

Finding the "Best" Solution: A Case Study in Venture Merchant Banking

In the following case study, Joseph Ingrassia, managing member of Capstone Business Credit, and Kelly Hickel, partner of The Turnaround Group, discuss the recent turnaround strategy for Best Maintenance, Inc., a New Jersey-based holding company with operating divisions in service station maintenance, environmental testing and tank replacement.

By Joseph Ingrassia and Kelly Hickel

Industry Positioning

Best Maintenance, Inc., a New Jersey "C" Corporation, headquartered in Freehold, NJ, operates as a holding company with the following operating divisions: service station maintenance, general contracting, engineering, environmental testing and tank replacement. The company began operations in 1920, and over the years its service and contracting network developed into a stable and predictable cash and revenue stream. The Best organization has always been owned and operated by three generations of the Best family. Charles Best is the current president and the third generation family member to manage the company.

In recent years, Best has seen its core market of petroleum retailers change from traditional service stations to convenience stores. This rise of convenience stores, co-branded outlets offering convenience items, branded fast food and petroleum products, filled the financial void left by the decline in types of automotive services provided by retail gasoline outlets. This change from service station to convenience store, as well as environmental issues and site contamination and remediation, has resulted in a decline in the total number of retail outlets for gasoline (between 1983 and 2002, the number of retail outlets for gasoline in the U.S. has declined by 43%). However, Best — with its strong marketing presence and name recognition — is uniquely positioned to maintain and grow its market share in the rapidly consolidating U.S. retail gasoline distribution market.

Ninety-five percent of Best's historical revenue comes from commercial customers within a 450-mile radius of Freehold, including locations from Maine to Maryland and as far west as Ohio. Fifty-seven percent of revenue comes from servicing petroleum retailing equipment and pump and tank construction for convenience stores and other retail gasoline stations. Twenty-nine percent of revenue comes from environmental construction and testing projects related to underground storage tank removal and soil remediation for residential and commercial customers. The remaining 14% comes from general contracting. During the last four years, three customers accounted for more than 27% of Best's annual revenue. The remaining customer base includes several thousand diverse customers. The customer retention rate (customers placing repeat orders each year) is 82%. This stability provides very consistent and predictable revenue and cash flow from operations.

The Problem:

Shift in Industry Dynamics & Overexpansion

In recent years, Best suffered from a failed expansion strategy and has been going through a five-year restructuring. During the early 1990s, the EPA and state governments mandated that all service station and underground petroleum storage tanks have double-wall construction to reduce the chance that leaking tanks would contaminate drinking water and cause other environmental damage. To meet this opportunity, Best grew from a regionally positioned services company located primarily in the Northeastern U.S. to a national company. By the end of 1996 — the time period for replacing the single wall storage tanks with double wall tanks — the government mandates that fueled Best's growth from a regional concern to a national one had ended. Because the company had transitioned itself from a regional petroleum services company to a national tank replacement and construction company, management believed that the company should continue to deploy its nationally positioned construction assets and bid on construction projects outside of the petroleum industry. The company soon began bidding on dormitories, sports arenas, convention centers, office buildings and other large-scale construction projects across America. Sales rose to \$265 million and, like many general construction companies during this period, net profit plunged. Aside from competitive bidding, delays caused by weather, contract disputes, environmental impact studies, rising material and labor costs on fixed cost contracts, Best was being hurt by its success.

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Lender Fatigue; Temporary Fixes

During this period of time, the company had negotiated a \$65 million asset-based loan arrangement with a New York bank, as well as other subordinated credit facilities with other financial institutions totaling \$100 million.

The core petroleum services component of their business was the cash cow that supported the construction group during the winter months and during periods when construction-related cash flow was restricted (due to one of the operational delays and cost over runs described above). In 2000, after facing rising losses from operational difficulties as a result of their national expansion, management decided to close down operations outside of the Northeast and focus on its core business of providing services to its core retail gasoline distribution customers.

