



“ A model like this is a great solution for the tens of thousands of faith-driven business owners who are looking for an exit after decades of hard work, but who don't want to give up the faith-driven culture of their businesses. ”

HENRY KAESTNER

HENRY KAESTNER

Managing Principal | Sovereign's Capital
USA



HENRY KAESTNER is a Managing Principal in Sovereign's Capital, a venture capital fund with offices in Silicon Valley, Washington DC, and Jakarta, Indonesia, that invests in faith-driven entrepreneurs in Southeast Asia and the US. Prior to co-founding Sovereign's Capital, Henry was co-founder and previous CEO, and then chairman of Bandwidth.com (NASDAQ:BAND) and its sister company, Republic Wireless (which spun out of Bandwidth in 2016). Together these companies have grown from \$0 to \$300 million in revenue. The values of Bandwidth.com have always been: faith, family, work, and fitness (in that order). From 2003 through 2007, Bandwidth.com was the fourth fastest-growing, privately-held company in the country, a position it achieved without acquisition or institutional funding. Prior to co-founding Bandwidth.com, Henry founded Chapel Hill Brokers (a predecessor to ICAP Energy), an institutional energy derivatives broker that became the top-ranked electricity broker in the country.

Henry has also been involved in a number of ministry and philanthropic activities. He co-founded DurhamCares, and was on the board of directors of Praxis, an accelerator committed to helping faith-driven entrepreneurs. He serves on the board of directors of Bandwidth,

CloudFactory, ThriveFarmers, First, and RevBoss.

Henry serves as an elder in the Presbyterian Church of America. He lives in Los Gatos, California, with his wife Kimberley and their three sons.

THE 321

3 people you admire (outside your immediate family and God)

- The Apostle Paul, whose holy ambition and zeal for the gospel blow me away
- David Morken (CEO Bandwidth), for his ability to lead and love
- CS Lewis/JRR Tolkien, for their ability to transmit God's truth to the world

2 things on your bucket list

- Go to the Holy Land with my family... hopefully also with a full complement of grandchildren someday.
- See my three boys and grandchildren (to be) walk with the Lord

1 unique experience that you've had

- Experiencing the joy of skiing through three feet of powder with my three boys

THE SEARCH FUND: AN ANSWER TO MAINTAINING CULTURE IN TRADITIONAL BUSINESSES

BY HENRY KAESTNER

The concept of the buy-out fund has been around for decades, if not centuries. The latest flavor of the buy-out fund, the “search fund,” has garnered an increasing level of press over the past few years. This is because of its ability to provide better investment returns than other flavors of private equity funds, but this is not the only thing that should make us all take notice. It’s the unique way in which “searchers” discover and acquire companies that make it a great model for marketplace transformation, and with time it might prove to be a very effective way to put money to work for God’s Kingdom while looking for solid investment returns.

Some Background

When we started Sovereign’s Capital (a venture fund family in the US and Southeast Asia), it was because of our belief that like-minded capital invested in a faith-driven entrepreneur might result in a company better equipped to love on its partners, vendors, customers, and employees in a way that pointed to something more significant than the manufacture and distribution of “widgets.” We believed, as do so many of you, that entrepreneurs fueled by the creation mandate and with their identity deeply rooted as a beloved child of God (not as the wunderkind of 20% month over month growth), might be a force for marketplace transformation on one hand, and on the other provide great financial returns for like-minded investors.

Through the grace of God, I think this thesis is being proved right. Don’t get me wrong—it’s too early to declare victory from the rooftops (other than THE victory). Still, we have seen that an entrepreneur whose hope is in the Lord can tap in this nuclear-like energy and lead businesses that scale, compete, and win in the marketplace.

We’ve seen this in Grab! in Southeast Asia, in CloudFactory in Nepal and Kenya, in FiveStars and ManCrates in the US, and in over 30 other businesses. What’s common among all of these businesses is what they are: fast-growing, venture-backed companies with valuations that are, at times, unbelievable.

