HOULIHAN LOKEY

UNPRECEDENTED

GOVERNMENT TECHNOLOGY AND SERVICES

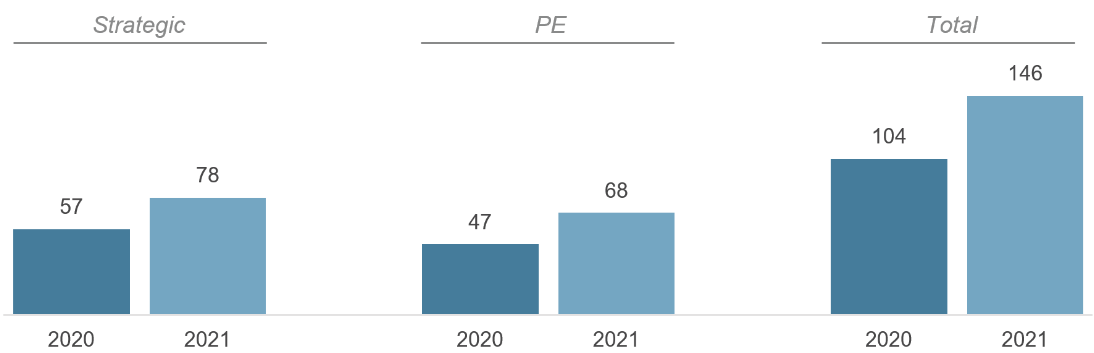
2021 YEAR IN REVIEW

2021 Year in Review

It's perhaps the most hackneyed term of the past two years but the most appropriate descriptor of the 2021 M&A market in the government technology and services (GT&S) sector. In no other year, over the past 20 years, has the sector M&A market achieved comparable volume, valuations, or strategic and private equity buyer breadth than in 2021. The most common question many industry dealmakers have been pondering as we enter 2022 is: “Can this hyperbolic M&A market continue?”

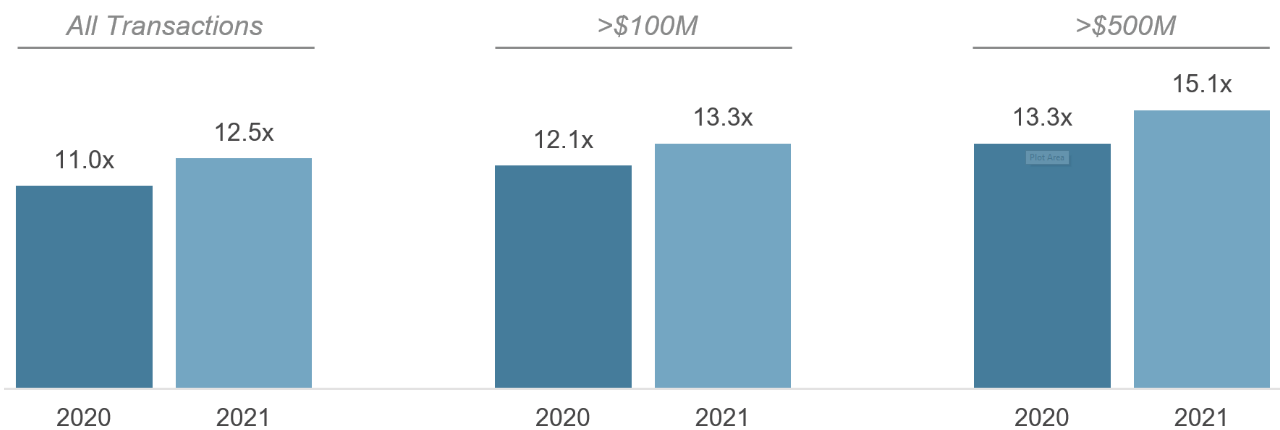
2021 Government Technology and Services M&A Highlights

M&A transaction volume in the GT&S sector increased ~40% in 2021, from 105 transactions in 2020 to 146 in 2021. Volume in the second half of the year was nothing short of extraordinary, with 92 transactions announced, more than any full year from 2012 through 2018 and just shy of 2019 volume (98 transactions). Seller-driven tax strategies, robust buyer interest, and historic valuations all contributed to the year's unprecedented volume. Strategic buyer activity increased 37%, and private equity transaction volume, encompassing both new platform investments and add-ons to existing platforms, expanded 42% from 2020 volume levels.



