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Deal Sourcing — It's Not So Binary

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Some investors refer to the lower middle market as the "dark web."

- New deals are tough to find.
- Closed deals are not always in a press release.
- Advisors on those deals don't necessarily have informative websites (many don't have websites at all).

Consider this scenario. An investor in California ends up seeing a deal from an intermediary in Maine. How does that happen?

The advisor and company founder may be family. They may have grown up together. They may have met on vacation. After all, this is a relationship-based business, and relationships occur in an infinite number of ways.

When sourcing deals, it's tough to account for and take advantage of the seeming randomness of the lower middle market.

Take this story.

Three years ago, when traveling to a small town in Arizona, a boutique investment firm I work with took the time to meet a small M&A advisor. They already knew the advisor would **not** be their most regular source of quality deal flow. The advisor did no more than 3 deals a year and was made up of two professionals who had jumped ship from a larger bank.

This meeting was a surprise to me, because in all my time working with this investment firm, they thought about origination from a very binary perspective:

- How many deals did we see this year?
- How many did we take a second look at?

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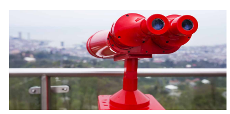

(http://www.axial.net/forum/2016-ma-sector-outlooks-whats-hot-and-whats-not/)

- How many meetings resulted from those deals?
- How many LOIs did we sign?
- How many deals did we close?

They were living with "Excel Head," as one of my clients describes it. Their outreach focused almost exclusively on larger, brand-name intermediaries who they knew would have a steady stream of deal flow.

So what changed? Why did they decide to reach out to the small Arizona advisor?

For the first time in their history, this investment firm had hired a business development professional — let's call her Laura. Her goal was to access a different channel of deal flow, nurturing relationships with smaller intermediaries — i.e., the **non**-Lazards and **non**-Harris Williams.

Laura reached out to this new audience with the desire to connect, despite knowing that their deal flow wouldn't have the volume or consistency of bigger household names.

Within the first year of an initial meeting with the Arizona advisor, Laura periodically got in touch in one of three unique ways.

1. She recommended other investors for deals in sectors her firm did **not** invest in.
2. She provided valuable market information, such as lesser-known conferences she thought the advisor would be interested in.
3. She relates to the intermediary on a more personal level by sharing articles on topics like health or even good vacation spots.

What she did **not** do was send a generic email on closed deals made by her firm.

She treated the advisor less like a sales opportunity and more like a peer. If she wanted to inform him about a closed deal, she personalized the message, differentiating it from the dozens of other "closed deal" emails the advisor received from other investment firms. In short, Laura was making a friend, building a relationship for the long term.

So, year one goes by. No deals are seen from the advisor.

Year two rolls around, still nothing.

At this point, from an objective view, it doesn't look like the advisor is worth staying in touch with, at least not very regularly. But Laura continues to connect with them.

Year three rolls around. Laura gets a call.

The Arizona advisor had something to discuss.

The company was a $20M EBITDA, privately held, founder-owned packaging company, in the health & beauty sector.

- The owner was looking to retire.
- The owner was looking for the right partner to take care of his family legacy.
- The owner was looking for expertise.

Taking a step back, how does such a small advisor get their hands on such a large company?

Well for one thing, **the 2014 SEC No Action Letter (http://www.axial.net/forum/sec-action-letter-2/)** means private company advisors don't need to register with the SEC as broker-dealers.

Result? Low barrier to entry. Proliferation of new advisors.

Secondly, why would the owner have this small advisor sell his company for him? Why not call Harris Williams or William Blair?

For the same reason the advisor called Laura with the deal. **Trust. Expertise. Personal relationship (http://www.axial.net/forum/the-new-proprietary-deal-flow/)**.

Laura was the first call.

Laura was the last call.

The deal closed.

But without Laura's persistence, the investment team would have never seen that deal.

Now, some skeptical investors might still want to know how many deals they saw last year and the year before that. So the small advisor really wouldn't qualify to be on their list. So why should they waste their time? Fair point.

The thing is, those investors are suffering from a **short-term view**. What about 4 years, 5 years from now? One unique investment could be the best investment in firm history, generating **record-breaking returns**. But such a mindset requires patience. It requires creativity. It requires a **long-term view**.

Such patience is a burden, but its fruit is sweet.

So, what's the takeaway?

If you're an investor, it's great to think with your binary hat. You need to generate returns. However, if you're running marketing and business development, it's time to wear a different hat. Your relationship hat. Your personal hat. Your long-term hat.

Your ROI will thank you.

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***By Jordan Meltzer, University of California Riverside* | *January 14, 2016* ()**

(http://www.axial.net/forum/introducing-reverse-search-funds-a-win-win-for-investors-founders-and-mbas/)

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