

Homeland Defense Journal

"He is best secure from dangers who is on his guard even when he seems safe." —Syrus Publilius

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Government Sales Channel Drives Value For Homeland Defense Related Companies

By Jeffrey Hamon
 For Homeland Defense Journal

Establishing a deep sales channel into government agencies is every bit as challenging as developing front-line technologies for homeland defense applications. Companies that have achieved strong sales relationships are receiving handsome premiums in merger and acquisition transactions, as buyers look to augment not only the latest technologies, but also their sales channel in these transactions.

Small and mid-sized homeland defense enabling companies that have developed a successful sales channel into federal government agencies, law enforcement and military departments are driving premium values in M&A transactions. In order to successfully capitalize on the industry expansion taking place, government contractors must continue to increase channel depth, and acquisitions are being targeted with channel development in mind. Notable announced transactions where a premium price has been contemplated for channel are the acquisitions of BAE's Advanced Systems unit by Integrated Defense Technologies (IDT) and L-3 Communications' (L-3) acquisition of Wescam, Inc.

The breadth of agencies with homeland defense mandates is massive, with needs arising at every angle of the government from the Customs Service to local police forces. Homeland defense technologies will find broad marketing appeal across the government spectrum, not limited to the traditional military and intelligence procurement, and including agencies like the Border Patrol, the Immigration and Naturalization Service and the Treasury Department.

A successful sales channel into government, defense and law enforcement agencies takes years to develop because of the sensitivity and secrecy of certain agencies, the permitting and clearances that are required to do business, and the amount of time necessary to complete a contract cycle. The difficulty in attracting new customers underscores the importance of maintaining strong personal contact with the core channel. Top

quality product offerings are essential to maintaining these relationships, as a sales channel with no underlying product or service is of no value. Providing reliable technology or services that can be customized to meet the changing needs of the client is essential to maintaining the channel long term. Furthermore, possessing the staff that can effectively manage the needs of each client, from technology and field usability to contracting and procurement, fosters the more successful channels.

Additional key differentiators when comparing sales channels from an M&A perspective, include the types and length of contracts, as well as the ultimate segment of the market served. Long-term, multi-year, sole-sourced contracts are the gems of the industry. Contracts that can be easily modified to fit different technologies, or those contracts that can foster sub-contracting abilities for add-on products and services are also a highly sought after commodity. For example, certain GSA contracts allow for other agencies to order under the terms of the contract without having to complete a separate contracting process. Additionally, certain market segments, including the electronic surveillance sector, have mandated purchasing set-asides for small to mid-sized companies in an effort to foster competition. The ultimate benefit to the smaller companies is the ability to develop a sought after channel.

Why is channel driving so much value from an M&A standpoint? A developed channel brings accessibility to the end users, provides an understanding of the nuances of the contracting process with specific agencies, and produces relationships that are deep enough to travel between agencies when there are alterations in agency staffing.

Accessibility gives players the first to market position as the homeland defense industry expands. Contract modifications and endless subcontracting scenarios allow companies to meet the urgent needs of the government and position those providers on the government's short list long term. Additionally, accessibility to a customer set with a defined budget for products and

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services that continues to expand provides for more accurate revenue forecasting.

Contract knowledge by specific agency should not be overlooked. As the industry continues to expand rapidly, providers that have this intimate knowledge become more attractive to the agencies themselves from a time-to-market standpoint for mission critical products and services. Companies that have a developed, long-standing channel often times understand the process better than the bureaucrats on the other side of the table. Furthermore, in certain instances RFPs can be written by one of the potential providers, with that company's specific product specifications, fostering a distinct competitive advantage and truncating the time to product or service procurement.

Relationships are the backbone of any successful provider in this industry. As new agencies are created to execute on the nation's homeland defense strategy, these relationships become even more paramount. The vast majority of the staffing for these new agencies will come from existing agencies, not from new "outsiders." Strong procurement relationships will successfully travel to these new agencies, leaving providers with the long-standing channels intact.

IDT and L-3 are clearly demonstrating the value of established channels in niche segments of the homeland defense market. In the case of the intended acquisition of BAE's Advanced Systems unit by IDT, a core successful sales channel with a diverse and proprietary product offering is driving this transaction. The BAE division is a legacy defense and government supplier of more than 300 RF-based surveillance products with approximately 70 percent of its revenues derived from sole-sourced contracts. IDT announced value for this business is \$146

million, which from a multiples standpoint equates to approximately 1.8X 2002 sales and 8X the division's 2003 projected earnings before interest, taxes, depreciation and amortization (EBITDA).

A similar story can be told of L-3 Communications' proposed acquisition of Wescam, Inc. In addition to Wescam's commercial applications, the Canadian-based company provides a diverse set of U.S. government agencies with electro-optic surveillance systems and has a thriving subcontracting practice with the industry giants. Wescam dominates its market segment and, like BAE Advanced Systems, operates under long-term, sole-sourced contracts. Wescam's market position is projected to garner \$118 million for L-3, or a multiple on sales of 1.18X.

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Jeffrey Hamon is a principal with RCW Mirus, Inc.

Since 1987, RCW Mirus has been providing investment banking services to closely held and family-owned businesses, venture backed companies and public corporations. Based in Boston, Mass., Mirus represents small businesses and medium-sized companies in a wide range of industries, including security and homeland defense, basic manufacturing, technology, distribution and services. Services include financial advisory and valuation services, including stock or asset sales, recapitalizations and corporate divestitures.



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