Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

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Top 10 Questions to Ask When Betting on Small Business Awards

1. ***How restrictive is the SB designation of the target's contracts?***
2. ***What percentage of the contract mix is both prime <u>and</u> F&O?***
3. ***How are the target's end customers performing against their SB contracting goals?***
4. ***Has this work ever been anything other than SB set-aside?***
5. ***Is there enough time left on the period of performance to shape current work to F&O?***
6. ***How differentiated is the work and are there any technical barriers to transition?***
7. ***How well is the target performing on the SBSA work?***
8. ***How capable is the target of winning prime work and what is the current prime / sub split?***
9. ***Is there an F&O contract vehicle that is a natural transition for the SBSA work and how accessible is it?***
10. ***Has the work changed sufficiently in size and scope to justify moving it out of SBSA?***

Handicapping the Small Business Field

- While SBSA designations help companies get their start, it is difficult to create enterprise value without transitioning work to F&O
- Some types of socio-economic contract designations (8a) are much more difficult to transition to F&O than others (WOSB)
- Some agencies are less likely to convert small business work to F&O regardless of whether or not they are meeting SB contracting goals
- Strong performance and differentiated capabilities can help small businesses retain their work through F&O transition
- The time to plan for transitioning out of SBSA contracts is several years before graduation, not when a sale is imminent
- There is no one size fits all – each agency and contract have unique F&O transition requirements and likelihoods of success

Making the Field

Every May, only 20 of the thousands of 3-year old thoroughbred horses in the world get a chance to line up for the Kentucky Derby and a shot at the elusive Triple Crown. These odds are only slightly longer than a small business' chance of transitioning to full and open (F&O). In June of 2007, the SBA passed new recertification requirements, which require any company with small business set-aside (SBSA) contracts to recertify if "other than small" upon change of control. The 2007 rule also places the decision on whether or not a company may continue performing work at the discretion of the CO. This has created additional contract continuation uncertainty for buyers of companies with SBSA exposure on top of existing concerns about their prospects when stepping up to face F&O competitors.

Source: SBSA Spend by Agency - OPM

Past Performance

Other handicappers prefer to bet on past performance. Just as no two tracks are the same, and weather and strength of competitive field factor into results, some agencies more often utilize small businesses. This is predicated by their mission requirements as much as the SB percentage goals dictated by the SBA. For example, the Air Force cannot buy planes from SBs and the Department of State needs uniformity in procurement for its global operations, so both are biased towards SBSA for nearly everything else. Would-be buyers of SBSA contracts in agencies like these have to wonder if the work will ever convert to F&O. Like a horse moving up or down in distance, odds makers scrutinize SBSA past performance to determine if it is the type of work that can make the move up to F&O.

Pedigree and Connections

Like avid horse bettors, acquirers of companies with SBSA contracts look for clues in the companies' pedigrees and connections (ownership, trainers, etc.). There are certain heuristics that are helpful. For example, has the horse been bred for speed, or distance, and how have its ancestors performed on various track surfaces? The variations of SBSA designations provide similar clues for handicappers. Companies with 8a contracts are the longest shots. They must petition to keep the work they are performing and are at the highest risk to lose that work immediately if they are acquired. Designations such as Woman Owned Small Business (WOSB) and Service-Disabled Veteran Owned Small Businesses (SDVOSB) are less restrictive. Garden variety SBSA contracts are the favorite to continue post-acquisition, but even the favorites are not guaranteed to win.

Beyer Speed Figures

Having covered pedigree, connections, and past performance, many acquirers still yearn for more objective data on which to make a decision. Horse racing fills this need with the Beyer Speed Figures, an objective measure of how fast a horse ran compared to all other horses in a similar distance at other tracks that day. While we lack a comparable metric for SBSA contractors, we can look at performance reviews, technical differentiation, contract scale and scope, and mission proximity to help handicap the odds of an SBSA contract converting to F&O. Smaller contracts with less differentiated technical characteristics, farther from mission criticality rarely make the turn to F&O. If all else fails, like constructing an elaborate exotic bet to cover the field, contingent payments around successful SBSA transition are one of the few places we still see structured deals in this white hot M&A market.

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