

Washington TECHNOLOGY

Market guidance: People, issues, opportunities and wild cards for the new year

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By *NICK WAKEMAN*

Throw out the crystal ball. High-tech executives will have to rely on instinct, experience and up-to-the-minute intelligence to navigate the government IT market in 2003.

The year begins with great promise: E-government initiatives get more funding and muscle, outsourcing gets a push from the White House, and the Department of Homeland Security finally gets established. The federal IT market, expected to grow from \$48.6 billion in 2002 to \$53.3 billion in 2003, gets a big boost from twin efforts to bolster homeland security and national defense.

High-tech companies are shifting resources, targeting new opportunities and eyeing acquisitions that will better position them to play in the government arena.

But this year's game will be played with multiple wild cards. The economy remains anemic. Budget battles are imminent on Capitol Hill and in state houses across the nation. And war with Iraq looms. Any systems integrators or government IT providers worth their salt had better pay close attention and retain the flexibility to adapt to changing policies and priorities.

Navigating the marketplace will require sharp eyes and nimble footwork. Hang on. 2003 is taking off.

Milestones of 2002

2002 was a blockbuster year that will be remembered for the largest restructuring of the federal government in 50 years, as well as laying the groundwork for greater business opportunities in e-government and outsourcing. The year also saw the Office of Management and Budget step forward as a major catalyst for change, and the Republicans take control of Congress.

DEPARTMENT OF HOMELAND SECURITY

The new department stands up Jan. 24, with most of the 22 agencies moving over March 1. From a historical perspective, the restructuring of the government is the largest since the Defense Department was created after World War II.

From a business perspective, the agency will have an overall budget of \$37.7 billion, of which more than \$2 billion is dedicated to information technology. And that's before new initiatives get under way.

The major agencies to be integrated include the Coast Guard, the Customs Service, the Immigration and Naturalization Service, the Secret Service, the Federal Emergency Management Agency and the Transportation Security Administration. The goal is that these agencies will seamlessly communicate, operate and share information. It will take IT to do that.

Tom Ridge will be the first secretary. His job will be to lead the integration effort that involves 170,000 employees, as well as make sure the department fulfills its mission.

The agency will have four major components: border and transportation security; emergency preparedness and response; chemical, biological, radiological and nuclear

countermeasures; and information analysis and infrastructure protection. Twelve undersecretaries will serve Ridge.

"The fact that we even need a Department of Homeland Security says we aren't safe right here at home," said J.P. "Jack" London, chairman and chief executive officer of CACI International Inc., Arlington, Va.

E-GOVERNMENT ACT

This legislation authorized a fund for e-government projects that starts at \$45 million in 2003 and grows to \$145 million in 2007. A question remains, though, whether Congress will follow through by appropriating the full amount.

The law also creates an Office of Electronic Government within the Office of Management and Budget, with an administrator appointed by the president. This is the position currently held by Mark Forman.

The law adds momentum to the 24 e-gov initiatives Forman launched under the Quicksilver program and reinforces OMB's role as a leader in pushing agencies to work together. The E-Government Act also lays to rest questions about whether Congress and the administration truly support electronic government.

"The message is that these guys are serious. The bill is going to vigorously drive e-gov," said Renato DiPentima, president of consulting and integration at SRA International Inc., Fairfax, Va.

DRAFT A-76 RULES

Outsourcing projects should get a helping hand from the new A-76 rules, which will become final this year. Industry has long complained that the old A-76 process for conducting competitions between the public and private sectors unfairly favored government competitors and were too long and costly.

The draft rule is based on Federal Acquisition Regulations and requires most competitions be completed within a year. It also imposes new procedures on public-sector bidders for calculating costs, requiring them to include in their proposals costs such as fringe benefits and facilities expenses. Executives said contractors have always included these costs, and that has put them at a competitive disadvantage.

"For companies like us, [A-76] competitions might be the biggest opportunity for the next couple years," said William Warren, vice president of corporate development at Resource Consultants Inc., Vienna, Va.

But Warren, who's company has entered 10 A-76 competitions under the old rules and won two of them, cautioned that it will be at least a year before the change is evident.

Still, Paul Cofoni, president of CSC Federal, cited the draft rules as one of the reasons his company's acquisition of DynCorp makes sense.

"If we can get a level playing field, we will be very competitive," he said. "This combination positions us better than either of us was before."

ACQUISITION BOOM

Mergers and acquisitions exploded, with companies large and small making deals. The motivation? For some, the goal was to broaden existing capabilities, such as information assurance, intelligence, command and control and cybersecurity, now in great demand. For others, it was to acquire customers in defense and intelligence agencies that traditionally are hard to crack.

And for some, the deal-making was just to get into the federal market.

The biggest acquisition of the year was Northrop Grumman Corp.'s acquisition of TRW Inc. for \$7.8 billion. The merger creates a company that will have between \$25 billion and \$26 billion in annual revenue. Of that, more than \$7 billion will come from information technology.

