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Gloucester Becomes Unglued:

Case Study of a Restoration

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Gloucester Becomes Unglued: Case Study of a Restoration

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The company's banker had said he was in a "CEO" (career ending opportunity) situation. The Gloucester Company had suffered substantial losses in 2001 and 2002, more than wiping out the company's net worth. Many vendors were refusing to ship; their calls were going unanswered; the company was in danger of missing payroll; employee morale was poor; and the company was in violation of loan covenants. Yet twelve months later, gross margin was up 40%, unit costs were down 22%, and G&A costs were down 45%. Profits were at an all-time high. For this outstanding work, the Turnaround Management Association awarded Capital Restoration LLC with the distinction of "Turnaround Of The Year" for a company with up to $50 million in revenue.

The Gloucester Company made this remarkable reversal under the direction and leadership of Armand Lucarelli of Capital Restoration LLC (CRL), Boston, MA. In order to save itself from a death spiral, the company needed to reposition its products and return to its core business, build credibility within the creditor community and the customer base. The company saw record-breaking sales and margin, a 30% increase in the credit line, and record profits in a commodity market place. The following chronicles this award winning restoration.

The Company:

Founded in the 1960's, Gloucester Company is a closely held manufacturer of adhesives and sealants. Its founder ran the business successfully for thirty-seven years until his death in 2000, when one of his children became President.

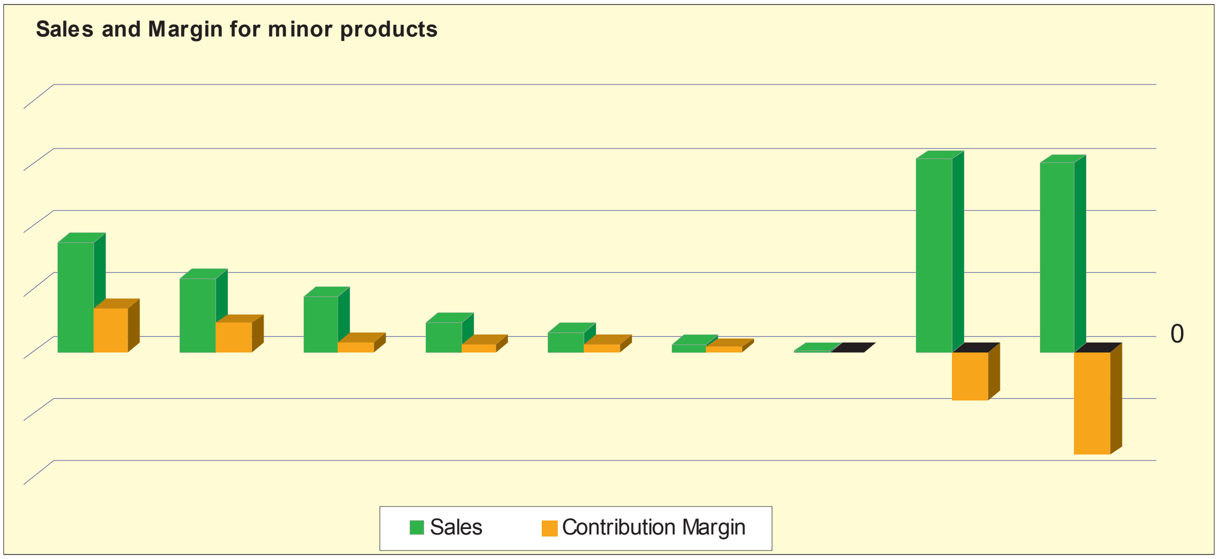
The company manufactures a variety of caulk products, which are sold in large and small home improvement retail stores under the brand name Phenoseal. The company's flagship product is Does It All!, a water based adhesive caulk. It also had developed a specialized line of caulk called ColorTones in 30 colors for use in kitchen and bath applications. In addition, it was also trying to compete with high-volume, low-cost manufacturers of a painter's caulk.

