

Creating Deal Flow in the M&A Marketplace

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Those involved in the M&A business will find the next year or so very challenging, whether they are principals such as strategic or financial firms, or agents such as intermediaries.

Aside from the three obvious economic factors, i.e., the sagging economy, the credit squeeze and the underperforming stock market, there are several other factors affecting the M&A marketplace for the foreseeable future:

- less companies coming to market to be sold which means fewer transactions
- valuations for companies being sold will be slightly less, but not by a lot
- not only has there been an

increase in middle market investment banks and private equity groups over the past five years, but Main Street business brokers are moving up market with considerable success

- approximately half the companies sold are done so without the use of an investment banker or broker
- the more successful M&A firms will be engaged by roughly half their clients outside their immediate region because of their industry specialization and/or competitive forces.

For all of the above reasons, both principals and agents in the M&A business must concentrate in 2008–2009 in creating more deal flow as business is getting tougher ...not easier.

Improving Your Business Relationships

The M&A business is all about relationships; it's a people business. Most graduates of MBA programs will tell you that the biggest benefit in later life from the graduate school is not the knowledge obtained from the courses, but the personal relationships resulting from their interaction with their classmates. Sourcing deals is like getting a new job...60% of jobs are created by personal connections.

Some of the strongest relationships result from quid-quo-pro where frequently one has to "give in order to get." Back in the late eighteenth century, when books were relatively rare, Ben Franklin would lend one of his cherished books to businessmen who he wanted to nourish. By obligating his business friends to him, Franklin received favors in return.

Not all people in a M&A firm are going to be good at generating deal flow, partly because their strengths are elsewhere such as analytical, organizational, computer-savvy, etc. Good baseball teams utilize different talents for different positions. However, when it comes to deal generation or rainmaking, your chances of success improve substantially if you are a TYPE A person. The latter implies such basic characteristics as

- 1 do what you say you are going to do;
- 2 return phone calls/e-mails;
- 3 respond quickly;
- 4 graciously thank people;
- 5 follow-up, etc.

Creating Deal Flow in General

One should take a long-term perspective in the M&A business as it pertains to creating deal flow. Many years ago when attending The Kellogg Business School's Merger Week program, one of the Kraft division presidents said that as a strategic buyer, he

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Lessons Learned: Strategic Planning and Execution for the New CEO

by **Steven Chilinski**

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Over the years, I have been CEO and “skin-in-the-game” investor in several middle-market manufacturing companies owned by premier private equity firms, such as Bain Capital, Parthenon Capital, and American Securities Capital. Two recent engagements were most challenging and good strategic planning case studies: the rejuvenation of an industrial dryer company with five years of double-digit declining order trends, and a healthcare instrumentation manufacturer

with prior year revenues down almost 10%. After a strategic overhaul of both companies, two divestitures, organizational realignments and focused execution, orders at the industrial dryer company grew at a 15% compounded rate over the following 3 years, and revenue trends at the healthcare products company quickly turned to the positive, posting a 5% sales increase in only 12 months. Before getting into lessons learned, however, I recall early in my career and just before starting my first CEO assignment, a business mentor offered me sage advice which, at the time, seemed rather simple but one I have applied in all the businesses I have managed:

- 1 hire and nurture great people,
- 2 make sure there is a unique defensible strategy and
- 3 identify three or four vital initiatives and focus on them incessantly.

Following this seemingly simple advice has helped me breathe new life into underperforming businesses and drive dramatic improvements in operating productivity. Following are some observations and highlights relating to the second point of this leadership mantra: designing and executing a unique defensible strategy.

The 100-Day Strategic Plan

New leadership generates a broad spectrum of feelings and reactions in an organization ranging from enthusiastic anticipation of growth and prosperity to concerned angst of unknown changes on the horizon. Quickly rallying

management and employees around a meaningful common vision not only helps unite the organization, but also creates a positive environment for change. Setting an aggressive 100-day timetable for completing a strategic plan builds a unified and motivated executive team and generates early momentum.

