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The McLean Group is a national, middle market investment bank serving businesses generating up to \$500 million in annual revenues. For more information, visit www.mcleanllc.com.

Feature Article:

Security Sector Technologies Poised for Continued Middle Market M&A Boom

By Geoff Nattans

The market for lower middle market government contractors remains vibrant —particularly in areas of cyber security, healthcare IT and environmental services—as highlighted by recent transactions including Boeing’s June 2009 acquisition of eXMeritus Software, Lockheed Martin’s acquisition of Eagle Group International and R.W. Beck’s sale to SAIC in August. Each of these transactions represents a large prime contractor acquiring best-in-class capabilities essential to fulfill requirements on existing contracts or to position themselves strategically to bid on new opportunities.

While cyber security, healthcare IT and environmental services have dominated recent government M&A activity and undoubtedly will remain high-priority areas of federal government focus, biometric technology is an example of an area within the larger security space that is becoming a major area of interest for strategic and financial buyers alike.

Biometrics, loosely defined as the use of hardware/software components to recognize humans based on one or more physical or behavioral traits, is a core component of several federal government initiatives addressing identity management, access control and surveillance. The most significant ongoing Federal biometric programs include DHS’ US-VISIT and E-Verify and the FBI’s NGI system.

Figure A. Ongoing Federal Biometrics Programs

<p>DHS US-VISIT</p>	<p>The DHS' US VISIT (United States Visitor and Immigrant Status Indicator Technology) system is a US immigration and border protection system for the collection and analysis of biometric data to be checked against a database containing identified terrorists, criminals and illegal immigrants. The massive DHS contract was awarded to Accenture LLP in 2004 with a maximum value of \$10 billion over ten years (five year base period with five one-year options).</p>
<p>FBI NGI</p>	<p>The FBI's Next Generation Identification (NGI) System is designed to expand on its existing biometric database system and will incorporate multimodal biometrics such as iris and facial imaging. The FBI contract for design, development, documentation, integration, testing and deployment of the NGI system was awarded to Lockheed Martin Transportation and Security Solutions in February 2008 with a value of \$1 billion over ten years. Lockheed beat out IBM and Northrop Grumman for this noteworthy contract.</p>
<p>DHS E-Verify</p>	<p>E-Verify is a DHS program in partnership with the Social Security Administration designed to help certify that employees hired by companies are legally authorized to work in the US. E-verify currently uses biometric data to enhance search and verification capabilities and it is expected that the technology will play a much larger role as the program expands. Approximately 1 in 8 new hires nationwide currently is checked by E-verify and it is estimated that the program will grow more than 400% from 2007-2009.</p>

Source: FedSources, Inc.

