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About Us

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:

ESOPs Offer Government Contractors a Creative Exit Alternative

There has been much written about traditional exit strategies for owners of Government Contracting enterprises. Far less ink has been devoted to unconventional transactions including sales to Employee Stock Ownership Plans (ESOPs).

While sales to ESOPs are normally very complex transactions, they can provide tremendous income tax benefits, selling shareholder benefits and corporate entity benefits. Employees find it attractive because they become “owners.” Government Contractors find it attractive because of certain rules they benefit from regarding Federal Acquisition Regulation (FAR) treatment of ESOP expenses.

ESOPs are company-sponsored, tax-qualified, retirement benefit plans with similarities to 401k and profit sharing plans. Under an ESOP, a Company establishes an Employee Stock Ownership Trust, which is governed by trustee(s) appointed by the Company's Board of Directors. Generally, the Trust is funded with the Company's pre-tax profits. The Trust, in turn, uses this cash to buy shares from the owner(s).

Over time (subject to certain vesting requirements), all of the full-time employees of the Company become owners in the Trust (and thus, owners in the Company). The sale of shares to the Trust can be staged over time provided that a minimum of 30 percent of ownership is sold in the initial ESOP sale. In essence, with an ESOP, an “inside” buyer is created in the form of a Trust owned by employees.

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Expert Tips: Defining the Value of Government Contracting — Business Science, Art or Alchemy?

When a shareholder of a small- or mid-size government contracting business initially considers an exit strategy, the first-order issue inevitably involves setting the business' value. Valuing a business is not an exact science, but it is not purely an art either. It is a little bit of both — a kind of an alchemy.

For centuries, alchemy combined elements of science, like chemistry, with art and astrology to define physics and behaviors of ancient world. Today we can quantify a business' value with industry conventions or approaches, methods and formulas. But the price that a business is sold for depends on the business' inherent aspects and those aspects that are not directly tied to the business' economic value.

Future economic capacity as seen through the acquirer's eyes is the determinant of value that sets the price. Capturing those future intangibles is the art of alchemy.

Elements known as value drivers, which are specific to a business or industry, have a marked impact on value. In strategic long-term planning for an exit event, a shareholder can focus his or her resources on improving certain value drivers to maximize the value of the business. The government contracting industry has its own unique set of value drivers that are important for any business owner to understand.

The value of a government contracting business is driven by identifiable key value drivers:

1. Financial Performance (Historical & Projected)

- a) How fast has the Company grown?
- b) What is the outlook for continued growth?
- c) Has the Company maintained a solid profit margin?

2. Contracts and Customer Relationships

- a) Is there any reliance on set-aside contracts (e.g. 8(a) or small business)?
- b) How long have you been working with key clients?
- c) How much backlog remains on the current contracts?

3. Management Depth and Professional Staff

- a) Is there depth to the management team behind the founders?
- b) Does the professional staff hold valuable certifications and/or clearances?
- c) Are there retention or option plans in place for key team members?

4. Market Differentiators and Core Competencies

- a) How are the Company's services differentiated within the marketplace?
- b) What is the Company's competitive landscape?
- c) What is the Company's track record with new business development?

A business owner should be able to assess and understand how each of these value drivers impact value. Some are obvious and some are buried below the surface. But it is critical to keep in mind that when preparing a business for sale, you need to step back and view your Company through the eyes of a potential buyer. Different buyers will view different value drivers as more important than others. Understanding this viewpoint is an art and mixing it with the science of cash flow valuation through the auction process often can realize that elusive goal sought by the ancient alchemists: turning something into gold. ♦



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Owner/Seller Benefits

If properly structured, with an ESOP sale, owners can:

- Extract tax-free proceeds from the sale of the business to the ESOP. *On the sale of a \$10 million business, this could result \$2 million to \$5 million more in the selling shareholders' pockets.*
- Diversify wealth allocation by effectively taking some chips off the table
- Create a framework for estate and business succession planning
- Sell stock for full value
- Create a market for a Company's closely-held stock, when such stock may otherwise be difficult to sell
- Participate in the Company's "upside," even after an ESOP transaction has occurred, and
- Continue to manage the business.



