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Uncertain Markets Don't End the Parade

by [Kevin DeSanto](#), Director,
[KippsDeSanto & Co.](#)

For the private shareholder considering his or her company's strategic alternatives (e.g., acquisitions, sale or merger transaction, external equity or debt financing, ESOP, etc.), the global financial headlines of the past 12 months may seem incredibly daunting. Add to the mix the real issues that affect government contractors - U.S. government budget pressure, the uncertain outcome of the 2008 presidential election and changing government contractor regulatory environment (e.g., recent changes in the SBA rules), to name a few - and we have quite the murky picture. These and other headline issues are important components of any thorough strategic planning process. However, they are just a few of the many components. For the well-positioned government contractor, 2008 represents a continuation of the robust market environment for building and extracting shareholder value. The government contracting industry is one of the few sectors experiencing positive overall market dynamics.

A look at the trading behavior of relevant companies in the public markets helps to put this in perspective. While the S&P 500 Index

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has traded down 3.4% between February 28, 2007 and February 29, 2008, the highly visible and traditionally stable business models of the large prime defense contractors (e.g., General Dynamics, Lockheed Martin, etc.) have traded up 24.7% during that same period (on an indexed basis). Likewise, traditional government services contractors (e.g., CACI International, SRA International, etc.), which have been experiencing strong growth fundamentals over the past 5-7 years, have traded up 18.4% over this time frame. By way of comparison, diversified IT companies (e.g., EDS, CSC, etc.), those companies that rely more heavily on a more volatile commercial customer base, have traded down 14.5% over the past 12 months.

Corporate buyers of government contractors, like investors, are constantly assessing (and re-assessing) their strategic direction and are continuing to aggressively make acquisitions. It helps them look good relative to their peers (growing when growth is hard to come by), effectively utilize and deploy capital (enhancing shareholder returns) and generally position themselves to ride a bigger wave as market and customer dynamics steady themselves (as they inevitably will). Median acquisition multiples over the past 4 years have consistently been in the range of 8.5x – 9.5x latest twelve months EBITDA for government contractors under \$100 million in revenue. Over 100 deals for government contractors have been consummated in each of these years. The data suggests that the fundamentals of the government contracting industry are strong enough to withstand the volatility experienced by other industry sectors.

Shareholders and management teams of private government contractors should focus on establishing a strong historical track record (customer performance, revenue growth, profitability), positioning for a strong 3-5 year forecast (backlog, new business pipeline), reducing the risk profile of the business (limiting set-aside contracts, distributing customer relationships and decision-making) and generally enhancing the leveragability of the company (access to IDIQ contract vehicles, quality people, differentiated capabilities). The decision to pursue the various transaction alternatives becomes easy (or should we say easier) at

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this point – when is the right time for the key people or the Company to pursue a transaction. Whether a buyer or seller, a well-positioned government contractor will have multiple alternatives and a clearer path towards successfully achieving the objectives of the stakeholders. Despite the headline issues mentioned earlier, 2008 represents a continued opportunity for government contractors to grow and harvest value.

Kevin DeSanto is a Co-founder and Director of [KippsDeSanto & Co.](#), an investment banking firm based in Northern Virginia that specializes in financial advisory services for government and commercial technology companies. KippsDeSanto's capabilities include M&A advisory, raising private financing and corporate strategic advisory services.