



## **2023 GOVERNMENT & DEFENSE CONFERENCE**

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**BAIRD**

**GOVERNMENT & DEFENSE RESILIENCE:  
STRATEGIES IN ACTION**

# A LEADING M&A ADVISOR TO THE GOVERNMENT & DEFENSE SECTOR

## 2022 – 2023 YTD STATISTICS

Advisor on:

**20**

Government & Defense transactions

**\$16B**

Aggregate transaction value

**\$775M**

Average deal size

## SELECT RECENT TRANSACTIONS

### CONSULTING

 Acquisition of  
 A Portfolio Company of  


### CYBER ENGINEERING

 Sale to  
 A Portfolio Company of  


### C4ISR

 A Portfolio Company of  
 Sale to  


### DEFENSE ELECTRONICS

 Investment from  


### HIGH-PERFORMANCE CONTROLS

 Sale to  


### GOVTECH

 Acquisition of  


### SIGINT

 Sale to  
 a Portfolio Company of  


### CYBER SECURITY

 Sale to  
 A Portfolio Company of  


### CYBER OPERATIONS

 Received Growth Investment from  


### DIGITAL TRANSFORMATION

 A Portfolio Company of  
 Sale to  


### HEALTH IT

 Sale to  


### GOVTECH

 A Portfolio Company of  
 Majority Investment from  


# A LEADING INSTITUTIONAL EQUITIES & RESEARCH PLATFORM

BAIRD

## DIFFERENTIATED EQUITIES FRANCHISE<sup>(1)</sup>

#1

Best Sales Coverage in Industrial

#1

Best Trading for Small / Mid-Cap Equities

#2

Overall Research, Sales, and Corporate Access

400+

Industrial, Technology, and Services Companies Under Coverage

## SELECT RELEVANT RESEARCH ANALYSTS



**Peter Arment**  
Senior Research Analyst  
Aerospace & Defense

Peter Arment is Baird's Senior Research Analyst covering Aerospace & Defense. Prior to joining Baird in 2016, he worked for 23 years in the industry. He was a Senior Aerospace & Defense Analyst at Sterne Agee, Gleacher & Company, and American Technology Research, and was an Analyst in this area at JSA Research. Peter received a bachelor's degree in economics from the University of Rhode Island.

## CURRENT COVERAGE UNIVERSE



(1) Coalition Greenwich 2023 surveys of North American Equity Investors. Surveys conducted with 95 small-cap and mid-cap fund managers and 235 traders. Rankings for qualitative metrics based on leading research firms in surveys.

# 6<sup>TH</sup> ANNUAL BAIRD GOVERNMENT & DEFENSE CONFERENCE

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## PANEL TOPICS

### Government & Defense State of the Market Update

[Baird Government & Defense](#)

### Disequilibrium: Funding U.S. National Defense in an Era of Monetary, Fiscal, and Geopolitical Disruption

[Strategas](#)

### The Span of Space: What Does Ukraine Today Tell Us About China Tomorrow?

[Fairmont](#) | [HawkEye 360](#) | [National Space Security Administration](#) | [SpiderOak](#) | [U.S. House of Representatives Defense Appropriations Subcommittee](#) | [U.S. Space Force](#)

### Seller Perspectives: M&A Lessons Learned

[REDLattice](#) | [Resonant Sciences](#) | [VTG](#)

### A View from Wall Street: Perspectives from Baird's Leading Aerospace & Defense Equity Research Analyst

[Baird Equity Research](#)

### Buyer Perspectives: Industry Leaders' Approach to M&A

[Anduril](#) | [Booz Allen Hamilton](#) | [CACI](#)

### Ukraine, IndoPacom, and The Digital Battlefield: How Modern Conflict is Defined by Electronic Warfare and EMSO

[CACI](#) | [Nextfed](#) | [U.S. Air Force](#) | [U.S. Army](#) | [U.S. Navy](#)

### The Future of Warfighting: From Innovation to Impact

[Hudson Institute](#) | [Metron](#) | [TSC](#) | [Two Six Technologies](#)

### Current and Over-the-Horizon Threats: Perspectives from the Intelligence Community

[ARKA](#) | [Office of the Director of National Intelligence](#) | [Renaissance Strategic Advisors](#)

### Private Equity Investing: More of the Same or Will the Floodgates Open?

[A&M Capital Partners](#) | [Capitol Meridian Partners](#) | [Cerberus](#)

