Deal Sourcing

Intermediaries, business development, and the future of private equity deal flow

Market Intelligence From:
Moelis Capital Partners
Kohlberg & Co.
Sentinel Capital Partners
Sutton Place Strategies

PLUS
Survey: What Intermediaries Want
Investment bankers and deal brokers reveal what they like and dislike in a private equity bidder
Editor’s Letter

No trend better demonstrates the maturity of private equity as an asset class than the rising number of professionals dedicated to sourcing deals—intermediaries and in-house business development experts.

This Privcap Special Report explores the roles of both professionals in the increasingly competitive world of PE deal sourcing.

First, the intermediaries. With proprietary deals scarce, intermediaries of all stripes have become fixtures of the private equity and broader M&A market, all the way down to the lower end of the midmarket. In surveying these professionals, we were interested in learning how they prefer to interact with private equity buyers, what annoys them about certain behaviors at the auction block, and what strategies they recommend for success as sale-process participants. We also asked them, to list, anonymously a few private equity firms that they feel to be exemplary bidders. I think you’ll find the results to be fascinating.

The intensity of the hunt for an edge in the deal market has given rise to a new job title within private equity firms—head of business development. We brought together three such professionals to engage in a candid and informative conversation about what they do, why their firms brought them on board, and the broader trends in private equity that require firms of all sizes to be more systematic about sourcing deals. You won’t be surprised that LPs care greatly about differentiated deal sourcing, and that the presence of a head of BD is welcomed by many of them.

Deal sourcing is a key function of the private equity firm. Privcap welcomes your ideas about ways we can explore the topic more thoroughly in the future.

Enjoy the report,

David Snow
CEO & Co-founder
Privcap
@SnowsNotes

In This Report

The Deal Whisperers
Amid increased competition for deals, some PE firms have added business development professionals. Three from Kohlberg & Co., Moelis Capital, and Sentinel Capital discuss what their roles add to deal sourcing.

Videos:
• PE’s Secret Weapon for Relationship Building
• Standing Out in a Competitive Market

What Intermediaries Want
A Privcap survey reveals that in dealing with private equity bidders, intermediaries value pricing…and honesty.

Why the PE Market Is Talking About Deal Sourcing
Deal sourcing is becoming increasingly critical for firms, says Nadim Malik of Sutton Place Strategies.

From the Archives
A selection of videos from Privcap’s archives.
The Deal Whisperers

Some PE firms have upped the ante on deal sourcing by adding a head of business development to foster relationships. Three of these professionals from Kohlberg & Co., Moelis Capital Partners, and Sentinel Capital Partners discuss their roles and the importance of differentiation of firms.

Bios

Andrew Bonanno is managing director of business development at Kohlberg & Co., a firm he has been with since 2009. He was previously a vice president of business development for the New York–based buyouts team of American Capital and has also worked for GE Equity. He received degrees from Connecticut College and Washington University.

Lex Leeming is a principal and head of business development at Moelis Capital Partners. Previously he was a principal with middle-market buyout fund Park Avenue Equity Partners and worked in strategy and marketing at American Express. Leeming received degrees from Tufts University and the Kellogg School of Management at Northwestern University.

Luke Johnson is senior managing director and head of business development for Sentinel Capital Partners. He previously spent 12 years at Platinum Equity, most recently as a principal and global head of business development, and was also a director at Kroll Associates. He received degrees from Pepperdine University and the University of California Los Angeles.

This expert discussion is based on the following Privcap video programs:

1. PE’s Secret Weapon for Relationship Building
2. Standing Out in a Competitive Market
Business Development Trend Grows

In the past 10 years, more private equity firms have added the role of head of business development as they try to bolster deal sourcing efforts.

“At its simplest level, we’re in charge of sourcing investment opportunities,” says Lex Leeming, principal and head of business development at Moelis Capital Partners. “But really, the role comprises the opportunity to be sort of an ambassador for the firm.”

The role also encompasses relationship management and trying to identify deal flow, along with making sure the firm is relevant to the intermediary universe.

“I look at my role as sort of architecting and playing air traffic control...in terms of all of the third-party intermediary relationships out there which are flowing us deals on a regular basis,” says Luke Johnson, senior managing director and head of business development for Sentinel Capital Partners.

While the position is effectively a sales force for firms, with relationship management thrown in, Andrew Bonanno of Kohlberg & Co. says they view it differently.

“I work with our operating partners and a deal partner to develop a thesis around a subsector within the five industries that we cover, and then try to proactively originate opportunities that are intermediated or proprietary,” Bonanno says.

