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PUBLIC CONTRACTS

Annual Review 2022

January 24 – 27, 2022

DAY 3

12:00 p.m. Claims, Terminations & Disputes

2:00 p.m. Construction Contracting

3:00 p.m. Small Business Contracting

4:00 p.m. Mergers & Acquisitions

WEDNESDAY, JANUARY 26, 2022

12:00 PM to 5:00 PM

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Alan Chvotkin
President, Pub K Group
Partner, Nichols Liu LLP

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Audience Notes

- Q&A – to ask a question of the panel, please type your comment in the Q&A box at the bottom of your screen. The panel will address as many questions as time allows.
- Materials
 - Available for download at <https://pubkgroup.com/pubk-annual-review-2022/>

CLEs

Pub K is applying for CLE approval for the Annual Review in Virginia, California, Texas, Florida, Colorado, and Kansas.

- Approval is expected but not guaranteed
- Pub K will notify participants of approval when received
- CLEs are available free of charge to Pub K subscribers
- For non-subscribers, the fee is \$75 for 1 CLE and \$150 for 2 or more
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CLEs

Important: Many state boards require us to verify participation *during* the event.

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SESSION 10

MERGERS AND ACQUISITIONS

WEDNESDAY, JANUARY 26, 2022

4:00 PM to 4:50 PM



Susan Gabay, Managing Director



HOULIHAN LOKEY



Kathryn Hickey, Partner

**PILIERO
MAZZA**



Damien Specht, Partner

MORRISON

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Key 2021 M&A Trends in the Government Contracting Industry – Record Transaction Volume

- Unprecedented M&A volume in 2021
 - ▷ Total volume up 39%
 - ▷ Strategic buyer activity up 37%
 - ▷ PE activity up 42%
 - ▷ Total volume in second half of 2021 higher than every full year since 2012 except for one year (2019)

Key 2021 M&A Trends in the Government Contracting Industry – Valuation Trends

- Median M&A multiple up 14% from 11.0x to 12.5x (expressed as EV/EBITDA)
- Premiums persist for assets of scale
- Companies positioned at the intersection of technology and mission garnering the highest valuations

Key 2021 M&A Trends in the Government Contracting Industry – Notable Strategic Buyer Transactions

- Technology/capability driven strategies
 - ▷ ManTech purchase of Gryphon Technologies (MBSE)
 - ▷ Leidos purchase of Gibbs & Cox (Maritime Autonomy)
 - ▷ Booz purchase of Tracepoint (Cyber/Digital Forensics) and Liberty IT (Digital Transformation)
 - ▷ CACI purchase of Bluestone Analytics (OSINT)

Key 2021 M&A Trends in the Government Contracting Industry – Robust PE Activity

- 27 new platforms in 2021, 30% greater than next best year over the past decade (2019)
- Notable players/transactions:
 - ▶ Platforms of scale – Amentum (Lindsey Goldberg / American Securities) and Peraton (Veritas)
 - ▶ Newer entrants (OceanSound, Godspeed, CI, Brightstar)
 - ▶ Near simultaneous exits/new investments (Carlyle, Macquarie)

Key 2021 M&A Trends in the Government Contracting Industry – Public Company Growth and Valuation Trends

- Modest decline in public company valuations (4% decline from 14.3x to 13.8x)
- Emerging pressures on growth (supply chain, award delays, tight labor market)
 - ▶ Median public company organic growth rate declined to 1% in most recent quarter (Q3 2021) vs. 8% in Q3 2019
- Potential near-term and longer-term impacts on M&A

KEY TREND: STRUCTURE

- Basic considerations in structuring any acquisition:
 - What assets are being acquired?
 - What liabilities are being assumed?
 - What are the tax implications?
 - What 3rd party consents are needed?

Transaction Structures

- Asset Purchase
 - Buyer purchases some or all of seller's assets. Buyer may or may not assume liabilities.
 - Exception – novation of federal prime contracts
- Stock Purchase
 - Buyer purchases seller's equity. Seller entity continues to exist but with new owners
- Merger
 - Combination of entities where one entity survives to hold the assets of liabilities of the combined entities

Basic Forms of Acquisitions – Asset Acquisitions

Pros and Cons to Asset Acquisition Structure

- Buyer
 - Can pick and choose specific assets and liabilities
 - No money wasted on unwanted assets (but may inadvertently fail to purchase an important asset)
 - Lower risk of assuming unknown or undisclosed liabilities
 - Often better tax treatment for buyer than stock acquisitions
 - Separating intermingled businesses (e.g., manual contract and employee transfers, dealing with shared services and IP)
- Seller
 - Left with known/unknown liabilities not assumed
 - If Seller is not a disregarded entity, often better tax treatment when selling stock
 - More complicated (e.g., assigning specific assets, transferring employees, transitional services and shared IP)
 - Lengthier time to closing
- Federal Contracting Assets
 - Prime contract novation
 - Security Clearances are not transferrable assets

