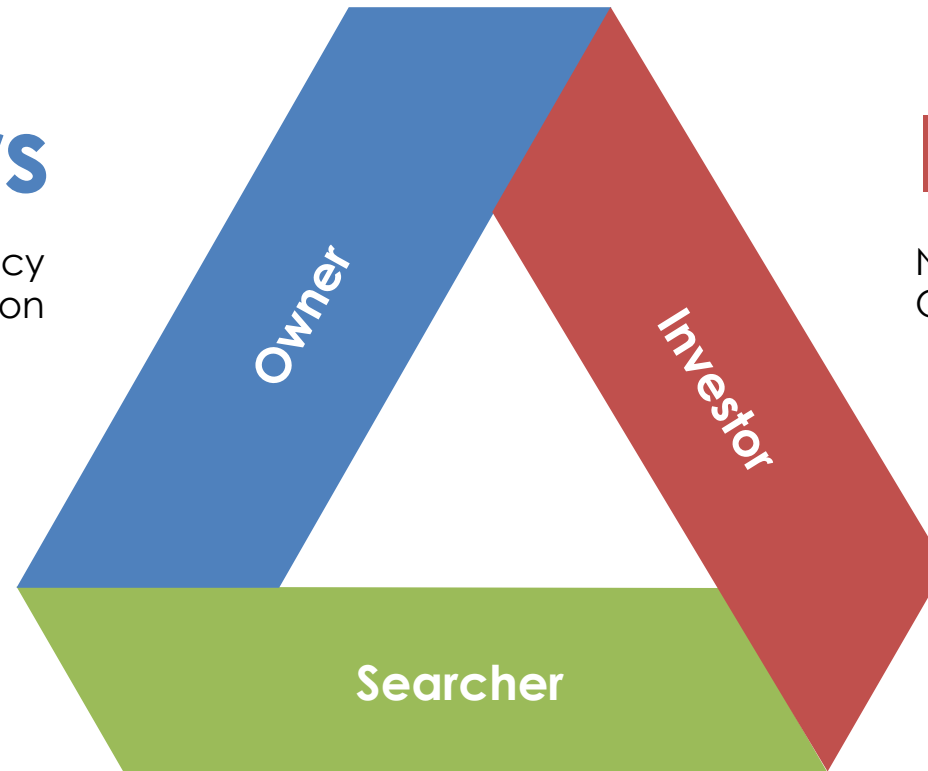
Search is a Three-Sided Market

Owners

Need: Liquidity, Succession, Legacy
Offer: Business, Transition

Investors

Need: Companies to buy, Labor, Returns
Offer: Capital, Guidance



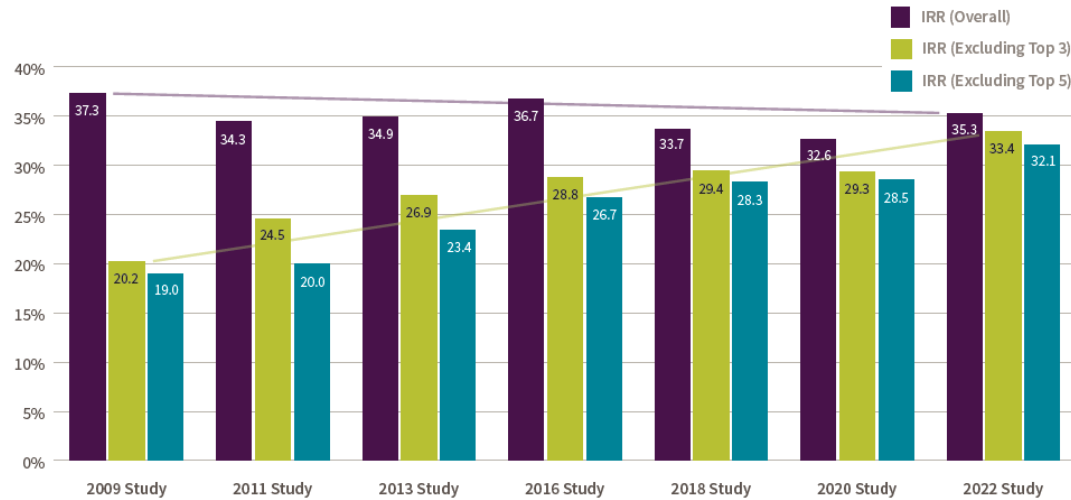
Searchers

Need: Autonomy, Capital, Mentorship, a Starting Platform
Offer: Labor, Leadership, Deals

