

# *Fannie May<sup>®</sup>*

*a turnaround success story*



# How Sweet it is: Fannie May in Good Taste

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*Compiled from Crain's Chicago Business,  
Chicago Tribune and other sources*

Archibald Candy Corp. (ACC), a Chicago icon with a decades-long history in the North American confectionery industry, faced a failed rollup strategy that had been started in the mid-nineties. The rollup had drained resources and burdened the balance sheet with an estimated \$170 million in debt—its pre-pack bankruptcy in 2002 had only restructured the balance sheet—and there had been no attempt to address the underlying operational and marketing issues that had been the root causes of the first bankruptcy. The same management team that led ACC into its first bankruptcy had developed a business plan showing sales growth and cost reduction to provide an exit from bankruptcy; unfortunately, the plan lacked concrete, actionable steps and its execution failed. The numbers were way off out of the gate...and the lenders were unhappy.

On top of that, ACC faced other challenges. As part of the rollup, the candy production for both the Canadian and U.S. divisions had been moved into a single facility in Chicago. This large, old facility suffered high costs and low productivity, thanks to dated equipment and layout, as well as expensive unionized labor. The company's approximately 250 retail stores in the U.S. had been

neglected for years and were in drastic need of refurbishment. The Canadian division, Laura Secord, was generating positive EBITDA but was hurt by the high U.S. production costs. And as every candy lover knows, the business was extremely seasonal, so the timing of any asset disposition, liquidation or sale was an important consideration.

Despite a decade of neglected brand marketing, ACC's brand value was still extremely high. Fannie May and Fanny Farmer's value was in the brand names and real estate but not as a stand-alone going concern, while Laura Secord still retained going concern value. With that in mind, post-bankruptcy sale attempts by the post-Chapter 11 owners began in late 2002, but met with no initial success: buyers were offering a nominal premium over liquidation value for the assets as significant ongoing operating losses made future operations problematic.



## *The fatigued exit lenders refused to finance the late 2003 seasonal inventory build . . .*

The fatigued exit lenders refused to finance the late 2003 seasonal inventory build . . . a decision that would push the company into liquidation fast.

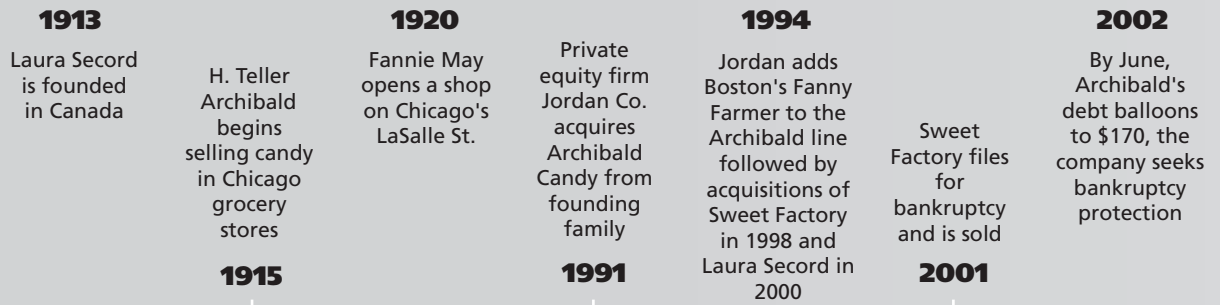
### **Could the candy maker be saved?**

Morris-Anderson & Associates (MA&A) was retained as CRO in May 2003. After analyzing the operations, marketing and financial issues, the team, led by Chicago-based Principal Jim Ross, realized that the company could be sold in several pieces to maximize value but only after the upcoming holiday season, and that a bridge lender would allow increased seasonal funding to avoid the value destruction of a quick liquidation. The answer was in negotiating a financing package that included LaSalle Business Credit and Delaware Street Capital, one of the company's major bondholders. The lenders and bondholders, once convinced that the restructuring plan had a clean and timely exit with manageable risks, supported the MA&A plan; a funding package was put in place that provided the working capital and seasonal credit line that would allow the company to continue operations through the end of the year, and allow the time necessary to position both divisions and their key assets for sale.

The team began to prioritize and attack long lead-time tasks. One of the first was to separate the two operating divisions. A key to realizing value of the Canadian business was to decouple it from its U.S. parent, and outsource the production of Canadian candy to a supplier who could produce the candy at a competitive price. The production processes that had to be transferred were extremely complex with the best of suppliers requiring

15 months to fully ramp up their capabilities. The team did not have that much time, so the team developed a strategy that included the production of a transition inventory that would bridge the gap for a new supplier. With financing in place to cover the company's needs only through December 2003 (end of the primary holiday season), the company began execution of its aggressive plan for a planned orderly wind-down of manufacturing operations, buildup of its normal seasonal inventory and manufacture of the transition inventory for Laura Secord.