Company and Employee Benefits

Subject to certain limitations, the Company can deduct payments to the ESOP for tax purposes and all related interest payments are fully deductible. These deductions can propel the Company into substantially increased cash flow (which makes the Company more competitive versus its peers). Through their participation in the ESOP, and without spending any personal cash, the employees become Company

owners. Many ESOP companies find this beneficial to attracting and retaining strong employees, and studies indicate that employee-owned companies usually are more productive than those not owned by employees.

Government Contractor Benefits

Federal Acquisition Regulations now state that ESOP contributions are an "allowable cost" provided they are not excessive. Furthermore, such contributions can be fully covered by cost reimbursement on cost-plus contracts. As such, the government is effectively bearing this cost. ESOPs also provide a liquidity opportunity for difficult-to-sell 8(a) companies. A minority interest ownership stake (of at least 30 percent) in an 8(a) company can be sold via an ESOP transaction provided the disadvantaged owner retains at least 51 percent ownership in the entity. When the company graduates from 8(a) status, additional ESOP stock sales can be executed. Keep in mind these government contracting benefits are in addition to the other traditional ESOP benefits discussed earlier.

While complex, ESOPs offer numerous concrete and intangible benefits to government contractor business owners. If you would like to discuss how an ESOP may benefit you and your business, contact The McLean Group at 703.827.0200. ♦



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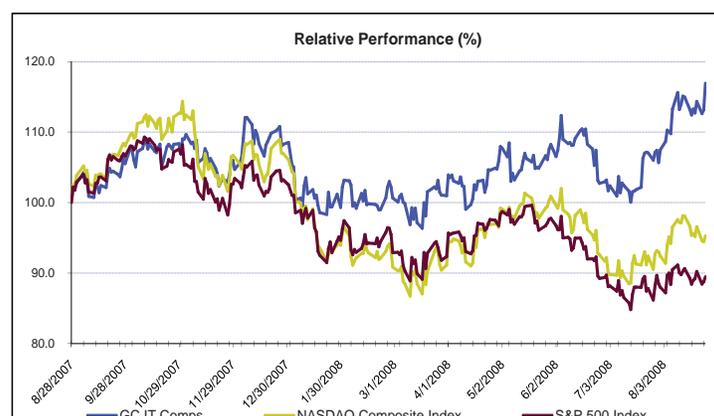
GC Industry Landscape Overview

Market Highlights

- Private equity continued to be active in acquiring and expanding platforms. This area is highlighted by The Carlyle Group's acquisition of Booz Allen Hamilton's government unit for \$2.54 billion. Activity is strong in the lower and middle markets, as well. For example, DC Capital Partners acquired and expanded its holding company, National Interest Security Company, LLC through the acquisition of four companies: Athenyx, IMC, Omen, and TMS.
- Third quarter 2008 middle market GC IT M&A activity is on par with activity in the third quarter of 2007 and may exceed it.
- More than 80 percent of GC IT companies acquired thus far in 2008 serve defense agencies.
- Revenue multiples of middle market GC IT deals disclosed are higher for the third quarter of 2008 than during the previous nine quarters.
- Despite the regulatory changes, there continues to be a steady stream of deals closed with small business attributes.
- Government IT spending is expected to grow five percent annually for five years, from \$66 billion in 2007 to approximately \$90 billion in 2013 (Source: EquaTerra).
- Large procurements continue to drive perceived value in the defense and intelligence areas. For example, the Comprehensive National Cybersecurity Initiative (CNCI) budget request is the single largest request for funds in the fiscal 2009 intelligence budget. And in early August 2008, the Defense Intelligence Agency announced a \$1 billion contract for information technology and information technology services.



