An Introduction to Private Equity Deal Sourcing

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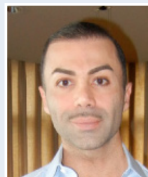

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In private equity, deal flow is the lifeblood of each firm. It is crucial to bring a stream of interesting deals into the firm. There are two types of deal leads: proprietary and non-proprietary auctions. Buyout professionals greatly prefer the proprietary, non-auction deals. These proprietary deals, since they are not structured auction processes, have less competition, which can allow for more favorable purchase price and terms.

You can think of deal sourcing like any sales channel. It is a funnel of unqualified leads turning to qualified leads, turning to active discussions, turning to NDA, turning to Letters of Intent, turning to executed transactions. At each stage, only a percentage of deals make it to the next stage. Therefore, if you start with 100 unqualified leads it may only turn into one completed transaction. Since it is a numbers game, it is crucial to generate and efficiently process as many deals as possible. Firms have diverse approaches to deal souring; some have huge in-house teams of deal-sourcing specialists; at some firms all deal professionals are responsible for deal sourcing and execution.

Key Channels to Source Deal Leads

To keep the deal funnel populated it is key to have good deal flow channels. The following are some of the typical deal sourcing channels for private equity sponsors:

1. **Investment Bankers.** Investment Banks are key sources of private equity deal leads. Banks typically run auction processes, which bring a large number of potential buyers.
2. **Consultants.** Strategic and financial consulting firms, like McKinsey, BCG, Bain, FTI Consulting often have corporate finance or restructuring practices which are aware of companies or divisions which are potentially up for sale.
3. **Lawyers.** Lawyers have large networks of clients and are oftentimes aware of upcoming transactions.
4. **Trade Shows.** Trade shows are a great way to meet a large number of companies in targeted sectors. By walking the booths, you can quickly meet hundreds of companies, many of which are looking for funding or acquirers.
5. **Analytical Screens.** Using Capital IQ, Bloomberg, or web searches, you can identify firms that fit your funds investment parameters. These electronic databases can provide contact information for debt and equity securities and for the CEO, CFO, and/or head of corporate development who are aware of possible transactions.
6. **Newspapers, trade magazines and websites.** Some leads come through reading newspaper articles, magazines, or PE-related or industry-specific websites.
7. **Cold-Calling.** A number of private equity firms have an established team of professionals who make outbound calls to businesses looking for companies and divisions for sale. When they target smaller companies they typically call the CEO or CFO of the business. For larger companies, they usually call the head of strategy or corporate development.
8. **Referrals.** Oftentimes, PE firms will provide commissions if a third-party brings them an interesting lead. Sometimes the party bringing in the lead has a proprietary opportunity or has locked up exclusivity with the seller. The further along the referrer has taken the transaction, the higher the commission percentage. These referrals can help supplement the internally generated deal-flow.

The private equity business is getting increasingly competitive, so bringing in more deals is crucial. Once a deal is sourced, negotiated, and closed, the hard work of operating and turning around the business really begins. ■

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Scott Mell, CIRA, CTP, has joined *McKinsey Recovery & Transformation Services* as one of the leaders of the practice. McKinsey Recovery & Transformation Services, founded in 2010, provides restructuring advisory services, interim management and bankruptcy planning with the support of McKinsey's industry expertise and experience.

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Journal

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Liquidation Basis of Accounting: FASB Proposes Guidance on Topic for Which Little Has Been Written

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On July 2, 2012, the Financial Accounting Standards Board ("FASB") issued an exposure draft of a proposed Accounting Standards Update to Accounting Standards Codification ("ASC") Topic 205, Presentation of Financial Statements, titled *The Liquidation Basis of Accounting* (the "Exposure Draft"). The AIRA submitted a comment letter to the FASB on October 1, 2012; see Exhibit on pp. 6-8.

Prior to the adoption of the Accounting Standards Codification, U.S. Generally Accepted Accounting Principles ("GAAP") provided very little guidance on what constitutes the "liquidation basis" of accounting or how that basis of accounting should be applied. Conducting a literature search on the topic yields a number of references to liquidation basis of accounting, but little actual guidance on implementation. Perhaps the most detailed guidance is contained in generally accepted auditing standards ("GAAS") which provides guidance on an auditor's ability to issue an unqualified opinion on liquidation basis financial statements. The GAAS literature[1] provides that a liquidation basis of accounting may be considered GAAP for entities in liquidation or for which liquidation appears imminent. GAAS allow an auditor to issue an unqualified opinion on such financial statements provided the liquidation basis of accounting has been properly applied and adequate disclosures have been made in the financial statements. The example opinion in the literature refers to a statement of net assets in liquidation and related statement of changes in net assets as the two financial statements upon which the opinion would be rendered.

In 1984 the AICPA released its Financial Report Survey, *Illustrations of Accounting for Enterprises in Unusual Circumstances and Reporting on Them by Independent Accountants* (the "Survey"), a survey of troubled enterprises, reorganized enterprises, and liquidating enterprises. In the scope and purpose of the Survey, the authors provide a short review of the then existing literature related to troubled, reorganized, and liquidating enterprises. This included Accounting Principles Board Opinion 30, "Reporting the Results of Operations", Financial Accounting Standards Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings", the quasi-reorganization section of Accounting Research Bulletin ("ARB") No. 43, and ARB No. 46, "Discontinuance of Dating Earned Surplus". The authors also cited Statement on Auditing Standards No. 34 ("SAS No. 34"), "The Auditor's Considerations When a Question Arises About an Entity's Continued Existence", reproducing SAS No. 34 as an appendix to the Survey. Drawing from the AICPA's National Automated Accounting Research System, the Survey included the financial statements and auditors' reports for three entities in liquidation.

Since the Survey, the AICPA issued Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code", now codified as FASB ASC 852, *Reorganizations*, addressing reporting during and upon emergence from Chapter 11 bankruptcy, but not addressing accounting for entities in liquidation.

The adoption of the Accounting Standards Codification in 2009 added no other significant authoritative guidance to address what constitutes liquidation basis accounting and the circumstances when liquidation basis accounting would be appropriately applied. International Financial Reporting Standards ("IFRS") are similar to existing GAAP in that IFRS currently does not provide explicit guidance on when or how to apply liquidation basis accounting.

In 2007 the FASB added a project to its agenda to address both going concern issues and the liquidation basis of accounting. For a time, the going concern aspect of the project was more immediate as the FASB sought to incorporate the AICPA's Codification of Statements on Auditing Standards AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, into GAAP. The FASB issued an exposure draft in 2008 on going concern considerations. As a result

Liquidation Basis *continues on p. 4*

1 Currently codified as AU Section 9508 section .33-.38

ALSO IN THIS ISSUE

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  Patrick A. Jackson, Esq.
- **INTRODUCTION TO PRIVATE EQUITY DEAL SOURCING**
  Alex Soltani and Matt Thompson, CIRA
- **HALL V. U.S., PART 2**
  Scholar in Residence, Jack M. Williams, CIRA, CDBV