Between 2000 and 2004, Best was able to reduce its secured financing from \$100 million to approximately \$25 million. Nonetheless, the company suffered from an excessive debt burden. Customer support during this period of retrenching was an essential element of Best's ability to turn the company around. Certain customers relied on the regional services that Best offered. Without Best to service their petroleum distribution networks, many of their customers would have had to contract with several smaller service companies which would have been a significant management problem because maintenance and service would not be consistent from store to store and the cost for these services would be greater. Best's customers helped the company stay afloat by paying account receivables for services and maintenance within minutes of their receipt. This, of course, could only be a temporary fix because it strained the relationships between Best and its primary customers. In addition, the tight cash flow prohibited Best from growing its business at the time as they lacked the liquidity to hire and train new employees to support the growth of their customers ever increasing petroleum retail distribution networks. Simultaneously, with implementation of one-minute after invoicing cash flow system, lender fatigue began to set in, further restricting their cash flow. In early 2004, the bank offered the Best's a significant discount on its loan if they could find a take out for a lump sum payment by December 2004.

Enter Turnaround Management

In late 2003, the Best organization was introduced to The Turnaround Group LLC, a Denver-based turnaround management group specializing in assisting family-owned businesses reposition their companies by negotiating with trade creditors, instituting systems for management accountability, negotiating debt restructuring and accounts payable settlements and arranging for new credit facilities. Kelly Hickel, principal of The Turnaround Group LLC and his partner, David Sunshine, assisted the Bests in instituting management systems which would position the company to attract capital and take advantage of the discount offered by their primary bank. With the assistance of The Turnaround Group, Best had accomplished a significant portion of the necessary restructuring. Management and the two turnaround managers worked so effectively together with management that Hickel and Sunshine were brought in as partners on a permanent basis to implement the turnaround strategy and focus the company's management on stable growth within their core competency with existing customers. Their plan included taking advantage of the increasing consolidation in their industry through the sale of petroleum distributors in their area of operations and through the acquisition of under-capitalized competitors whose service areas overlap within Best's service area. The major missing component of the plan was a solid source for new capital.

New Capital Solution: Venture Merchant Banking

In November 2004, Hickel contacted John Rice, managing member of Capstone Business Credit, LLC to assist in the financial restructuring of the bank debt and to provide working capital facilities to help the company better service its existing customer base and increase the level

of sales growth and profitability. Capstone Business Credit is a vertically integrated merchant banking company that provides capital to assist its clients in realizing sales opportunities through purchase order, trade finance, accounts receivable factoring, asset based lending and equity investments resources for companies that are growing rapidly, in some form of financial distress or otherwise lack assets required by more conventional asset based lenders or banks to secure their credit facilities.

In early January 2005, Capstone Business Credit purchased the existing loan from Best's asset-based lender and second subordinated loan from a New Jersey bank and amended and restated certain terms and conditions of the loans. Through the amendment and restatement Capstone was able to provide equipment financing, inventory financing, accounts receivable factoring and a trade finance facility to the Best organization. Negotiations began immediately with an equity fund for an equity investment of approximately \$10 million. The equity investment is scheduled to occur in the first quarter of 2006 after Best's annual audited financial statements are published, showing evidence of the completion of the turnaround evidenced by a return to growth and profitability.

In June 2005, Best was able to increase its monthly sales volume to \$6 million per month by using the purchase order financing facility offered by Capstone Business Credit. Through the use of this facility, Best has demonstrated to its customers that it has the financial strength to service their needs as they grow. This is a significant step forward for Best because it is demonstrating to both their suppliers and their customers that their patience and cooperation during the turnaround period of the last five years was worth the effort. Their customers are now being rewarded with the timely completion of work and rendering of services, as well as the ability to become more reliant on the Best organization to service all of their maintenance needs for their growing petroleum distribution networks. Best's suppliers are also being rewarded for their assistance during the restructuring because they are now seeing an increase in business from Best, along with payment in a timely manner for services and goods provided.

It is projected that by year-end 2005, all the restructuring costs will be booked on Best's balance sheet and that sales will increase to more than \$85 million for the fiscal period. The sales increase is a result of the availability of both capital and customer demand. The beauty of the sales increase is that Best was operating profitably at its current sales level. The additional sales will create incremental profit of approximately \$3.9 million in fiscal 2005 with 100% leverage on the cost of goods sold. This net profit increase does not require the addition of any additional employees or equipment systems and is incremental profit that was unattainable without the financial support of Capstone Business Credit, the implementation of the turnaround strategy developed by The Turnaround Group and the lifelong relationships between the Best principals and their customers. **abfj**



Joseph Ingrassia is managing member of Capstone Business Credit, a privately-held, venture merchant banking firm, that provides structured financing to developmental stage firms — with typical sales of less than \$50 million — that are involved in the domestic and international trade of finished consumer and industrial products. Contact Ingrassia at (212) 755-3636 or joe@capstonetrade.com.

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