Mergers, Acquisitions and Small Business

Howland – May 2008
Background

Current
- Director and GM, Retail Division, BAE Systems Products Group
- Formerly Armor Holdings Products Group
- Retail Portfolio includes:
  - Hatch law enforcement and military gloves
  - Hiatt handcuff and restraints
  - Protech tactical apparel
  - Kleenbore, Break-Free, B-Square, Speedfeed weapon accessories
- All were small business acquired between 1996 and 2006

Past
- Co-led M&A practice for DFI International (now Avascent Group)
  - Advised defense services firm on Mod&Sim small business acquisitions
  - Advised large defense electronics firm on services acquisition
- Strategy and M&A at Raytheon Company
  - Led acquisition of UTD, a small business in intelligence services
- Navy Surface Warfare Officer (stationed at 32nd Street)
Current Trends in M&A

**Estimated Defense M&A Deal Volume**

![Estimated Defense M&A Deal Volume](chart)

**Analysis**

- Large deals drove the volume in 2007
  - Armor Holdings
  - Washington Group
  - Smiths
  - Raytheon Aircraft

- As expected, foreign firms (led by the UK) were prolific acquirers, directly or via new U.S. platforms
  - BAE Systems
  - QinetiQ
  - Meggitt
  - VT Group

- Logistics and high-end product support services became sought after in FY07
  - As did key component manufacturers down the supply chain

*Source: Infobase DM&A articles, projections*
5 Key Factors Drive Prime M&A Strategies

Example M&A strategy: Aggressive entry into Chem/Bio detection through fold-in acquisitions of leading CBRNE R&D firms in the $50-$100M revenue range
Ways that Primes Screen Candidates

Sources of candidates can include:
- NDIA, Other Associations
- Contracts Databases
- Business Databases
- Conference Attendees
- Industry Journals, Articles
- I-Banks, M&A Advisors

Prioritization Criteria

Based on Customer Criteria, to include:
- Target Size
- High-level Valuation
- Customer/Market
- Tech/Capabilities
- High-level Risk

Filter Criteria

Based on Customer Criteria, to include:
- Customer Perception
- Operating Performance
- Mgmt Competence
- Contract Specifics
- Staff Clearances

Acquisition Targets

Deep dive research will often include:
- Detailed Contract Research
- Detailed Company Research
- Customer Discussions
- Subcontractor Performance

Will also find candidates through teaming, subcontracting, competitions or personal relationships … these candidates usually bypass the screening
Buyers or their consultants will draft an “Investment Thesis” focusing on strategic fit and value for executive level and/or Board level decision-making.
Factors in Valuations

The final price is a combination of a number of factors: target baseline value, synergy value, intensity of competition, what a target is willing to accept, etc.

**Hypothetical Prime Valuation Scenario***

- **Contracts** (full value, life, backlog, EACs, Prime v. Sub) to determine sustainability, risks, opportunities, including value of small business contracts
- **Customer base and relationships** to determine risks and opportunities
- **Capabilities and Technologies** (including IP and staff clearances) to quantify potential revenue synergies by allowing additional opportunity or raising capture probabilities
- **Financial metrics** (rates, book-to-bill ratios, revenue growth, margins, cash flow) to generate valuation model assumptions
- **Leadership/Management** to include analysis of a firm’s cultural characteristics and the incentives offered to employees

*Based on ranges set by Trading multiples, Comparable Transaction multiples, complex NPV analyses
Summary and Key Points

➤ Get into key market niches within the larger markets Primes are targeting

➤ Once there, get yourself known

➤ Work closely with the primes in these markets and develop your company relationship with key customers

  • Operational excellence and intimacy with a desirable customer set are the best ways to sell yourself

➤ Transition your small business contracts where possible

  • Besides allowing the Buyer to factor the full value of the contract into the valuation, it demonstrates the customer’s reliance on your services

➤ Ensure you have a compatible company culture and are not overly reliant on key management or personnel

  • Don’t be the firm that attracts employees with “off the wall” incentives that will not be replicable under a public company, compliance culture
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