### From Data Chaos to Autonomous Systems: The Future of AI in Government

[Accenture](#) | [Capstone](#) | [Google Public Sector](#) | [High Point Aerotechnologies](#) | [Microsoft](#) | [Shield AI](#)

## 2023 BY THE NUMBERS

50+ Speakers & Panelists

1,000+ Attendees

## CURRENT / FORMER GOVERNMENT OFFICIALS



**William (Bill) Adkins**  
Professional Staff Member,  
Defense Appropriations  
Subcommittee, U.S. H.R.



**Chuck Beames**  
Former Principal Director, Space &  
Intelligence Systems, DoD



**Dr. Stacey Dixon**  
Principal Deputy Director of  
National Intelligence



**William Flynn**  
Director, Cryptographic, Electronic,  
and Cyber Warfare, U.S. Navy



**Lt. Gen. Michael A. Guetelin**  
Commander, Space Systems  
Command, U.S. Space Force



**Col. Leslie F. Hauck III**  
Director, Electromagnetic Spectrum  
Superiority, U.S. Air Force



**Brig. Gen. Jake S. Kwon**  
Director of Strategic Operations,  
HQDA G-3/5/7, U.S. Army

## PARTICIPATING COMPANIES





# GOVERNMENT & DEFENSE CONFERENCE TAKEAWAYS

**Following a skittish start to 2023, investors are optimistic about a soft-landing and robust defense spending while companies are laser-focused on operational performance**



## Macro Environment

- Geopolitical events have resulted in Ukraine serving as a testing ground for defense technology and equipment and have highlighted the need for spending on munitions and missiles in addition to R&D. The conflict in the Middle East has renewed demand for technology to counter terrorist threats
- AUKUS had ushered in a new era of collaboration and alliance between Australia, U.K., and the U.S. in the Indo Pacific region to counter the Chinese threat
- Continuing Resolutions (CRs) are “business as usual” in Washington – occurring every year since 1998. Political brinksmanship and the 2024 Presidential election will be a key focal point for companies and investors in the second half of next year
- The National Debt crisis and political dysfunction in Washington have resulted in the recent Moody’s downgrade of U.S. debt. Interest costs on the growing U.S. debt are predicted to exceed Defense spending by 2029
- 2023’s inflationary environment has driven higher interest rates and tightened credit markets. Stabilization in the second half of 2023 has resulted in more predictable financing markets, particularly for high quality credits
- Newly proposed rules by the DOJ and FTC will expand the scope of antitrust scrutiny. If enacted, the rules will result in more time, diligence, and costs via regulatory scrutiny in HSR filings



## Government & Defense Market Context

- The concept of a bi-polar world has shifted to a multi-polar world, with both near-peer and terrorist threats of concern
- Government & Defense stocks are not correlated to the broader equity markets; valuations are aligned with sentiment around defense spending and are countercyclical in recession environments
- Government & Defense companies significantly outperformed broader markets in 2022 and are generally keeping pace in 2023
- C4ISR companies have outperformed the S&P in 2023, with investor enthusiasm for these “technology innovators.” Primes have substantially lagged due to programmatic challenges and margin contraction given rising operating costs in an inflationary environment
- Government Services companies with exposure to energy and infrastructure – notably ICF and Parsons – have outperformed other Government services stocks. C4ISR companies with programs aligned to fast growing swim lanes – UAS and C-UAS, electronic warfare, hypersonics, and National Security space – have also outperformed in 2023
- There has been a notable shift in public company capital deployment strategies – Government Services companies are focused on margin improvement and deleveraging, Primes are allocating more significant cash to share buybacks, and C4ISR companies are focused on highly strategic M&A



## Public Company and M&A Perspectives

- 2023 M&A volume in Government Services is on track to exceed 2022, with much of the activity for sub \$100M deals
- Until the recently announced acquisitions of Guidehouse by Bain and the divestiture of Raytheon’s Cybersecurity, Intelligence, and Services business, there were no billion dollar deals in the Government Services sector in 2023
- 2023 Defense sector M&A activity remained slow as buyers focused on programmatic visibility and current EBITDA, while sellers have not yet realized the benefit of strengthening supply chain and production contract visibility. Notable exceptions include the transformational transactions of Ball Aerospace by BAE and of Aerojet Rocketdyne by L3Harris
- Stabilizing credit markets have emboldened financial sponsor platforms, with seller financing, preference securities, and contingent structures filling the valuation gap
- Private equity dominated M&A activity in 2023, with PE platform and add-on transactions representing 61% of Government Services deals and 49% of Defense deals
- Strategics are looking to create value through portfolio shaping – driving divestitures of slow growing and non-core businesses with M&A activity in space, cyber, electronic warfare, and unmanned, among other prior high growth markets