Meeting a 100-day planning timetable rests squarely on the shoulders of the senior management team, with shareholders and directors serving as a valuable sounding board. Given the management teams’ direct link to the market and operations, they are best able to analyze and assimilate the key drivers of strategy: customer needs, differentiation, competitive advantages and core competencies. This comment may seem obvious but there are instances where non-operating directors and investors have injected themselves too forcefully in planning discussions to the detriment of the process. To facilitate planning, a 3 to 4 day off-site retreat, gathering all functional domestic and international executive management members, creates an effective environment for brainstorming and team building. A highlight of one retreat, I remember, was a late night epiphany when a new strategy was formulated transforming the industrial dryer company, which in the past focused solely on selling large equipment, into an organization of “thermal processing experts providing quality products and services over the complete life-cycle of customer applications”. Adopting this new

application life-cycle strategy led to dramatic 17% and 20% increases in world-wide equipment and aftermarket orders in the second and third year following implementation. Astounding the team and ownership was the magnitude of our equipment life-cycle opportunity when our planning uncovered that this sleepy \$50 million revenue company had a massive \$1.1 billion world-wide equipment installed base of which only 30% was on our radar screen for aftermarket service.

4 Elements of an Effective Strategic Plan

Even though millions of companies have developed strategies over the decades, amazingly, a strategic plan still represents many things to many people, ranging from a 100-plus page analysis to a simple 5-year financial projection. The most effective plans have 4 key elements.

—Simplicity:

Long-winded statements using consultant-speak accomplish nothing. A succinct definition of direction and how to get there are crucial, especially since virtually all employees, to varying degrees, will be held accountable for, and measured by, the successful execution of the business strategy. Complexity and ambiguity are the enemy of execution.

—Clarity of the End Game:

The esoteric and often used “maximize shareholder value”, though certainly worthy, does not provide sufficient clarity to stakeholders, especially employees. The end game of

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a strategy needs to be stated in the context of a company's business, and should be actionable and measurable. For instance, the measurable goal of the healthcare products company was to "become the #1 promoted instrument brand of all key customers in three years".

— Define the Target Market: Market opportunities are boundless. To ensure optimum resource allocation (both human and monetary), a precise definition of target market and customer is paramount. Daily, the Wall Street Journal has companies announcing divestitures and asset write-offs due to past pursuits of opportunities that may have had sound financial justification at the time, but ultimately deviated from the core business.

— Determine Defensible Competitive Advantage: The essence of a sound business strategy is a defensible competitive advantage linked with a compelling customer value proposition—Why will customers want to buy from us and only us? The healthcare products company created a strong defensible position by negotiating exclusive agreements with critical suppliers that guaranteed sole sourcing of the highest quality instruments—a prerequisite for selling to the surgical specialist market.

Execution: Aligning Operating Initiatives with Strategic Plans
Great strategic plans are dead in the water without the right talent and a system to ensure supporting operating activities

are being executed. An effective system I have employed connects strategy with operating activities as follows: Strategy → Critical Initiatives → Action Items.

A corporate strategy typically aligns with 6–8 supporting "critical initiatives". Executing these critical initiatives is supported by identifying and monitoring specific measurable action items, assigning responsibilities, completion dates, and creating a meaningful performance award system. An action item for the industrial dryer company was "improve on-time parts shipments from 45% to 98% in 12 months" (impressively the goal was achieved in seven months). Monitoring the status of action items provides valuable insight into levels of management performance, policy issues, organization problems and other road blocks that need to be quickly addressed to continue progress toward strategic goals. By design, completing action items achieves critical initiatives and ultimately the company's overall strategy.

Acclaimed executive coach and advisor, Ram Charan observes, "An edge in execution comes from having the right people in the right jobs, synchronizing their efforts, and releasing and channeling their energy toward the right set of business priorities". Strategic plans provide the road map for gaining this edge in execution, but ultimately success lies in selecting the right business priorities, hiring the right people, and staying aligned and focused, or more simply "getting the job done". ■



Why Consider "Skin-in-the-Game" Hiring for your Middle Market Portfolio Companies?

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- "Skin-in-the-game" executive vacancies in middle market portfolio companies typically attract much better qualified and more interested candidates willing to invest up to \$300K, presuming growth opportunities are legitimate and equity valuation at exit for attaining EBITDA targets are potentially lucrative.
 - Overwhelming majority of "skin-in-the-game" executive hires remain with their PE ownership until the portfolio company's exit strategy is successfully implemented and seek to do another successful "deal" with them.
 - Equity investment plus sweat equity opportunity & the chance to profitably grow a middle market portfolio company mean more to "skin in the game" CEO hires, per se, than huge starting salaries, expensive perks like autos & big relocation packages.
 - "Skin-in-the-game" executive candidates expect thorough, two-way due diligence and understand they must provide more professional references, accomplishment exhibits and comprehensive background info on themselves.
 - "Skin-in-the-game" executive hires are willing to share the risks up front with the PE ownership and do not require "high maintenance" and will treat the business like it was their own versus "yours".
 - Qualified and interested former big company P&L managers typically prefer driving a "skin-in-the-game" Ferrari than the bureaucratic and political "Lincoln Town Car".
- For more information on Gilreath proven "skin-in-the-game" hiring process, contact Jim Gilreath today.

