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Managing the Challenges of M&A During and After the Federal Government Shutdown

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Government contractors have faced significant uncertainty in 2025. Despite initial hopes of an invigorated Federal Government contracting environment that would spur investment, the impact of DOGE and now the October 1, 2025, Federal Government shutdown has created significant challenges for GovCon M&A.

However, despite the obstacles, deal flow is still relatively strong. Buyers, particularly mid-size strategics, are viewing the current environment as a discount window to take advantage of an uncertain market and acquire in advance of downstream sale. Sellers, especially those approaching retirement age, remain in the market, and timing is still optimum for small business sellers and buyers to take advantage of the Safe Harbor provisions of the SBA's new recertification rule.

With that said, the Federal Government shutdown has created challenges when crafting deal terms. How then are buyers and sellers dealing with the shutdown? What are potential landmines that need to be considered?

This article addresses some key areas that should be addressed in negotiating a deal that is impacted by the shutdown.

Valuation – Valuations are often tied to the achievement of an Adjusted EBTIDA target for an historical or forecasted period of time. Preliminary valuations are frequently subject to adjustment should rolling trailing twelve month adjusted EBITDA fall below the initial valuation threshold. The Federal Government shutdown will result in 4th quarter 2025 numbers falling below pre shut down expectations for contractors whose funding is adversely affected or where work is delayed when government oversight or administration is required for work to proceed on funded contracts. How are buyers and sellers dealing with this? We are seeing deals where the parties agree to look through the shutdown – that is, there is no impact to valuation so long as revenue and adjusted EBITDA levels return to pre-shutdown levels. In evaluating the viability of this potential workaround, multiple factors come into play including understanding what period of time is required to return to pre-shutdown levels, especially when a Company's workforce may be adversely affected for those employees or 1099s who may seek alternative employment in non-impacted industry sectors. In some instances, upfront consideration is being moved downstream to an earnout or other contingent payment based on resuming pre-shut down revenue and adjusted EBITDA levels. Slippage in pipeline awards can also complicate projected performance targets.

Working Capital – Impacts to working can be significant due to payment delays and an increase in unbilled or potentially unrecoverable costs. Payment delays, for instance, can result in a highly inflated receivable balance that will favor the buyer if not effectively normalized in establishing the working capital peg or target. Likewise, receivable levels can decrease on certain contracts which are impacted due to work stoppages and delays – these must also be addressed.

Shutdown Related Costs – Incremental costs associated with the shutdown, especially those related to employee retention, should be tracked, monitored and ideally treated as an adjustment to EBITDA.

At Risk Work – A contactor may continue work on a contract where stoppage is impractical or to maintain good relations with the government customer. Where funding or payment is not assured at the time of shutdown, such costs can accumulate as unbilled receivables and recoverability will need to be a focal point during diligence. Sellers should carefully evaluate the impact of cost recovery.

Third Party Funding Considerations – Deals where third-party lending is key for a buyer, risk is being ameliorated through the use of seller financing, thus lessening the strain on senior lenders. Also pivotal is finding a lender that is knowledgeable of the government contracting industry. Now is not the best time to obtain funding from lenders that do not have experience in the space.

Earnouts – There has been a proliferation of the use of earnouts and deferred payments in the purchase of Federal Government contractors in 2025 primarily as a result of the uncertainty of DOGE, streaming of the procurement process, termination of contracts, award delays, etc. The Federal Government shutdown will further impact earnout dynamics, especially for payments based on 2026 or near term performance. Just a few considerations are:

- **Reduction in Workforce** – Contractors that experienced a decrease in workforce due to voluntary terminations during the shutdown must often replace those employees/consultants to achieve pre-shutdown revenue and profit levels. Delays in finding and onboarding employees may be key to returning to pre-shutdown levels – this can be exacerbated where the new employees must be approved/cleared by the customer. This can impact both revenue and profitability during the earnout period.
- **Burning Hot** – while burning hot on contracts post shutdown may help achieve or exceed target revenue levels, margins may be adversely affected. Careful consideration of the consequences of burning hot will often vary by contract or contract type and may require contract officer approval.
- **Performance Based Milestones** – earnouts that are milestone based or tied to a specific non-financial goal or objective (e.g., contract renewal) may be adversely affected by the shutdown. Timing delays should be considered upfront where practical.

Earnout provisions will require careful negotiation to arrive at an equitable resolution.

In conclusion, the government shutdown has added increased complexity to an M&A environment that was already fraught with challenges. Having an experienced and cohesive deal team will help address such challenges as will negotiations that benefit from considering the other party's perspective in arriving at deal terms that are fair to both parties.

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