Color Spot Files for Bankruptcy

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On Tuesday, May 29, Color Spot Holdings filed for Chapter 11 bankruptcy protection in U.S. court in Delaware. Color Spot Holdings includes the four Color Spot divisions: Color Spot West, Hines Growers, Inc., Color Spot Southwest (Lone Star Growers, Inc.) and a merchandising division that provides in-store service to Color Spot's customers (which include The Home Depot, Lowe's, Walmart, Kmart, Rite Aid, Orchard Supply and Kroger).

Filings indicate that Color Spot has approximately $117.5 million in bank debt, plus about $20.7 million in unsecured trade debt. Top unsecured creditors include Express Seed, Ball Horticultural Company, Nursery Supplies, Inc., Summit Plastics, The HC Companies, Inc. and Container Centralen. The first four are owed more than $1 million each.

In the filing, Color Spot reports having less than $50,000 in assets, and $100 million to $500 million in liabilities, on sales of about $268 million in 2016 and $248 million in 2017.

Raymond James & Associates was hired in February to attempt to sell the company, with some 37 parties executing non-disclosure agreements and three expressing interest in purchasing all or part of the company. Color Spot is hoping to sell the business to pay off most of its debt, and has asked the court to set July 16 as a bid deadline.

Events leading to Chapter 11

Paul W. Russo, a former VP at tool manufacturer The Stanley Works, was appointed CEO of Color Spot in March 2017 after serving as COO in 2014 and on the Board of Directors for seven years. He stated in the court filing that Color Spot had suffered from declining market share and revenues since 2014. He blamed the six-year drought and accompanying water restrictions in California and adverse weather events in Texas.

Most telling, however, is the statement, "[Color Spot's] focus on customer service waned as [the company] grew in size, which translated into losses of certain markets with key customers."

According to the filing, after his appointment as CEO, Mr. Russo began implementing a restructuring plan, which included:

- Negotiating an amendment and restatement of the existing revolving credit facility with Wells Fargo

- Soliciting customer support by meeting with the leadership of key customers to identify and address problem areas

- Right-sizing production capacity to match revenues, including closing four of 13 nurseries in the first nine months of his tenure

- Simplifying the product mix to improve production efficiency and increasing inventory investment in best sellers, eliminating production of 40% of the genera grown which were contributing less than 10% of sales

- Eliminating layers of management to improve responsiveness, which, along with facility closures, generated a 30% reduction in employee headcount in nine months

Apparently, those efforts weren't enough to prevent the bankruptcy filing.

Founded in 1983 by Michael Vukelich and Jerry Halamuda, Color Spot grew organically and through acquisition to six nurseries in California, two in Texas and one in Oregon, comprising 11 million sq. ft. of greenhouse, 6 million sq. ft. of shadehouse and 83 million sq. ft. of outdoor production, with 1,600 full-time employees. Michael passed away in 2011; Jerry retired as CEO and President in 2017. He could not be immediately reached for comment.

My thoughts on the bankruptcy

Nobody, not even competitors, likes to hear of the failing of a nursery. I don't like reporting it. But it comes with the territory. It's usually hard to get principles on the record, so I depend upon public documentation for the "facts."

I put the word in quotes, because not everything I reported above is necessarily true. For instance, did Color Spot fail because of weather? I ask because many other nurseries are dealing with the same conditions in the same markets. Drought and water restrictions are as much a part of this business as Mother's Day and Christmas. As a business owner, you find ways to deal with them. Australia endured a decade-long drought, and yes, some nurseries failed. But others survived, thanks to good management and clever product strategies. Of course, one main reason for getting big and spreading out across various regions of the country is to prevent a weather situation such as a drought from taking you down. Then again, name a region of the country that doesn't face weather challenges seemingly five out of ten years. You can't.

I called out the line about Color Spot's customer service waning as the company grew in size. That, to me, is a bigger factor, and one that puts every large nursery business at risk. Can you continue to excite and delight your customers as your business gets bigger and bigger? Or do you become a victim of your success? Do your thousands of employees care about the company the way you and a few dozen did when you started? How do you teach and protect that culture? It's the same topic I brought up regarding Bell Nursery and their recent sale to Central Garden & Pet.

Lastly, one of the solutions they attempted to Color Spot's dire financial situation, the simplifying of the product mix to improve production efficiency, may have worked against a turnaround. Last I knew, successful businesses grow what customers want to buy, not what is most efficient to produce. In my experience, making production decisions based on spreadsheets instead of customer feedback rarely works. Focusing on high-margin items sounds good on paper, but you can only be so narrow and deep before consumers get bored.

Is it inevitable that the big will eventually fail? No. But the risks seem to be greater. I'm sure that everyone who runs a large nursery is analyzing Color Spot's situation, to make sure they're doing all they can to not be the next one that Beytes has to report on.

What do you think? Am I on the mark? Or is there more to the story than I am aware of? Let me know your opinion, expert or otherwise, HERE.

Thanks for reading,

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