Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

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10 Divestitures to Remember

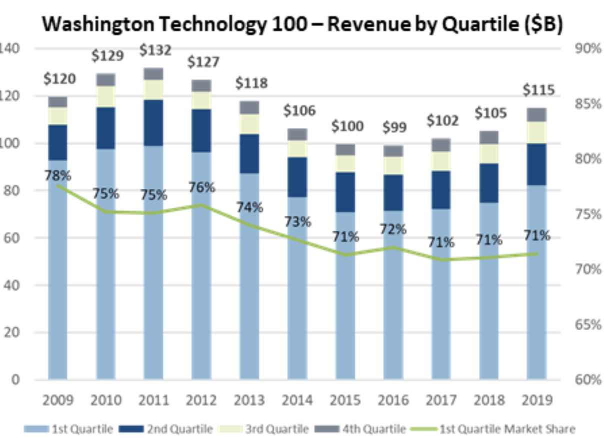
1. ***Fluor expects to spin off its AMECO (equipment rental company) and federal business***
2. ***AECOM expects to divest its Management Services segment to Lindsay Goldberg and American Securities***
3. ***DXC expects to spin off three business units, which make up almost 25% of its current revenue***
4. ***L3Harris spun off its Night Vision business to Elbit Systems of America (ESLT) for $350M***
5. ***General Dynamics divested its call center business to Maximus for $400M in cash***
6. ***L3 sold Vertex Aerospace Business to American Industrial Partners for $540M***
7. ***DXC Technology spun off US Public Sector business to Vencore and KeyPoint to form Perspecta***
8. ***PwC divested its federal business to Veritas Capital (now Guidehouse)***
9. ***Cubic divested its Global Defense Service and ABM divested its Government Services (ABMGS) to Valiant***
10. ***Harris' government IT services branch sold to Veritas Capital for $690M in cash***

M&A Consolidation: Reality or Perception?

- Headline grabbing M&A deals and high valuations create pressures to participate in the M&A market as companies combat FOMO
- Conventional wisdom around "federal market consolidation" invokes competition concerns, but the data does not support the anecdote
- Bankers fan the flames with claims of "bigger is better" because their compensation model incentivizes them to focus on larger deals
- In a consolidating market, we would expect Washington Technology's Top 100 total revenue to grow as new companies fill open slots
- In reality, total revenue of the Top 100 shrank by 3.8% and revenue share of the top quartile dropped by 6.1% from 2009 to 2019
- Ignoring the come-ons and staying true to strategic rationale and cultural compatibility remain the keys to enterprise value creation

Connubial Enthusiasm

As engagement season peaks, it is not hard to feel left out of the excitement when photos of happy couples take over your social media feed. It is the same feeling seeing images of handshaking CEOs and the headlines of upcoming unions and bright futures for recently acquired or merged entities. Seemingly, each month brings a greater sense of urgency for singles and independent CEOs to join in and buy. Lost in the excitement are the successes of stand-alone entities and strategic partners that are not ready to be legally tied. Also overlooked are the acts of conscious-uncoupling, or divestitures, that do not get the same publicity. This leaves the question – are a handful of big M&A deals evidence of federal market consolidation? Or, more likely, are flashy headlines obscuring federal market deconsolidation?



Since 2009, Washington Technology's Top 25 companies have lost 6.1% of the total revenue market share of the Top 100.
Source: Washington Technology

Mixed Signals

The state of market consolidation can be viewed through historical data from Washington Technology's Top 100 government contractors. If market consolidation occurs, new companies enter the Top 100 as slots open, growing the total cohort's topline. However, the Top 100's total revenue shrank 3.8% from 2009 to 2019 ($120B to $115B). Massive divestitures in the top quartile point to deconsolidation (total revenue declined by 11%), while the lower quartiles experienced total revenue growth (+19% in the 2nd quartile, +24% in the 3rd, and +30% in the 4th). This does not necessarily contradict the consolidating market thesis as the largest companies may be losing market share due to self-inflicted wounds that more than offset acquired revenue. But more likely, it reflects the duopolistic nature of the market. While sampling bias may be to blame for the consolidation thesis, the data suggests "it's complicated."

Pressures to Commit

Much like a Yenta conjuring the notion of a biological clock to urge on a match, federal market specialists have touted the "federal market consolidation" trend for years, creating the concern that mid-sized companies may find themselves unable to compete at the highest levels or for the largest contracts. Bankers are also incentivized to craft the image that "bigger is better" and leverage companies' fear-of-missing-out (FOMO) on favorable opportunities to generate success fees (which are keyed to a percentage of total consideration). While Washington Technology's Top 100 list may not be a perfect proxy for federal market-wide trends, it is the best data available and does highlight the market's complexity. Shrinkage among the top quartile should give pause to anyone rushing to put a ring on it.

Finding the One

While business passions may dictate the reasons for running off with a hot prospect, there is plenty of time to find the right match for your acquisitive growth. Although it is true that the number and collective value of M&A deals has steadily increased over the past 3 years, deal volume does not axiomatically equate to consolidation. So, don't let the buzz of new acquisitions pressure you into buying too quickly. Sealing the deal is a big commitment that requires significant self-discovery, forward planning, and thorough due diligence of prospective targets. Prior to any LOI, it is critical to define strategic priorities and objective evaluation criteria, so that when a potential target comes along, you can quickly assess compatibility and handicap long-term prospects for the relationship's future. Only fools rush in, as nearly 50% of marriages end in divorce – a failure rate far lower than that of corporate M&A transactions.

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