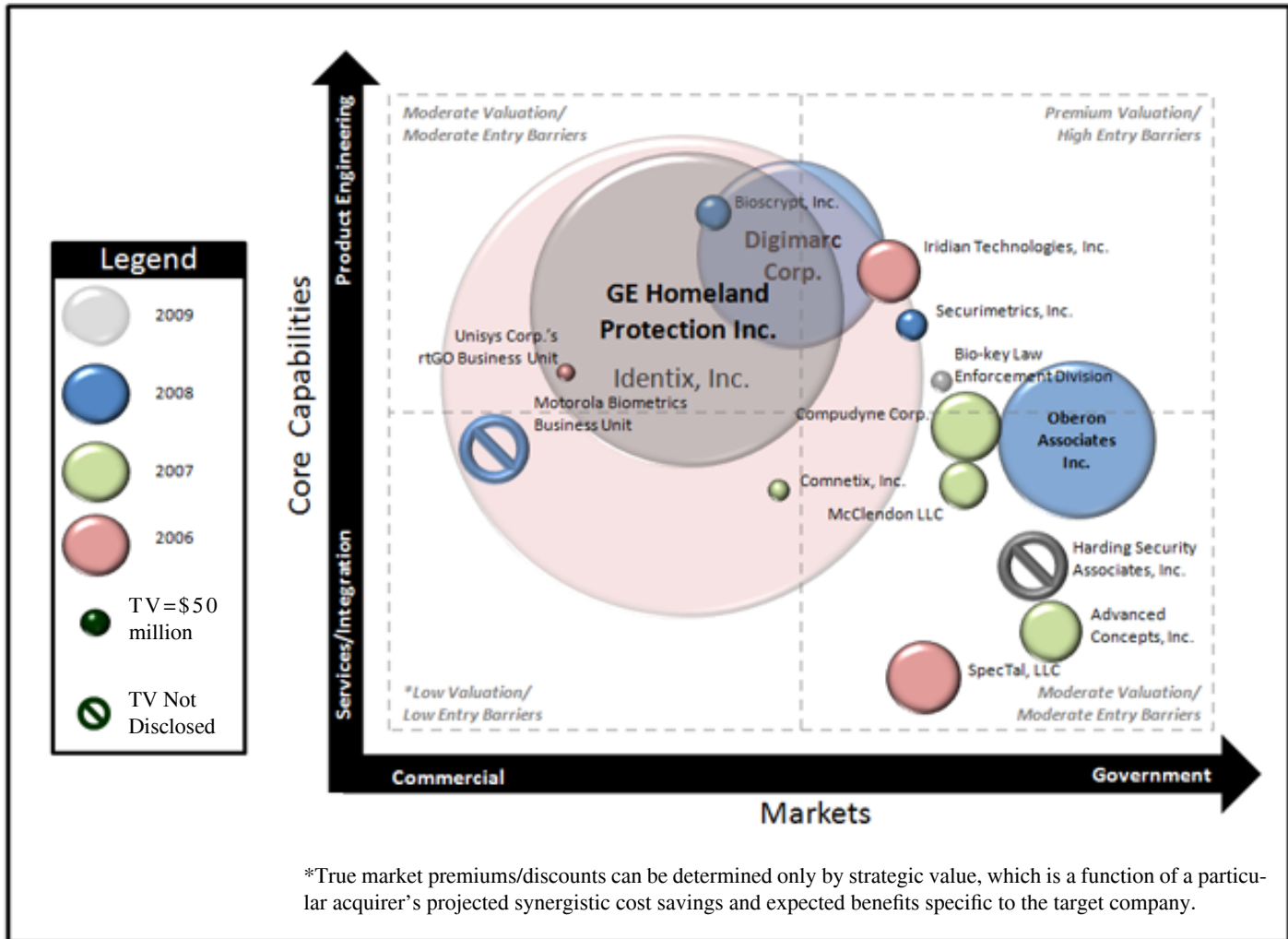
Transaction Analysis

In the government services sector, lower middle market M&A activity within a particular functional area often foreshadows an impending increase in federal funding or major contract awards. Large prime contractors (i.e. Lockheed Martin, BAE Systems and Raytheon) and their mid-sized counterparts (i.e. L-1 Identity Solutions, SRA International and NCI, Inc.) audit their existing capabilities and agency relationships regularly and run gap analyses against growth targets and areas of focus for coming fiscal years. Existing gaps which cannot be filled organically through internal reallocation of financial or human capital resources must be addressed strategically through acquisition.

Figure B. exhibits a sampling of middle market acquisition targets in the security space since 2006 plotted as a function of core capabilities and customer markets served. The largest transactions (denoted by relative bubble size), including Viisage Technology's August 2006 merger with Identix to form L-1 Identity Solutions (\$791.1 million), L-1's subsequent acquisition of Digimarc Corp. in August 2008 (\$306.3 million) and Sagem Securite SA's April 2009 agreement to acquire GE's Homeland Protection Unit (\$580.0 million), involve targets whose core capabilities include a mix of high-end product development and complementary integration services. Further, these larger transaction targets generally have more commercial customer relationships than federal agency contracts. Nearly all of these companies were focused on or had some level of biometrics capabilities.

The lion's share of recent biometric deals, however, involved lower middle market, government-focused targets with transaction values of \$25 million - \$200 million. While detailed valuation data is not widely available, acquirers generally have applied the highest valuation premiums to targets providing sophisticated hardware and software engineering services to the US DOD and Intelligence Community.

Figure B. Selected Security Firm Acquisition Targets with Biometrics Expertise, 2006 – Present



Source: Capital IQ

Since valuation multiples are derived from revenue growth rates (among other inputs), buyers place more confidence in the future prospects of the US federal programs which have and will continue to receive the largest annual discretionary budgets.

