Kraus Group

Debt acquisition, financial and operational restructuring and $100 million MBO

Background

The Kraus Group is one of the largest manufacturers and distributors of flooring products in North America and Australasia. Founded in 1958, the Group has a 25 acre integrated nylon extrusion and carpet manufacturing facility in Waterloo, Ontario and carpet factories in Dalton, Georgia and Queensland, Australia. The business also has distribution facilities for its own brand and premium branded flooring products across North America. The business employs approximately one thousand people.

Historically, Kraus had grown both organically and through debt financed acquisition. The business had maintained a stabilised EBITDA of approximately $30 million p.a. on sales of approaching $350 million. In 2007, the management team bought out their partners in a leveraged buyout. This buyout coincided with a huge reduction in the US new housing market, together with a significant decline in commercial carpet sales in the USA, while the business' Canadian heartland also experienced a significant slowdown in economic activity. At the same time, Kraus Group suffered a significant loss of competitive advantage as the Canadian dollar appreciated by 30% against the US dollar from 2009 onwards, while the industry as a whole suffered as oil prices increased substantially.

As a result of this downturn in activity, the business was increasingly unable to service its $125 million debt burden. In addition the reduced investment returns experienced in recent years resulted in an increasingly unmanageable pension liability which had a substantial cash impact on the business. Achieving goal congruence between the secured debt holders, which comprised a syndicate of six banks and a private individual, became increasingly challenging and in October 2011 the business was marketed for sale by PWC.

Hilco's Role

Hilco acquired the secured debt owed to the banking syndicate and effected a financial restructuring of the Canadian legal entities. The restructuring resulted in one of the largest 'pre packaged' receiverships of a Canadian entity and also provided useful clarity as the status of Pension creditors in Canadian receivership and bankruptcy proceedings. The acquisition and financial restructuring involved five separate legal jurisdictions and 14 separate legal counsels. Once the formal restructuring was completed, one third of the business' secured debt burden was written off, a number of onerous historic liabilities were removed and a large part of the original debt burden was refinanced with a new lender.

Results

From the outset of the process a senior Hilco team, led by Paul McGowan and Chris Emmott, was allocated to take non -executive roles on the Kraus board to act as a sounding board for the senior management team. In addition, Hilco's manufacturing restructuring team, led by Hugh Whitcomb, embarked on a series of operational restructuring projects across the business functions to drive greater efficiency and best practice. These initiatives have delivered over $2.5 million of cost savings to the business to date while the proportion of 'seconds' produced has been significantly reduced.

Hilco worked with the management team and union leaders to help restructure the historic union agreements which were onerous and uncompetitive. The renegotiation, which was approved by over 80% of the unionised work force, significantly altered working practices within the manufacturing operations and resulted in further savings of $1.8 million p.a. Hilco Real Estate was instructed to renegotiate the leases for the Canadian distribution centres, which resulted in savings of $1.2 million p.a.

The Hilco team applied a continuous improvement methodology to the business to drive growth. The business has implemented wide ranging new financial and operational processes including weekly KPIs, effective budgeting tools and a new employee incentive programme with Hilco's support.

Hilco installed a new leadership team and business plan in 2013 and the business secured a substantial working capital facility with one of the world's largest financial institutions.

Substantial invetment in stock and new product development has secured major new accounts in some of North America's largest retailers, enabling the business to benefit from the return to growth in the housing market.

Key Facts

- Major Canadian exporter employing nearly 1,000 people saved from potential closure
- Debt restructuring to reduce **$125m** debt burden
- **$100m** acquisition & working capital line, achieved through pre-packaged receivership and bankruptcy
- Significant new restructuring legal precedents set

Results

- **$2.5m** of savings achieved to date
- Business achieving significantly improved profitability and sales performance has been stabilised
- New leadership team installed
- Major new retail accounts won
- New working capital facility secured with Wells Fargo