# WASSERSTEIN'S

PHOTOGRAPHS BY DAN SAELINGER

# SPOILED FRUIT

THE LATE DEALMAKER'S BUYOUT FIRM HELPED DRIVE OREGON PRODUCE SELLER HARRY & DAVID INTO BANKRUPTCY BY PILING ON DEBT AND PAYING OUT BIG DIVIDENDS.

BY ANTHONY EFFINGER

# Bruce Wasserstein,

dead for two years, still casts a pall over the Rogue River Valley of southern Oregon.

There, in and around the town of Medford, more than 2,000 employees of Harry & David Holdings Inc., the century-old seller of mail-order pears and holiday fruit baskets, labor at a company that went bankrupt in March 2011 after private-equity firm Wasserstein & Co. loaded it with $200 million of debt that it couldn't pay back—even as Wasserstein's firm took profits for itself.

For decades, Harry & David set the standard for high-quality fruit. Its Royal Riviera pears, sold worldwide, are known elsewhere as Comice, a sweet and juicy variety developed in France that fared even better in southern Oregon, where the soil is volcanic and the winters are mild. In 2005, when Harry & David was preparing to sell shares to the public, the company cited a survey saying that 60 percent of Americans earning more than $75,000 knew the Harry & David brand.

**CEO HEYER RILED REPEAT CUSTOMERS BY CHANGING THE PRODUCT LINE. HE CALLED THE OREGON WORKERS 'IDIOTS,' ACCORDING TO TWO FORMER EMPLOYEES.**

**Wasserstein**, above, named **Ellis Jones**, above right, CEO when he founded the firm in 2001. Jones named **Heyer**, right, to run Harry & David after Wasserstein died.

PREVIOUS SPREAD: STYLING BY WENDY SCHELAH. THIS PAGE CLOCKWISE FROM LEFT: DANIEL ACKER/BLOOMBERG; JAMIE RECTOR/BLOOMBERG; JENNIFER GRAYLOCK/AP PHOTO

"Back in the day, they offered a very distinctive product," says Pamela Danziger, president of Unity Marketing, a Stevens, Pennsylvania–based company that researches luxury goods. "Over time, they became less distinctive. Specialty fruit became much more available."

Harry & David's journey from an industry standard for holiday gift giving—about 60 percent of sales happen from Thanksgiving to Christmas—to bankruptcy shows what can happen when a private-equity investor like Wasserstein freights a small company with debt, making it more vulnerable to the ravages of recession and competition. When Wasserstein took over Harry & David in 2004, it was the fourth buyer in 20 years, with three of the new owners paying a substantial premium to the previous one.

The bankrupting of one of Oregon's oldest corporations under New York–based Wasserstein riles local officials. Harry & David is the largest non-health-care employer in the region. It hires 6,000 temporary workers every year to pick, pack, and ship fruit. Those jobs are crucial in Medford, a city where unemployment stood at 11.3 percent in July compared with 9.4 percent for the rest of the state. "Many people here see the Wasserstein people lining their pockets," says County Commissioner Don Skundrick. "There is strong feeling in the community that they are taking Harry & David down the road to ruin."

Former employees are angry, too. Medford is rife with executives that the new management fired, and 2,700 workers and retirees had their pensions terminated and shifted to the government-sponsored Pension Benefit Guaranty Corp. after Wasserstein & Co. and other bondholders made dumping the retirement plan a condition for investing $55 million in the company after it emerged from bankruptcy.

In the year leading up to the bankruptcy, Harry & David was run by Steve Heyer, a former president of Coca-Cola Co. and chief executive officer of Starwood Hotels & Resorts Worldwide Inc. He riled repeat customers by changing the product line and also pursued promotions, including one with Oprah Winfrey, that boosted costs without lifting sales, according to former employees. Those employees declined to be identified because they say they're concerned that talking on the record would make other companies wary of employing them.

Heyer was a friend of Bruce Wasserstein, whose firm had sold Odwalla Inc., one of its portfolio companies, to Coke in 2001 when Heyer was running a new venture unit there. Wasserstein invited him onto the board of Lazard Ltd., which Wasserstein ran from 2001 until his death. At Harry & David, Heyer collected a salary of $500,000 a year and was awarded options to buy 15 percent of the company's closely held stock. Heyer also got plenty of perks: Wasserstein let him run the company from Atlanta, and his employment contract called for him to fly first-class to Medford. Early in his tenure, Heyer leased a private jet to fly to Seattle to try (unsuccessfully) to persuade Starbucks Corp. to sell Harry & David products.

Heyer is now chairman of Next3D Inc., an Atlanta-based company that streams 3-D movies to subscribers, a job he had while he was running Harry & David. He declined to comment.