Differentiation Is Key

With so many middle-market private equity firms, it’s important for intermediaries to see unique capabilities—something different or special.

“Being able to differentiate yourself in what is now a very efficient, very transparent market is absolutely critical,” Leeming says. “There’s so much money coming into the asset class. There’s so much money chasing very few really attractive deals.”

The track record for partnering with management teams is the differentiator that Sentinel Capital tries to impress on prospective targets.

“In those situations, a lot of the time, we’re bringing more than just that capital to bear,” says Johnson. “We’re bringing our operational expertise, our ability to put in place the right systems and processes to help scale companies.”

Bonanno says that Kohlberg goes through a process of writing proprietary white papers to “elevate the IQ of the partnership...develop our angle. And then, when we go out and speak with specific industry bankers, we say, ‘This is what we’re looking for.’”

In the end, the business development professionals at a PE firm are not there to take the place of deal partners but to complement them and manage relationships.

“We’re responsible for institutionalizing those relationships and making sure that this air traffic control, the right and left hand, are communicating and coordinated.”

—Luke Johnson, Sentinel Capital Partners

“I work with our operating partners and a deal partner to develop a thesis around a subsector within the five industries that we cover, and then try to proactively originate opportunities that are intermediated or proprietary.”

—Andrew Bonanno, Kohlberg & Co.

Deal Sourcing Style Matters

As the PE deal market has become more transparent and efficient, limited partners have started caring more about how a general partner sources its deals.

If you have a fantastic fund, “LPs want to know that you have the mechanisms in place to re-create that deal flow,” says
Moelis Capital’s Leeming, “that it’s not just a one-hit wonder.”

While there may be a perception among LPs that proprietary deals exist, that isn’t necessarily the case.

“I personally have never seen a proprietary deal, and I’ve been doing this for 14 years,” says Sentinel’s Johnson. “In such a competitive environment today, a seller really has a fiduciary responsibility to at least talk to two people.”

Tapping into connections from college or elsewhere may no longer work to source deals.

Kohlberg’s Bonanno says that he thinks about his business as 80 percent of the deal flow coming through intermediated channels, with the other 20 percent coming from the firm’s white-paper initiative. “I believe that leads to a lot more of these one-off conversations, limited processes, and as we’ve tracked it, we’re seeing results,” he says.

Traveling the country talking to bankers, visiting conferences and trade shows, helps Johnson develop intelligence and information that he uses to create a thesis and drive some deal opportunities as a result.

“Not only are we the ambassador externally, selling our firms and our value propositions,” Johnson says, “but it’s incumbent upon us to also sell internally to our deal partners.”

“I don’t think we need a lot of talent coming into the country. What we need is more technology; we need companies with expertise.”

“Being able to differentiate yourself in what is now a very efficient, very transparent market is absolutely critical. There’s so much money coming into the asset class.”

—Lex Leeming, Moelis Capital Partners

DON’T MISS THE ENERGY EVENT OF THE YEAR

PRIVATE CAPITAL AND THE TRANSFORMED NORTH AMERICAN OPPORTUNITY

DECEMBER 11th 2014
THE HOUSTONIAN, HOUSTON TX
A PRIVCAP MEDIA EVENT

New technologies have profoundly changed the game in the North American energy market, opening up once inaccessible deposits of oil and gas to vast new possibilities and realigning the interests of a continent.

What do these changes mean for the private capital investment opportunity?

FOR MORE INFORMATION, VISIT PRIVCAP.COM/ENERGY2014
What Intermediaries Want

A joint Privcap/Sutton Place Strategies survey reveals that in dealing with private equity bidders, intermediaries value pricing, but also a track record of honesty.

What do the intermediaries think of your firm? What influences their decision to invite you to a sale process, to let you through to the next round of bidding, or to speak well or ill of you to their clients?

Price is an important factor, but it’s not the only one. Investment bankers, deal brokers, and other intermediaries want to do business with bidders who can quickly offer either credible indications of interest or a fast “no.”

These views are clear in the results of a recent survey conducted jointly by Privcap Media and Sutton Place Strategies, a leading provider of deal-sourcing intelligence.

In July, we reached out to a group of mostly U.S.-based middle-market deal intermediaries and asked them to anonymously answer a series of questions about themselves, their experiences, and their preferences in dealing with private equity firms. The results are below.

We also asked them to list any firms that in their experience “consistently demonstrate integrity, expertise, and professionalism in the sale/auction process.” The firms that were most commonly listed are featured at the end of this section.