Search Fund Returns

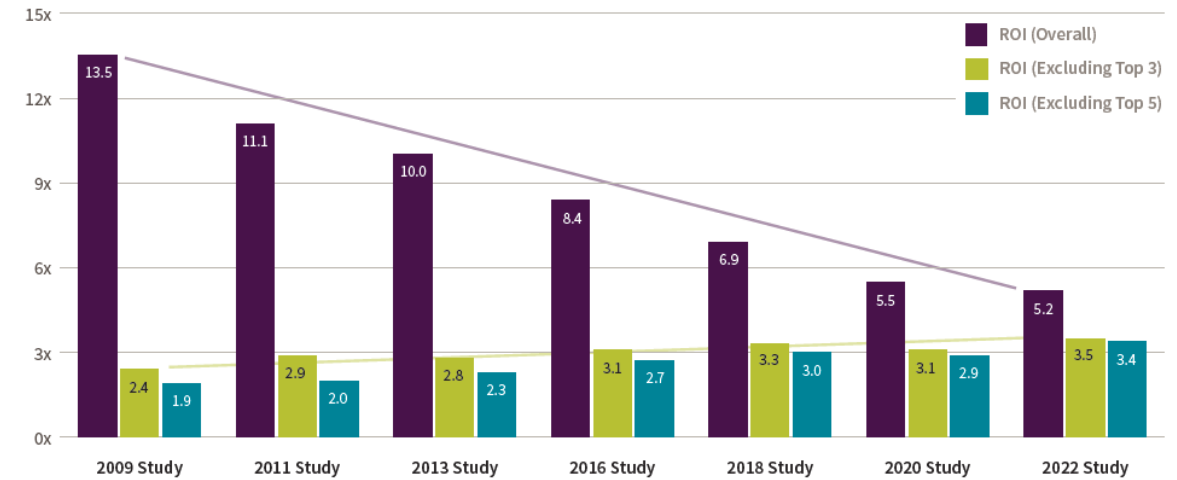
IRR

FIGURE G | AGGREGATE SEARCH FUND IRR (2009 – 2021)



MOIC

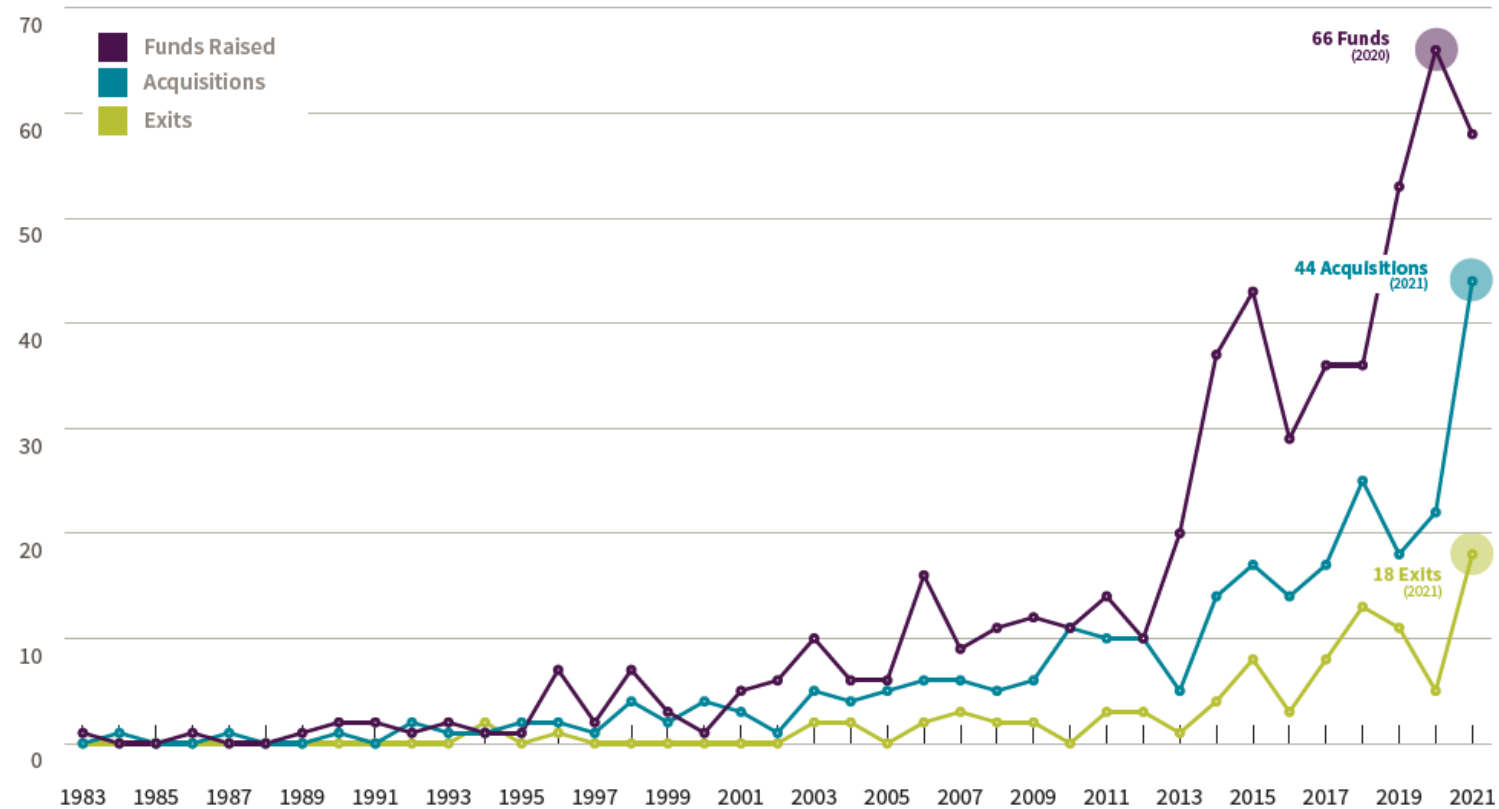
FIGURE F | AGGREGATE SEARCH FUND ROI (2009-2021)



