Q&A: The Hostess Auction — What To Expect

Lindsey Jahn, Associate Editor

Interview with Anthony Michael Sabino, Professor of Law, Tobin College of Business, St. John's University

As Hostess continues its bankruptcy auction process, the company has announced the lead bidders for many of its popular brands, including Wonder Bread and Twinkies. *Food Manufacturing* [1] spoke with Professor Anthony Michael Sabino about the bankruptcy auction process and what it means for both buyers and sellers.

Q: How does the bidding process typically work in a bankruptcy situation?

A: The bidding process works only one way; the "highest and best" bid wins. Highest means most dollars, and best is qualitative; it essentially means the most cash today, as opposed to cash later (i.e., A $ 100 million with half cash and the other half in stock or cash to be paid later can be beaten by, say, $80 million cash today because it's the most cash in the shortest time).

By far, the best bid is all cash, and thus in the vast majority of cases the bidder that shows up with the most cash and has it all in cash wins.

Q: Hostess has chosen to sell its brands separately. Why is this the best option for the company?

A: It's the old adage of "the sum of the parts is greater than the whole." As a whole, Hostess has a diversity of brands that inevitably attracts some bidders, but is of little interest to others. Therefore, by breaking the whole into pieces, each piece can attract the most interest from buyers who want that specific brand and are willing to pay for it. This leads to more competitive bidding and more money for creditors.

Q: What considerations are being made by Hostess as it goes through the auction process?

A: At this point, since Hostess is being liquidated, it's just a matter of "dressing up" the brands and encouraging spirited bidding, such as the breaking up of brands as discussed above. Other than that, it is permitting bidders to conduct "due diligence," that is, inspect the books and records, the physical assets and such, so they know what they are bidding on.

Q: Hostess has already announced lead bidders for many of its bread brands, such as Wonder, as well as Drake's and Twinkies. Now that the leaders have been chosen, what is the next step in the process?

A: Lead bidders, sometimes called "stalking horses," start the process by essentially setting the floor on bids. The good news for Hostess is it can only go up from there. Competing bidders now know the minimum bid that they have to beat. So if Bidder A adds a few million to beat the lead bidder for Twinkies, then Bidder B has to add another few million, and Bidder C has to add even more. It makes the bidding build to a crescendo, and that means more cash to be paid out to creditors.

Q: Is there any risk involved for the potential buyers of these brands? What considerations are likely being made on the buyer's side of this auction?

A: There is always risk. Bidders have to decide just how much they are willing to pay, how much they can afford to pay, and so on. Bidders obviously don't want to overpay (think of Alex Rodriquez and the Yankees). You want value, but don't want to overpay.

Bidders will also have to consider business risks, such as can they make this work? Sure, Twinkies has inestimable brand name recognition, but can you sell it and make a profit, given the costs involved, such as raw materials, labor and marketing? It seems pretty certain that there is an enormous demand for Twinkies right now, but will that wane if diet conscious Americans rethink their waistlines — and their budgets? Bidders will have to carefully weigh all these risks of acquiring even these iconic brands.

Q: Once the bidders have been selected and their purchases approved, how long will it take for the products to be back on the shelf? What will this process be like?

A: Once bidders emerge victorious, the court has to approve it, and Bankruptcy Judge Drain has to issue an order. That could be done in one to two months max, but if somebody appeals (claiming the auction was unfair, for example), the auction might have to be redone, taking more time. The appeals process itself could add months.

Assuming the auction goes smoothly, Judge Drain approves it, then the sale is “closed” (much like a house sale), and the winning bidder officially owns Twinkies or Drake’s or whatever. Without problems, that could be done by Memorial Day.

Then it’s up to the buyers as to how fast they can gear up and get product on the shelf. Fourth of July might be optimistic because it’s closer than you think. The word going around is that the interested parties are targeting back-to-school season in the fall, since there will most likely be incredible demand to put Twinkies or Devil Dogs in little Johnny’s or Mary’s lunchbox.

Prof. Sabin is a professor of law at the Tobin College of Business at St. John’s University in New York City, where he teaches bankruptcy law and other complex subjects, and a partner at Sabino & Sabino, P.C., N.Y., where he has represented major creditors in large bankruptcy cases for some 30 years.