The team recognized that going-concern buyers would be interested only in selected Fannie May and Fanny Farmer assets: namely, its brands, IP and retail properties. The current plant operation was not economically viable, so the fixed assets and inventory would need to be sold separately, likely in a §363 process. The team arranged the sale, which consisted of an aggressive process of reaching out to both financial and strategic buyers. While there was significant interest expressed by potential buyers, the size and complexity of ACC made the long-term transition of the stand-alone business to a new business model too risky for most financial buyers. In essence, ACC needed to find a buyer with existing production capability or one that could outsource all manufacturing, and concentrate on leveraging the brands through distribution and retail. And the transition of production capacity became a major issue that financial buyers had to overcome. However, the strategic buyers realized that brand value was incremental to and supportive of existing channels, making overall value potential greater. Additionally, organizational synergy could improve pro forma results for many, and the additional



pounds could add value to existing production capability provided they could attain relatively quick transition.

But...initial bids from this group did not reflect the added value potential!

### How did the team save the company through sell-off?

Disposition strategies were developed for each of the major asset groups. The U.S. and Canadian divisions were staged for separate sale activities. The team, which included MA&A's Jim Ross; Jenner & Block's Mark Thomas and John Sieger; Neil White of McDermott Will and Emery; and Michael Levy from the investment-banking firm Paragon Capital Partners, coordinated the sale activities with the wind-down of the U.S. operations facilitated through a Chapter 11 bankruptcy filing.

The signing of an Asset Purchase Agreement concluded at the end of the primary holiday season for the Fannie May and Fanny Farmer brands, and initiated the process of closing the U.S. manufacturing facilities and retail stores, worker lay-offs, and Chapter 11 filing. Amid public scrutiny, political posturing

and a lawsuit from the Teamsters, intense negotiations with the unions helped provide a "soft-landing" to employees while fixed assets were sold.

As word spread of the events (thanks to a shut-down memo that was leaked to the press), Fannie May's inventory liquidation began. Initial demand was very strong and held steady as daily news broadcasts provided free advertising of impending store closures to the public. The team reacted very quickly to the high demand: the closure schedule for low volume and geographically remote stores was condensed, remaining inventory was consolidated into high-volume retail stores primarily in the Midwest, and planned price discounting to fully sell out inventory was cancelled. The ability to leverage the Fannie May brand to capitalize on the perceived scarcity of final production allowed ACC to quickly close its 245 American stores and realize a 100% gain on liquidation value over pre-closure estimates.

While liquidating the inventory and fixed assets, the team concentrated on completing the sale of the brand and retail properties. The goal was to identify at least two strategic buyers who could obtain

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**2002**  
In October, Archibald emerges from Bankruptcy with Secured Bondholders acquiring 100% of equity and writing off \$120 million in debt

Saddled with \$170 million debt to bondholders, Archibald defaults on payments in April, secures new financing from LaSalle Bank  
**2003**

**2004**  
Archibald Candy files for Chapter 11 in January. Alpine Confections offers preliminary bid of \$18 million

In time for Valentine's Day, Alpine Confections, with an interim license to manufacture Fannie May, distributes product through retailers and online; Archibald ceases operations  
**2004**

**2004**  
Archibald auctions U.S. brand, IP and real estate to Alpine Confections in April

In May, Pension Benefit Corp. assumes Archibald employees' pensions  
**2004**

**2004**  
Gordon Brothers acquires Canadian chocolatier Laura Secord in July

incremental value from the brand, IP and retail real estate, and bring them into the auction process.

### How can Fannie May's value increase at auction?

The first step was taken when the stalking horse was selected: ACC entered into a stalking horse asset-purchase agreement with Utah-based Alpine Confections, Inc. in which, among other things, Alpine agreed to buy the brand, IP and the company-owned real estate for \$18 million. The bid was subject to higher or better bids at the auction, but gave the privately held company an interim license to manufacture Fannie May. The license allowed them to immediately begin producing product and provide a bridge supply of product to the mass market channel while helping to retain the value of that channel for the eventual buyer at the \$363 auction. Alpine's significant investment in developing production capability and product distribution capability also carried over to the auction as added incentive to be the highest and best bidder.

The bid deadline was March 30 at 11:00 am. However, due to the extraordinary interest by numerous parties in purchasing individual parcels of real estate, a pre-bid deadline of March 23 was set for submission of non-binding expressions of interest. A lengthy conference call was held with those parties on March 26 to answer questions, enabling them to submit qualified bids by

the deadline. A form asset-purchase agreement for the real estate was submitted to the qualified parties. This preliminary process enabled the team to gauge the ultimate value that could be realized if the real estate was sold on a parcel-by-parcel basis. Once bids were received on the March 30 deadline, the team had 48 hours to review the asset-purchase agreements that comprised the bids and evaluate the financial withdrawal of potential bidders. More than 55 bids were submitted by way of written asset-purchase agreements.