Source: 2022 Stanford Search Fund Study

Search Fund Activity

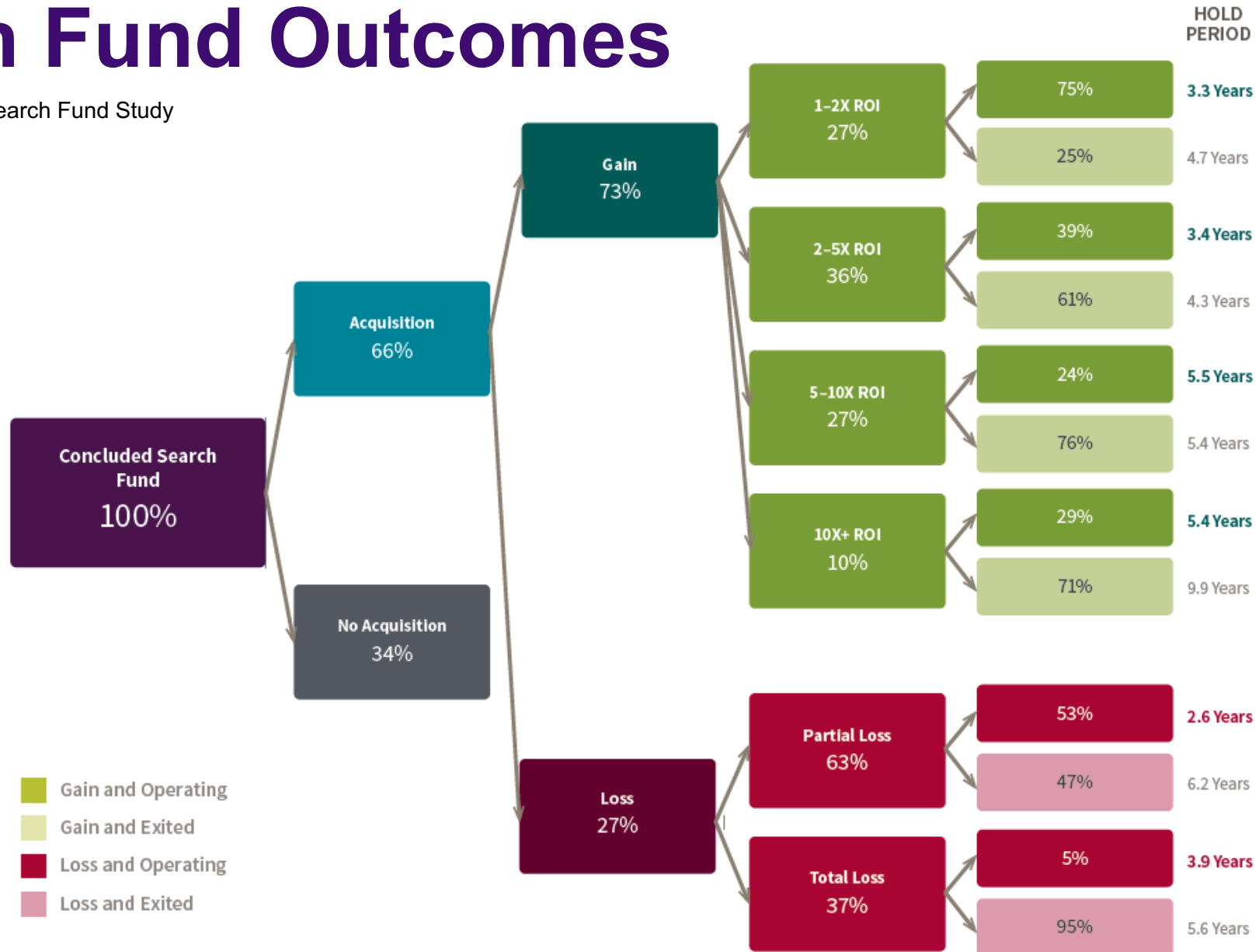
FIGURE B | SEARCH FUND ACTIVITY BY YEAR



Source: 2022 Stanford Search Fund Study

Search Fund Outcomes

Source: 2022 Stanford Search Fund Study



The Search Phase

Proprietary Search

- Start with and Industry Thesis
- Create a list of targets
- Call owners directly seeking engagement

Advantages

- Targets of specific industry/geography
- Non-Competitive situations
- Opportunity to engage with seller

Brokered Search

- Build network of business brokers
- Receive teasers for opportunities
- Participate in auction processes

Advantages

- Committed seller
- Information prepared
- Credible advisors



Let's look at some real teasers!

TROPICAL (the “Company”) is a 100 year old company providing clean room dust control services, uniform rental and repair, and commercial laundry services for pharmaceutical companies, healthcare providers and other commercial and industrial clients.

Overview



Large and Growing Market

Stable growth from the industrial market and more rapid growth within clean room end market



Recurring Revenue

Revenue model is recurring in nature, 70% of revenues recurring, with built in price escalations



Diversified Customer Base

Limited customer concentration risk, and demonstrated history of client retention



Market Leadership

Tropical has an estimated 35% market share in its region and there are strong barriers to entry