Basic Forms of Acquisitions – Stock Purchases

B. Acquisition of Stock

- Buyer acquires Target's outstanding stock from the stockholders of Target for stock of Buyer, cash or other consideration
- Completed through stock purchase agreement
 - Negotiate directly with Target's stockholders
 - May acquire less than or 100% of outstanding shares (most strategic Buyers will want 100% ownership)
 - May not work with larger shareholder bases where direct acquisitions of shares can be cumbersome or logistically difficult in the private company context
- Target continues to hold all of its assets and liabilities both before and after the transaction – now with different stockholder(s)

Basic Forms of Acquisitions – Stock Purchases (cont'd)

Pros and Cons to Stock Acquisition Structure

- Buyer
 - Cannot pick and choose specific assets and liabilities – will assume all liabilities (known and unknown)
 - Often worse tax treatment for buyer than asset acquisitions, unless a tax election is made to treat the sale as an asset acquisition
- Seller
 - Not left with any contingent liabilities
 - Often better tax treatment for seller than sale of assets
- Not practical if the Target has large number of stockholders, as holders must individually agree to sell and negotiations with multiple shareholders can be costly and time consuming

Basic Forms of Acquisitions – Stock Purchases (cont'd)

Pros and Cons to Stock Acquisition Structure

- Government Contracting Assets
 - Will not trigger novation of prime contracts
 - For small business set-aside contracts, may trigger notifications of change in control / recertification
 - For targets with facility security clearances, will require submission of a change of condition package and if buyer has no clearance, post-closing structure to protect cleared work.

Basic Forms of Acquisition – Mergers

Pros and Cons to Merger Structure

- Buyer
 - Cannot pick and choose specific assets and liabilities and assumes all liabilities (known and unknown)
- Seller
 - Not left with any contingent liabilities
- Typically only majority consent of Target stockholders required – very effective way of completing acquisition of a Company with a large number of stockholders
- Numerous third party consents may be required if Target merged out of existence (alternatively, if a reverse triangular merger, many third party consents may be avoided)
- Appraisal rights providing dissenting shareholders with the right to require a Company to pay them the “fair value” for their shares may apply
- Government Contracting Assets
 - In reverse triangular merger, survival of target avoids novation, loss of clearances
 - In other merger structures, extinguishment of target triggers novation, loss of clearances

Novation Agreements and Related Issues

- Federal prime contracts are transferrable only with government consent (FAR Part 42)
- Transfer must be found in “Government’s best interests”
- Novation Agreement must be signed by Buyer, Seller and Government
- Only processed following closing
- Buyer guarantees seller’s past performance; Seller guarantees Buyer’s future performance
- Lengthy process; often an interim subcontract is necessary

DCSA Considerations

- Facilities Security Clearance (FSC) cannot be transferred to a Buyer in an asset sale or merger
- Non-cleared Buyer can hold a cleared target as a subsidiary; if DCSA requirements are met
 - No FOCI concerns
 - Submission of change of condition package following closing (should be socialized pre-closing)
 - KMPs of subsidiary remain in place
 - Cleared personnel remain in control of cleared work
 - Exclusionary resolutions adopted to ensure non-cleared parent cannot control cleared work by the subsidiary

2021 Key Developments: Litigation

- *Odyssey Systems Consulting Group, Ltd.*, B-419731 et al., July 15, 2021, 2021 CPD ¶ 260
 - Odyssey protested the award of a set-aside Task Order under OASIS SB contract where awardee was acquired by a large business after proposal submission but prior to award
 - Odyssey claimed that the SBA's new provision at 13 C.F.R. 121.404(g)(2)(iii) –the 180 day rule for proposals – made the awardee ineligible for award
 - GAO asked SBA OGC's view, and SBA opined that awardee remained eligible because, although recertification was required, the awardee remained eligible because this award was under a set aside Multiple Award Contract
 - GAO deferred to SBA, agreeing that the only impact of the transaction is that the agency could not take small business credit for the task order award. SBA OHA came to the same conclusion (SBA No. SIZ-6135)

