Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

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Gold at the End of the 2015 M&A Rainbow

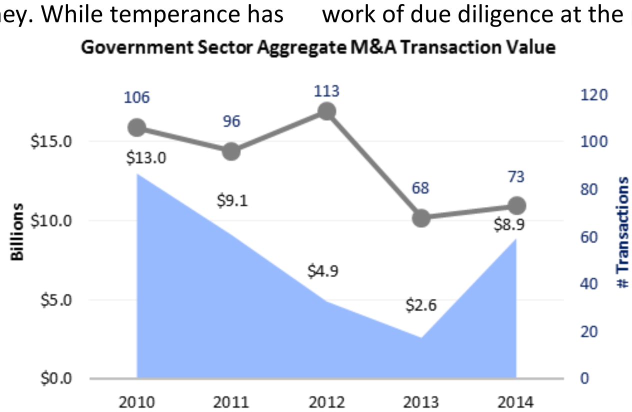
1. ***2014 bidding volume begot 2015 contract awards, with the winners now testing the M&A market***
2. ***The most budget visibility we have enjoyed since 2010***
3. ***Persistent abundance of attractive debt financing for federal names***
4. ***Organic growth rates alone cannot meet investor expectations***
5. ***Public company valuations and balance sheets support strategic buyer appetite***
6. ***Mature duration of PE platforms leading to top-off transactions, full exits, and a few second acts***
7. ***Portfolio shaping momentum continues in response to "new normal" competitive pressures***
8. ***Positioning to buy past performance for the next generation of GWACs and IDIQs***
9. ***Sellers willing to entertain offers rather than play through to the next cycle***
10. ***Rush to exploit the narrow window of visibility before the 2016 election cycle***

Federal M&A in 2015: Ditching the Dirge and Dancing the Jig

- After several years of decline, 2014 aggregate federal M&A transaction values were greater than 2012 and 2013 combined
- 2015 is off to a stronger start with renewed budget certainty, anemic organic growth rates, and plentiful financing fueling deal flow
- Also contributing to M&A volume is a crop of aging private equity platforms that are looking to exit before the 2016 election cycle
- Qualifying all the deal flow is a challenge, with the best buyers applying strict screening criteria and going "all-in" on very few candidates
- Diligence is paramount with many market participants burned by recent events and ground truth residing deep in customer organizations
- Integration is still the most frequent point of failure, but also the key to unlocking enterprise value in a services deal

St. Patrick's Day Parade

After a bleak few years in the federal sector, there is renewed certainty and cause for optimism. The green shoots of 2014 bid and award activity translated into an uptick in M&A activity. Sellers are saddling up to the transaction bar, attracted by buyers seeking to plug organic growth holes and cheap financing flowing more freely than Guinness on St. Patrick's Day. With brisk deal activity, it is increasingly difficult for buyers to keep their wits about them, and even harder to cut through the buzzword blarney. While temperance has no place in M&A, discipline is critical to ensuring revelers do not get carried away and wake up with an integration hangover. It is not the luck of the Irish that determines M&A success, but dogged dedication to a focused strategic vision and clear-eyed cultural and business diligence.



After several years of declining aggregate deal volume in the government sector, deal velocity and volume are on the rise. While the preponderance of transactions still occur in the <$50M range, the 2014 share of deals greater than $100M was the highest since 2007 and 2015 is off to a fast start.

Source: Houlihan Lokey

The Three Leaf Clover

Like St. Patrick's famous pedagogical tool, the holy trinity of M&A is sourcing, seducing, and structuring. Deal flow can come from anywhere – with tales of success from both banked and proprietary sources – and it is critical to rigorously qualify opportunities. The best buyers scrutinize M&A ideas as closely as they would organic bid opportunities, applying strict screening criteria, and being willing to say "no" because there are more good opportunities than there are resources to pursue them. Similarly, successful buyers relentlessly court targets, seducing them away from other suitors. The winning bidder is the one who wants it more than anyone else and makes themselves most attractive to the seller. Part of this "buyer of choice" courtship is crafting the cleanest deal structure – minimizing complexity and maximizing speed and certainty of close.

Diligence Snakes and Shamrocks

There is rarely a perfect "dream date" at the pub, and every deal has a smudge on its pint glass. Moreover, every investment committee, lender group, and Board room has more federal market non-believers than before. These critics have been burned by the vicissitudes of political and budgetary winds, as well as the false idols of cost synergy, margin expansion, new market entry, and recompete retention. The best way to drive these snakes out of deals is through the hard missionary work of due diligence at the program level. The path to transaction salvation lies in the superior situational awareness on competitive positioning that can only be derived from ground-level views deep within customer organizations. Combined with capture myths derived from customer intimacy, the snakes will soon be seeing shamrocks.

Chasing Leprechauns

For all of the effort to find, court, and close an acquisition, generating enterprise value from the deal can be harder than catching a leprechaun and claiming his gold. For every cost synergy, there are offsetting incremental "dis-synergies," and unlike in other sectors, the human element in companies dominates federal government services. Benefits issues drown out financial rationale for most employees, cultural differences trump strategic vision, and deal success hinges on the management of both. With nearly 100 annual M&A transactions per year – many of which do not go as planned – there will be skeptics in every deal. The best way to win over these critics is through the miracle of organic growth. Achieving early wins that neither legacy company could have accomplished on its own is the surest path to capturing the pot of gold.

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