Another commonality is what they are not: traditional, mainline, positive cash flow businesses that provide the marketplace and cultural fabric accompanied by valuations that can hold up at any stage of the economic cycle. It’s an issue of what is often thought of as dull/boring versus exciting/new businesses. The point of this white paper is that we (Sovereign’s) and a whole lot of others (as price is a function of supply and demand) have missed how traditional, “dull” businesses are such a great force for the Kingdom. We started our venture fund to help cultivate the Kingdom-affirming culture while the DNA was being set in the early days, then help that company and DNA scale to impact more lives and markets. We’ve come to realize that a complementary need in the marketplace is to find companies that have already scaled such DNA and are impacting lives in traditional companies, and invest with an eye toward maintaining those cultures that affirm human flourishing as founders exit.

Thus we intend to be a part of a larger group that aims to fix this, and in so doing, invest in a new generation of high capacity, faith-driven leaders. This also means investing in the businesses and communities in which they serve, all with an eye toward building enterprises for God’s glory, seeing hearts transformed by the gospel, and doing so at entrance valuations that allow for more cultural impact per dollar invested. Just as importantly, we believe that investing in this class of business can provide risk adjusted returns, at or above venture.

Search Funds: Better Returns and Spiritual Integration Because of a Unique Staffing Model

“Search funds” are fueled by “searchers”; typically these are newly minted MBAs who are looking to forgo the management consulting or investment bank tracks in favor of being a CEO of a company on day one. Not all new MBA entrepreneurs become searchers. Some young entrepreneurs, inspired by a new problem for which they feel uniquely situated to solve, head off to start the next big new SaaS business or Hyperloop competitor. We see these folks on the venture side of things where thousands of venture capital funds are eager to learn about (and then bid up) the next Uber or AirBnb. Others, however, are more interested in more traditional businesses—those whose value is established rather than aspirational. These are the entrepreneurs we are focusing on in this paper and in our new fund. The businesses these entrepreneurs will run come in all sorts and shapes, anything from restaurants to light manufacturing to distribution. Searchers understand and value a company whose product market fit was established decades ago, and who has shown a long history of delighting customers, providing meaningful employment and who has a history of being a valuable member of the industry and the village/town/city where it’s based.

How a Search Fund Works

Searchers typically raise funds to fuel their search by selling units in their new fund (effectively selling units in their career). This provides the searcher with a modest salary and expenses and gives each unit holder the right to convert their investment into equity in the new company as well as an option to purchase more, which provides the equity capital necessary for the acquisition. The searcher typically then ends up with 20-25% of the newco with the balance being split between the search fund investors and a small option pool for key employees.

Why It’s Better

The advantage of this model versus the more traditional buy-out fund is that it’s the searcher who finds the deal and establishes the all-important relationship with the seller/founder/outgoing CEO. This is the searcher’s dream job. They’ve found it and are therefore more likely to stick with it, perhaps dedicating their entire career to this company. The early relationship with management means they better understand the business they are buying and have relational equity with the outgoing leader. This provides mentorship as well as a smoother transition than would occur from a buy-out fund that recruits a new CEO post-transaction. The searcher then typically spends the next year learning from the former CEO and the senior management team before making changes too early that might compromise the standing of the company. The company then benefits from a searcher who knows the business and has new energy and ideas to grow the company.

We believe a model like this is a great solution for the tens of thousands of faith-driven business owners who are looking for an exit after decades of hard work, but who don’t want to give up the faith-driven culture of their businesses. These are men and women who are experts in their industries and leaders in their communities. With some level of earn out, they have every incentive to see the new owner prosper in the business. With the right type of Kingdom-minded seller, they should have additional incentive to invest in the discipleship of their successor as they are eager to see their business have the type of godly legacy that hopefully motivated them for their career.

We are committed to this model. We think there’s an opportunity to take it to a new level by bringing on board a team or cohort of searchers (perhaps 6-8) who can unite and take encouragement in shared purpose, combining the best attributes of a fellows program and its focus on discipleship with a YPO-type group that can provide community and encouragement both during and after the search process. Additionally, we believe that a fund (or a holding company for a more permanent capital model) that invests in searchers can provide additional benefits—from deal flow generation to procuring the networks of advisors—that can help the searcher through the transaction and beyond. Imagine a world of intergenerational friendships driving business forward around the globe for God’s Kingdom.