Performance of the GC IT public companies* over the past three years is on par with the general market indices...



...but is up about 20 percent relative over the market during the last 12 months.

Select GC M&A Transaction Deals in 2008

Acquired	Acquirer	Notes
MTC Technologies	BAE Systems, Inc.	\$451.1 million (1.0x revenue, 11.7x EBITDA)
SI International	Serco, Inc.	\$541.6 million (0.9x revenue, 12.0x EBITDA)
Kadix Systems, LLC	Dynamics Research Corp.	\$47 million (2.0x revenue, 12.4x EBITDA)
SM Consulting, Inc.	SAIC Inc.	Transaction amount not disclosed.
AEA Technology plc	Project Performance Corp.	\$66.6 million
Oberon Associates	Stanley, Inc.	\$170.4 million (3.5x revenue)
Carolina Management and Technology Inc.	MicroTechnologies, LLC	Both are certified as small businesses; transaction amount not disclosed

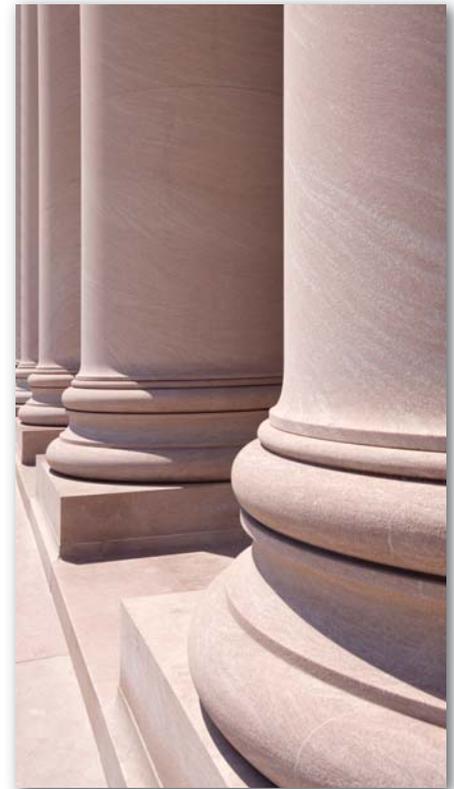
* Financial data provided by CapitalIQ. Historical Equity Pricing Data supplied by FT.com. FTSE™ is a trade mark of the London Stock Exchange and The Financial Times and used by FTSE International Limited under license. Capital IQ is licensed by FTSE International Limited to publish the FTSE. Estimates data provided by Reuters. SEC Filings provided by Edgar Online Pro.

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.



The McLean Group’s Select GC Transactions

<p>has been acquired by</p> <p>Federal IT and Communications Solutions Provider</p> <p>As M & A Advisors </p>	<p>has acquired</p> <p>IT Government Contracting</p> <p>As M & A Advisors </p>	<p>has been acquired by</p> <p>Aerospace and Defense Manufacturing</p> <p>As M & A Advisors </p>	<p>has acquired</p> <p>Purchase Price Allocation Government Contracting IT Services</p> <p>As Business Valuators & Financial Advisors </p>	<p>Business Valuation Government Contracting Engineering and Technical Services</p> <p>As Business Valuators & Financial Advisors </p>
<p>Business Valuation Government Contracting Management Consulting</p> <p>As Business Valuators & Financial Advisors </p>	<p>Business Valuation Government Contracting Budget & Finance Management Services</p> <p>As Business Valuators & Financial Advisors </p>	<p>has acquired</p> <p>Purchase Price Allocation Government Contracting Global Risk and Crisis Management Services</p> <p>As Business Valuators & Financial Advisors </p>	<p>Purchase Price Allocation Government Contracting Services</p> <p>As Business Valuators & Financial Advisors </p>	<p>has been acquired by</p> <p>Government Contracting IT Services</p> <p>As M&A Advisors </p>

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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.

