

Defense Services M&A at Mid-Year 2005: Robustness Still Rules

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The move to consolidate the services segment of the defense and federal market actually outpaced the market from 2004, a hot market in its own right.

Counting U.S. defense services firms and others with a principally federal component, some 40 deals were completed in 2005 through June 30, compared to 37 for the same period last year. *See table at right.*

While the DoD budget slows on a percent basis and platform builds come under greater scrutiny, the market forces argue for continued vibrant M&A activity in the services sector.

The deal flow this year reveals several observations:

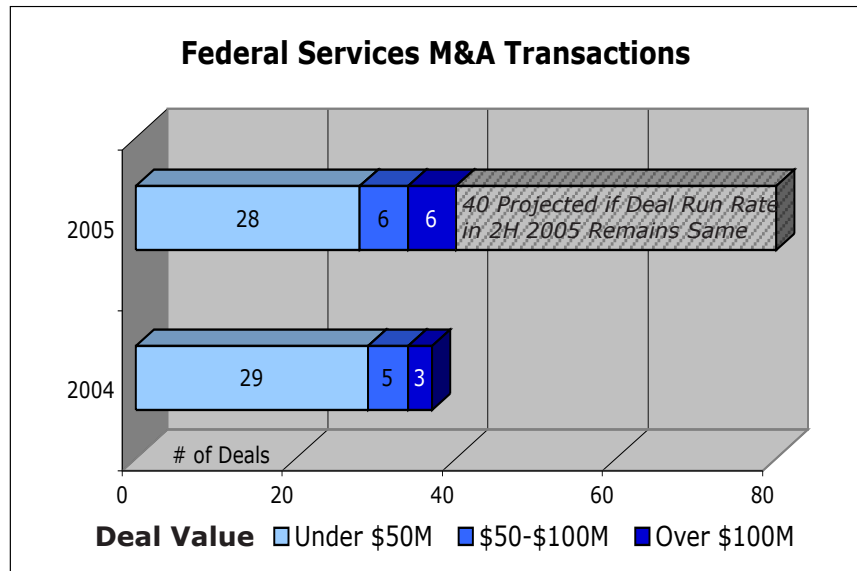
Public companies remain in play. With the L-3 Communications buy of Titan (pending) and the Nortel Networks acquisition of PEC Solutions, two more public companies in the sector disappeared. This public group, which has yet to be replenished by new IPOs since the 2002 rush-to-market, continues to attract domestic and international suitors looking for meaningful revenue build-up or a U.S. presence.

Mid-tier acquirers still stream into the market. Mid-tier acquirers are increasingly using M&A to augment organic growth. Two new M&A entrants came this year—Indus Corporation and Applied Signal Technology (NASD: APSG). This stratum within the services sector has ready access to private debt and equity capital, in some cases public capital.

Solid private firms opt for M&A instead of the IPO route. Three sizable, successful firms—Sytex, Gray Hawk Systems and Galaxy Scientific, all rumored to be on a possible IPO track, elected to sell instead. The pricing delta between the two options is now narrow, while the sale gives shareholders instant liquidity (something the IPO path often does not).

Cube Corporation and IAP Worldwide Services acquired the World Services subsidiary of Johnson Controls.

The macro factors that drove the services M&A in 2004 have repeated in spades this year. Debt capital remains affordable, with many commercial lenders educated in the federal sector seeking to build their M&A book of business across a wide ranging portfolio. Private



Emerging consolidation in the facilities management segment. While the technology and IT services world has encountered massive consolidation over the last decade, the lower tech group of companies that provides logistics and base operations to the military has not. Two deals suggest that sector will be seeing more M&A. VT Group plc acquired

equity, no longer a stranger to the federal market as it was for so long as a group, regularly invests in the sector, often taking serial federal entrepreneurs and building platform companies around them. Federal IT Systems, backed by Kelso and Company and headed by executives who started and sold Paravant, embodies this capital source, having acquired IT Spatial in June.

The services sector as a whole remains attractive, with analysts looking for as high as 10% annual organic expansion. Several factors drive this growth.

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large fuselage sections, fuel tanks for space boosters, and helicopter hub and rotor assemblies.

Terms of the transaction were not disclosed.



Privately held **DataPath, Inc.** acquired the assets of privately held **M&C Systems, Inc.** Plano, Texas-based M&C Systems is a provider of satellite communications monitoring and control systems.

DataPath said that the acquisition gives it “new control and monitoring systems capabilities for satellite earth terminals, transportables, Very Small Aperture Terminals (VSATs), and Telemetry Tracking and Control (TT&C). DataPath will draw on these technologies to expand its end-to-end satellite earth terminal network and system management offerings, enhancing its ability to support heterogeneous earth terminal networks.”

Terms of the transaction were not disclosed.



Symmetricom, Inc. (NASDAQ: SYMM) completed its acquisition of the Frequency and Time Standards product line of **Agilent Technologies, Inc.** (NYSE: A).

The Santa Clara, Calif.-based Frequency and Time Standards product line includes the 5071A Primary Frequency Standard, one of the highest-performing commercial caesium standards available for timekeeping.

Agilent (then part of **Hewlett-Packard Co.**) pioneered the caesium standard in 1964 and has historically addressed the high-performance end of the market, including timekeeping for the United States as well as for official time authorities and measurement institutes throughout the world.

For its part, Symmetricom pioneered the use of caesium atomic clocks on board the Global Positioning System (GPS) satellites, enabling full opera-

EADS: Government Aus Continued from page 5

let’s be clear: we still think the idea smells worse than Camembert). EADS would also have more room to welcome U.S. investors—and this, together with the absence of the French government from its roster of shareholders, would give it far better traction in the U.S. marketplace.

And, most compelling of all, is the idea that a financially-driven EADS would be more free to locate businesses, and to source work, where it made

the most operational sense to do so. No, the company isn’t going to get all the way to this goal—customers have always had the power to dictate terms in this area, and always will—but at least EADS would only be feeling this pressure from the bottom up (as most of its competitors do) and not from the top down as well.

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With an aging federal workforce—and one less able to internally integrate enterprise technology solutions—government must outsource more services. That is particularly true for inherently non-governmental activities, as Uncle Sam attempts to tightly align core competencies with its existing workforce.

As the DoD transforms itself into a more networked ecosystem that directly addresses worldwide threats, support services contractors are positioned to supply the analysis and implementation needed to meet the mission.

Further, as support for new weapons platform wanes, funding will gravitate to older systems that require upgrading

and maintenance. Services contractors are custom fit to provide the testing, operations and training that underpin sustainment of these older systems.

All the stars remain aligned for continued M&A in this sector. Look for more of the same the rest of the year.