Along with M&A volume, median M&A valuations have continued to rise, with the median valuation across all transactions increasing 14% from 11.0x in 2020 to 12.5x in 2021. Notably, the best positioned assets, those with scale (>$100 million of revenue) and/or alignment with buyers' most coveted technology capabilities and areas of mission focus, have traded at multiples substantially higher than the overall sector median. Public company buyers, buoyed by their own strong valuations over the past several years, have consistently paid premiums above their own valuations for strategic assets. In nearly 50% of the 45 M&A transactions announced by public buyers in the sector from 2019 through 2021, the transaction M&A multiple exceeded the buyer's own trading multiple at the time of transaction announcement.

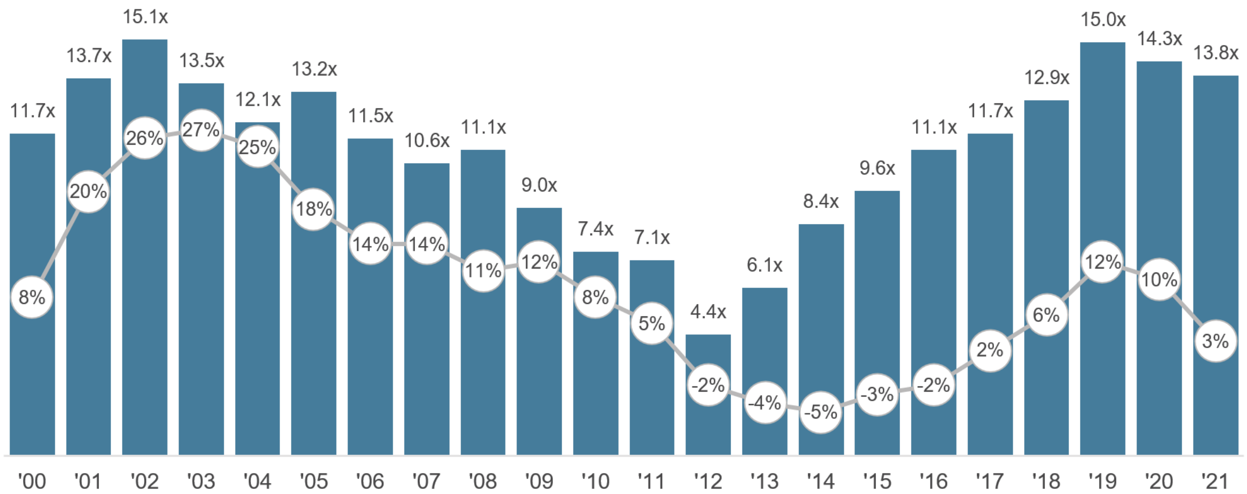
M&A Transaction Multiples by Size



What is causing the valuation frenzy? M&A has historically been a lagging indicator of business performance. Notably, public companies in the sector achieved their highest valuations over the past 20 years and their highest revenue growth rates over the past decade during 2019 and 2020. This perfect storm of historic valuations and euphoria over strong business performance ushered in a dramatic shift in buyers' preferences for capital deployment in favor of M&A in 2021. Clearly, the 2021 M&A market benefited from this shift.

Source: Houlihan Lokey proprietary M&A database, as of December 31, 2021.

Median Sector Revenue Growth Rates and Valuation Multiples for Publicly Traded GT&S Companies



2021 Reflections: An Unprecedented Year

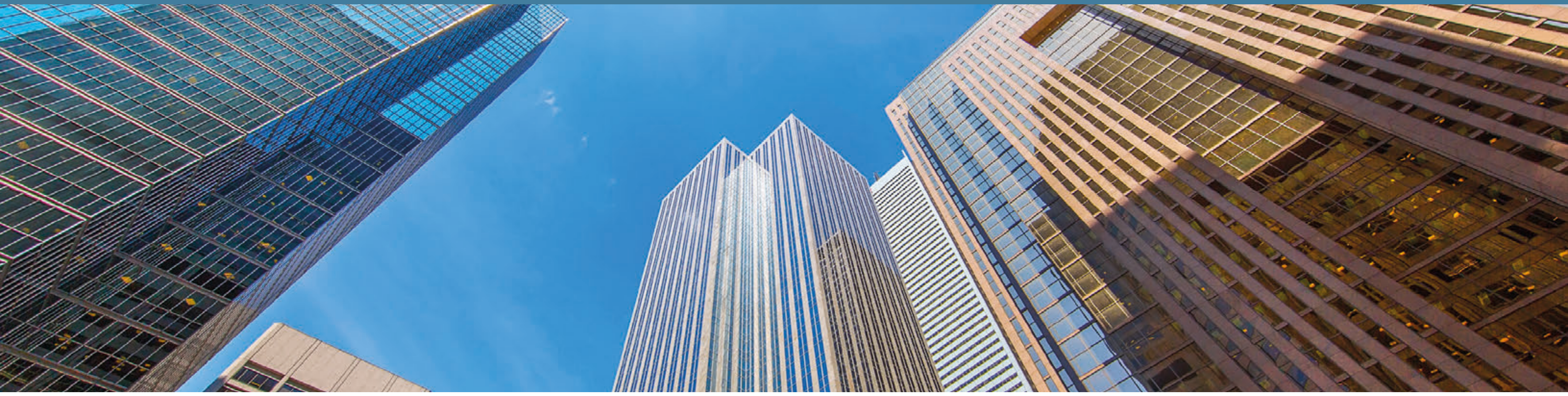
So many trends and transactions this year are worth noting. Below are our most noteworthy reflections on the year's M&A activity.

