Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

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Top Ten Ways to Cut Down the M&A Nets

1. ***Recruit and retain the right talent: It is "poor man's M&A"***
2. ***Peak at the right time: Head for the exit with maximum backlog visibility***
3. ***Defense wins championships: Secure base to avoid grow-over challenges***
4. ***Pick your spots: Be wary of "buzz word bingo" auction properties***
5. ***Schedule strategically: Line up financing early in the season before it really counts***
6. ***Game plan carefully: If the first time you hear of the company is when you receive the CIM, someone else is better positioned to get it***
7. ***Hit your free throws: Manage integration to prevent strategic value slipping away***
8. ***Make the extra pass: Take care of the talent first – the contract portfolio is perishable***
9. ***Practice at game tempo: Plan at least as much for revenue synergies as cost savings***
10. ***Make halftime adjustments: If you are failing as a buyer, it may be time to sell***

Federal M&A Bracketology

- Like conference tournament upsets, the recent wave of transformative M&A deals is wreaking havoc on bracket seeding
- Consolidated procurements, tax cuts, and abundant cheap capital are driving consolidation of "bigger is better" powerhouses
- The "power five" conference contenders provide credibility and scale but need M&A to round out their portfolios
- Mid-tiers are more nimble than the bigs, more credible than the smalls, and are formidable competitors in their domains
- While many may try, only the best coached small businesses can mount an unrestricted tournament run to a successful M&A exit
- Most small businesses never even make it to the big dance, content to remain "lifestyle" businesses without transitioning

The New Blue Bloods

Recent "Merger Monday" headlines are dominating conversation as mega-deals and new entrants remake the industry landscape. With CSRA and GD creating the next Blue Blood alongside Leidos, it is easy to draw comparisons to the Kentucky teams of the late 40s and early 50s, or the UCLA teams of the late 60s and early 70s. Macro budget tailwinds, consolidated procurements, and a dearth of organic growth are driving consolidations. Cheap and abundant leverage and savings from tax cuts are also providing the accelerant that a "one and done" blue chip recruit can provide to fuel a championship run. While size and depth matter in the current market, they are no guarantors of success. Teams will continue tweaking lineups and the Xs and Os through portfolio pruning and contract and capability tuck-ins up until the final whistle.

Power $5B Contenders

While the top seeds may garner disproportionate headlines, the next few finishers – especially in the "power five" conferences (ACC, Big 10, the SEC, the Pac-12, and the Big 12) – are especially dangerous in the middle of any bracket. Nobody wants to face Alabama in a 9 seed or Oklahoma in a 10 seed any more than they want to take on SAIC, CACI, Booz, or the newly formed Perspecta (the combination of DXC, Vencore, and KeyPoint). While the win-loss records for these teams may be impacted by beating each other in the regular season, these teams are battle-tested and tournament ready, with strong balance sheets and dedicated Corporate Development teams. They rely on M&A primarily to increase total addressable market the way many coaches recruit players from overseas. Similarly, they may make acquisitions to cover the loss of key recompetes the way transfer students can fill injury voids.

We are experiencing an increasingly "barbelled" market with consolidating large businesses and the over 15,000 small businesses (under $100M of revenue) hollowing out the middle of the market.

Source: Wolf Den Associates analysis, Federal Procurement Data System

Mid-Majors That Can Play Big

Despite the long shadows cast by the highest seeds, "mid-major" players continue to capture much of sector organic growth as these responsive mid-tiers often put slower major conference heavyweights on upset alert. Like Gonzaga or Wichita State as 4 seeds, Novetta, KeyW, and ICF are not sneaking up on anyone. These are well-known contenders that have differentiated capabilities and customer positioning and can take down any large competitor in their chosen domains. They are able to recruit, woo customers, and court M&A targets by appearing more credible than the smalls and more nimble and cost effective than the bigs. That said, there is increasing pressure on this group to buy or be bought. Their balance sheets may preclude them from doing larger deals while their concentrated portfolios are attractive to acquirers.

Small Ball is Big Business

Amid all the budget increases and partisan rancor this season, the one thing that is not changing is small business preference. Opponents argue against these entitlement programs the way many criticize giving automatic NCAA tournament berths to the Ivy League and Patriot League champions every year. The reality is that many of these 16 seeds never make it past the round of 64. Some will bust NCAA brackets by leveraging set-aside advantages to build infrastructure, talent, and contract portfolios to transition to the unrestricted Sweet 16 before selling. Others will pull off leveraged recapitalizations or mergers of equals at some point along the path to transitioning, just happy to make it to the big dance at all. The vast majority of small business set-aside companies will remain lifestyle businesses or choose an Employee Stock Ownership Plan (ESOP) – the National Invitation Tournament (NIT) of M&A alternatives.

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