2021 Key Developments: Litigation (cont'd)

- *Morgan Bus. Consulting, LLC*, B-418165.6 et al., April 15, 2021, 2021 CPD ¶ 171
 - After MBC submitted its proposal, the Navy became aware of the sale of a key subcontractor. The Navy assigned multiple weaknesses based on that sale.
 - MBC argued that, by virtue of a press release and unrelated notification of a different CO, the agency was on notice that the transaction would merely affect the entity's name and would not impact performance
 - The GAO noted that agencies do not have affirmative obligations to discover corporate transactions that may affect contract performance.
 - However, here the Agency was aware of the transaction and, as a result it was reasonable to consider the transaction.
 - GAO denied the protest finding that the Navy reasonably assigned a weakness to MBC's proposal based on the potential impact of the transaction on performance

2021 Key Developments: Litigation (cont'd)

- *Vertex Aerospace, LLC*, B-420073 et al., November 23, 2021, 2021 WL 6337900
 - Vertex protested the award of an Air Force Task Order alleging that the agency failed to consider the likely effect on performance of a corporate transaction wherein DynCorp, the awardee, was acquired by Amentum
 - While the agency was unaware of the acquisition upon receipt of proposals, it formally learned of the acquisition during proposal evaluation when a novation request was submitted.
 - GAO found that this put the agency CO on notice of the transaction and novation, meaning that the CO had a responsibility to meaningfully and reasonably consider the effect of the transaction on proposals, and particularly on DynCorp's ability to perform

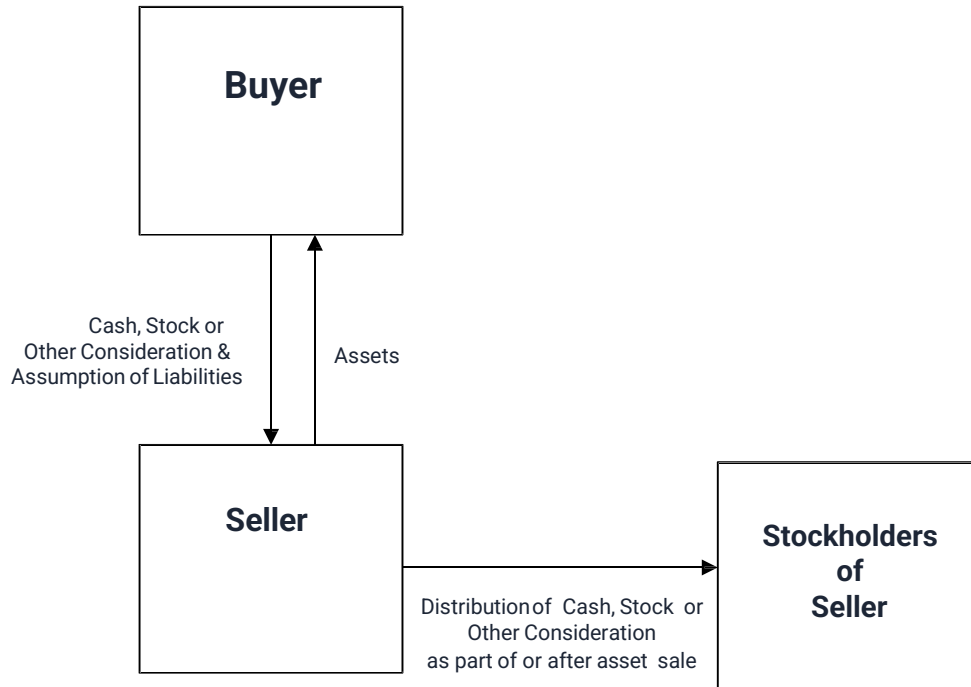
2021 Key Developments: Litigation (cont'd)

- *Vertex Aerospace, LLC*, B-420073 et al., November 23, 2021, 2021 WL 6337900 (ctd.)
 - No pre-award documentation existed describing the agency's analysis.
 - Agency alleged that it sought information confirming DynCorp's ability to perform following contract award, however this information came from Amentum (not DynCorp) and failed to answer key questions regarding consolidation of contract performance activities and the intended use of intercompany procedures
 - GAO sustained Vertex's protest, finding that the agency failed to adequately obtain or document the information necessary to confirm that DynCorp could effectively perform the task order
 - Compare to the denied protest in *PAE Aviation and Technical Servs., LLC*, B-417704.7, B-417704.8, June 8, 2021, 2021 CPD ¶ 293, (concerning the same transaction)