Strategic buyers are charting a course toward new frontiers and are becoming more progressive in their M&A investment decision-making.

They are increasingly focused on acquiring (sometimes smaller scale) assets with game-changing technology solutions and/or assets that have adopted different (non-services) business models. Booz Allen Hamilton's two-step acquisition of Tracepoint (cyber/digital forensics), CACI's acquisition of Bluestone Analytics (OSINT), SAIC's acquisition of Koverse (data analytics/AI), and Parsons' acquisition of BlackHorse (cyber/electronic warfare) are a few examples. The common denominator of many of these transactions is that they represent longer-term "bets" where near-term financial results and metrics are not the key drivers of success of the acquisition in the eyes of the buyer. As with many sectors of the economy, technology is driving an unprecedented shift in the defense and government contracting market.

Source: S&P Capital IQ.

Note: Chart includes Anteon, Booz Allen Hamilton, CACI, CSRA, DRC, Engility, Leidos, ManTech, MTC Technologies, NCI, Parsons, PEC Solutions, SAIC, SI International, SRA, Stanley, and Titan (for periods in which each business was publicly traded).



Speaking of new frontiers, **2021 saw an unprecedented level of interest in the space market**, which is likely to continue in 2022 and beyond. Defense primes (Raytheon's acquisitions of SEAKR Electronics and Blue Canyon), government services companies (CACI's acquisition of SA Photonics), private equity groups (AE Industrial Partners' establishment of Redwire), and special purpose acquisition companies (SPACs) have all contributed to the space hysteria. If 2021 wasn't the "Year of Space," 2022 most certainly will be.

Last but certainly not least, **private equity activity dominated the landscape in 2021**. The number of new platform investments in 2021 (27 new platforms) dramatically exceeded the number of new platforms created in any year over the past decade (~30% vs. the second best year, 2019). A few prevalent themes worth noting:

