Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

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Ten "Must Have" Diligence Items

1. ***Independent analysis of the "capture myth" behind major program wins and pipeline opportunities***
2. ***Examination of the resources and timeline required to convert pipeline opportunities into revenue***
3. ***Recent award fee metrics, cure notices, and related customer correspondence***
4. ***Option year renewal and contract value de-obligation history***
5. ***Direct Labor ratio and other possible signs of delivery and recompete risk***
6. ***Time-lapsed view of pipeline composition (size, shape, quality)***
7. ***Gate review reports on key pursuits (qualitative and quantitative assessment of capture maturity)***
8. ***Post-mortems on recent no-bid decisions and lost bids (juxtaposed against forecast assumptions)***
9. ***Analysis of labor rates, portfolio composition, and set-aside dependence over time***
10. ***CPARs, PPIRS, and other independent measures of customer satisfaction***

Due Diligence Dalliance

- Subpar acquisition performance is due more to incomplete due diligence and overly optimistic forecasting than to market deterioration
- As in other sectors, federal transactions require sound fundamental understanding of individual company positioning and prospects
- Buyers are performing more due diligence than ever – stranding transactions in limbo – but still are not asking the most critical questions
- Understanding that a Seller's entire book of business will turn over within a few years of closing is the first step in successful diligence
- Accurately forecasting returns requires gaining insights into the execution, funding, and recompete positioning for each individual program
- State-of-the-art is an early "no fingerprints" channel check led by professionals on the front lines of the business capture lifecycle

From *Beta* to *Alpha*

By most metrics, many of the federal services acquisitions made in recent years are underperforming. Despite strong headwinds of late, these difficulties are mostly company-specific, and were predictable. The failure to adequately identify and quantify these downside risks is more the result of incomplete due diligence and overly optimistic forecasting than widespread market deterioration. Throughout a decade of robust sector growth, the primary areas of due diligence focus were market-based or *beta* – identifying and quantifying the proverbial fast-moving currents. This provided a false sense of security by overlooking or de-emphasizing many of the critical company-specific success factors, or *alpha*.

Bottoms Up

In a sector as nuanced and regulated as the federal market, it is easy to burn a lot of calories working down from the top. Each customer has its own mission focus, strategic vision, procurement proclivities, technology trends, vendor ecosystem, and contract vagaries. It is easy to exhaust diligence teams and run up massive service provider bills before getting to the critical bottom-up analysis. Nervous buyers are performing more due diligence than ever and transactions are getting stranded short of closing, yet many critical questions are still going unasked. Conventional backlog conversion metrics no longer hold, so it is imperative to undertake an opportunity-by-opportunity review of performance, customer satisfaction, funding prospects, and competitive positioning for recompetes. Similarly, due to shrinking recompete run rates and lower than normal pipeline conversion factors, savvy buyers would be well-advised to dig deeply into pipeline quality and the likelihood of delivering the opportunities in the pipeline.

Conversion and Erosion

The basic business identity in the federal services market is that leads beget pursuits, pursuits beget bids, bids beget awards, and awards beget revenue. Understanding the conversion and erosion factors at each juncture is vital to accurately projecting revenue roll-off and potential uplift attributable to new awards. Wolf Den's Deconstructed Iterative Conversion and Erosion (DICE) model integrates more than 20 key variables and accounts for composition of the pipeline, differential win rates, award timing, recompete shrinkage, and contract value puffery. The output of the DICE model (graphic at left) parametrically converts pipeline data to likely revenue growth rates for a range of new business and recompete win rates.

Next 12 Months Organic Growth Rate

New Business Win Rate \ Recompete Win Rate	0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
10%	-29.4%	-28.2%	-26.9%	-25.7%	-24.4%	-23.2%	-21.9%	-20.7%	-19.5%	-18.2%
20%	-26.8%	-25.6%	-24.3%	-23.1%	-21.8%	-20.6%	-19.3%	-18.1%	-16.8%	-15.6%
30%	-24.2%	-22.9%	-21.7%	-20.4%	-19.2%	-18.0%	-16.7%	-15.5%	-14.2%	-13.0%
40%	-21.6%	-20.3%	-19.1%	-17.8%	-16.6%	-15.3%	-14.1%	-12.8%	-11.6%	-10.4%
50%	-18.9%	-17.7%	-16.5%	-15.2%	-14.0%	-12.7%	-11.5%	-10.2%	-9.0%	-7.7%
60%	-16.3%	-15.1%	-13.8%	-12.6%	-11.3%	-10.1%	-8.9%	-7.6%	-6.4%	-5.1%
70%	-13.7%	-12.5%	-11.2%	-10.0%	-8.7%	-7.5%	-6.2%	-5.0%	-3.7%	-2.5%
80%	-11.1%	-9.8%	-8.6%	-7.4%	-6.1%	-4.9%	-3.6%	-2.4%	-1.1%	0.1%
90%	-8.5%	-7.2%	-6.0%	-4.7%	-3.5%	-2.2%	-1.0%	0.2%	1.5%	2.7%
100%	-5.8%	-4.6%	-3.4%	-2.1%	-0.9%	0.4%	1.6%	2.9%	4.1%	5.4%

Voice of the Customer

Gaining insights into individual program dynamics is difficult, especially considering that Sellers will limit Buyers' ability to speak with government customers until the transaction is nearly closed. Even then, the customer calls are usually pre-screened, well-rehearsed, and rarely provide any insights. In the unlikely event that anything new emerges from the official customer calls, it is typically too late to do anything about it. A common response to this conundrum is to enlist the support of third party purveyors of senior government relationships and access. These resources rarely have current insights into individual procurement competitive dynamics and relying on them can perpetuate the emphasis on *beta* over *alpha*. Current best practices dictate performing a comprehensive "no fingerprints" channel check – canvassing competitors, teammates, and government contracting officials and program managers – early in the due diligence process, while there is still time to mitigate any negative findings and alter terms accordingly.

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