By far the most active strategic company in recent security and biometric-related M&A, L-1 Identity Solutions has made nine acquisitions in the space since 2006. Each of L-1's acquisitions added a critical capability or entrée into a particular agency or sector. The Company's acquisition of McClendon, LLC (\$65.7 million) and Advanced Concepts, Inc. (\$77.5 million) in July 2007, for example, added critical product engineering and service capabilities within the coveted US Intelligence Community. Accordingly, L-1 has nurtured the targets' valuable Intelligence Community relationships to cross-sell products and services while making newly acquired products available to existing customers. The industry's most recent transaction was BIO-key International's August 2009 agreement to sell its Law Enforcement Division to InterAct Public Safety Systems—adding more than 2,000 customers and making InterAct the world's largest public safety software company.

Financial buyers have shown recent interest in security contractors as well. In June 2009, private equity firm GTCR acquired McLean, Va.-based Harding Security Associates, Inc. through its biometric and cyber security-focused platform Six3 Systems, Inc. In September 2007, The Gores Group acquired CompuDyne Corp. for \$101.8 million after the holding company spent the preceding decade rolling up small biometric engineering firms to a form a successful platform. Private equity firms likely will make up a larger share of biometric M&A in the near future as companies with superior technologies isolate themselves from their peers and position themselves as attractive prospects for growth capital investments or buy-out opportunities.

Acquisition Positioning

Analysis of recent M&A activity in the biometric space suggests several key positioning strategies to guide lower middle market business owners who sit at varying stages of the business cycle. The highest barriers to entry into the sector exist in the upper right quadrant in Figure B, where companies provide sophisticated hardware/software development services to the most restricted and highly classified agencies of the US Department of Defense and the Intelligence Community. These high barriers are created by the prevalence of proprietary intellectual property, high capital requirements and strong agency relationships developed through many years of successful engagements. It comes as no surprise that this quadrant also represents the capabilities and customers common among companies achieving the largest valuation premiums in government M&A transactions. Valuation multiples, generally derived as a function of projected annual growth rates, also can be dependent upon a company's market penetration and product/service mix. For example, a potential acquirer will be more confident in the projections of a target with an expected revenue growth rate of 15% that also has significant market penetration and long-term relationships, than it would for a company with the same projected growth rate (or perhaps higher), but very little historical market penetration or measurable customer relationships.

The lowest barriers to entry into the space exist in the lower left quadrant in Figure B. This quadrant contains companies providing less sophisticated consulting and integration services mainly to commercial customers on a one-off basis or in a limited-scope relationship. Companies in the lower left quadrant can move up by developing or acquiring more sophisticated product development capabilities to complement their core services for an end-to-end solution offering. These companies can move right by performing well on limited-scope commercial engagements to build experience and credibility to win government subcontracts (or teaming arrangements) and ultimately bid on prime contracts. To be fair, there is ample opportunity to build a lucrative biometric business solely within the commercial sector, but historical transaction multiples demonstrate that companies that provide products and/or services to government agencies are more likely to capture premium valuations when sold.

Opportunities

Myriad opportunities exist in both the public and private sectors for lower middle market contractors in the biometrics space. Within the government sector, specifically DOD and DHS, there exists a tremendous need to address



interoperability challenges among existing, disparate systems. The FBI's NGI system, for example, was designed to comply with established global standards enabling the transmission and interchange of biometric records by disparate systems. The DHS US VISIT initiative, on the other hand, will attempt to enable the interface of up to 16 different systems, many of which currently run on proprietary (non-standard) platforms—ultimately preventing information sharing. Further, as US foreign policy adapts to the evolving global climate and the likelihood of a perpetual multi-front engagement strategy (simultaneous conflict with nation-state(s), terrorists and other global concerns) it will require innovative technologies to maximize the efficiency of limited, stretched resources. The US government will rely on prime contractors to develop and integrate these disruptive technologies. Those prime contractors, in turn, will seek out smaller firms through M&A to add mission-critical capabilities that will enable successful delivery on contract commitments.

The private sector also presents a nearly limitless array of prospective security and biometric applications across many industry groups. From sporting and recreational venue security (Walt Disney World currently is the US' largest commercial biometrics application) to customer relationship management, biometric technologies have made only a small impact when compared to inevitable developments that time and innovation will produce.

Geoff Nattans is an Associate within The McLean Group's Government Contracting practice.