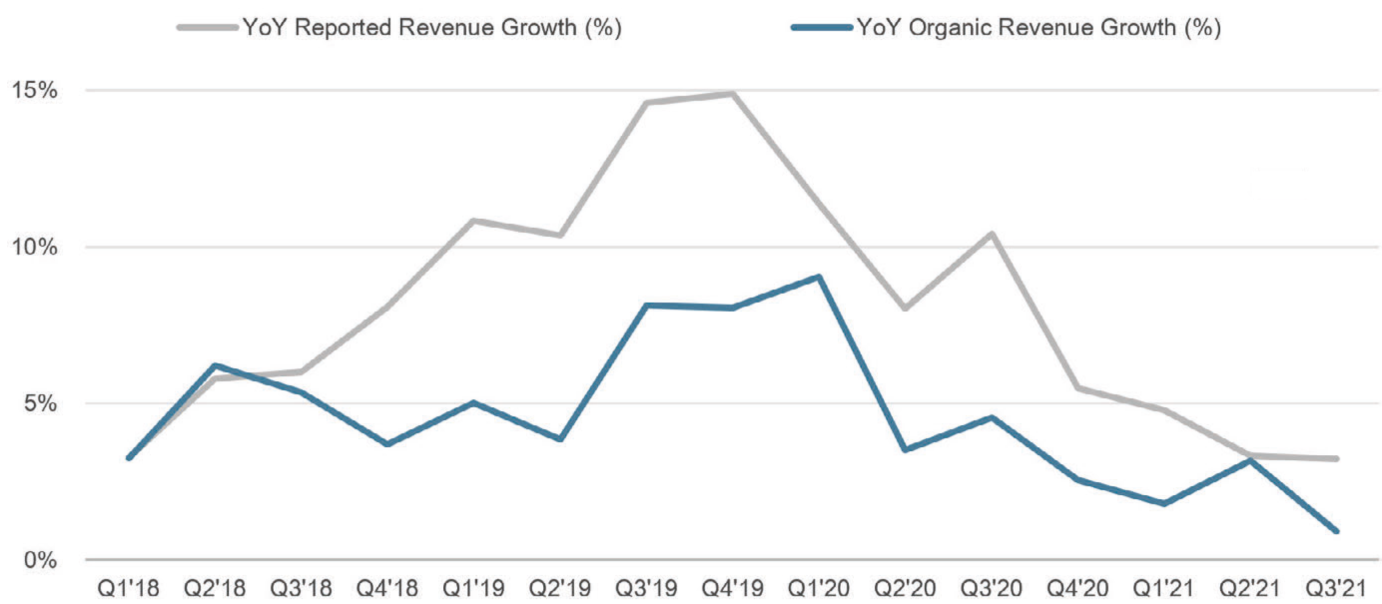
- *Out with the old, in with the new*. Several prominent funds realized near simultaneous exits and new platform entries over the past year. Macquarie's sale of Dovel Technologies to Guidehouse and investment in Procentrix, and Carlyle's sale of Novetta to Accenture and investment in IST Research/Two Six Technologies, are notable examples.
- *You have to be in it to win it*. Several funds with lofty ambitions have recognized the importance of being in the game—first with a smaller acquisition, followed by a more transformational acquisition. Both Arlington Capital and Welsh Carson have successfully pursued this strategy (with MCR/SPA and GovCIO/Salient CRGT, respectively).
- *The rookies*. Funds that are newer to the GT&S sector (even though some of their principals aren't) have been aggressively pursuing new platform investment theses. Note CI Capital's acquisition of Cadmus, OceanSound's acquisition of DMI, Godspeed's acquisition of Varen Technologies, and Brightstar's acquisition of ERC. Look for the rookies to be key contributors to a sustainment of 2021 volume levels in 2022.
- *The new behemoths*. Both Peraton (backed by Veritas Capital) and Amentum (backed by American Securities and Lindsay Goldberg) have amassed tremendous scale that rivals that of the largest government services companies. Both Peraton and Amentum have revenues approaching $10 billion following a series of significant acquisitions (namely, Peraton's purchases of Northrop Grumman's IT services business and Perspecta and Amentum's pending purchase of PAE). *Almost in the blink of an eye*.

Source: Based on publicly available information and details/metrics for transactions on which Houlihan Lokey was advisor.

Public Company Valuation and Growth Dynamics

As noted in the chart on page 3, notwithstanding the M&A market euphoria, public company valuation multiples in the GT&S sector declined 4% in 2021, from 14.3x in 2020 to 13.8x in 2021. This valuation multiple decline has coincided with the emergence of new industry headwinds. In 2020, the industry saw very modest impacts to performance from COVID-19-related shutdowns. However, in 2021, the industry experienced a potpourri of issues impacting sector growth rates and near-term growth prospects, including award delays (particularly in the Intel community), supply chain challenges, tight labor markets, and the U.S. military's withdrawal from Afghanistan. Median public company total and organic growth rates peaked in the mid-2019 to early-2020 timeframe and have declined markedly in 2021. Median total and organic revenue growth rates were 3% and 1%, respectively, in the most recent reported quarter (Q3 2021), down from 15% and 8% in Q3 2019.

Median Sector Growth Rates 2018–2021 for Publicly Traded GT&S Companies



As we have seen in previous upcycles in the GT&S sector, slowing growth rates might stimulate more M&A activity in the near term as buyers face increasing pressures to achieve forecasted growth rates. However, over the longer term, as M&A activity typically lags business performance, sustained lower growth rates will inevitably cause buyers to moderate both their appetites and valuation assessments for M&A targets.

Source: S&P Capital IQ and public company investor materials.

Note: Median of BAH, CACI, LDOS, MANT, PSN, and SAIC.

Reading the Tea Leaves for 2022

So what does this all mean for the M&A market in 2022?

In all likelihood, sector M&A volume will have difficulty maintaining 2021's frenetic pace. While buyers' M&A appetites show no signs of waning, the extraordinary supply of M&A targets that were "for sale" in 2021 will likely moderate in 2022. A more balanced supply and demand environment can certainly be more favorable to sellers, who will have a lower hurdle to command the attention of a broad universe of buyers.

