

Top 10 Shutdown Takeaways

1. *Short-term pain, but minimal long-term damage*
2. *Companies impacted will temporarily pause discretionary investments*
3. *New starts in affected agencies are on hold and will modestly impair growth in civilian-centric companies*
4. *Business as usual for most; contractor employees, not federal employees, will feel the most pain*
5. *M&A market remains brisk, but closings may get pushed and civilian-centric valuations may come under pressure*
6. *Some contractor staff who are furloughed or LWOPed will consider exiting the sector or changing companies*
7. *Get ready for the #1 explanation for underperformance*
8. *Cash flow pressure will create problems for SBs with civilian-centric portfolios*
9. *The wall is being built; this is a charade of politics and semantics*
10. *Batten down the hatches...the coming storms (debt ceiling, 2020 budget, presidential election) could be far more impactful*

The Winter of Our Discontent

- 🐾 Near-term impacts are real but modest; the debt ceiling, 2020 budget approval, and 2020 election cycle carry greater potential impact
- 🐾 The M&A party (excl. civilian companies) continues...expect a busy 2019, with some possible closing delays and/or multiple pressure
- 🐾 This shutdown will last longer...but even in a worst-case scenario, permanent damage to the federal sector is minor and will heal
- 🐾 Lingering revenue losses, profit declines, and shrinking headcounts will negatively impact short-term growth, margins, and valuations
- 🐾 To survive, hard decisions must be made on retaining staff on payrolls, investing in R&D, and reshaping business portfolios
- 🐾 The U.S. Government represents a stable business partner in the long run and opportunities and growth will return eventually

Cold Front

This winter's government shutdown has driven a cold front over the federal sector. The frost brings concerns for preserving revenue and retaining workforce while controlling overhead costs. Many will feel the cold sting of lost or delayed wages, unrecoverable revenue, and reduction in government services. "Who Cares" sentiments minimize urgency – 75% of the Fed Gov't is business as usual, and agencies that are shutdown are ones (except DHS) Trump thinks should not exist. While the view of the federal sector as safe with unmatched revenue visibility is challenged every shutdown, it is more resilient than the broader market. Earnings and valuation multiples will be impacted but can recover. Be wary of companies who blame their underperformance on the shutdown unless they are civilian or non-essential.

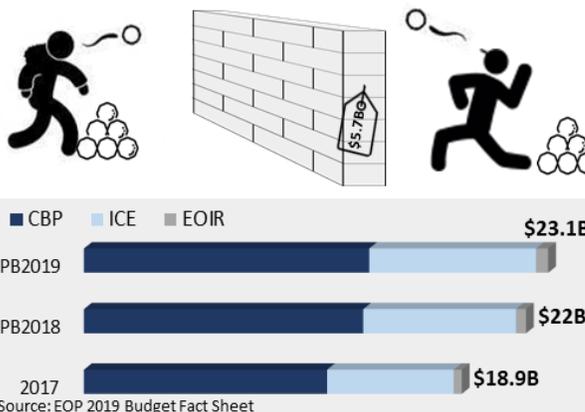
Snow Storm

As the fallout of the shutdown accumulates and headwinds strengthen, business projections will begin to drift. The visibility into the federal market's predictable forecasts and stable revenue streams that has been so attractive to banks and private equity investors could begin to cloud. Impacted investors will seek other markets and may not immediately return when the ice melts, as the causes of revenue declines and market instability will be quickly forgotten. More concerning, some small businesses will not survive the winter as a result of delayed payments and lost revenue. As businesses hunker down, take a more conservative approach, and streamline operations, employees who have flocked to the federal market (and affected agencies) for stable jobs and important missions may leave and migrate to balmier commercial opportunities.

Polar Vortex

The government freeze is a consequence of petty politics, with gov't and contractor employees as pawns. While it is unknown how long this polar vortex will last, it will impact future legislative imperatives like the debt ceiling increase and the 2020 budget authorizations. We can expect it to be more biting than the 2013 shutdown, where Moody's reported a \$20 billion economic impact with an estimated loss in GDP of up to 0.5%, and OMB/BLS estimated deferred creation of 120K jobs. These dark days may stymie near-term internal investment and company valuations, as capital seeks refuge from risk. Ironically, this could be offset by a broader market correction that makes the federal market attractive. Expect labor market tightening as employees exit the federal market and become more difficult to replace.

Border Security and Immigration Enforcement Funding



Welcome Thaw

To weather our winter of troubled history will require firms to make hard decisions to retain staff on payrolls and keep a focus on innovation to preserve their market edge. The shutdown may also catalyze another wave of portfolio rebalancing as non-impacted customers and capabilities become increasingly attractive. Indeed, it could be argued that those coming to market now without any shutdown impact may command premium valuations. It is important to remember that the U.S. Federal Government is arguably the largest enterprise in the world and represents a consistent and stable business partner in the long run. The timing may be uncertain, but soon our dreadful marches will turn to delightful measures as the promise of reliable growth will return when the debt ceiling is raised, budget passes, contracting thaws, and there is a quickening to spend the budget backlog.