SOS Response to Your Turnaround Crisis

by **Jim O'Connor** | founder and president, The O'Connor Group, Inc. | **p** 781-254-9917 | **e** jimo@theoconnorgroup.com | **w** www.theoconnorgroup.com



Pick up any financial publication, scan the headlines, and see how worrisome the news is to anyone owning or responsible for running a business in 2008.

U.S. Economy will stumble along until 2010, IMF says.— report calls situation “worst since the great depression”
USA Today

“Fed Minutes Reflect Worries about Downturn”
Wall Street Journal

“The Nation is in the Throes of a Recession”
Ex-Fed Chief Alan Greenspan

“Crude Closes at New Record”
almost any publication at least twice a week

Successfully managing a business is tough, and because of the current economic trends

affecting all business, it will only get tougher. And the irrepressible optimism of the entrepreneur and leading executive will cause him/her to intentionally ignore that idea that businesses will fail. Oh to be sure, folks think that a business failure is something associated with “other companies”. They say, “Oh come on now it’s never going to happen to my company.”

Perhaps this is what the owners and managers of Aloha Airlines and ATA Airlines thought just before they filed for bankruptcy and ceased operations. And what about the recent bankruptcy filings of the large national retailers, The Sharper Image and Linens 'n Things? Will they too cease operations in the near future? Can we ignore the hundreds of manufacturers who have closed their doors

over the last decade? No. Business failure is what happens to others, right? Wrong.

There are no simple solutions when it comes to fixing underperforming and failing businesses. But at the very least, equity holders as well as management would benefit greatly by working with a qualified and proven turnaround professional who makes their living by helping struggling companies.

As previously profitable and healthy companies need to improve their financial performance, the ability to have an expert, a Certified Turnaround Professional, working with management could make the difference between a revived, profitable company, and another of the many corporate failures that routinely make the headlines of America’s business publications.

“Why an outsider?”

Often, you can recover with the current team in place, but the risks of failure can be great. Bringing in seasoned and proven turn around professionals would be well worth the cost to get your company back on track. Time is a critical success factor for business recovery. An experienced Turnaround Professional will guide the company through the recovery process, with a firm hand, but also with an open

mind. Working with troubled entities for many years, your consultant should act like an orchestra leader to the current management team.

This “orchestra” will “sound” and operate better by combining the specific company and industry experience that the incumbent management team has with the specialized and focused turnaround skills that your consultant brings to the table.

The advantages of bringing a fresh perspective to your team will allow for improved performance within the first quarter. Because your Turnaround Professional will not be saddled with any inherited baggage, or need to be defensive of past decisions, he will be able to move the most serious issues facing the business forward with speed and certainty.

Psychological Stages Are Barriers

Most of us have heard of the stages of grief as: Denial, Anger, Bargaining, Depression, and finally Acceptance. Troubled companies often experience the same stages as they face the demise of the organization. Often the equity holders, company management or even the Board of Directors spend much too much time in the first stage, the stage of denial. In the world of troubled companies, the denial stage, will

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What is Sustainable Resource Ventures?

by **Schuyler ("Sky") Lance** | managing principal, Sustainable Resource Ventures | p 978-369-5043 | e sky@sustainvc.com | w www.sustainvc.com

Sustainable Resource Ventures makes investments in the early and expansion stages of companies that provide social and environmental benefit to the world. We target these "triple bottom line" companies primarily in the areas of:

- Food and Organics
- Health and Wellness
- Energy and Environment
- Education and Media
- Community and International Development

Sustainable Resource Ventures manages a series of venture capital investment funds through a program called the Patient Capital Collaborative (PCC).

