Federal market offers safe harbor

The worldwide economic turbulence has dealt only a glancing blow to the defense and federal government mergers and acquisitions market, with big, mid-size and small deals moving forward. The U.S. government gave its approval to Italian defense firm Finmeccanica SpA’s $5.2 billion acquisition of DRS Technologies Inc.; Serco Group plc stepped closer to closing its $423 million acquisition of SI International Inc.; and D.C. Capital Partners’ government platform, National Interest Security Co. (NISC) LLC, bought Multi-Threaded Inc. (MTI) for an undisclosed amount.

Such continued action in the federal and defense market is not unusual.

“The federal and defense sector isn’t completely recession-proof, but it’s a more stable place to be than the commercial marketplace,” said Ray Bjorklund, senior vice president and chief knowledge officer at McLean, Va., market researcher FedSources Inc.

In the past five recessions, the sector outperformed the S&P 500 by 42 percent, according to a September report by Rockville, Md., investment bank Aronson Capital Partners LLC. The company bases its comparison on stock valuations for four top government and defense contractors.

Investors should look for strategic buys in “fast-growing markets, including cybersecurity, health care [information technology], intelligence community, homeland security” and a broad spectrum of defense technologies, Aronson said.

Intelligent Money

The Office of the Director of National Intelligence reinforced that advice, pegging spending on the National Intelligence Program in fiscal 2008 at $47.5 billion, up 9 percent from the previous year’s $43.5 billion.

That growth in intelligence spending is music to the ears of Thomas Campbell, founder of private equity firm D.C. Capital Partners LLC and NISC chairman. NISC’s purchase of MTI is the ninth in 14 months. Campbell was a partner — with Robert McKeon — of Veritas Capital and co-founder of the Veritas Capital Fund from 1992 through 2006, when he left the company to found D.C. Capital and, with the purchase and merger of three intelligence technology companies, NISC. Six subsequent purchases have added to the company’s intelligence capabilities. For example, MTI helps extract intelligence from data and media sources.

“It’s a smart strategy, based on close observation of the market,” Bjorklund said. “You delve into the market statistics and learn that the intelligence budget is growing at a significantly faster rate than the rest of the federal spending budget, that the demand is not only for military intelligence and special programs but also for homeland security intelligence work. You find an unsatisfied demand and position yourself to meet it.”

Campbell knows this sector well. In 2001, he was at Veritas when it bought Vertex Aerospace from Raytheon Co. for $270 million and sold it two years later, for $650 million, to L-3 Communications Corp. He also was involved in Veritas’ $20 million purchase of the scandal-plagued intelligence and counterterrorism provider

Coincidentally, Campbell was instrumental in developing Integrated Defense Technologies Inc., which Veritas sold in 2002 for about $550 million to DRS Technologies, currently on its way to becoming a Finmeccanica asset.