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Saving The Twinkie

A FTI CONSULTING SUCCESS STORY

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Despite its iconic brand and products (Wonder Bread, Hostess Cup Cakes, Yodels, Ding Dongs and Twinkies, among more than a baker's dozen of other similarly well-known breads and cakes), Hostess Brands, which was founded in 1930 and was one of the largest wholesale bakers and distributors of snack cakes in the United States, emerged from bankruptcy in 2009 with a host of the same problems that had forced it into bankruptcy in 2004. It had a crushing debt burden and a declining EBITDA that left it with little capital to invest in modernization or research and development. Commodity prices were rising, adding to the company's costs and shrinking margins even as consumers were turning away from snack foods. Addressing these challenges would be extremely difficult given Hostess' aging infrastructure, underutilized facilities, and a host of inefficient union-mandated delivery practices that shut it out of promising markets and retail venues. On top of that, the company faced enormous pension liabilities.

These legacy problems continued after the company's initial bankruptcy. In January of 2012, it again was forced to file for bankruptcy protection.

FTI Consulting was engaged by Hostess in 2011 (a year in which the company lost $341 million — twice as much as it had lost in 2010 — and added debt) to provide interim management support and assist with the development and assessment of a turnaround plan (TAP) to allow Hostess to overcome its challenges and (in a worst-case scenario) create a comprehensive wind-down plan if liquidation became necessary.

It did, and the TAP became an invaluable key for unlocking and maximizing the value trapped inside Hostess' long-troubled business.

The Cream Inside The Plan

The turnaround plan, developed in conjunction with Hostess management and other advisors after examining, analyzing and reviewing the company's business processes and financials, contained both cost-saving and revenue-generation initiatives to maximize profitability and resolve operational inefficiencies.

The cost-reduction piece was aimed at reducing operating costs and interest from the company's debts to enable the organization to become sufficiently liquid to fund much-needed capital improvements.

Several of the TAP's initiatives were directed at decreasing costs associated with the company's union-negotiated compensation packages (including pension benefits) and eliminating archaic work rules that prevented Hostess from pursuing potentially profitable business opportunities. For example, many of the company's collective bargaining agreements made it impossible to deliver to certain types of stores. This meant that it was not possible to deliver Hostess products profitably to many convenience and dollar stores, vending machines and movie theaters due to the company's cost structure – where servicing such low-volume, low-revenue locations was unprofitable. This created gaps in Hostess' distribution network. And many potential customers wanted deliveries to be made to warehouses, not to stores. Union rules forbade that, as they prohibited deliveries of both bread and cake at the same time— only one or the other could be delivered by an employee, effectively mandating that two people do the job of one.

Changing this delivery process by outsourcing low-volume and low-revenue stops to third-party distribution operators would boost profitability, as well as gain market share for Hostess' products. However, this inefficiency, and the compensation issues, could be addressed only by modifying approximately 400 Collective Bargaining Agreements (CBA) of Hostess' 12 unions.

Nonetheless, many of the TAP's restructuring initiatives designed to eliminate inefficiencies did not require modifications to the CBAs. Some of the strategies that FTI Consulting helped evaluate included:

- Reducing excess baking capacity and improving the efficiency of the remaining bakeries by closing and selling underutilized plants and modernizing other facilities.
- Extending the shelf life of certain Hostess products (with enzymes) from 28 to approximately 45 days to increase market penetration to smaller retail outlets, filling white spaces in the market.
- Reducing by 10 percent the ingredient weight of Hostess CupCakes, Zingers, Ding Dongs, Coffee Cakes and Twinkies, thus lowering the cost to produce (Hostess estimated the annual savings to be approximately $7.3 million).
- Outsourcing the production of low-volume or seasonal products.
- Upgrading the delivery fleet (to reduce fuel and maintenance costs) and consolidating distribution centers, closing those with less than three routes.
- Installing warehouse management software (with radio frequency identification tags, or RFIDs, on pallets) in certain distribution centers, thereby improving process efficiency by reducing time and errors on the loading docks.
- Closing unprofitable bakery outlet stores and modifying pricing strategies.
- Lowering the company's general and administrative costs through headcount reductions by consolidating business units and outsourcing certain functions such as human resources.
- Restoring the company's advertising and marketing budgets to generate revenues for new product research and development.