## Technology & Innovation

- GovTech and MissionTech are a focus area for investors as the Government increasingly looks to speed up innovation and adopt disruptive technology and business models
- GovTech is software for federal, state, and local governments that helps modernize and transform the business of Government
- MissionTech consists of software that helps enable the mission of Government; with disruption innovation in high growth capabilities including AI, Cyber, UAS and C-UAS, and Space
- The GovTech market is more mature than the MissionTech market with established private equity investors and public companies providing commercial technology and business models
- While the Government is expanding its efforts to encourage more rapid innovation through SBIRs, STTRs, and OTAs, it is still falling short in developing the technology of tomorrow – venture capital and growth equity investors are filling that gap
- Venture capital investing in Government & Defense tripled from 2019 through 2022 and is expected to double between 2022 and 2027
- Valuations are driven by proven business models and software metrics (re-occurring is not equivalent to recurring) as well as the “halo effect” of successful and visionary venture and growth equity investors

# KEY PANEL TAKEAWAYS

## Funding U.S. Defense in an Era of Disruption



- Economic volatility is creating political volatility and a reversion to a 1970s model where the country faced higher inflation, an energy embargo, and a turbulent political landscape
- Rising inflation must be combated by higher interest rates, leading to austerity measures which create economic instability and embolden our enemies
- The ability to take on a multi-polar challenge in the world will be impossible when the interest on our debt continues to grow at an accelerated rate and soon will exceed the defense budget
- The defense budget has a potential for a 4% swing, moving from 3% projected growth if the debt deal is honored, to an automatic 1% cut in the event a budget deal is not reached – further complicating economic stability in the face of increasing spending demands

Strategas

## A View from Wall Street



- Defense stocks are benefitting from record-high backlog levels supported by continued investment in procurement and RDT&E within defense budget
- Geopolitical conflicts and direct industry orders have placed pressure on munition inventories and are here to stay
- Inflationary pressures have exposed profitability corrosion on firm-fixed-price defense contracts and highlighted Government services insulation via cost-plus contracts
- Large defense stocks have underperformed in 2023; national security priorities will likely flip investor sentiment in 2024
- IPO activity resurgence is expected in the second half of 2024 with space SPACs likely to be absorbed

Baird Equity Research

## The Future of Warfighting



- Speed to operationalize innovation is important in today's fight
- Rapid fielding of next-generation warfighting solutions will be predicated upon the propensity of industry to collaborate with research labs and end-users to harmonize capability development with the needs of warfighters
- Industry continues to be focused on driving innovation to impact through forward leaning organizations including the Chief Digital Artificial Intelligence Office (CDAO) and Defense Innovation Unit (DIU)
- Enabling contracting officers to align contract structure to ensure the capacity to effectively procure novel technologies will be paramount to success in near-peer competition
- Despite the challenges, industry sentiment is optimistic that the Government is adapting towards an innovative future

Metron | STR | TSC | Two Six Technologies

## M&A Lessons Learned



- Cultural alignment is rooted in a shared vision for the Company – protecting the Company from “what we don't do” is equally as important as alignment on future strategy post transaction
- Importance of having advisors in place in advance of a sale process, including an experienced legal team to establish the correct organizational and employee related documentation
- Critical to proactively prepare ahead of launching a sale process, including working with investment banking and accounting advisors on preparation of historical and projected financials
- Design of a sale process can vary significantly, ranging from pre-emptive to a field with strategics and sponsors; companies should consider approach to optimize their outcome

REDLattice | Resonant Sciences | VTG

## Market Leaders and Their M&A Strategies



- M&A volume was slow in the first half of the year; as sellers have gotten more confident in the macroeconomic outlook they have started to return to the market
- While macroeconomic conditions have not changed the strategic considerations around M&A from a buyer perspective, increasing interest rates have changed the math around valuation
- The higher rate environment is forcing public companies to increase focus on managing balance sheets and lowering leverage
- Preemptive / one-off transactions are often preferred to processes; it is very important to spend the time to develop those relationships, often times over the course of many years