The products are marketed through an independent commissioned sales force. These products compete with products manufactured and marketed by large, well financed companies including GE and DAP who controlled the shelf space in the home centers. The revenue from these home centers comprised a substantial portion of Gloucester Company's revenue. The loss of this revenue stream would have been devastating for the company.

The Situation:

In 2000 the company began to expand the product line without careful attention to the realistic potential for sales and the

Exhibit 1



resources required to manufacture and launch these products. The company suffered substantial losses in 2001 and 2002, eliminating the earnings that it had accumulated over 40 years. Vendor relations had been broken, customers were concerned, and the banking relationship was destroyed. Employee morale was low, and both good management practices and controls were nonexistent.

When Capital Restoration was engaged, the controller's mailbox contained over 60 unreturned phone messages from suppliers who were waiting for payments that they had been promised within the previous 30 days. Planning was virtually nonexistent, and the available resources had been poorly allocated. The commission sales forces had not been paid in several months. We later learned that they were ready to drop the line because some faced being forced out of business for lack of payment on earned commissions. Employee moral was poor. Finally the bank was on the verge of foreclosing.

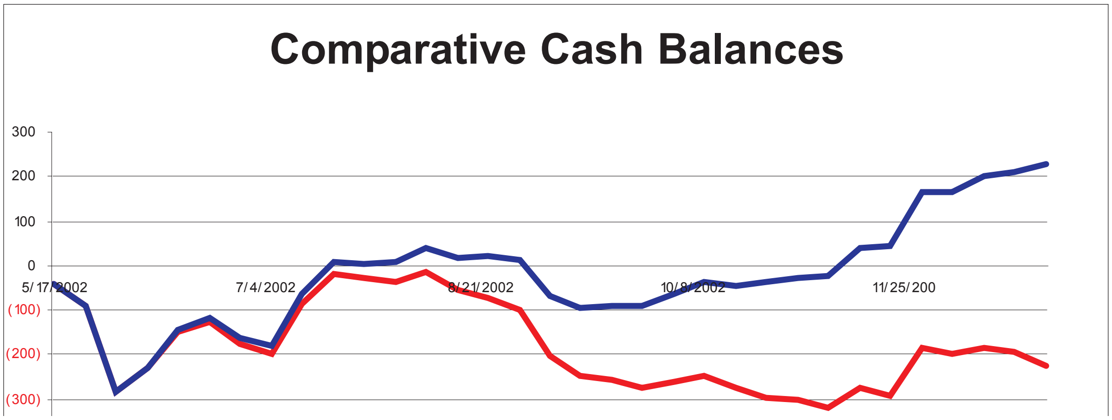
The new senior management team had devoted substantial time and money to changing what was once a solid corporate culture. The team employed several ill-conceived and poorly executed initiatives in an attempt to broaden the product line, create a more sophisticated company image, and reposition the company's marketing strategies. It also created a new entity to lease equipment, rent a facility, and procure raw materials at inflated prices.

The company had expanded its product line to include a new item called ColorTones. This increased costs considerably. Production runs were small, retooling was costly, and inefficient machinery was employed. Labor costs spun out of control. The company was using hand-fill machines to meet the demand for ColorTones and other product lines. This poor planning led to excessive overtime and numerous part-time employees. Output was running at 50% or less of machine capacity. The company was manufacturing in two separate facilities, which created more inefficiency.

Instead of focusing on raising productivity and lowering costs, the company invested in labeling equipment. Hoping to increase retail sales, they changed the product packaging. Instead of printing directly onto the plastic cartridge, as was the norm in this commodity marketplace, they applied glossy labels to cartridges. This was a strategically faulty plan. The company's gross profit decreased 29% in 2002, and sales were up only slightly. The market, which is controlled by two major companies, grows only 2% a year.

Internal systems indicated that the contribution margins on ColorTones and painter's caulk were negative. The following chart depicts the profit and loss from minor product lines based upon standard costing. Actual losses on ColorTones appeared to be substantially larger due to the fact that actual labor costs versus standard labor were understated.

