Market Turmoil – What This May Mean To Your Company

By Michael Smigocki

We are currently witnessing turmoil in our debt and equity markets not seen since the days of the Great Depression. The stock market has lost trillions of dollars of value. The credit markets have severely tightened as banks are retaining as much of their capital as possible in anticipation of potential future losses in their loan portfolios. The government has attempted to free up credit as well as reassure the markets through the passage of the bailout package and also making direct equity investments in financial institutions. When you couple all of this with the uncertainty of the election's impact on the government contracting marketplace, we are certainly swimming in uncharted waters.

I have met with several bankers, CEOs and other industry experts, to discuss the current turmoil and to assess the possible impact to their companies and the government contracting marketplace as a whole. This article will share some of those thoughts.

Leveraged acquisitions will be significantly reduced. Until recently, banks have been quite willing to lend to government contractors and private equity groups for purposes of acquiring other companies or contracts. This M&A lending has been providing much of the fuel for the hot M&A market we have been experiencing the past few years. Now however, expect the banks to lend only to the most credit-worthy customers and for deals that only make financial sense (i.e. minimal risk). This is going to have a noticeable impact on the number of acquisitions completed in the marketplace, as well as possible reductions in the acquisition price.

Expect increased scrutiny and oversight by the banks of those contractors that actively borrow and whose line is consistently near its maximum. For those companies that are undercapitalized and heavily dependent on their working capital line of credit (or other term debt), expect much more scrutiny of the company's receivable base (both billed and unbilled) as well as the interim and year end financial performance on its contracts and the company as a whole. We have already witnessed this occurring in the marketplace as various banks have engaged our firm to analyze and scrutinize certain of their customers and report back to the credit committee as to our observations. In order to address this situation, Companies should:

- Ensure that only valid billed receivables are included in their borrowing base.
- Pay very careful attention to the interim financial reporting provided to banks ensuring that proper cutoffs are made and ensure as much accuracy in these reports as possible.
- Ensure revenue recognition is proper and that valid explanations are available for unbilled accounts receivable.

Expect other marketplace changes under the Obama administration. Almost everyone agrees that there will be a shift away from the spending priorities of the current administration -- defense, intelligence and homeland security.

The budgets and contracts of the government are mostly in place for the next fiscal year. However, whenever there is a change in administration, many of these current contracts and spending items are called into question. Expect many of these programs/projects to possibly be terminated for the convenience of the government, or not have the options years exercised.

Finally, the 800-pound gorilla that the new president as well as Congress will inherit is the recently passed bailout package. Current estimates are that costs for this package may exceed $1 trillion, which will make any spending priorities of the new administration all the more difficult to implement.

The old adage of "*the more things change, the more they stay the same*" has always been relevant to this marketplace. Those companies that continually adapt their strategic planning to address the changes occurring in the marketplace are the generally the ones that thrive.

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