Other deals of note: CSC's intention to acquire DynCorp; Veridian Corp. buying Signal Corp., IBM Corp. purchased PricewaterhouseCoopers LLC, DigitalNet Inc. acquired Getronics Government Solutions Inc., and Perot Systems Corp. entered the government market by buying ADI Technology Corp.

The pace is expected to continue in 2003. Even large companies such as Lockheed Martin, which made more than 17 acquisitions in the 1990s, and Raytheon Co. are back in the game. Raytheon finished off 2002 with a pair of deals to pick up communications technologies, its first deals in four years.

"We'll make selective acquisitions after careful consideration," said Vance Coffman, chairman and CEO of Lockheed Martin.

Expected to take a breather, though, is Northrop Grumman. Company CEO and Chairman Kent Kresa called the TRW deal a "capstone acquisition," signaling an end to its deal-making, at least for now.

THE IPOS

Anteon International Corp., ManTech International Inc., MTC Technologies Inc., SRA International, SI International Inc. and Veridian all conducted initial public offerings of stock. As the commercial technology industry continued to slump, the steady and predictable growth of the government market looked attractive to the investing public.

As private companies, these were already active acquirers. Now they'll have more muscle to raise capital and make deals. Some of these companies might be the next 800-pound gorillas in the government market. *

Wild cards

Everyone needs a plan. Just don't set it in stone. Play close attention to these wild cards, because they could alter the government's plans and priorities overnight.

WAR WITH IRAQ

This is the wild card that likely will trump all others. The major cardholder right now is Saddam Hussein.

Preparations for war have meant increased demands from the Defense Department for command and control systems, sensor technology and space and satellite technologies. There also are the logistical requirements of moving and managing soldiers and equipment.

And if there's war?

"Money will have to be diverted from civil agencies that aren't directly involved in the war effort," SRA's Renato DiPentima said.

Even companies that are major defense players could see a downside to a war. The military is not going to want to take needed ships, tanks and planes out of service for upgrades.

"Most assets are going to become unavailable," RCI's William Warren said. "So, while we expect to see long-term income grow, we may see a short-term contraction."

BUDGET UNCERTAINTY

Except for the Defense Department, the federal government ended 2002 operating under continuing resolutions, so a question hanging in the air is how quickly will Congress act to approve budgets for fiscal 2003, which is now in its second quarter. Among the budget proposals are \$37.7 billion earmarked for homeland security efforts.

"It's the lifeblood questions: When will we get out from under the continuing resolutions, and when can we pursue new opportunities funded by new money?" DiPentima said.

Complicating matters is the economy, which keeps moving in fits and starts. If it continues to falter, how will the government react -- more cuts, or increased spending as way of stimulating the economy? If the economy starts to boom, how soon will that translate into opportunities for government contractors? What would war do to the economy and the budget?

"There are a lot of things we have to wait and see how they shake out," said Larry Davis, president of Aronson Capital Partners LLC, Rockville, Md.

State governments, many which have rules requiring balanced budgets, also are under severe constraints. The National Conference of State Legislatures estimated that states are facing a collective deficit of nearly \$50 billion for 2003. Many project cuts and delays are expected.

NEW REPUBLICAN CONGRESS

Now that the Republicans control the White House and both houses of Congress, what changes are in store?

Some things won't change. Rep. Tom Davis, R-Va., will still be the most active member on IT and procurement issues. But how big a role will Sen. Joseph Lieberman, D-Conn., play now that the GOP controls the Senate and he has presidential aspirations?

Issues likely to get continued support in a Republican Congress are outsourcing and missile defense. Both represent IT-rich business opportunities.

DEPARTMENT OF HOMELAND SECURITY

The department may come together Jan. 24, but that doesn't mean the requests for proposals will start flowing out the door that afternoon.

The early energy will go to making 170,000 employees from 22 agencies into a single agency. That task dwarfs even the largest corporate merger. And the government doesn't have much experience merging operations.

"At least in the corporate world, you can get practice doing mergers and acquisitions," said GTSI Corp.'s Dendy Young, president and CEO of the Chantilly, Va., company. "Any corporation would be challenged for a decade by this kind of integration activity."

So the wild card: How long will it take to create a single agency, and how much will that delay the new business opportunities so many people are counting on?

AVAILABILITY OF WORKERS

Both the government and the private sector face the task of finding and keeping the right people. The government work force has a growing number of people eligible for retirement. The Office of Personnel Management estimates that through fiscal 2005, about 16.7 percent of the government IT work force will retire. One answer to this issue will be more outsourcing, which means more business for contractors.

But from the contractors perspective, the competition for workers is as intense as it is for contracts. Lockheed Martin's Vance Coffman said the work-force issue is one of the biggest challenges facing the company, and the industry in general.

"The recruiting process for Lockheed Martin is going quite well, but that doesn't mean we'll be in the same position five or seven years from now," he said. "As an industry and as a nation, we must be more focused on encouraging our youth to move into the engineering and technical fields." *

Senior Editor Nick Wakeman can be reached at nwakeman@postnewsweektech.com.

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