

The Restructuring of Specialty Chemicals, Inc.¹

I. Introduction

During late March 2016, Regina L. Turner sat in a West Virginia office overlooking the Ohio River, contemplating seemingly insurmountable challenges. Turner had recently been appointed chief executive officer (CEO) of Specialty Chemicals, Inc (SCI), a market leader in the production of lubricant and fuel additives, to aid in the company's turnaround. Over the last several years, falling oil prices, a surging dollar and headwinds from slowing international demand – particularly in China – had dampened the cash-flow generating power of SCI. By the end of 2015, earnings before interest, taxes, depreciation, and amortization (EBITDA) had fallen to \$495 million from \$840 million in 2013 (**Exhibit 1**) and cash holdings had dwindled over the last year by more than \$73 million (**Exhibit 2**). But it was three immediate challenges that troubled Turner the most.

First, SCI carried a relatively large debt load, resulting from a 2006 leveraged buyout (LBO) that was financed with nearly \$4 billion of debt. While a December 2012 recapitalization refinanced a good portion of the debt, \$1.1 billion of unsecured bonds from the LBO were set to mature at the end of September 2016 (**Exhibit 3**). Second, as a hedge against future volatility in petroleum input costs, in June 2015, the company entered into swap contracts to purchase oil at a price significantly higher than the current spot rate. As competitive pressures in the cheap-oil environment pushed the price of petroleum additives down, the costs of the swaps squeezed SCI's profit margins. Third, looking forward, SCI faced two near-term operational challenges:

¹ The case was prepared by Michael Friedman (Chapman and Cutler, LLP), Larry G. Halperin (Chapman and Cutler, LLP), Randel Lewis (University of Denver), and David C. Smith (University of Virginia). This setting is fictional and should be used only for discussion purposes in a pedagogical setting.

(1) SCI's European manufacturing facilities required substantial upgrades to meet new EU environmental standards, and (2) one of SCI's largest U.S. operating facilities required a shutdown to address immediate safety and efficiency concerns. The two operational challenges would require significant capital outlays in 2016 and reduce production during the upgrade process.

These issues weighed heavily on Turner, an experienced petroleum engineer and industry executive, hired by the SCI board to reverse the downward performance at the company. Turner's experience included a recent successful turnaround of a bankrupt specialty chemicals company. Her January 2016 appointment to the CEO position had the blessing of SCI's creditors, who were eager to work with a credible SCI management team. Turner held a firm belief that the company could be successful going forward, but this would require the stakeholders in SCI to work through the current challenges that threatened the company's survival.

II. History of SCI

Specialty Chemicals Inc. was founded by the brothers Francis and Thomas MacPherson as the Little Kanawha Refining Company in Parkersburg, West Virginia in 1879 to refine carbon oil produced in West Virginia's booming oil sands fields.² The MacPherson brothers were originally salt miners, but discovered that the oil coming up through their salt brine wells on the Little Kanawha River had high value in its own right. When the MacPhersons started the Little Kanawha Refining Company, Parkersburg was establishing itself as a growing marketplace in

² The first discoveries of oil in West Virginia date back to the early 1800s. Substantial oil and natural gas reserves were uncovered around the area of "Burning Springs" on the Little Kanawha River, named for the naturally venting gas in the area that could be ignited with a torch. The drilling and use of oil as an industrial product in West Virginia – in lamps and as lubricant – predates by several decades the 1859 construction of the "first" oil rig in Titusville, Pennsylvania. See *Where it All Began*, by D.L. McKain and B. L. Allen, D.L. McKain Publisher, 1999.

the nascent U.S. oil industry.³ The city's location was ideal for a refinery, as the refined products could be then transported by barge on the Ohio River, or by rail, to other cities throughout the east. By the end of the 1880s the Little Kanawha Refining Company was also manufacturing chemicals, primarily ammonia, from the byproducts of the refining process.

The Little Kanawha Refining Company expanded its refinery business through the first part of the twentieth century, reaching a production level of 1,000 barrels per day by 1916 and 2,000 barrels by 1925. By the 1930s, the company owned and operated a half-dozen refineries throughout West Virginia, Kentucky, and Ohio, and hundreds of oil wells, an extensive pipeline network, and river terminals and barges for transporting oil on the Ohio River to eastern markets. In 1932, the company acquired an Ohio firm specializing in using graphite and chlorine to increase the performance of oil as a lubricant at high temperatures. The company also continued to manufacture ammonia-related nitrogen and nitrate products by converting natural gas into hydrogen in a process known as "Steam Reforming."

During the 1950s and 1960s, the Little Kanawha Refining Company continued to ramp up its refinery and chemicals businesses, primarily through acquisitions.⁴ In the 1960s, the company also expanded internationally, opening lubricant additive manufacturing plants in France, Belgium, and Germany. In 1968, the company changed its name to Kanawha Oil, Inc. By 1970, Kanawha Oil was generating over \$800 million in annual sales, with holdings that included 12 refineries and four ammonia plants worldwide, 6,500 miles of crude and natural gas pipeline, and hundreds of river barges. With the shift in consumer attention towards fuel

³ See, e.g., "History of WV Mineral Industries – Oil and Gas" West Virginia Geological and Economic Survey, July 16, 2004, <http://www.wvgs.wvnet.edu/www/geology/geoldvog.htm>.

⁴ Acquisitions included the Acme Oil Company (1951), Motor City Tankers (1953), Huntington Oil Company (1953), Standard Ammonia Company (1956), and the American Refining Company (1961).

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