The Patient Capital Collaborative

The Patient Capital Collaborative (PCC) is a series of committed funds designed to invest in companies that apply for financing through Investors' Circle, a national association of accredited investors who provide "Patient Capital for a Sustainable Future." Through the PCC, Sustainable Resource Ventures invests as the lead or participant in rounds of equity and equity-related securities as small as \$500,000 and

as large as \$5,000,000.

The PCC is funded by its Limited Partners—primarily high net worth individuals, many of whom are successful business entrepreneurs and leaders in the field of sustainability.

Why is it Called a "Collaborative" Instead of a "Fund"?

The PCC is unique in that it draws upon its LPs to assist in due diligence. When looking at a recent renewable power generating company, for instance, the PCC drew not only upon the experience of its GP, but upon the experience of:

- A mechanical engineer
- A past consultant in McKinsey's energy practice
- An investment banker from a boutique investment bank that focuses on socially responsible, environmentally friendly enterprises
- The retired founder and CEO of a major high tech company (with an engineering degree from MIT)

... all of whom are LPs or active members of Investors' Circle looking to participate in the investment opportunity.

Moreover, the PCC's Investment Committee

consists of seven of its LPs—leading business people and investors in the field of "future sustainability."

How Does Sustainable Resource Ventures Get Deal Flow?

Deal flow for Sustainable Resource Ventures comes primarily from two sources:

- 1 The Investors' Circle application/screening process; and
- 2 Word of mouth—deals that come from the GP's "green investing" networking and 25 years of investment contacts.

Investors' Circle Application/Screening Process

Investors' Circle (IC) receives approximately 650 applications per year from companies seeking early-stage funding. The IC staff (offices in San Francisco and Boston) screens those applications using broad measures to determine their



suitability to be shown to the Investors' Circle membership. In particular, the IC staff is looking for meaningful social and/or environmental benefit in the companies' product and service offerings. About half the applications received pass through this initial "top level" screen.

For those companies that are invited to continue through the process, a three-page summary of the company is posted online for IC members to view. At this point IC members (including Sustainable Resource Ventures and the PCC) are free to contact any company in which the member has an interest in potentially investing.

Of particular note, IC sponsors two conferences each year (Boston in November and San Francisco in May), and all the "posted" companies are fur-

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often last for years, nay even decades. How many companies do we know that have lived in denial, with their operations in constant decline? Do we all remember Digital Equipment, Penn Central? Trans World Airlines? Polaroid? Did their failures happen quickly? Is it fair to say that their business leaders may have been in denial for a long, long time?

Although companies often spend way too much time in denial, once they deal with, and move beyond it, the subsequent stages usually proceed much faster. In the second stage of Anger, management will start blaming others and outside forces for their company's poor performance. "Perhaps it's unfair foreign competition or staff incompetence that has caused all these problems."

Then they enter the Bargaining stage, where they will try to justify first to themselves and then to anyone who will listen, that their previous plans, which have not improved the company's performance in the past, will now improve the company's performance. But those same old plans seldom work, now do they?

As failures continue, the management team quickly moves into the Depression Stage. This is the stage in which you will lose some of your team. It's a stage in which members of management, and sometimes even the Board members start moving away from the business, if not physically, then at least emotionally. It is at this point that they become introspective, considering their role in the

"I understand where
we are and where
we have been,
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moving forward in a
new direction with a new
focus and clarity".

company's struggle, but are not sure what to do next. It is here that the Company is at its most vulnerable point because management is in a state of flux, and not effectively correcting or improving the business.

Finally, the Acceptance Stage allows companies to say, "I understand where we are and where we have been, now its time to start moving forward in a new direction with a new focus and clarity". It is here, at the Acceptance Stage that most Turnaround Professionals are retained, and this change must happen if there is to be any real improvement in the business. Hopefully company ownership hasn't arrived at this stage too late to effect the necessary turnaround.

The qualified Turnaround Professional will manage the process and perhaps even the business. He will play the role of mother, father, teacher, doctor and nurse to the business. At times, he will act as a cheerleader one day, and the company's psychologist the next day. He will examine the patient, looking for symptoms and he will analyze the facts, all with the idea of delivering a prognosis and treatment plan for your business. He will do whatever is necessary to save his patient and his Hippocratic attitude will be noticeable to the team he leads and advises.