Finding 1:

Inbound/Outbound Agnostic

Are your relationships with private equity firms created from inbound or outbound efforts? Respondents were asked to select one.

- Majority from inbound
- Majority from outbound
- About half inbound and half outbound
Finding 2: Just Email Me

With regard to receiving communications from private equity firms not related to specific sale processes, what forms of communication do you prefer? Respondents were asked to rank each option by preference.

- Communication via email
- Occasional scheduled in-person meetings
- The occasional phone call
- Impromptu networking and meetings at industry events
- Useful research, market views, and engaging content
- Marketing brochures via emails, in-person meetings, or conferences
- Consistent phone calls/emails or scheduled in-person meetings
- Accurate and up-to-date information in online databases
- None

Finding 3: History Matters

How much of a role does history with a private equity firm, as either a buyer or seller in a transaction, play when determining whom to invite or advance in a new sale process?

- Very relevant
- Somewhat relevant
- Not relevant
Finding 4:

**Honest Valuations, Please**

In running a sale process with private equity firm participants, what attributes do you most value and appreciate on the part of these PE participants? Respondents were asked to rank in order of preference.

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Honest expressions of valuation and intent</td>
<td>8</td>
</tr>
<tr>
<td>Quick responses</td>
<td>9</td>
</tr>
<tr>
<td>Thoughtful questions/insights into target company's operations and strategy</td>
<td>7</td>
</tr>
<tr>
<td>Thoughtful engagement with management team</td>
<td>4</td>
</tr>
<tr>
<td>Useful research, market views, and engaging content</td>
<td>5</td>
</tr>
<tr>
<td>Proposed deal structure/ease of close</td>
<td>3</td>
</tr>
<tr>
<td>Deployment of ample due-diligence resources</td>
<td>6</td>
</tr>
<tr>
<td>Long-term vision for company</td>
<td>2</td>
</tr>
<tr>
<td>Proposed management retention strategy</td>
<td>1</td>
</tr>
</tbody>
</table>

Finding 5:

**Price, Then Personality**

What factors help a private equity bidder win the deal? Respondents were asked to rank in order of importance.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest bid</td>
<td>10</td>
</tr>
<tr>
<td>Personality fit with management behavior during auction</td>
<td>9</td>
</tr>
<tr>
<td>Rapidity and professionalism in due diligence and bidding process</td>
<td>8</td>
</tr>
<tr>
<td>Strategic vision impresses management</td>
<td>6</td>
</tr>
<tr>
<td>Network/operating resources made available post-acquisition</td>
<td>5</td>
</tr>
</tbody>
</table>
Finding 6:  
**Valuation, Then Size**  
What are the main reasons potential bidders decline deals? **Respondents were asked to choose all that apply.**

- Lack of growth potential of business
- Valuation
- Quality of management
- Sector not relevant for bidder
- Size of company not in bidder’s range
- Lower profit margins

Finding 7:  
**Phony Bids Rankle**  
What do you find most annoying/troubling in a sale process on the part of PE bidders? **Respondents were asked to rank in order of most annoying/troubling.**

- Disingenuous indications
- Slow or incommunicative participation in the process
- Poor personal interaction with seller/management team
- Tactics that undermine or attempt to disintermediate the sale process
- Evident lack of insight into market and business strategy
Finding 8:  
**Sellers Want Big Auctions**

How often does a seller request a quiet or limited process when selling its business?

- Less than 20% of the time
- 20-40% of the time
- 40-60% of the time
- 60-80% of the time
- Over 80% of the time

Finding 9:  
**Show Me the Funding**

When running a limited process, what factors are most relevant in determining whom to invite as a potential buyer? *Respondents were asked to check all that apply.*

- Highest certainty of close from a funding perspective
- Prior relationship with PE firm as a buyer or seller
- Relevant firms that have been most acquisitive in recent history
- Direction of seller regarding whom to invite
- Longevity of relationship and consistent outreach by PE firm
- Are trying to win business to represent firm in another sale process
Finding 10:

Ten Firms That Inspire Trust

Name up to 10 private equity firms that consistently demonstrate integrity, expertise, and professionalism in the sale/auction process.

The following nine private equity firms were mentioned three or more times by intermediary respondents. Listed in alphabetical order.

Audax Group
Clearview Capital
H.I.G. Capital
Huron Capital Partners
Linsalata Capital Partners
Pamlico Capital Partners
The Riverside Company (Cleveland/NYC)
Riverside Partners (Boston)
Sun Capital Partners
The Sterling Group

Honorable mention: These firms were mentioned twice by intermediary survey respondents. Listed in alphabetical order.

