

2006 MID-YEAR REVIEW

Defense Services M&A Market: Steady As She Goes

As the year surges past its mid-point, dealmaking in the government technology services sector is running strong, writes *DM&A* contributing editor Paul Serotkin.

During the first eight months of 2006, buyers pursued technical services firms in the defense and federal sectors at the same robust pace as in recent years.

The numbers tell the story: Through mid-August, 50 deals in the space had been completed, compared to 48 over the same period last year. The deal profile was similar – nearly 70% of the transactions were completed for purchase prices of \$50 million or less.

This speaks to the great value that smaller firms can bring modestly and much larger acquirers in both client penetration and technical discrimination.

Financial buyers continued their interest in the sector, reinforcing the belief of fund managers that value enhancement from their investment in sector firms still has upside.

The M&A appetite among Tier 1 defense integrators for services properties actually slowed some, more a function of dwindling targets of meaningful size, no doubt.

The push by market leaders to diversify their weapons and aircraft portfolio still resonates, however. Witness Lockheed's recently announced acquisition of Pacific Architects and Engineers (PAE). PAE, with 6,000 employees, supports military readiness, peacekeeping

missions, nation building activities, personnel recruitment and training and disaster relief services.

Raytheon engaged in two smaller transactions for tech-rich firms. General Dynamics spent the first half of the year shepherding its Anteon acquisition through regulatory waters, then hived off a \$200 million segment deemed to be in conflict with the core GD.

SAIC, after a quiet M&A year in 2005, returned to market, reprising its traditional role of acquiring smaller, tactically supportive companies. The three were for purchase prices reportedly under \$50 million. At press time, SAIC was rumored to be in discussions with a \$300 million-plus Beltway firm, which would be more in line with its stated objective of larger transactions leading to its planned IPO.

The Winners

Our vote for biggest M&A winner to date in 2006 is Virginia-based Alion Science and Technology. Already having acquired three firms in the first half, Alion in early June announced it was acquiring the divested piece from Anteon, as part

of the government agreement with GD to remove certain contracts that presented conflicts of interest.

Alion picked up 900 personnel in the transaction. It is the 10th acquisition that Alion has completed since it became a for-profit company after many decades as the Illinois Institute of Technology Research Institute. See the March *DM&A* for an interview with Alion Chairman Bahman Atefi for more on the company.

Another winner is Wireless Facilities, Inc. the San Diego firm that continues to add valued defense companies to its legacy wireless networking portfolio. The strategy builds on one initiated by WFI President Eric DeMarco when he arrived there after a successful run at Titan Corporation. WFI recently announced it was acquiring \$60 million Madison Research Corp., one of the Huntsville stalwarts sought by many suitors over the years.

Financial Strategies Realized

Analysts looked askance in 2005 when funds were raised by SPACs – Special Purpose Acquisition Corporations. SPACs raise capital in an IPO despite having no operational unit in the company. They typically declare a market segment in which they plan to invest. Perhaps inevitably, SPACs formed in the defense and federal sectors, on the strength of the reputation of executive management in the industry.

In April Federal Services Acquisition Corp. (FSAC) announced its first transaction, the purchase of Advanced Technology Systems (ATS),



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a Beltway firm with revenue slightly north of \$100 million.

Fast on its heels was an announcement by another SPAC, Fortress America Acquisition Corp., buying an entity known as VTC LLC (combining Vortech and Total Site).

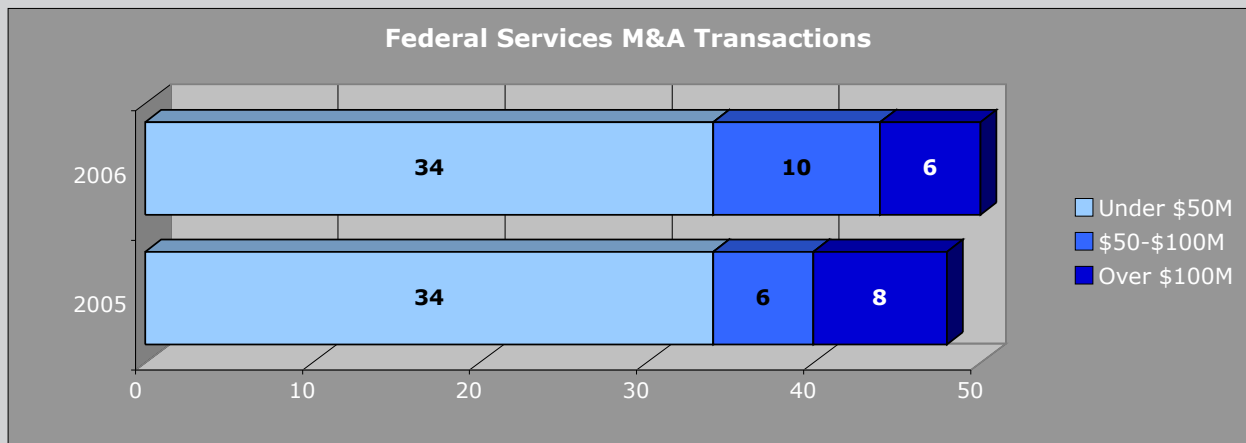
In June TAC Acquisition Corp., an-

illustrated these themes.

In three, large companies (Teledyne, SAIC, Raytheon) acquired businesses under \$20 million that provide services in joint doctrine and joint operations. The push toward integrated operations and policy among the services in prosecuting

there.

No fewer than four Huntsville transactions were announced this year - CAS (by EDO Corporation), Madison Research (by WFI), 3D Research (by Schafer Corporation), and Morgan Research (by Stanley Associates.) ♦



other SPAC, acquired Aviel Systems, providing a public market platform for the company operated by long-time federal sector executive John Chapel.

These SPAC transactions had more import than mere M&A. They immediately created three new public companies, each with the opportunity to use public coin to grow and acquire.

Jointness, Intel and Homeland Security Themes Dominate

The defense/federal M&A market continued to reflect the underlying global events swirling about it.

Transactions in the sector centered on three themes: jointness, intelligence, and homeland security. Deals completed in the last 90 days

military campaigns induced the purchase of these joint-savvy suppliers, respectively, CollaborX, Cornerstone Industry and Virtual Technology.

With the averted UK air threat as backdrop, Kroll, Compudyne and EDO Corporation all acquired companies with pronounced intelligence and homeland security practices — Homeland Solutions, Signami and Impact Science and Technology (IST), respectively.

Post-BRAC Fallout

The other current running through federal M&A in 2006 was that of 'Huntsville.' The Huntsville area benefited from recent decisions under the BRAC, reinforcing the area as a defense-friendly region. Predictably, buyers have accelerated the acquisition pace of firms headquartered