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Increase EBITDA and Cash Flow Through Various Cash-Type State and Local Incentives

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Because of today's high deal multiples, private equity (PE) firms need to improve efficiencies and cut costs through consolidation. State and local governments are eager to retain or attract new jobs and increase capital expenditure in their jurisdictions. This presents a great opportunity for obtaining state and local credits and incentives. By understanding what triggers credits and incentives, PE firms can lower their cost of doing business.

PE groups can reduce costs significantly and increase earnings before interest, taxes, depreciation, and amortization (EBITDA) or cash flow by pursuing credits and incentives in the due diligence or post-acquisition phases of their transactions. One PE firm recently purchased a manufacturing company that was operating 12 plants across multiple states at approximately 50 percent capacity. The biggest challenge facing the firm was reducing the company's excess costs and avoiding additional costs to do so.

As part of the firm's strategic plan, it analyzed various scenarios for the 12 plants to determine where the most efficient cost savings and consolidation opportunities existed. This analysis included reaching out to the various state and local jurisdictions to determine which were offering incentive packages for training, equipment investments, technology upgrades, equipment relocation costs, and the hiring of new employees. Because the head count and capital expenditure at certain plants would actually go up, the firm was able to use that carrot as a way to negotiate increased incentive packages from the competing states.

Each state responded with incentive proposals to retain the company's operations and reward it for future investment in head count and capital expenditures. The net result: The PE firm secured $10 million in "cash-type" incentives to reduce the company's future operating costs at four of the eight plants that remained after consolidation. These types of incentives might include cash grants, state and local withholding tax rebates, state income tax credits, property tax abatements, sales tax credits, and utility discounts that increase EBITDA or improve cash flow. As this example demonstrates, credits and incentives from state and local governments should be an integral component of business strategy. Companies that don't pursue these incentives potentially are leaving millions of dollars on the table. PE firms should take four important actions to capture the full benefit of credits and incentives:

Recognize the Opportunity

Most executives are unaware that even the most basic business functions can qualify for credits and incentives. Companies can qualify for funds from state and local governments for investing in machinery and equipment, consolidating facilities, expanding plants, hiring new employees, relocating employees, and offering job training.

To determine if a portfolio company qualifies, executives should review its three-year business forecast for capital expenditures, expansion, consolidations, and hiring new employees.

Overcome Common Misconceptions

Business leaders pursuing acquisitions often ignore the value in credits and incentives by:

1. **Moving too fast:** Rushing to close a deal and implement a post-acquisition rationalization plan, executives can overlook valuable opportunities.
2. **Assuming they are too small:** Leaders of small and midsize businesses often assume that credits and incentives are reserved for larger companies.
3. **Losing focus:** Because acquisitions and integrations are incredibly complex endeavors, executives are reluctant to add steps that will complicate the process further.

The most effective way for business leaders to avoid these missteps is to effectively weave credits and incentives into their business strategy. In addition, if a company is forecast to hire 25 or more employees or spend $2 million or more in capital in the next three years, it could qualify for government funds.

Manage the Timing

Most states have a “but for” clause when determining which companies qualify for credits and incentives: That is, but for the credits and incentives, a company wouldn’t have made the decision to expand its operations. To avoid negating the clause, companies shouldn’t announce workforce expansion, sign a lease, or buy equipment until the incentives have been secured. Because credits and incentives can be significant value drivers in deals, executives should begin this analysis no later than post-acquisition rationalization.

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Conduct a Comprehensive Analysis of Opportunities

Credit and incentive offerings are constantly evolving and can vary by state. Because executives are focused on operations and strategy, they often rely on in-house teams, which typically lack the expertise to identify and evaluate all the available options and opportunities.

For example, a company used its internal team to secure a $1.2 million incentive package. Late in the process, a third-party expert reviewed the project and found significant opportunities to qualify for more state assistance. As a result, the company was able to secure $3 million in additional incentives.

As PE firms pursue acquisitions, they would do well to make credits and incentives a primary component in their strategic decisions. With the assistance of experts to provide analyses and counsel, they can better position themselves to achieve significant operational savings.

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