BB&T Capital Partners
Blackstone Capital Partners
Blue Point Capital
Bregal Partners
Charlesbank Capital Partners
Gridiron Capital
Riordan, Lewis & Haden
Saw Mill Capital
TA Associates
WestView Capital Partners
Windjammer Capital Investors

*This survey is based on questionnaires filled out by 41 deal intermediary professionals.
LPs are more interested than ever in how GPs find their deals, says Nadim Malik of data and analytics firm Sutton Place Strategies. This is creating a surge in the number of deal intermediaries and PE firms hiring internal-business-development professionals.

**Bio**

Nadim Malik, Founder and CEO, Sutton Place Strategies, founded his firm in 2009, with the core business of deal-origination analytics, providing data to private equity and mezzanine lenders. He was previously a vice president of business development at American Capital Strategies. Malik received a bachelor’s degree from Colgate University.

Privcap: Why are so many people talking about private equity deal sourcing?

**Malik:** You hear a lot of talk in the private equity industry about it becoming a very efficient and mature market, and that may be true in certain areas of private equity. It’s certainly not the case when it comes to deal sourcing. There’s a lot of opportunity for a private equity firm to capture the minds of boutique advisers, to see deals that others aren’t seeing. Deal sourcing is becoming more competitive and more critical in the private equity industry, and it’s not a trend that’s going to change anytime soon.

**What are investors asking GPs about deal sourcing?**

**Malik:** I spoke to a partner at a fund that just closed its fundraising, and he described to me how this time around they spent a lot of time describing to their LPs the institutionalization of their business development and deal sourcing, so that if any one person or something else were to change within the firm, the overall strategy wouldn’t be harmed. LPs have a greater appetite for co-investing and direct investing than ever before. So a private equity fund that can come in and show a higher share of market coverage and more proactive, thorough deal sourcing strategy—and essentially access to deal flow that others do not have—can really differentiate themselves in the eyes of their investors.

**How many intermediaries are now active in North America?**

**Malik:** According to our data, in 2013 there were 750 different sell-side intermediaries that closed at least one sale of a business of $5M to $10M in enterprise value or greater in the U.S. or Canada. And there were about 2,100 different professionals at those 750 intermediaries who worked on those deals. Breaking that landscape down further: Of those 750 intermediaries, 75 percent did three deals or less. So from an activity standpoint, you definitely have a concentration at the top of the league table with well-known firms and investment banks and financial advisers doing dozens of deals, in some cases. On the other end, you have this long tail of boutique advisers doing five, four, three, two, one deal a year.

**There are an increasing number of business-development professionals in PE firms. Why do you think that is?**

**Malik:** Seven or eight years ago, there were probably around 40 firms that had a person dedicated to this role. This is someone who’s spending a majority, if not all, of their time just sourcing deals. Today it’s more than 300—and maybe even 400—firms that have someone dedicated to this role.

When the professionals doing deal execution are in investment mode, they are typically head down, trying to get a deal done for four, maybe 12 straight weeks. During that time, they’re not really focused on marketing or deal sourcing or relationship building. They’re going to come up for air after that time ... then they have to restart the marketing engine and look for their next opportunities. If they had a business-development professional, they would have kept the funnel going and had countless opportunities that they otherwise would have missed. So intuitively there are clear advantages to having someone in that role.
From the Archives

HUMAN CAPITAL & CAREERS

The Story of Riverstone
Riverstone Holdings co-founders Pierre Lapeyre and David Leuschen discuss wanting to be known for energy rather than PE, and the unforeseen shale revolution.

Carnegie’s Diversity Challenge
Private equity plays an integral role in the portfolio of Carnegie Corporation, says co-CIO Kim Lew.

MIDDLE MARKET

Creating Value in the Canadian Middle Market
Canadian companies face challenges that are pronounced in the middle market, says Thecla Sweeney of Birch Hill Equity Partners.

How Corinthian Does Business
Corinthian Capital Group’s Kenneth Clay discusses their middle-market expertise, sourcing entrepreneurial companies, and a recent exit.

REAL ASSETS

Deal Stories: Emerging Markets Infrastructure
Our panel of experts from Pembani Remgro, IFC, and NSG Capital tells of investments they’ve made in the infrastructure of emerging markets and how they performed.

How Small Institutions Tap Private Equity
Martin Day, a partner in Canadian firm Caledon Capital Management, describes what it takes for smaller institutional investors to successfully allocate to PE.