During the 2 days between receipt of the bids and the actual auction, each contract submitted by each potential bidder was reviewed for consistency with "standardized" real estate and IP purchase contracts. Deviations from the "standard" contract were identified and assigned a monetary value that quantified whether the changed contract provision was a benefit or detriment to ACC. This process adjusted each gross bid for specific, unique contractual provisions, resulting in an adjusted bid value that enabled the team to compare more than 40 different contracts on an "apples to apples" basis.

Using the calculated adjusted value, the team decided how it would package the assets for bidding at the auction, and minimum bids for each lot were set. By breaking the assets into the four lots and offering the assets in order, the team established "floor" values that built up the ultimate value of the final lot.

- (1) IP only
- (2) 31 parcels of real estate offered on an individual basis
- (3) 31 parcels of real estate offered as one single group
- (4) IP and the real estate offered as one single group

With more than 100 people in attendance, representing more than 40 qualified bidders, Mark Thomas conducted the April 1, 2004 auction at Jenner & Block's offices. All told, more than 300 bids were made during the auction. In addition to bidding on price, several bidders made increased bids by eliminating contractual provisions that had led to negative adjustments to a gross bid's adjusted value. After more than eight hours, Alpine—which also makes Mrs. Field's, Maxfield's, Hallmark Chocolatier and other brands from its facilities in Utah, Ohio and Vancouver—won the Fannie May and Fanny Farmer IP and 31 real-estate parcels for a cash sale price of \$38.9 million, more than double the amount of the original stalking horse bid. On April 2, 2004, bankruptcy court approved the results.

### **What about Laura Secord, the Canadian division?**

An aggressive sales process was launched for the Laura Secord (LS) division in the spring of 2004. Significant changes were put into effect at LS as the U.S. operations were wound-down. Senior management positions were filled at LS as comparable positions at ACC were terminated. All LS inventory was moved to Canada, and new transportation and warehouse facilities were established. Accounting and data processing systems

were moved to LS's corporate office in Toronto as well. While LS was moving quickly to become a stand-alone operation, the team was working constantly with century-old Ganong Chocolates of Canada to develop the outsourcing capability. Key to the smooth, timely transition was knowledge transfer and hands-on technical support—something any new buyer would look at under a microscope before completing the acquisition.

The LS transaction represented cross-border problems as well, as it involved assets in both the U.S. and Canada. With the parent in U.S. Chapter 11 proceedings, the team had to orchestrate a complementary legal process in Canada to ensure free and clear title to the buyer. With the assistance of Tracy Sandler of Osler, Hoskin & Harcourt LLP, a joint U.S./Canada sales hearing was conducted that resulted in a joint approval of the sale motion by both U.S. and Canadian courts.

Though several other interested buyers aggressively pursued the stalking horse roll, by June 2004 the team selected at \$22.5 million (CAD) M&M Meat Shops, a specialty frozen-foods franchise operator in Canada looking to diversify. In preparation for the July auction, the team met with interested bidders and again used the formula described earlier for the bidding process; at the auction, bidders actively mixed both cash bids and contract adjustment bids to establish the net value bid. The winning bidder was GB Palladin Capital, a division of Gordon Brothers Group, with a gross cash bid in excess of \$27 million (CAD), and contract adjustments valued at an additional \$3.5 million (CAD).

## What's the short version?

ACC represents a classic case in which MA&A was able to take over a troubled company that was in serious danger of a crash and burn liquidation. However, MA&A was able to quickly understand where the pockets of primary value were, and develop a coherent strategy that paved the way for new funding that allowed time to execute the strategy. The stakeholders funded the practical plan, and MA&A and the other case professionals improved stakeholder recoveries by \$45 million while preserving hundreds of jobs.

- Total recovery on sale of assets exceeded \$82 million (USD); this compared very favorably to the estimated \$37 million that might have been recovered if the company had gone through a forced liquidation.
- The company was able to successfully operate through the key December holiday season and generate more than \$27 million net cash.
- Laura Secord retained its going-concern business value and continues to be a strong retailer in the Canadian market.
- Fannie May and Fanny Farmer brands have returned to the retail market in the Midwest, where many loyal customers will again have access to the candy they grew up with.
- Nearly 2,600 employees were provided a soft landing with severance benefits that amounted to approximately 75% of the Company's obligations.
- The company's manufacturing facility was sold and is expected to be transformed into a retail center that will provide a large number of new jobs to the Chicago community.

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