With the right turnaround practitioner not concerned with just a quick fix but rather long-term solutions, the troubled company can become healthy once more with a new and improved outlook for a better future. ■

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ther screened by committees consisting of experienced IC members to determine which 20 will be invited to present at each IC conference. I serve on the Energy and Environmental Committee, and our committee had the difficult task of narrowing 88 companies down to 5 to invite, after reviewing the companies' business plans and talking with several of the CEOs. The other four committees representing the other industry groups did the same, resulting in 20 companies invited.

I receive copies of all the presenting companies' business plans, and at the end of the day my job is to conduct due diligence on the most promising handful of companies and pick the best couple of investments to make per conference.

Using 2007's actual data, the diagram (see right) pictorially depicts the benefit to The Patient Capital Collaborative of this rigorous process.

What Recent Investments Have You Made?

This year the PCC has invested in:

- **New Day Farms** the largest grower of organic heirloom tomatoes on the east coast; and
- **Ocean Renewable Power Company** a prototype-stage tidal power generation company

Sustainable Resource Ventures also invests from time to time in companies sourced outside IC, and in these cases Sustainable Resource Ventures invests its own firm's capital.

Over Your Career You Have

Made Larger and Larger Investments. Why Would You Today Go Back to Making Smaller Investments in Early- Staged Companies?

I'm often asked this question— especially since I have an audited investment track record of top performance that spans nearly two decades and could use that track record to raise a very large fund. The answer is: The number of early-staged companies seeking capital that have the potential to provide meaningful benefit to our society and environment is large— and there is a real shortage of

get them to that first big institutional stage of venture capital ... and the faster and more professionally these companies get funded, the quicker society will realize their benefits.

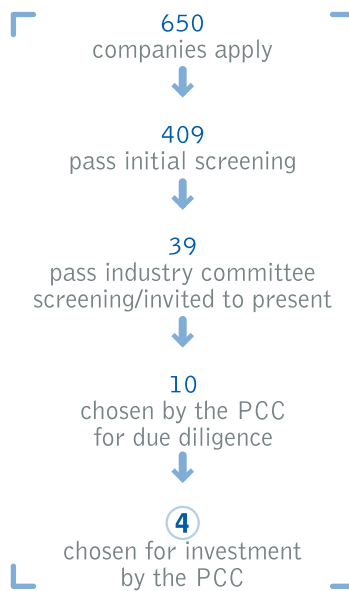
Schuyler ("Sky") Lance is the founder of Sustainable Resource VenturesSM, a venture capital firm dedicated to making investments in early-stage companies that provide meaningful social and/or environmental benefit to the world. After working in the High Technology Division of the Bank of Boston and later

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would visit his peer companies (competitors) once a year to lay the groundwork to be notified when and if they would consider selling the company. One obvious corollary to that is for investment bankers and private equity groups to make a concerted effort to business friends and certain peers so that they may refer business to each other that does not fit their profile.

As a modest size investment bank or private equity firm, it frequently is beneficial to focus on a few industries such as consumer products or technology enabling companies. By doing so, the idea is to market oneself to certain industries, but to accept clients outside this scope if the deals come over the transom.

Most are acutely aware of the eroding manufacturing base in the USA which means that as less and less deal flow emanates from manufacturers, more and more deal flow will have to come from the service sector. Because of this phenomenon, many M&A firms had to "think out of the box" and readjust their approach to deal sourcing. For example, Gemini Investors realized in early 2000 that hot companies were too pricey, so they made investments in the "old economy". Jim Goodman, one of the founders, had previous experience in restaurants and entertainment companies. Gemini made three successful investments in this space such as Buffalo Wild Wings, a chain in which 60% of revenues came from chicken wings and beer, where most of the locations were next to



experienced investors that will "bother" to spend time with start-up and early-staged companies. Let's face it: making a 10% IRR over five years on a \$25 million investment creates more dollars for a fund's GP than getting a 100% IRR on a \$500,000 investment over the same period—about five times more, in fact. But someone has to fund these promising start-ups in the first place to

as an investment officer with Pacific Life Insurance Company, Sky in 1990 co-founded the private equity firm Windjammer Capital Investors that today has over \$1.2 billion in capital under management. After 16 years of top quartile performance, Sky left Windjammer three years ago to apply his 25 years of investment experience to "making the world a better place." ■

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college campuses. Gemini also invested in Wingstop, another restaurant chain featuring chicken wings with 80% of revenues as “take-out.” Like many private equity groups, 70% of their deal flow comes from investment banks, 15% from other PEGs and 15% from direct deal sourcing.