Heyer's replacement, restructuring expert Kay Hong, commutes from San Francisco. She took the company into bankruptcy and was paid $26,000 a week to run it in receivership, according to bankruptcy court filings. Cassandra Bujarski, a spokeswoman for Wasserstein & Co., who is at Sard Verbinnen & Co. in Los Angeles, said Hong declined to be interviewed.

## WASSERSTEIN'S BAD DEALS

Of the five companies the New York firm owns, two have been through bankruptcy and a third was downgraded by Standard & Poor's.

| NAME | HARRY & DAVID | PENTON MEDIA | HANLEY WOOD | SPORTCRAFT | ENCOMPASS DIGITAL MEDIA |
|---|---|---|---|---|---|
| BUSINESS | Mail-order food | Trade publications | Construction periodicals, trade shows | Maker of sports equipment | Outsourced television broadcasting |
| ACQUISITION DATE | June 2004 | September 2005 | August 2005 | October 2003 | April 2008 |
| PRICE | $253 million | $385 million | $650 million | $110 million | *Terms of purchase not disclosed* |
| RESULT | Files for bankruptcy in March 2011 | Files for bankruptcy in February 2010 | S&P lowers rating to CCC on April 28. | Firm declines to disclose performance. | Has made two acquisitions |

*Source: Wasserstein & Co.*

Harry & David emerged from bankruptcy on Sept. 14. It had sought protection from creditors in March after Heyer sharply cut prices on gourmet pears, fancy fruit baskets and Moose Munch caramel corn during the December 2010 holidays, former employees say. Revenues had been soft in the wake of the financial crisis, and when the 2010 holidays were over, sales for the period had fallen 2 percent, to $262 million, according to company filings. Heyer's discounting drove net income down 56 percent, to $13.8 million.

Wasserstein & Co. and another private-equity company, Highfields Capital Management LP of Boston, bought Harry & David from Yamanouchi Pharmaceutical Co., then Japan's third-largest drugmaker, for $253 million in June 2004, putting up $82.6 million in cash and borrowing the rest.

Eight months later, Harry & David sold $245 million of bonds, some of the proceeds of which went to pay Wasserstein and Highfields a dividend of $82.6

A Medford **pear orchard**. The company started in 1910 when Sam Rosenberg bought 240 acres.

COURTESY OF HARRY & DAVID

million. Months later, the firms took two more payouts totaling $19 million, assuring them a 23 percent return no matter what happened to sales of fancy pears and mixed nuts.

Harry & David fell victim to a practice that's common in the private-equity industry, says Brian Quinn, assistant professor at Boston College Law School and a specialist in mergers and acquisitions. Directing a company to sell bonds and then taking the proceeds is legal, he says. Whether it's best for the purchased company is another matter. "It doesn't pass the smell test," Quinn says. "They are running this company without anything at stake."

Ellis Jones, CEO of Wasserstein & Co., says Harry & David's debt load was small compared with other companies taken over by private-equity firms. "We bought Harry & David with more equity than you would normally in the private-equity business," he says. Even after the bond sale, Harry & David had less debt than most buyout targets, he says. Until the 2008 crisis, its average debt was about 2.5 times Ebitda, or earnings before interest, taxes, depreciation and amortization, Jones says. The average multiple of debt to Ebitda

**THE DEAL SAVANT MADE HIS REPUTATION BY PUTTING TOGETHER TIME INC. AND WARNER COMMUNICATIONS AND ADVISING KKR ON HOW TO SWALLOW RJR NABISCO.**

for retail companies owned by private-equity firms from 2005 through 2008 was 1.5 times, according to Bloomberg's M&A database.

Wasserstein & Co. was a private-equity sideline for Bruce Wasserstein, the deal savant who helped combine Time Inc. and Warner Communications Inc. in 1990, a year after advising Kohlberg Kravis Roberts & Co. on how to swallow RJR Nabisco Inc. for $25 billion—a drama chronicled in the best-selling book *Barbarians at the Gate* (HarperCollins, 1990).

The former CEO of Wasserstein Perella Group Inc. and then Lazard died suddenly of heart failure in October 2009 at 61. Wasserstein's namesake company manages money left to his heirs through a trust as well as funds invested by the Pennsylvania Public School Employees' Retirement System and other institutions.

Two of the five companies Wasserstein & Co. currently owns—Harry & David and magazine publisher Penton Media Inc.—have been through bankruptcy in the past two years. A third, Hanley Wood LLC, a publisher of construction periodicals, was downgraded to CCC this year by ratings firm Standard & Poor's, which questioned Hanley's ability to comply with loan covenants because of poor performance.

Wasserstein investors, however, have made money on both bankrupt companies, Jones says: Harry & David through dividends and Penton when another private-equity firm bought a stake before it sought protection.

A Harry & David **fruit-sorting facility**. The company employs 2,000 full-time workers.

