

Mergers & Acquisitions Capabilities and Service Offerings

Despite persistent economic and geopolitical uncertainties, mergers and acquisitions (M&A) activity in the government contracts sector remains strong. Notably, in its Summer 2024 update, Meridian Capital indicated that aerospace, defense, and space M&A activity in the first six months of 2024 increased approximately 8% over the second half of 2023 (210 and 195 transactions, respectively).¹ Recent prominent transactions include Boeing's agreement to acquire Spirit AeroSystems, KBR's agreement to acquire LinQuest, and Honeywell's agreement to acquire CAES Systems.

Buyers continue to recognize the attractiveness of government contractors, highlighted by a steady cash flow and the ever-increasing government need for innovation, technology, and traditional aerospace and defense goods and services. Sellers recognize the attractiveness of their business portfolios and offerings, resulting in a market that is primed for additional M&A activity.

How HKA Can Help

Although compliance with the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), Cost Accounting Standards (CAS), and other relevant government contracting regulations may not be at the forefront of buyer and seller negotiating teams, investment bankers, M&A attorneys, and other key stakeholders, HKA recognizes the importance of maintaining an awareness of the aforementioned regulations and statutes during the deal-making process. Our Government Contracts team has experience supporting M&A activities by providing due diligence support, assisting with post-deal integration, and preparing external restructuring proposals in accordance with DFARS 231.205-70. HKA works in tandem with key stakeholders to enable the transacting party to achieve a balance between understanding and considering key compliance requirements and achieving its strategic business objectives.

Due Diligence Support

- Analysis of contract backlog/pipeline
- Evaluation of contract mix
 - Contract types and related risks and opportunities
 - Full and open competition vs. set-aside programs
 - Small business status implications
 - Inclusion of relevant flow-down clauses
- Assessment of compliance risk areas
 - CAS applicability
 - DFARS business systems applicability
 - Status of DCAA and other government audits and investigations (e.g., False Claims Act)
 - Incurred cost submission history/status
- Analysis of cost and pricing issues
 - Population of contracts subject to the Truthful Cost or Pricing Data statute (commonly referred to as TINA)
 - Disclosure practices and history

¹ "Aerospace, Defense & Space M&A Activity Update: Summer 2024," Meridian Capital, July 10, 2024. Available at: <https://meridianib.com/ma-trends/aerospace-defense-space-ma-update-summer-2024/>

Post-Deal Integration

- Understand the impact of the acquisition(s) on (i) current business structure and related processes and (ii) relevant compliance requirements, including FAR, DFARS, and CAS
- Establish an optimal organization structure from a compliance and strategic perspective
 - Home office
 - Segments
- Identify a compliant, competitive indirect rate structure to facilitate growth objectives and maximize/preserve profits
- Enhance business processes, policies, and information technology platforms
- Update Cost Accounting Standards Board (CASB) Disclosure Statement(s), as applicable
- Understand DFARS business system requirements and design an internal control framework
- Provide training and related support
- Aligning cost accounting practices and XRP estimating practices
- Suspending external restructuring costs from billing and settlements until an advance agreement is executed after audit completion
- Revising Disclosure Statement(s), including documentation to support cost accounting practice changes resulting from external restructuring activities that are exempt from cost impact calculations

External Restructuring Proposals (DFARS 231.205-70)

- External Restructuring Proposal (XRP) applicability: Assets or operations of companies not previously under common control are combined
- Benefits of submitting an XRP:
 - Allowance of certain otherwise unallowable reorganization costs if savings can be justified
 - Cost impact exemption (FAR 30.603-2(e) and 48 CFR 9903.201-8)
- Department of Defense (DoD) will not pay restructuring costs unless there is a written determination that savings exceed costs by at least 2:1
- HKA uses leading industry practices to prepare XRPs, including:
 - Determining restructuring activities and objectives
 - Segregating restructuring costs
 - Developing a plan that shows net present value of costs and savings
 - Determining DoD's participation rate or "share" of projected costs and savings
 - Developing detailed cost and savings bases of estimates (BOEs)
 - Determining cost accounting practice changes of combined business

Representative Experience

HKA advised on disclosure requirements in a company's equity purchase agreement and potential liability quantification for an intelligence and communications contractor that was in the process of being acquired. Government contracting topics relevant to HKA's work included CAS, business systems, and indirect rates.

HKA assisted a multi-billion-dollar aerospace and defense contractor with the preparation and submittal of an XRP following its \$2 billion acquisition of another aerospace and defense contractor's communications-related product line. HKA advised the client regarding potential savings activities, analyzed cost and savings data, developed BOEs, drafted sections of the XRP narrative, and provided guidance regarding related cost accounting practice changes.

HKA assisted a shipbuilding contractor with the internal restructuring of its organization, including the wind down and closure of certain locations. HKA reviewed direct and indirect cost data, analyzed pricing impacts, advised the client on cost accounting practices and compliance, and supported negotiations with the client's government customers and auditors.

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