Team Continuity

Tenured leadership team, expecting full mgmt. continuity

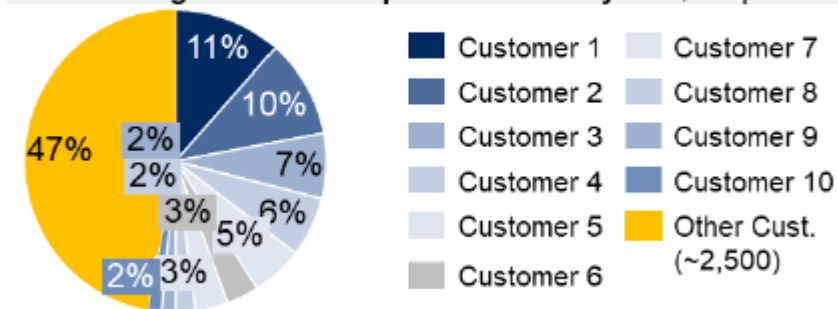


Opportunity for Add-ons

Deal team has identified accretive add-on acquisition potential

Highlights

Top 1 and 2 customers have been **doing business consistently with Target Co. for the past 30 and 20 years, respectively**



Financials

\$ in 000s	2019A	2020A	2021A	2022A	2023A	2024E	2025E
Revenue	20,860	17,045	23,164	28,219	30,080	32,137	34,344
Operating Expenses	10,820	10,505	14,116	15,511	15,267	16,980	18,076
Gross Profit	10,040	6,540	9,048	12,708	14,809	15,156	16,267
Gross Profit %	48.1%	38.4%	39.1%	45.0%	49.2%	47.2%	47.4%
EBITDA	\$ 1,961	\$ 567	\$ 2,116	\$ 4,189	\$ 5,514	\$ 5,880	\$ 6,434
EBITDA %	9.4%	3.3%	9.1%	14.8%	18.3%	18.3%	18.7%

This cash only Dermatology practice (cosmetic and medical) has been proudly serving an affluent area of Los Angeles since 1989. The owner works 20 to 25 hours per week, not excluding vacations and holidays.

Overview

The practice is General and Cosmetic Dermatology providing medical dermatology, wrinkle treatments, sclerotherapy, dermal fillers, skin checkups, and other services.

A top-rated medical practice, their core beliefs include customer satisfaction and safety.

The practice is owned by the onsite doctor and is supported by 3 employees.

Owner willing stay on post sale 6 months up to 2 years in current part-time basis.