Exhibit 2
Comparative Cash Balances



Yet, despite the internal mayhem, demand for "Does it All" remained strong. The outside sales representatives had done a good job of insulating the market from the internal chaos. Capital Restoration felt there was a core business worth restoring. CRL's activity-based simulation model offered a ray of hope. Could this company be salvaged?

The Process:

Finance:

A thorough analysis of the company was impeded by its lack of accurate financial information. Nevertheless, CRL was able to piece together the situation with great effort.

During the assessment process, CRL found a solid core business in the Does It All! product line. Accounts receivable days outstanding were a low 42 days with some dilution issues. The company's relationship with the trade was a real concern, because they were stretched well beyond normal credit terms. A prolonged inability to procure raw materials would have been the death knell.

CRL identified a number of cost-saving opportunities. These included paring back the product line and reducing raw material costs. Unnecessary spending on marketing, superfluous personnel, and excessive fringe benefits needed to be eliminated. These cost reductions would not have an immediate effect on cash, as it would take two or more operating cycles for the reductions to turn into cash. The following graph depicts projected cash balances for the the company had it remained on course, versus the balances following the incorporation of CRL's recommendations The bank was at a crossroads. If they foreclosed on the loan, they faced losses or a Chapter 11 proceeding. The bank agreed to forebear from foreclosure for a certain period of time, though it would not increase its exposure. With no other sources of working capital available, CRL was forced to turn to internally generated operating funds in order to pull Gloucester out of the death spiral.

CRL advised the company on trade relations and helped it to maintain a continual flow of merchandise. This was an enormous task, which required the "smooth tongue of the gods," as well as a solid grasp of cash and cash commitments. He studied the supplier list, communicating with non-essential suppliers, and paying essential suppliers COD. This honest communication and planning provided critical credibility to the credit community, which allowed essential raw materials to flow.

Three months into the crisis management phase, the banking relationship entered a new phase. As the turnaround plan started to take hold, the company showed profits. The PRESIDENT had resigned, and improvements in operating efficiencies were ahead of schedule. The bank entered into a new forbearance agreement and increased the credit facility. This allowed the company to accelerate sales and extend additional credit to its customer base, which moved more merchandise through the distribution channel.

Cash remained tight throughout the fall of 2002. CRL negotiated 60-day terms on all new shipments from a key vendor. This provided critical working capital during the strong fall sales period.

Cash became short again in the spring of 2003, when a potential strategic buyer spread rumors and reduced cross merchandising space in the home centers, in the hope of purchasing the company at a reduced price. While this hindered a normally healthy sales period, CRL was able to overcome the impediments and produce profits. CRL positioned the company for a strong sales push in the fall of 2003.

Operations:

CRL identified the key operational issues during the initial review. Lucarelli created predefined goals and objectives for operations that focused on resolving these key issues: efficiency, labor distribution, product mix, systems, and employee morale.

Manufacturing operations were out of control. The company was using antiquated hand-filling machines that were manned by three people, instead of optimizing the use of new high-speed filling machines. The changeover to high-speed filling machines saved the company $400,000 in temporary labor, and reduced overtime and other waste.

Systems and planning were lacking. Lucarelli worked with plant managers to institute new disciplines and methods on the plant floor. The goal was to move from a manufacturing-for-orders strategy to a systematic operation. Goals and objectives were established for each shift and each machine. Employees knew in advance which products the machines were going to be running each day. They understood their objectives, and, as a team, they decreased machine downtime and increased production speed. As this strategy took hold, the company increased output and reduced production time. Backorders became a thing of the past, eliminating frustration from customers and sales personnel.

A major cost increase was the changeover from a printed cartridge to the use of a high gloss label that showed possible uses for the product. The switchover to labels had been done under the theory that a customer would be more likely to purchase greater amounts of the product if he or she saw its potential uses. Each label added approximately ten cents to Gloucester Company's manufacturing costs. Cost containment was critical-the competition was printing directly onto the cartridges. The labels added approximately ten cents to Gloucester Company's manufacturing costs, putting Gloucester at a cost disadvantage. The labeling machine was run by four people and consumed valuable warehouse space. CRL sourced and negotiated a vendor to replace the labels with printed cartridges that resembled the labels.

