KIM: How new owners turned Twinkies into solid gold

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While Americans rejoiced when Twinkies reappeared on store shelves in the summer of 2013, nobody has had more reason for celebration than Metropoulos & Co. and Apollo Global Management LLC (together "M&A"), which purchased Hostess Brands out of bankruptcy liquidation just months earlier.

The tale of Hostess' beginning, demise (twice) and rise from the ashes is a fascinating case study of iconic brands, mismanagement and human tragedy and how "private equity"/buyout firms can make mind-boggling sums in the blink of an eye.

The first Hostess cupcake was created in 1919 and the Hostess brand was founded in 1925 when Continental Baking bought Taggart bakery, the maker of Wonder Bread. Twinkies were invented by James Dewar in 1930 as a cheap bakery item during the Depression and became an instant hit. Ding Dongs and Ho Hos were introduced in 1967 and Interstate Baking Co. acquired Continental in 1995.

Interstate filed for Chapter 11 bankruptcy protection in 2004. According to *The Atlantic*, the company was "collapsing under the weight of flagging sales, overly generous union contracts replete with ridiculous work rules and gobs of debt." Under Chapter 11, Interstate continued to operate while attempting to "reorganize" its debts and business.

Interstate emerged from bankruptcy in 2009, with private equity firm Ripplewood Holdings paying $130 million for control (and hedge funds Silver Point Capital and Monarch Alternative Capital providing $360 million of debt financing) and the company's two major unions, the Teamsters and the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union contributing $110 million in annual wage and benefit concessions.

Unlike most Chapter 11s, the renamed Hostess Brands exited bankruptcy with more debt than when it entered. By January 2012 the company was ***back*** in Chapter 11, seeking additional capital and ***more*** concessions from the unions.

Understandably, the unions were loath to grant further concessions on top of those given just three years earlier. Management threatened to cease operations and liquidate if the unions refused to cooperate. Following a bitter strike, Hostess changed its bankruptcy to a Chapter 7 liquidation and 18,500 employees lost their jobs.

This real-life drama played out here in Columbus, where Phillip "Sap" Essex and Gene Brierly took over a bakery in 1948 (thanks to The Republic for the historical assist). At one point, Sap's Donuts employed 600, making it one of the biggest in the city. Sap's merged with Beatrice Foods in 1972 and Beatrice was purchased in 1979 by Interstate (which changed Sap's to Dolly Madison).

In April 2013 M&A purchased the Hostess and Dolly Madison bakeries and brands for $410 million ($186 million of their own cash plus debt), free and clear of all prior obligations and "legacy" issues (including 350+ *separate* collective bargaining agreements). The new owners subsequently invested $160 million to upgrade and automate baking and packaging.

Key to success was abandoning the Direct Store Delivery ("DSD") model, which utilized company-owned trucks (on which Wonder Bread and Twinkies weren't allowed to ride together) and company-employed drivers to serve 5,500 routes, in favor of a Direct-To-Warehouse ("DTW") model, where all shipping is done by third-parties to customers' warehouses. This resulted in distribution costs dropping by more than half, from 34% of sales to 16%.

Windfalls to M&A happened in quick succession. Hostess was able to borrow to pay a $905 million dividend to M&A in July 2015. In November 2016 M&A sold a 58% stake in Hostess to Gore Holdings for $725 million (with Hostess becoming a public company again—TWNK). At a recent price of $17, TWNK is valued at $2.2 billion.
From their original investment of $186 million, M&A received the $905 million dividend, $725 million from Gores and are still left with TWNK shares worth $924 million (Apollo actually sold the majority of its shares last month), a total of more than $2.5 billion. This equates to a ***13-fold return in just four years***, a gigantic mountain of gold.

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