Anduril | Booz Allen Hamilton | CACI

## Private Equity Outlook



- In the current market, valuation is the most challenging aspect, often seeing a wide bid-ask spread between parties in the face of one-to-two turns less leverage in a buyout model
- Concern for a shutdown is overblown, result likely to impact short-term cash flow – a focus on mission critical services, Intel, and defense will help defend against any lost revenue
- Greater transaction volume for companies with less than \$20M EBITDA due to their valuations being less connected to the debt capital markets as compared to larger assets
- PE funds will feel pressure to find high returns for businesses they invested in pre-2022 given the current market environment which will force funds to hold onto their investments for longer periods of time

A&M Capital Partners | Capitol Meridian Partners | Cerberus

# KEY PANEL TAKEAWAYS (CONTINUED)

## The Span of Space



- Space is different from other warfighting domains in that national systems do not deliver sufficient capacity – international and commercial partners must all be leveraged
- Dramatic decreases in launch costs have rippled through the industry, making more rapid development possible and leading to the proliferation of commercial startups
- Adversaries are leveraging the same technology trends as the U.S. to advance their space-based capabilities; decreases in cost has expanded the number of parties active in the space domain
- Following the onset of the Ukraine conflict, the DoD has developed the necessary connective tissue to deliver commercial capabilities which bring resiliency, redundancy, and excess capacity to DoD assets
- Given how dynamic the threat environment is and the critical role of space in addressing it, program offices have recalibrated to focus on capabilities rather than systems to keep pace
- Cyber is extremely important for space as the domain exists for critical data – the next “Pearl Harbor” will likely be a cyber-attack in the space domain, and some of our adversaries (particularly China) have more advanced capabilities

[Fairmont](#) | [HawkEye 360](#) | [National Space Security Administration](#) | [SpiderOak](#) | [Defense Appropriations Subcommittee](#) | [U.S. Space Force](#)

## Threats to the Intelligence Community (IC)



- IC funding has grown 20%+ over the past five years (\$102B in GFY24 request); market expects historical ratios of IC-to-DoD spend (10 – 13%) to continue
- The threat environment is as fragmented, diversified, and complex as ever – there are more threats from more sophisticated adversaries with a high mix of capabilities and techniques
- Commercial data and open-source intelligence will play a critical role in how the IC prosecutes the conflicts of the future; requiring collaboration with allied nations and private-public sector partnerships
- The Government is receptive to dual-use technology that can serve Intel-specific analytic missions, as well as broader non-IC applications
- The scale and pace of adversary action has turned economic security into a matter of national security
- Customer stickiness and long-term contracts can create strategic moats (and valuation premiums) for companies with strong Intel portfolios

[ARKA](#) | [Office of the Director of National Intelligence](#) | [Renaissance Strategic Advisors](#)

## Electronic Warfare & the Digital Battlefield



- The EW / SIGINT market for DoD procurement and RDT&E is approximately \$9.2B with approximately \$2.5B of contractor addressable spend (excluding classified budget spend)
- We are at a critical inflection point for all DoD services as they transition to next generation programs such as TLS-EAB and TLS-BCT for U.S. Army, Spectral for U.S. Navy, and MEGFoS for U.S. Marine Corps
- Open software and hardware architectures aligned with MOSA and SOSA enable rapid technical insertion and spiraling of capabilities into platforms
- The future fight will involve real time interoperability with a joint approach between all DoD services as well as international coalition partners
- Critical to evolve from a kill chain approach to a kill web approach to avoid a single point of failure
- Important programs such as EMBM are critical to ensure mission clarity on blue force and red force activities
- Conflict in the Ukraine has revealed how the changes in technology have significantly changed tactics on the battlefield as evidenced by EW countermeasures against UAS attacks

[CACI](#) | [Nextfed](#) | [U.S. Air Force](#) | [U.S. Army](#) | [U.S. Navy](#)