CHRIS MUELLER

Wasserstein & Co. started life as the buyout unit of investment bank Wasserstein Perella. It went independent in January 2001 after German bank Dresdner Bank AG bought the rest of Wasserstein Perella for $1.56 billion. Much of the firm's job is managing the proceeds of that sale for Bruce Wasserstein's estate. It has launched two private-equity funds: U.S. Equity Partners I & II. The first fund, started at Wasserstein Perella in 1997, had an internal rate of return of negative 1.6 percent before it liquidated its investments and shut down in 2009, according to the Pennsylvania retirement fund, which invested $73.8 million and got back $67.2 million.

USEP II, which started in 2001 and still owns companies, including Harry & David, had an internal return of 10.6 percent as of Dec. 31, the retirement fund says. The pension fund had put in $214.6 million and had gotten back $202.2 million as of the end of 2010.

"They would have trouble raising a new fund today with that performance," says Steven Kaplan, a professor at the University of Chicago's Booth School of Business.

Harry & David was launched by an Oregon business pioneer named Sam Rosenberg when, in 1910, he bought 240 acres (97 hectares) in the Rogue River Valley called Bear Creek Orchards. After Sam's death in 1914, his sons, Harry and David, both Cornell University–educated agriculturists, started shipping their pears to upscale restaurants in Europe. They survived the Great Depression by persuading corporate leaders to send the Royal Rivieras as gifts to customers. The brothers launched their Fruit-of-the-Month Club in 1938, and sales jumped. Around the same time they changed their last name to Holmes to skirt a boycott of goods from Jewish-owned companies by Germany, according to a history of Harry & David by Portland State University.

David died in a car crash in 1950, and Harry left the business three years later because of a heart condition. Harry & David continued to prosper under new managers by selling gourmet foods that at the time weren't available in supermarkets. By 1961 , the company had sales of $8 million, and it continued to grow steadily from there, according to the *International Directory of Company Histories* (St. James Press, 2001).

Harry & David sold shares to the public in 1976. It remained independent until 1984, when R.J. Reynolds Industries Inc., a tobacco company looking to acquire fast-growing businesses, took it over for $74 million. Two years later, vitamin maker Shaklee Corp. paid Reynolds, by then called RJR Nabisco Inc., $123 million for it. Then, in 1989, Japan's Yamanouchi Pharmaceutical swallowed up Shaklee. Through all these owners, Harry & David kept growing. In 1993, it began supplementing its mail-order business with a network of retail stores. In 1997, sales hit $300 million, according to the *International Directory*.

**HARRY & DAVID WENT THROUGH FOUR OWNERS IN 20 YEARS, WITH THREE PAYING A BIG PREMIUM OVER WHAT THE PREVIOUS OWNER PUT DOWN.**

Yamanouchi hired Citigroup Inc. to help sell the company, and the bankers reached out to Wasserstein because it was known as a buyer of mid-sized consumer companies, Jones says. Wasserstein & Co. took over in June 2004. Harry & David posted record mail-order sales for the year that included the 2004 holidays. Bruce Wasserstein then authorized the 2005 bond sale.

Business started going downhill in September 2008, when markets seized just before Harry & David's busiest season and many corporate executives cut back on gifts to customers. "This event happened before our one selling period," Jones says. "You can imagine that the Christmas we had was extremely difficult." During the next two years, sales continued to fall, hurt in part by competition from Internet retailers like Amazon.com Inc., which had begun selling its own fancy fruit baskets created by other producers. Revenue fell 13 percent in the year ended in June 2010 to $426.8 million. The year before, it had fallen 10 percent. In February 2010, four months after Wasserstein died, the buyout firm ousted Harry & David CEO Bill Williams, a 21-year veteran.

Heyer, now 59, immediately shook things up. He added artisanal cheese to Harry & David's gift baskets and opened 16 "pop-up" stores—operations that occupied rented space for just a month or two—in cities including Boston, New York and San Francisco. Harry & David had about 125 permanent stores nationwide at the time. Heyer also started selling chicken pies made by two women on Cape Cod who had won Oprah Winfrey as a booster.

Nothing worked. Heyer spent too much on expensive fixtures for the pop-up stores, a former employee says. And the fancy cheese raised costs,

## BARBARIANS IN THE ORCHARD

After decades of independence, the Medford, Oregon–based company became a toy of the dealmakers.