Backup Materials

Basic Forms of Acquisitions – Asset Acquisitions

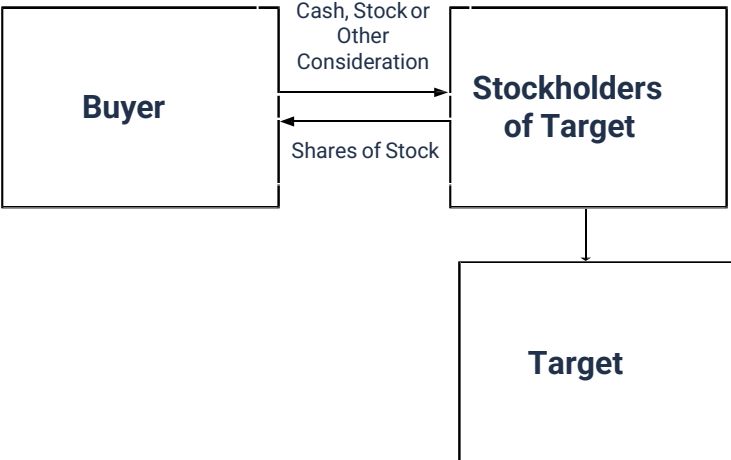
Acquisition of Assets



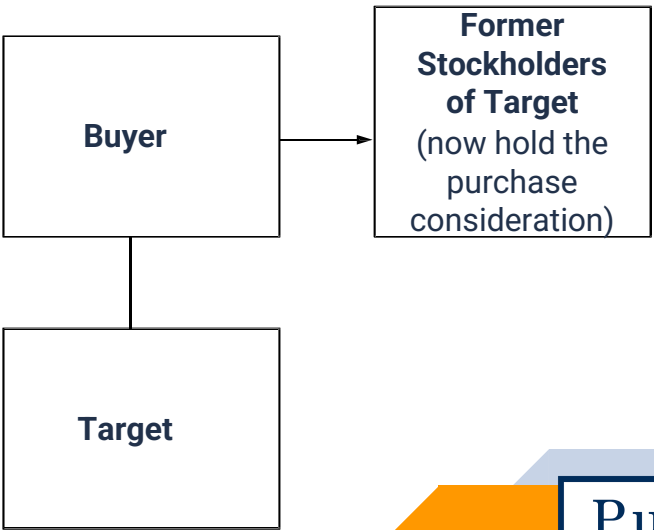
Basic Forms of Acquisitions – Stock Purchases

Acquisition of Stock

Before:



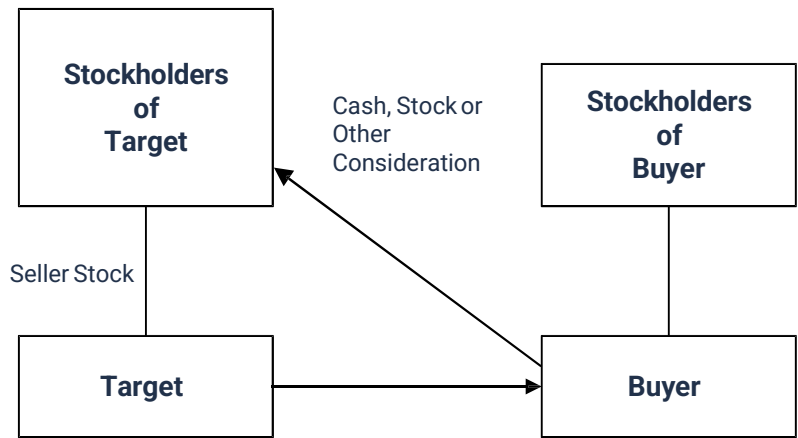
After:



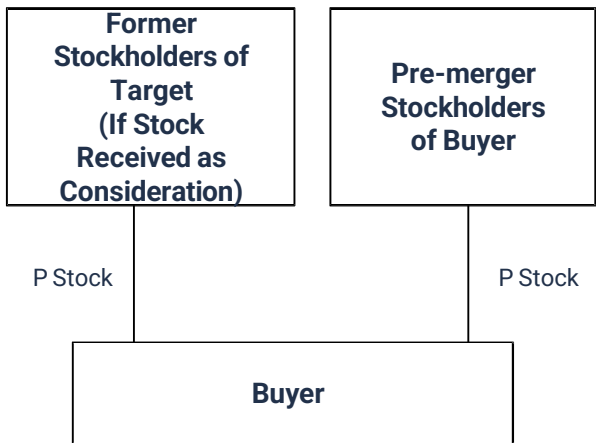
Basic Forms of Acquisition – Mergers

Straight Merger

Before:



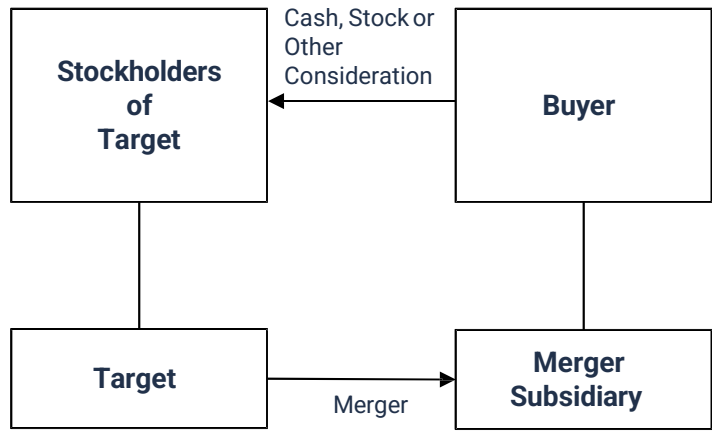
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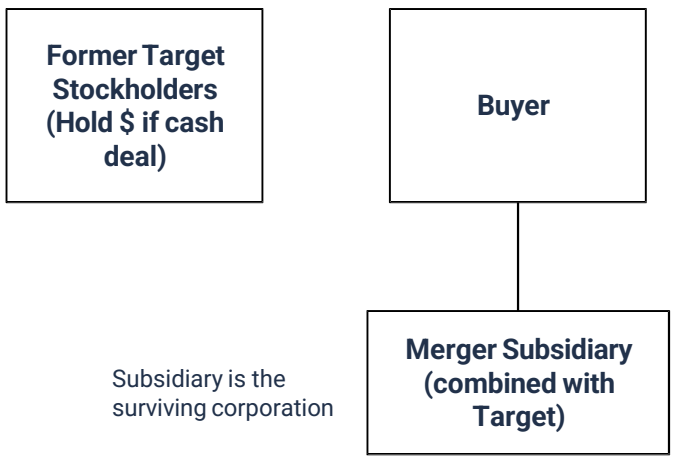
Basic Forms of Acquisition – Mergers (cont'd)

Forward Triangular Merger

Before:



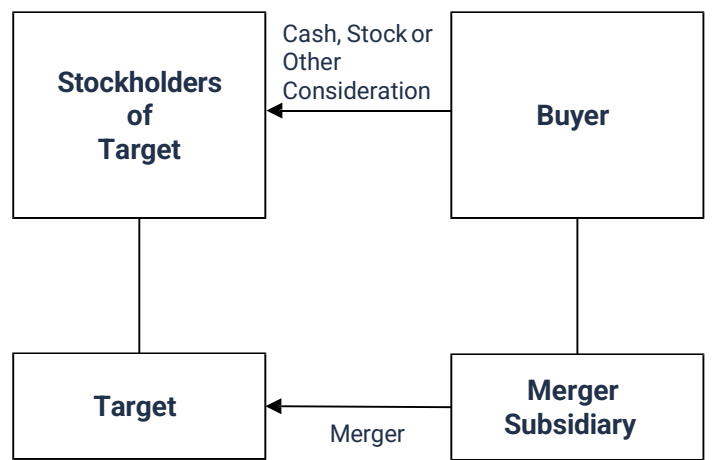
After:



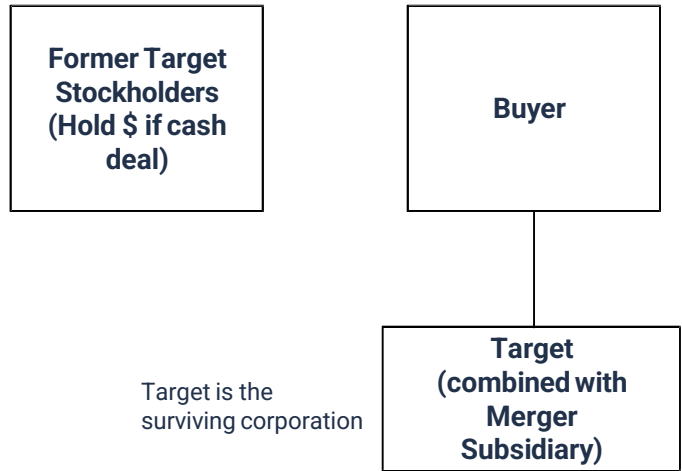
Basic Forms of Acquisition – Mergers (cont'd)

Reverse Triangular Merger

Before:



After:



THANK YOU!

Susan Gabay
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Pilieromazza

Questions or Comments?
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Thank you!

**See you tomorrow at 12:00 p.m. for
Day 4 of Pub K's Annual Review 2022**



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