## AI Market Overview



- The overall global AI market was about \$150B in 2022, of which about 27% is hardware and software for generative AI, with an expected annual growth estimated at 20% through 2032
- Defense is the primary driver of AI-related spending, with a FY2024 funding request of \$1.8B, up from \$1.4B (28%), for the U.S. Government’s AI deployment effort
- AI measures its generations in months, while the Government onboarding processes take several years, so the difference in timing will be the biggest obstacle in leveraging AI in defense
- Focusing on educating how AI will transform Government missions, the risks of not adopting AI, and implementing federal acquisition reform will be critical in building the infrastructure to more rapidly adopt AI capabilities
- National Defense is about 2% of the use cases for AI – other current AI initiatives include increasing the speed of FDA drug approvals and automated application reviews for Government benefits

[Accenture](#) | [Capstone](#) | [Google Public Sector](#) | [High Point Aerotechnologies](#) | [Microsoft](#) | [Shield AI](#)



# GOVERNMENT & DEFENSE CONFERENCE 2023

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Jon Rucker | Ultra Intelligence & Communications



Jane Chappell | Altamira



Daniel Clifton | Strategas



James Lisowski | SciTec



Mile Corrigan | Noblis



Dr. Stacey Dixon | Principal Deputy Director of National Intelligence



Les Cheek | Baird Financial Sponsors Group  
David Lorch | Cerberus  
Alex Nivelles | A&M Capital Partners  
Mike Gozycki | Capitol Meridian Partners



Peter Arment | Baird Equity Research  
John Baylouny | Leonardo DRS



Brig. Gen. Jake S. Kwon | U.S. Army  
William Flynn | U.S. Navy  
Col. Leslie F. Hauck III | U.S. Air Force



Brian Hobbs | Accenture Federal Services  
Ron Ash | Accenture Federal Services  
Ira Entis | Accenture Federal Services



Christopher Merdon | NTT DATA Public Sector  
John Song | Baird Government & Defense



Stephanie Mango | CGI Federal  
Jean Stack | Baird Government & Defense



Peter Arment | Baird Equity Research  
Alan Pellegrini | Thales North America



John Hassoun | VTG  
John Ayers | REDLattice  
Dr. Micah North | Resonant Sciences  
Nicole Coffey | Baird Government & Defense



Joe Dodd | National Space Security Administration  
Chuck Beames | SpiderOak; York Space Systems; SmallSatAlliance;  
Former Space & Intelligence Systems, Department of Defense  
Lt. Gen. Michael A. Guetlein | U.S. Space Force  
William (Bill) Adkins | Defense Appropriations Subcommittee,  
U.S. House of Representatives  
John Serafini | HawkEye 360



Davey Gibian | High Point Aerotechnologies  
Charlie Moskowitz | Accenture  
Aaron Weis | Google Public Sector  
Daniel Lerner | Microsoft  
Brandon Tseng | Shield AI



John Song | Baird Government & Defense  
Mike Lewis | CACI  
Chrissy Cox | Booz Allen Hamilton  
Adam Porter-Price | Anduril



Dr. Daniel Patt | Hudson Institute; THL; STR  
Brandon Wolfson | TSC  
Van Gurley | Metron  
Joe Logue | Two Six Technologies



Arun Gupta | NobleReach Foundation



Peter Arment | Baird Equity Research



Joe Dodd | LinQuest



Bill Gattle | LightRidge Solutions



Dennis Kelly | Eclipse Technologies





# November 21, 2024

Robert W. Baird & Co. Incorporated

1775 Tysons Blvd., Suite 1400 | McLean, VA 22102

<p><b>Jean Stack</b>          Managing Director          (o) 703.394.1831          (m) 703.626.4188  <a href="mailto:jstack@rwbaird.com">jstack@rwbaird.com</a></p>	<p><b>John Song</b>          Managing Director          (o) 703.394.1832          (m) 240.620.2481  <a href="mailto:jsong@rwbaird.com">jsong@rwbaird.com</a></p>	<p><b>Alex Sevilla</b>          Managing Director          (o) 703.394.1833          (m) 305.951.8235  <a href="mailto:asevilla@rwbaird.com">asevilla@rwbaird.com</a></p>	<p><b>Jonathan Kirkland</b>          Director          (o) 703.394.1867          (m) 919.308.8699  <a href="mailto:jakirkland@rwbaird.com">jakirkland@rwbaird.com</a></p>	<p><b>Nicole Coffey</b>          Director          (o) 703.394.1835          (m) 410.984.9999  <a href="mailto:ncoffey@rwbaird.com">ncoffey@rwbaird.com</a></p>
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