The practice has been growing steadily.

It is SBA pre-approved

Highlights

Growth opportunities are accepting insurance, marketing (none today), expanding the services hours to a traditional 40-hour week.

- Owner's part-time hours: 20 to 25/week, and she is the sole doctor at the practice
- Business currently does not accept insurance - intentional strategy to keep margins high
- SBA pre-approved

Financials

	2023	2022	2021
GROSS SALES	\$ 2,407,468	\$ 2,230,206	\$ 2,116,892
GROSS PROFIT	\$ 1,958,770	\$ 1,829,511	\$ 1,734,252
DISC. EARNINGS	\$ 1,598,350	\$ 1,494,490	\$ 1,433,674

2023 Seller's Discretionary Earning 1.6M

2023 Adjusted EBITDA 1.2M

Industry – What to Seek or Avoid

Desirable

- Fragmented
- Growing
- Sizable—both revenues and number of companies
- Straightforward industry operations
- Relatively early in industry life cycle
- High number of companies in target size range
- Healthy and sustainable profit margins (EBITDA >15%)

Undesirable

- Highly consolidated
- Declining
- High competitive intensity / limited barriers to entry
- Complex / technologically intense
- High customer / supplier pricing power
- Unpredictable exogenous factors
- Working capital intensive
- Regulations constrain growth

Acquisition Target Characteristics

Good to Own

- Attractive industry characteristics
- Recurring revenue
- High margin
- Predictable earnings
- Low working capital / capex
- High % of EBITDA converts to cash flow
- Good management team
- Low customer, supplier, product, employee concentration
- Low cyclical / seasonality
- Clear path to growth

Good to Acquire

- Good price & structure for the risk
- Good seller profile
- Ability to finance
- You are excited to run it
- You can create value

Funding an Acquisition – Uses & Sources

EBITDA **2,000**

Deal from Seller POV

		Multiple	
Cash at close	8,000	4.0x	80%
Earn out	1,000	0.5x	10%
Seller Note	1,000	0.5x	10%
<hr/>			
Purchase Price	10,000	5.0x	

Uses

		Multiple	
Cash at close	8,000	4.0x	75%
Earn out	1,000	0.5x	9%
Seller Note	1,000	0.5x	9%
Working Capital	500	0.3x	5%
Fees & Expenses	200	0.1x	2%
<hr/>			
Total	10,700	5.4x	

Sources

		Multiple	
Sr. Lender	4,000	2.0x	37%
Line of credit (drawn)	500	0.3x	5%
Earn out	1,000	0.5x	9%
Seller Note	1,000	0.5x	9%
Equity	4,200	2.1x	39%
<hr/>			
Total	10,700	5.4x	

What Creates Value?

$$\text{EV} = \text{Cash Flow (EBITDA)} \times \text{Multiple}$$

Revenue Growth

- More to current customers
- New customers, products
- Raise prices
- Geographic, industry expansion

Margin Enhancement / Cash Generation

- Lower COGS, SG&A
- Add-ons + consolidation
- Reduce working capital
- Reduce financing costs

Market, Size & Scale

- Market Conditions
- Buyer Universe
- Available Capacity
- Technology

Risk Mitigation

- Key man / management team
- Customer / supplier concentration
- Systems & controls
- Reporting & metrics

ETA at Kellogg

- Courses
 - Intro to ETA 150 students / year
 - 200 level course(s) – coming Spring 25
 - EMBA ETA boot camp – tentatively Sept 13-14 in Miami
- Outside of Class
 - ETA club ~ 150 members
 - Zell Fellows – 11 students who will pursue ETA upon graduation
 - Booth Kellogg ETA Conference – 11/4/24
 - Entrepreneurship at Kellogg Case Competition
- After Kellogg
 - 10+ Students / year pursuing ETA post-graduation
 - 5+ Alumni / year pursuing ETA
 - 350+ Subscribers to ETA alumni newsletter

A few notable alums...

					
	Mike Smerklo '97	Lis Settini '98	Manny Saxena '18	Nikita Sunilkumar '17	Mark Maybee '05
Pre-K	 		Manufacturing Engineer		
Post K	 	 	SEARS HOLDINGS		
ETA			 		
Now	 				 

How Alumni Can Participate in ETA

- Search
- Join a Search Backed Company
- Hire a CXO
- Board Member
- Invest
- Speak at Kellogg
- Case Protagonist

Q&A

Where do I Learn More?

- Reach out to us
 - alex.schneider@kellogg.northwestern.edu
 - matt.littell@kellogg.northwestern.edu
- List of resources in the app