

Why experts have dubbed Peraton's deal to buy Northrop's IT arm 'transformative'

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Monday's news that Northrop Grumman Corp. (NYSE: NOC) **would divest its federal information technology and mission support services business** to Peraton Inc. for \$3.4 billion was both a big splash and inevitable conclusion.

Northrop had been rumored to be pursuing a divestment of its IT business for some time, as the Falls Church defense giant continues to hone its focus on growth on aerospace, space, defense, manned and unmanned technology systems.

It also allows the contractor to benefit from an all-cash buy from Peraton for a business that had recently seen narrowing margins for Northrop while demand for IT services is still very hot, said **Bob Kipps**, managing director of Tysons investment firm KippsDeSanto & Co. — now owned by Capital One Financial Corp. (NYSE: COF).

“From a financial perspective, Northrop's Technology Services business had been shrinking for the past few years and its profit margins were generally below the rest of Northrop,” Kipps said in an email. “So, unit performance combined with a very strong M&A market for the TS business made this an attractive time to part with TS.”

While Northrop did not disclose its IT business' profitability, Kipps said Northrop's 2019 10-K put it at roughly 11.5%, which when applied to its disclosed \$2.3 billion in 2020 revenue would suggest the deal price was nearly 13 times its 2020 earnings before interest, taxes, depreciation and amortization (EBITDA).

In selling its IT and mission support operations, Northrop is following a comparable path to Lockheed Martin Corp., which offloaded its Information Systems & Global Services business to Leidos Holdings Inc. (NYSE: LDOS) in 2016 for \$4.6 billion. That

move allowed the defense giant to sharpen its defense and aerospace systems focus while creating a massive IT services player in the market.

While maybe not as impactful as the Leidos deal, Kipps noted the "transformational" acquisition of Northrop's IT business will more than triple the size of Herndon-based Peraton, which is owned by New York private equity firm Veritas Capital Management LLC, making it a more formidable player in a market full of growing competitors feasting on the federal government's need for modernized IT infrastructures. The deal is expected to close in the first half of 2021.

"Peraton's new size and profile very much enhance its growth and strategic options," Kipps said.

The likes of Leidos, General Dynamics Corp. IT, CACI and Science Applications International Corp. will remain "meaningfully larger" than Peraton even after this deal is done, Garrett Asta, senior vice president with financial services company Houlihan Lokey, said in an email. But it's a big step nonetheless.

"From a revenue standpoint, this catapults Peraton ahead of ManTech, the federal solutions business of Parsons, as well as a few of the less IT focused public companies like PAE and Vectrus," Asta said.

Herndon-based ManTech recently made its own acquisition, buying Hanover, Maryland-based cybersecurity firm Minerva Engineering for an undisclosed sum last month.