The McLean Group Advises eXMeritus on Sale to Boeing

McLean, VA – The McLean Group announced that it acted as the exclusive mergers and acquisitions (M&A) advisor to eXMeritus in its sale to The Boeing Company (NYSE: BA).

eXMeritus, founded in 2000 and based in Fairfax, Virginia will add to the security and intelligence sector of Boeing Integrated Defense Systems’ Network and Space Systems unit. Jim Albaugh, CEO and President of Boeing Integrated Defense Systems stated, “The addition of eXMeritus to our team is a strong enhancement to the Boeing capabilities developed through years of experience on secure networks for some of the most complex systems in national security today.”

The financial terms of the deal were not disclosed.

The McLean Group’s Government Contracting team focused its efforts on finding a buyer that would leverage eXMeritus’ proprietary technology as a key part of its corporate strategy. Managing Director Joe Golden said that “This deal was extremely successful in matching up eXMeritus with a buyer that really valued its technology and wanted to provide its employees a terrific platform going forward.”

“The McLean Group provided us with expert knowledge about our industry and the sales process. Furthermore, they had the contacts in the industry allowing us to connect with the right buyer. Both Kathleen Crow and Joe Golden were very professional throughout the entire transaction enabling it to run smoothly from both ends. We were more than pleased with all of the work that The McLean Group put into this deal,” said Robin Alman, owner of eXMeritus.

This transaction adds to the history of successful federal contracting advisory assignments for The McLean Group. Managing Director Kathleen Crow said, “The government contracting arena continues to be active, particularly in the areas of cyber security and information technology applications. It’s an exciting time to be in the industry especially because of the changes occurring in Washington right now.”

For more information about this transaction, visit Boeing.com or contact:

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- Joe Golden | jgolden@mcleanllc.com | (703) 752-9023



The McLean Group: Specializing in Government Contracting

The McLean Group’s investment bankers can help companies address the challenges ahead. We act as trusted, essential advisors to government contractors considering short-term or long-term sell-side and/or buy-side M&A and capital formation opportunities. The McLean Group’s investment bankers leverage their skills in navigating the complex M&A process particular to this industry to maximize their clients’ value.

The McLean Group’s GC practice incorporates:

- An industry-focused team led by highly-experienced investment bankers
- The McLean Valuation Services Group, which annually completes more than 50 valuation engagements involving government contractors
- A Board of Advisors comprised of prominent business leaders, many of whom have extensive experience in politics, government, the military and government contracting
- An exceptional research staff
- An in-house Exit Strategies Institute for business owners planning exit strategies 18 months to 48 months out.



Selected McLean Group GC Experiences

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About The McLean Group

The McLean Group is a national, middle market investment bank providing mergers & acquisitions (M&A), capital formation, market intelligence, business valuation, litigation support and exit planning services. The McLean Group serves businesses generating up to \$500 million in annual revenues. Headquartered in Washington, DC's technology, communications and government contracting corridor, the firm is among the largest independent middle market investment banks in the region. The McLean Group is a FINRA Registered Broker/Dealer and Member FINRA/SIPC.

- **M&A:** The McLean Group uses its considerable expertise in a wide variety of industries to identify the most probable and suitable candidates in order to complete transactions under the most favorable terms for its clients.
- **Capital Formation:** The McLean Group arranges private equity, venture capital, senior debt and subordinated debt in amounts ranging from \$5 million to \$250 million to support clients' expansion, mergers & acquisitions (M&A), refinancing, recapitalization, leveraged buyout and shareholder liquidity objectives.
- **Market Intelligence:** By leveraging superior competitive analyses, we provide business executives with comprehensive market intelligence reports, which give the market insight and analytical expertise required to reduce risk and uncertainty in strategic decision making.
- **Business Valuation:** As a core competency and complement to its M&A business, The McLean Group provides business valuation services, including intangible asset and financial security valuations for a variety of transactions, financial reporting and tax purposes.
- **Litigation Support:** From quantifying economic damages to valuing a minority interest in a business, the firm has the business valuation experience and credentials to support cases involving a variety of legal issues.
- **Exit Planning Services:** Based on its extensive experience advising owners of middle market businesses, The McLean Group has developed a proprietary process that analyzes more than 60 value/risk drivers that can have a significant impact on the value of a business.

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