The question remains: "How long will the current frothy M&A valuation environment continue?" The strong capitalization of the sector (the median debt/EBITDA ratio for the publicly traded GT&S companies is currently only 2.1x) and abundance of private equity and debt capital are both conducive to continued strength in the M&A market. Furthermore, sector executives have a strong appetite to use M&A as a tool for acquiring innovative, technology-focused capabilities that will serve as growth accelerators. ManTech's acquisition of Gryphon (MBSE), Booz Allen Hamilton's acquisition of Liberty IT (digital transformation), and Leidos' acquisition of Gibbs & Cox (maritime autonomy) are all examples of this trend.

While these dynamics bode extremely well for a continuation of the "2021 M&A Train," inevitably a healthy dose of introspection starts to permeate buyers' thinking about M&A priorities and valuations. If sector leaders struggle to overcome some of the current industry headwinds and see sustained declines in their own growth rates and valuations, we are likely to eventually see some normalization in M&A valuations. However, in the near term, provided that broader economic factors remain favorable (inflation, COVID-19, interest rates, etc.), we expect to see last year's vibrant M&A market continue in 2022.

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Recent Government Technology and Services Transactions

Software Modernization

SOLUTE

has been acquired by

Sigma Defense

a portfolio company of

SAGEWIND CAPITAL

Sellside Advisor

Digital Engineering

GRYPHON TECHNOLOGIES

a portfolio company of

ae Industrial Partners

has been acquired by

ManTech

Sellside Advisor

IT Modernization

procentrix

has been acquired by

MACQUARIE

Sellside Advisor

Supply Chain

NOBLE MISSION. POSSIBLE.

has acquired

FEDERAL RESOURCES

Revolver, Term Loan & Senior Subordinated Notes

Acquisition Financing & Refinancing

Exclusive Buyside Advisor & Placement Agent

Health IT

Dovel Technologies

a portfolio company of

MACQUARIE

has been acquired by

Guidehouse

a portfolio company of

VERITAS

Sellside Advisor

IaaS

ViON

has divested its as-a-Service Business to

Peraton

a portfolio company of

VERITAS CAPITAL

Sellside Advisor

Cyber/EW

i3

has sold its equity interest to

an Employee Stock Ownership Plan ("ESOP") formed by the Company, creating a 100% employee-owned company.

Financial Advisor

Energy/Environment

CI CAPITAL PARTNERS

has acquired

CADMUS

Buyside Advisor

Space

MCR The Command Edge

has been acquired by

ACP

Sellside Advisor

Systems Engineering

BRIGHTSTAR CAPITAL PARTNERS

has acquired

ERC

Buyside Advisor

Maritime Autonomy

GIBBS & COX Maritime Solutions

has been acquired by

leidos

Sellside Advisor

Consulting

WBB QUALITY COMES STANDARD

a portfolio company of

H.I.G. CAPITAL

has been acquired by

serco

Sellside Advisor

Geospatial

WOOLPERT

a portfolio company of

LONG POINT CAPITAL

has been acquired by

MSD

Sellside Advisor

Submarine Warfare

SEA CORP SYSTEMS ENGINEERING ASSOCIATES CORPORATION

has been acquired by

KAPCO DEFENSE

Sellside Advisor

Hypersonics

i3

has divested its *Hypersonics Business* to

LOCKHEED MARTIN

Sellside Advisor

Healthcare/Data Analytics

IMPAQ

has been acquired by

AIR AMERICAN INSTITUTES FOR RESEARCH

Sellside Advisor

Rated No. 1 Investment Bank for All Global M&A Transactions in 2021

Source: Refinitiv.

No.1 M&A Advisor for All U.S. Industrials Transactions

Source: Refinitiv.

No.1 Investment Bank for All Global M&A Transactions

Advisor	Deals
Houlihan Lokey	**549**
Goldman Sachs & Co	511
JP Morgan	508
Rothschild & Co	437
Morgan Stanley	393

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Our Aerospace, Defense & Government (ADG) practice within the global Industrials Group is a leading M&A advisor to aerospace, defense, government services, and national security companies in the United States. Since 2020, the practice has closed 50 transactions and has a staff of approximately 30 investment bankers in Washington, D.C., and Los Angeles. The ADG practice is one of the largest industry banking groups dedicated to the ADG sector worldwide.

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ABOUT HOULIHAN LOKEY

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, and valuation. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm's commitment to client success across its advisory services. Houlihan Lokey is the No. 1 M&A advisor for the past six consecutive years in the U.S., the No. 1 global restructuring advisor for the past seven consecutive years, and the No. 1 global M&A fairness opinion advisor over the past 20 years, all based on number of transactions and according to data provided by Refinitiv. For more information, please visit HL.com.