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# Vestar Minority Deal Turns Into Turnaround

Minority-stake investments are one good way to deploy money in a credit crunch, but the experience of **Vestar Capital Partners** in a 2003 deal demonstrates the importance of negotiating the right to take control if things go sour.

New York-based buyout firm Vestar Capital broke into the disposable cup and dinnerware industry about five years ago with a $240 million investment for a 32 percent stake in Illinois-based **Solo Cup**. The sum enabled the company to buy its ailing long-time rival, **Sweetheart Cup**, creating the country's largest food service packaging company with combined sales of more than $2 billion.

The story has a happy ending: the company's recent performance has been strong. In its annual earnings report, released this month, the company reported generating net income of $68 million in 2007, up from a loss of $375 million the previous year. Gross margins for the year rose 2.2 percentage points. At least on paper, Vestar Capital has earned double its money thanks to its contractual 18.5 percent rate of return. And last October, Standard & Poor's changed the outlook on the company's 'CCC+'-rated debt to positive, indicating its credit rating could be upgraded thanks to its significant debt reduction. But the investment got off to a rocky start, and didn't improve for a number of years.

To start, Solo Cup's management, led by the founder's son, **Robert L. Hulseman**, had no experience merging two $1 billion-plus revenue businesses. Solo Cup and Sweetheart operated on separate invoice input systems, which meant losing some of the benefits of scale in an industry dominated by large, demanding foodservice customers like McDonald's and Starbucks, said **David Garfield**, managing director with turnaround consultant **AlixPartners**. By 2005, Solo Cup, with just over $1 billion in debt, was able to eke out a mere $2.43 million in cash flow from operations.

Then came 2006, when the cost of resin jumped 44 percent, and, in an unprecedented blow, stayed there. Raw materials comprise 50 percent of the company's production costs, and those costs weren't easily passed on to Solo Cup's customers. By the end of that year, Solo Cup was buckling under its $1.2 billion debt load, and the company's worsening metrics triggered an underperformance clause in Vestar Capital's deal contract, giving the firm control of the board.

"We were having a near-death experience," said **Daniel O'Connell**, Vestar Capital's founder and CEO. The firm replaced the entire management team, including Hulseman family members. Sweetheart executive **Bob Korzinski** took the chief executive role, and Vestar Capital hired AlixPartners at the end of 2006.

Vestar Capital, AlixPartners and Solo Cup's new management executed "Project 450," a plan to scrounge up at least $450 million dollars to pay down debt. It did sale leasebacks on six manufacturing facilities to the tune of $130 million, liquidated money-losing operations, sold its Japanese business and, lastly, unloaded Hoffmaster, a tableware brand, to LBO firm **Kohlberg & Co**. for $170 million. Meanwhile, AlixPartners' Performance Improvement Plan reduced costs on sourcing, logistics, manufacturing, and sales and marketing. During the nine months of AlixPartners' retainer, EBITDA rose from $110 million to $190 million, O'Connell said.

Though Vestar Capital didn't foresee Solo Cup's troubles, CEO Korzinski said that, even in hindsight, the Sweetheart deal wasn't a mistake. "If it hadn't happened, the situation would be worse," he said, predicting Solo Cup and Sweetheart would have been in more trouble after the raw material cost jump if they had remained separate companies.

With Solo Cup's debt at a manageable level of $700 million, the company next plans to focus on its final stage of growth under Vestar Capital. O'Connell said a push for new product development, and a boost in marketing and sales efforts, are next on the agenda. It'll be another six to twelve months before the firm is ready to exit, he said. —E.G.