Once these strategies were fully vetted by Hostess' management team and operational-level employees, the risks fully understood and the financial benefits agreed upon, the TAP could be used as the basis for negotiations with the unions to seek those modifications to the CBAs that would allow Hostess to emerge from bankruptcy as a going concern.

One Dozen Unions

Hostess' initial proposal to the unions did not require pay cuts. Instead, it placed on the table an overhaul of the multi-employer pensions that placed a financial burden on the company and changes to the aforementioned archaic work rules.

Unfortunately, the International Brotherhood of Teamsters (IBT) rejected the company's initial proposal. Once that became a non-starter, the company returned to the bargaining table with a cost-saving package that required compensation reductions along with work rule changes.

Between April and September of 2012, the wind-down plan, which emerged from the road map to profitability outlined in the TAP, was developed. During this time, negotiations with the unions continued, and the company explained what could happen if a deal could not get done — how from the time, for example, a Twinkie was made to the time someone bought it at, say, Target, the CBAs were devouring the profits the company needed in order to modernize and survive.

The two largest unions — the IBT and the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union (BCT), which represented over seventy-five percent of Hostess employees — responded differently. The IBT took a closed vote in which the membership agreed to the proposed wage cuts and other CBA modifications, including the TAP-designed changes to delivery methods and to commission pay. The BCT, however, took an open vote and in early November of 2012 struck 12 Hostess facilities and set up picket lines at 12 other sites. Other union employees would not cross the lines. As a result, operations were materially disrupted at those 24 facilities.

The baker's strike made it impossible for Hostess to fill customer orders or even stock its own products at its retail stores. Because of this blow to Hostess' operations and cash flow, the company lost its ability to fund ongoing operations.

Shortly thereafter, Hostess started to wind down operations and begin the liquidation of its assets.

Unlocking the Surprise Inside Hostess

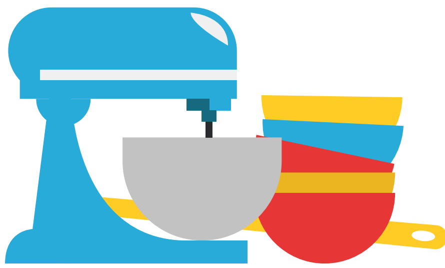
The TAP helped inform and maximize the sale of Hostess' assets by showing potential buyers the path to profitability and ways to unlock the value contained in Hostess' brands and facilities once they were separated from the company as a whole and free of the onerous CBA wage and work rule obligations.

FTI Consulting, Hostess and other advisors developed a sales process designed to attract as many potential buyers as possible and thereby maximize the value that could be retrieved in the sale. One key was separating the bread and cake lines that historically had been produced, delivered and marketed together. Certain buyers were only interested in the individual cake or bread business, but separation of the two business lines before the bankruptcy filing was virtually impossible due to resulting financial consequences from the collective bargaining agreements. The TAP was critical to devising the standalone cake plan. This involved, in part, reducing the number of cake plants from 11 to five and implementing a warehouse direct delivery model with third-party distributors. This would produce significantly higher margins for the cake business.

Hostess entered the sales process with more than $1 billion in secured debt obligations. As a result of the various sales (the largest was private equity firm Apollo Global Management and Metropoulos & Co.'s $410 million purchase of the snack cake business, including Twinkies; Flowers Foods bought Wonder, Merita and five other bread brands for $360 million; McKee Foods, maker of Little Debbie snacks, paid $27.5 million for Devil Dogs, Ring Dings, Yodels, Yankee Doodles, Funny Bones and Drake's Coffee Cakes), Hostess was able to return almost a billion dollars to its creditors. Certain plants reopened within 30 days of the sale, restoring a portion of the lost jobs.

Although the TAP was not able to keep Hostess together, it revealed a path to profitability that saved jobs, preserved creditor capital and returned America's iconic snacks to the consumer.

And on July 15, 2013, approximately six months after Hostess was forced to shut down operations, Twinkies returned to the shelves.



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