

Mastering the Federal Contractor Merger

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Guest Article

“Deal success is not random,” assert authors David Harding and Sam Rovit in the new book *Mastering the Merger*.

That’s particularly true for corporate deal-makers operating in the federal sector.

While study results differ, the authors cite one public survey that shows a mere 30% success rate among big company mergers. And, yet, virtually all Fortune 500 companies are the product of multiple deals.

So are the public federal services firms.

Several went public in 2002, using IPO capital to acquire aggressively. Other long-time buyers, such as Titan, rapidly built their portfolios through M&A as well.

So what do the authors cite as successful acquirer characteristics? They:

1. ...are active deal makers that make acquisition execution a core competence.
2. ...cut their teeth on small deals (relative to the buyer size) and graduated to larger ones. In fact, their research shows that the acquirers with the best shareholder returns typically bought firms no larger than 15% of their size.
3. ...succinctly define their core business, then invest in and defend it (liberally using M&A)

4. ...buy high growth assets. Seems obvious, but in practice this point is both controversial and stands popular business operation on its head. Responding to Wall Street, acquirer CEOs and CFOs insist that acquisitions be immediately or shortly ‘accretive’ to earnings, i.e., earnings per share (EPS) must increase as a result of the deal. The authors show such a standard is not even necessarily desirable; their survey indicate that true value is more often achieved by buying ‘dilutive’ targets (the opposite of accretive, in terms of the acquired firm’s effect on the buyer’s EPS) in that the latter companies are growing faster.

Several companies in the federal services sector epitomize this view of M&A excellence. Two that quickly come to mind are Anteon and CACI.

Both followed the authors’ prescription for success.

Anteon (NYSE:ANT), which went public in Q1 2002, has acquired three firms since then — ISI, STI, and IMSI, with respective reported revenue of \$130 million, \$20 million and \$30 million, well within the 15% seller-buyer ratio recommended.

Prior to that, as a private capital backed entity, the company had completed a series of transactions, one a year on average since its formation in 1996. With the exception of Analysis & Technology, at \$170 million in revenue, it did not breach the 15% rule. In the case of A&T, the company added scale

needed to thrust it into sector elite status, while deepening its core base in IT and engineering services in the Navy and other armed services branches.

The stock market liked all its post-IPO deals, with the stock price running to new plateaus in mid-2003 and mid-2004.

Similarly, CACI (NYSE:CAI) has been a remarkably disciplined acquirer. In its seven announced transactions from 2001 through April 2004, the company acquired firms in the revenue range of \$12 million to \$55 million, well within the 15% threshold.

Those transactions enabled CACI to reinforce its brand as technology services provider in intelligence and defense markets.

With the capital market for federal contractors steadily improving and its reputation as acquirer firmly entrenched, CACI stepped up in May 2004 to buy the defense piece of American Management Systems, a \$250 million entity. At that, though, with CACI now well over \$1 billion in revenue, the 15% line was only marginally breached.

One could argue that these venerable federal contractors ‘did M&A right’ — embedding acquisition as a core competency, buying right-sized firms relative to their capacity, and investing and defending their core business.

For more on the book, *Mastering the Merger*, go to www.masteringthemerger.com.



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