

Testimony of John J. Sherman
Founder, Director and Former CEO, Inergy, L.P.
Before the United States House of Representatives
House Committee on Small Business
July 25, 2013

Good morning. My name is John Sherman and I am from Kansas City, Missouri, near the congressional district of full committee Chairman Sam Graves. I am an entrepreneur who has been fortunate enough to launch and successfully grow and develop two companies from scratch. I am here today because I have been asked to share with you my experience with the SBIC program while building Inergy, L.P., an energy infrastructure company.

Three partners and I launched Inergy in 1998. We were seasoned professionals in the propane industry; and through our experience, we thought that we could build a successful enterprise in the sector. There were approximately 5,000 independent propane retailers across the U.S. Many of the owners of these businesses were at or nearing retirement age, often without family members prepared to take over the business. We believed we could build a scalable business.

Our strategy was simple:

- acquire local and regional propane operators with excellent customer service and safety records;
- grow the business rapidly, both through acquisition and organic expansion;
- access the public capital markets using a Master Limited Partnership (MLP structure) to ensure our ability to grow; and
- ultimately diversify into the broader energy sector.

We funded the start-up with \$600,000 of our own money and raised \$900,000 of equity from the seller of our original acquisition prospect. We went to several banks that turned us down for additional funds but eventually obtained an additional \$4.5 million acquisition loan. The bank loan was with a local Kansas City bank, had strict covenants, and was personally guaranteed by us and our spouses.

With a goal of ultimately going public, we recognized that we would need private equity to serve as a bridge to an eventual IPO. We also recognized that – in addition to gaining capital – we needed the expertise that comes with institutional capital and the business discipline that must go along with it. We were business operators, not financial professionals; and we recognized that we needed access to expertise to help us get to that next level. So we talked with a number of private equity and mezzanine financing firms.

We ultimately connected with an SBIC, Kansas City Equity Partners (KCEP); and on December 31, 1999, we signed an agreement with KCEP for Inergy's first private equity investment. KCEP purchased a \$2 million preferred interest in our fledgling company.

It is important to point out that KCEP took the time to get to know us. They recognized that we had deep expertise in the propane industry, our business plan was solid, and the founders were at risk. Plus, KCEP was flexible as to our financial structure; and they were not asking for control, which was important to us.

We used that initial \$2 million investment to acquire a number of small, independent propane operations over the ensuing months. We also benefitted from the partnership with this SBIC as they helped us zero in on what it would take to access public capital markets.

By January 2001, we had identified a significant potential transaction – Hoosier Propane located in Indiana – that would provide the critical mass necessary for us to take Inergy public. We secured bank financing and obtained \$7.4 million in equity from the sellers. The sellers also carried back a \$5 million loan, but that left a gap of \$16.5 million.

A group of private equity investors led by Kansas City Equity Partners purchased a \$16.5 million preferred interest in Inergy as the anchor investment. All members of the group were qualified as Small Business Investment Companies (SBICs). The other SBICs included Mid States Capital, Invest America, Kansas Venture Partners, Rocky Mountain Capital, Diamond States Capital, and Southwest Partners.

That \$16.5 million was the key piece of capital that allowed us to make a strategic acquisition. Very shortly after we closed that transaction, we filed the paperwork for the IPO process. Just seven months later, in July 2001, Inergy went public. We continued to grow the company dramatically after that, completing more than 75 retail propane acquisitions, becoming the third largest propane company in the country, and employing nearly 3,000 people.

Over the years, we diversified Inergy into the midstream energy sector; and today the company is recognized as a major developer and operator of U.S. energy infrastructure including storage, pipelines, and logistics assets. In May, we announced a merger with Crestwood Midstream Partners, which will create a \$7.5 billion midstream energy company that is extremely well positioned to leverage the growing importance of the emerging shale plays around the country. The combined company will continue to create even more jobs and invest large amounts of capital in energy infrastructure across the United States.

We could not have done any of that without the initial investments we received from the SBICs. Although we have raised billions in capital over the years, no investment was more valuable to us than the SBIC capital we raised that allowed us to reach critical mass and take Inergy public.

Thank you for the opportunity to share the Inergy story.