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Are we approaching the end of the line for market consolidation?

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Merger-and-acquisition activity in the government technology and professional services market has certainly become a fact of life this year, even as deal volume so far for 2018 is down from last year.

But the raw number of deals tells one side of the story. Government services transactions totaling $100 million in enterprise value stand at 14 for this year so far versus 20 last year, but a total value of $16 billion in transactions have taken place this year compared to $11 billion last year, according to a presentation given at the Professional Services Council's Vision conference Tuesday.

And the median deal value is $400 million year-to-date versus $235 million last year, as presented by Vision volunteer Adam Harrison in Falls Church, Virginia. That further indicates that 2018 is a year dominated by megadeals whereas 2017 was dominated by a string of relatively smaller deals.

Buyers are certainly willing to make larger bets in line with budget growth in defense and technology modernization. But considering what assets already been acquired for scale and what other businesses have already divested to focus more on their core, Harrison suggested that the market is "in the fourth quarter in terms of overall government services consolidation."

So as we often ask repeatedly, what are the next dominos to fall? It was only last week that a panel of investment bankers at an event hosted by Morrison & Foerster cautioned that the government M&A dynamic has a supply-demand imbalance to work through in terms of buyers and sellers, the latter of which are seeking to fetch big returns in a market on the upswing after years of downturn.

Sellers also know that buyers are willing to place those larger bets given the perception of more positive tailwinds, overall economic optimism and still relatively favorable credit markets. And some sellers also want more certainty in their backlog and revenue profile before looking to exit.

The involvement of private equity of course is also a looming factor in looking at how the government market M&A will shape out. They have access to capital and are looking to deploy it in a market they have found plenty to like in recent years in terms of return on investment and cash flow.

As Harrison pointed out, it was only a few years ago that government services companies and similar businesses within larger defense primes typically were no more than $6 billion-$8 billion in annual revenue. Leidos and General Dynamics' IT services segment have since raised the scale threshold to around $10 billion through megadeals of their own.

There is also the emergence of large commercial, global engineering and construction companies like KBR, AECOM and Jacobs in particular with respect to government services. They "and a few others really have put a lot of strategic effort into M&A," Harrison said.

But the market has also seen a "disappearance essentially of the mid-tiers," Harrison said.

"As the bigger guys get bigger and we still have a lot of small business focus in terms of small business set-asides and other things, we're becoming more barbell-shaped in a way," Harrison said.

"And so the question is… to think about what does that barbell shape mean to industry? Do we see other companies or see other combinations of companies through private equity or other measures as a way to offset that lack of the mid-tiers?

"It's just something to think about over the next few years," he said.