Procurement systems were primitive and limited. The staff had never heard of an MRP system. Bob Curran of CRL worked diligently with the people involved in purchasing, teaching and mentoring employees at all levels. These employees learned to predict materials requirements and alert vendors in advance, in order to eliminate product outages.

This process was not without its bumps in the road. Three months into the project, stocks of labels and printed cartridges began to run dangerously low. A warehouse manager called to alert Lucarelli, who was away at a conference, that the cartridge manufacture would be unable to fulfill the company's needs for the next 30 days. Needless to say the CRL team went into action to resolve this critical situation. They burnt up the phone lines and were ultimately successful in persuading the label manufacturer to search his warehouse for some of the company's labels. As luck would have it, he had the labels, and the negotiations started. We ended up with the labels, and the vendor obtained some cash. This was the last time the company suffered a materials shortage.

Product mix was a major issue. The ColorTone line came in 30 different colors. This line had very small production runs, high inventory levels, and no profit margin. The Does It All! products distributed to the home centers were packaged differently than those which used two-tier distribution. This created extraneous products within the system. Painter's caulk had some volume, but the manufacturing cost exceeded the selling price. Liquid caulk, silicone, and waterproofing were products that consumed resources and added little to the bottom line. To conserve resources, and focus on the company's core business, a decision was made to eliminate ColorTones, painter's caulk, liquid caulk, silicone and waterproofing from the product line.

In addition, Lucarelli's review indicated that ColorTones were under-costed, which resulted in substantial losses on each tube manufactured. Although the elimination of this new product line had a negative impact on the relationship with one or two regional chains, and created some confusion in the marketplace, this move increased productivity substantially. Direct labor costs decreased 45%.

Employee morale was at an all-time low when CRL arrived. Management had made many promises that never materialized. Senior management was despised by many of the employees. CRL reduced head count in non-core areas-an action that received positive response from 99% of the employees. The elimination of waste at all levels was noticed by the labor force, and had a positive impact on employee morale. While employees did not know the extent of the damage, they knew that the company was in serious financial trouble. CRL felt it was important that the employees were engaged and believed they were part of the solution. Improved moral and productivity would be key elements in driving the turnaround.

Employee empowerment requires time and effort. When the Gloucester Company's employees began to realize that everyone was being treated equally, and were being held accountable, they took notice. Lucarelli felt that establishing goals and objectives would be critical to improving employee morale. Further, he believed that employees needed to be rewarded for exceeding goals and objectives. Despite protests from board members that quarterly rewards would suffice, Lucarelli insisted on immediate feedback. He explained that these people had received many promises and no cash. The company struck a deal with the employees, offering daily rewards of pizza and drinks for those who meet the initial objectives. Many laughed and felt it would never work.

A few days after the program was instituted, a team exceeded their goals. They ate to their hearts' content the following day. About a month later, Lucarelli was walking the plant floor on a hot summer day and noticed one of the employees going full-throttle. Upon inquiring, the employee told him that he had a big weekend coming up and would need a free lunch on Monday. The employee exceeded his ten-hour goals in eight hours. The program was altered to a cash bonus system shortly thereafter.

As time passed, many employees took ownership of their jobs, and of the success of the company. The employees started to feel they were part of a team. They began to see Gloucester as their company and realized that they were part of the solution, even in difficult times. March of 2003 was a slow month. The weather was horrible in the Northeast, and retail sales were slow. The company was running a sales promotion to influence revenue, but in the last days of the month, it appeared the company would lose money for the first time in months. Mid-morning on March 31, an order came over the transom for a truckload of product. The plant was closed, and no management was on-site. The warehouse manager saw the order, called a trucker, and loaded the merchandise himself. The company continued its profitable trend. This employee embodied the new team spirit at Gloucester, a company that was beginning to have a future.

Marketing and Sales:

After CRL had completed the crisis management phase, restored the company to profitability, and created a positive cash flow, it was faced with the challenge of solidifying its image in the marketplace. Gloucester had not advertised in major trade journals in years. The company had undergone a very difficult period when it eliminated its ill-conceived products from the market, and removed its well-recognized logo from packaging. It would take prudent steps to position the company as an invigorated enterprise with a strong future. With that in mind, Lucarelli set out to create a stronger and more vibrant image of Gloucester.