Another private equity group that has created deal flow by utilizing a different approach is Tuckerman Capital. Not only do they provide a single source for ALL the financing, i.e., equity, debt and mezzanine, making the deal more expeditious, but a substantial amount of their deal flow comes from entrepreneurs and former CEOs who co-invest side-by-side with Tuckerman. However, of most interest is that Tuckerman is investing in companies in the lower end of the middle market frequently located in the rural areas of North Dakota, Minnesota and Louisiana where valuation multiples of 4.5 to 5.5 times EBITDA prevail.

Creating Deal Flow—Specifically

In this day and age of the Internet, whether you are an investment banker, a private equity group or a strategic acquirer, it is important to maximize your Internet capabilities. Probably most people in the M&A business receive 40–50 emails a day, a half of which are junk e-mail. So a general e-mail outlining their investment criteria gets deleted right away. However, a very specific e-mail from a buyer or seller, I take careful notice. At Tully & Holland, our database includes 1000 private equity

groups and 10,000 professionals involved with M&A. On a recent e-mail blast from Tully & Holland describing a specific situation, we received three interesting non-related responses; a cosmetic company with \$4 million EBITDA; a signage company with a \$12 million EBITDA; and an appliance fixture company with sales just under \$100 million.

The other specific way to create deal flow is to implement an organized outbound telephone calling system. The following are examples of three private equity groups.

North Atlantic Capital in Portland, Maine started in 1986 as a generalist investing in New England companies including boat manufacturers, baby food, cracker company and a waste collection company. Along the way, their focus changed to companies in the technology enabled business services. Based on a lot of prior industry research in specific industry segments, two associates call 1000 companies per year reaching 60% of the CEOs. Their opening remarks state: “We invest in companies just like yours, and we would like to share with you some of the research we have surfaced in your niche.” In some instance, the associates have made up to 12 calls to the same company. In the last five deals, four were a result of this outbound telephone calling.

Summit Partners in Boston is a well known private equity group with over \$1 billion of assets. Between Boston, San Francisco and London, they have 30 callers. Their callers

pitch to the CEOs that Summit will make a 40% investment now to give the owner some liquidity, with the follow-on 60% investment in five years or so based on an agreed upon valuation formula.

Advent International also in Boston has an aggressive out-bound system with 13 callers. At least 1/3 of their deals come from this system. Specifically, their overall deal flow is as follows: cold calling, 35%; investment banks, 25%; industry contacts, 20%; and syndicated deals, 20%.

I would be remiss if I didn’t mention the power of mailings. A lot of investment banks sneer at business brokers who sell business on Main Street USA. Well, watch out. Ed Telling of The Telling Group in Courtland, New York started off selling retail stores. Now, as a virtual company, he sells 4–5 companies a year, the last one for \$25 million. Aside from referrals, he spends \$100,000 a year on an aggressive mailing campaign using very professional colored inserts that would grab almost anyone’s attention.

Business brokers in general leave a lot to be desired when it comes to their methodology for valuations and writing an Offering Memorandum. However, when it comes to marketing and obtaining “listings” of companies for sale, as a group they are often way ahead of investment banks. Transworld is the largest group of business brokers in the southeast with 10 offices and 90 employees. Ten of those employees are now selling middle

market companies in which the largest transaction was a company with sales of \$23 million. Transworld currently has 1,200 listings or an average of 120 per office with an advertising budget of \$1 million.

And finally, the best advice I can give investment bankers is twofold:

- 1 represent some buyers during the course of the year because you will surface a lot of potential sellers, and
- 2 after you have completed a sell side assignment, go right back to those potential buyers who you engaged in that assignment and see if they will hire you either on the buy or the sell side... in as much as you have become an industry expert based on the last deal.

Conclusion

Creating deal flow and/or implementing an effective deal sourcing program in the middle market is certainly a critical aspect for those involved in the M&A business.

One of my favorite football coaches was the famous Bear Bryant of Alabama. He was an icon in many ways and revered by those who came in contact with him. In one of his legendary half-time “pep-talks”, he would tell his players: “Go out there and make something happen. Don’t just block one player, block two. Don’t let one of your teammates make the tackle, everyone pile on. Go after the ball, make the guy fumble. Make something happen.”

Well, so much for Bear Bryant. But in all seriousness, in creating deal flow, you have to make something happen. ■