What Every Entrepreneur Needs to Know About Selling a (Federal Contracting) Company

First in a series (initially published June 2005)

Many talented people start and grow successful companies.
They are so busy building the business they often do think about selling the firm. Yet decisions made today could affect valuations years later.

We address typical questions that company owners have regarding exit from the business. While the answers apply to many industries, we slant them from the perspective of a federal contractor, the market focus of Minuteman.

(Note: we make reference to a single founder but often there are a number of founders or a number of persons who have acquired a material portion of company stock over time.)

When is the right time to sell?

Each company founder will have a different answer.

There are a three overarching factors common to all liquidity situations — the personal status of the founder, the state of the company and the conditions of the merger and acquisition (M&A) market.

When all three are aligned in favor of selling, then the compulsion to exit should be great.

Where does the founder stand personally? Has the founder been at it a long time and wishes to undertake another endeavor? Does the founder feel the company's employees, if not the founder himself, would flourish in a larger business setting?

How is the company performing?

It's always better for exit planning to sell a business on the upside. Buyers tend to highly value companies with a documented potential of growth.

Like 'location' is the be-all in real estate, so is 'timing' in the M&A business.

One Minuteman client put the company for sale upon capturing the last two of four re-competed contracts awarded as a small business set-aside, each of them five year awards. The founders realized that four years hence they faced the prospect of becoming a 'non-small business' bidding on contracts set aside by the federal government for small firms; their value right then stood at peak and they desired to exploit that market position. (They did, with a sale to a very large firm!)

How does the M&A Market look?

For federal contractors, the market is optimal.

Capital has flowed into the sector in the post 9-11 world, funding programs that improve intelligence gathering, centric-based warfare systems, and physical/cyber security. Further, as the federal government embraces ever complex technologies and its workforce ages, the obvious result is increased outsourcing of government services to private firms.

All those factors have conspired to attract capital for M&A and public offerings of company stock, a valuation-friendly result for company founders seeking to exit.

Again it comes to timing. Pressures are mounting to rein the federal budget, while demands for federally funded health care and retirement grow in synch with the baby-boomer generation. How long can we afford to fund the lofty levels of government expenditures, and the contractors who manage federal operations? At some point the M&A market for federal contractors will soften — the question is when.

I care about the fate of my employees after the M&A deal AND I seek to maximize the purchase price for my company. Is achievement of both objectives possible?

As with any transaction between two parties, the one with leverage gets the better deal. In the federal sector, as we write this, those firms with the most leverage support intelligence agencies; their employees have top secret security or higher clearances.

All things being equal, however, some compromise may be in order.

Buyers value firms on the basis of the potential of future cash flows, i.e., the solidity of existing and presumed contract awards and the profitability of each. They will make certain assumptions about cost savings, synergies and leveragability in developing the valuation model for your firm. That may lead to assumptions about seller employees, office location and operating procedures not to the seller's liking.

To reach price and cultural nirvana, sellers should put together a post-deal checklist of the key aspects about which they will not waver, such as:

- certain employees must be employed for a given period post-transaction
- the company office must stay as is for a certain period of time
- salaries cannot be cut and raises/bonuses must be honored
- benefit structures must, in the aggregate, be maintained

While you must always maintain a flexible stance, having such a firm list helps to dictate the bounds of the discussion at the outset.

Where should I look for guidance when thinking of selling?

Most companies have used outside accountants and attorneys to perform corporate work. Start there for advice. They may point founders to an M&A advisor who manages the selling process. These firms are known as investment banks, M&A advisors or business brokers.

All have the expertise in positioning the firm for sale, researching and discreetly approaching the relevant buyer market, negotiating the transaction and managing the M&A project from start to finish.

To the extent founders have a board of advisers or directors (a great idea!), that is also a good place to start the search. These persons have knowledge about the seller, and can often recommend external M&A support.

What should I look for in a M&A advisor?

We recommend firms that:

- understand your industry and have worked in it for some time, with senior personnel having spent at least part of their career working on the corporate side

- have a feel for entrepreneurship, either as a director of another company, a consultant to small and mid-tier firms or as a policy advocate for smaller company issues

- express as much passion about your business as you do

- understand the M&A process in its entirety

- are able to commit senior level people to your account and not rely unduly on junior employees

- have national if not international coverage, since your buyer may come from any geography

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