Many successful companies make only slight changes to their logos over time, hoping to create a continuation of look and image. Gloucester had been known for its "house boat" logo. The earlier management team had removed this well-known symbol from the packaging and replaced it with images of projects that might require the use of caulking. These full-color images added to the cost of the cartridges and were of no perceived value to customer recognition and sales efforts. CRL conducted some basic marketing research and confirmed that the old logo had had a positive impact. The interim team wanted an updated logo with more pop. This logo occupied by the project images, and would be a less expensive two-color image.

The company engaged the SRK Group, Inc., a marketing firm, to design the logo. This created some interesting dialogue with the previous marketing firm, who decided on its own to design competing images. Instead of letting this create friction, however, CRL turned the project into an enriching project for all parties. The final product was an outstanding logo that conveyed the notion of "does it all." This logo's color design reduced cartridge costs by seven percent.

During the crisis management phase, Gloucester's product line had changed and inappropriate products had been removed from the market. Four months into the project, CRL determined that it was time for Gloucester to create some buzz in the market by filling out its current product line. Gloucester had superior products that required more exposure, new names, and marketing support. Once such product was a completely clear caulk that had previously been buried in what management called the Kitchen Line. The market had few competitors for caulk of this kind-crystal-clear, water-based, and highly adhesive. After several brainstorming meetings with marketing firms and management, the name Does It Clear was selected. The product received strong reviews in the market, which opened new channels of distribution as well as new geographical areas. More importantly, it showed the retail community that the company was alive and well. To quote the largest two-tier distributor in the Northeast, "I see only three caulk companies growing and creating a market, DAP, GE, and Phenoseal (Gloucester)."

Sales Force

The company sold through outside commissioned sales representatives. The inside sales manager had been terminated just prior to the engagement of CRL, and the President, who took over this function, was a disruptive influence until his resignation in the fall of 2002. The outside sales representatives had not been paid in several months, which left them with no choice but to consider dropping the line. Lucarelli was concerned about the sales force and their ability to provide continued support to Gloucester. To resolve the issue, he brought the major sales representatives in for a sales meeting. Although many had expected to be told that the company was closing, they left the meeting energized and confident about Gloucester's commitment to pay their unpaid commissions.

In the summer of 2002, the President had an upcoming meeting with the head buyer of a major home improvement retailer. The purpose of the meeting was to discuss the expansion of Gloucester's shelf space and increasing the number of stores that carried Gloucester's products. Prior to the meeting the President informed the head buyer that if he wasn't going to get an order, he would not attend the meeting. Needless to say, the buyer canceled the meeting and Gloucester did not receive an order. After the President resigned, the head buyer gave a warm reception to the new team, and Gloucester began the process of expanding Gloucester's shelf space and regional reach.

CRL undertook the task of rebuilding confidence in Gloucester. It was instrumental in rebuilding commitments from sales representatives, large distributors, retail customers and employees. CRL invigorated major channels of distribution including Lowe's, TruServe, and ACE. Sales programs and aggressive marketing provided the company with the largest forth quarter in the company's history.

Results:

The restoration of Gloucester beyond its former glory took a lot of hard work by everyone involved. It was a team effort by employees, Capital Restoration LLC, Widett & McCarthy (debtor counsel), outside sales representatives, and vendors. The company became very efficient and well managed, with margins in a commodity market so strong that they were the envy of the industry.

Serving as a regional provider to major home centers is a challenging business. Many companies have found themselves forced out of business because of price cuts, over-dependence, or lack of management skills. This was an exciting and challenging assignment for Capital Restoration LLC.

The restoration of Gloucester from its terminal state required every skill that the CRL team had acquired in nearly a century of combined experience. Every segment of the business had to be restored; financial controls, budgets, materials planning, manufacturing controls, operating procedures, marketing and sales plans, and human capital all were restored to a pristine state.