**1886** Bear Creek Orchards founded.

**1910** Sam Rosenberg buys Bear Creek.

**1914** Rosenberg's sons, Harry and David, start selling Comice pears to high-end hotels and restaurants in Europe.

**1934** Harry and David start selling pears by mail in the U.S.

**1938** Fruit-of-the-Month Club starts.

**1976** Harry & David sells shares to the public.

**1984** R.J. Reynolds buys Harry & David for $74 million.

**1986** RJR Nabisco sells Harry & David to Shaklee Corp. for $123 million.

**1989** Yamanouchi Pharma buys Shaklee for $395 million.

**2004** Wasserstein & Co. and Highfields Capital buy Harry & David from Yamanouchi for $253 million.

**2011** Harry & David declares bankruptcy in March, emerges in September.

*Harry and David in 1948*


*Ad circa 1946*

COURTESY OF HARRY & DAVID (3)

another says. The chicken pies didn't meet expectations, former employees say. Heyer then lost interest, says Kristin Broadley, co-founder of Centerville Pie. "I feel like we were a little used," she says.

In early 2010, Heyer leased a corporate jet to fly to Seattle to pitch Starbucks CEO Howard Schultz on selling Harry & David products in his 17,000 coffee shops, according to a former employee familiar with the trip. They met for about 90 minutes. Schultz was polite but didn't commit to anything, the person says. Heyer and his team stayed at Seattle's Four Seasons, the former employee says.

Heyer was a risky choice for Harry & David, says Tom Pirko, president of Bevmark LLC, a Buellton, California–based consultant to the food and beverage industries. Pirko got to know Heyer when Heyer was at Coca-Cola and Pirko was a consultant to the company, Pirko says. "Steve came in with a jackhammer," he says. Shortly after his promotion to Coca-Cola president in 2002, the company fired 1,000 people. "He was the most-hated person in Atlanta," says Pirko, who says he likes and respects Heyer.

In 2004, Heyer was passed over for the post of CEO. Instead, the company

**OPRAH WINFREY HELPED HARRY & DAVID SELL CHICKEN PIES FROM CAPE COD. THE PROMOTION DIDN'T MEET EXPECTATIONS.**

brought Neville Isdell out of retirement to take the job. Heyer resigned, collecting $23 million in severance, according to the *Atlanta Journal-Constitution*, and was soon hired as CEO of Starwood Hotels. In April 2007, he resigned after losing the support of the board of directors. "Issues with regard



Harry & David **pop-up stores** in San Francisco and Boston. The faces in the pears are **Broadley** and **Bowen**.

to his management style have led us to lose confidence in his leadership," board member Stephen Quazzo said in a statement at the time. Heyer declined to comment.

Heyer hit Harry & David like a hurricane, according to former executives there. He fired many of Bill Williams's managers and brought in his own. He often called Harry & David workers "idiots," two former employees say.

Heyer required managers to sign a one-page "culture contract" laying out the methods they would use to run the company. "We give straight and frequent feedback," the contract says. "We hate long meetings and never have them without a decision-making purpose. We hate gravity, old thinking and habits. Our favorite word is *NEXT*!"

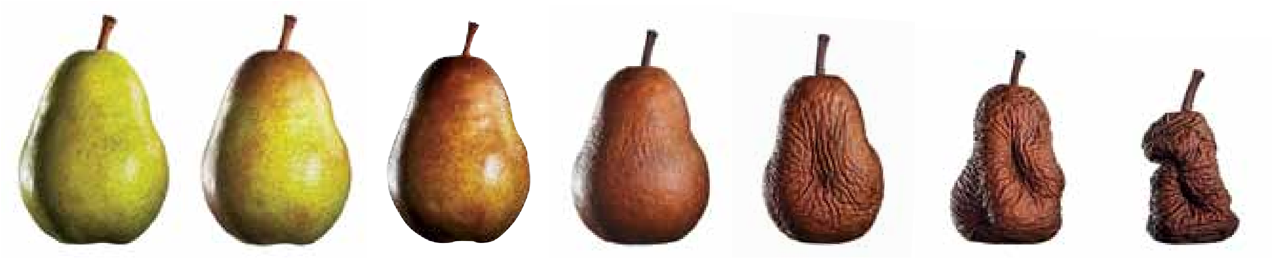
Heyer changed the company slogan to Happiness Delivered and called himself "chief happiness officer" in at least one press release.

One of Heyer's biggest blunders, former employees say, was rearranging the contents of Harry & David gift baskets. He had workers lay out samples of all the baskets in a warehouse, and he went down the line, adding and removing items, one former worker says. The changes made it impossible for returning customers to easily repeat an order from the year before on forms that the company sent out, former employees say, and many customers didn't buy.

Heyer also closed one of Harry & David's two call centers and hired Cincinnati-based Convergys Corp. to do the work, with operators taking calls from their homes. Customers frustrated with the Convergys salespeople abandoned more orders than they had in the past, former employees say. Heyer canceled the contract in February, according to a complaint filed by Convergys against Harry & David in U.S. District Court in Medford in March, saying that Harry & David failed to pay $3.1 million to terminate the contract.

Heyer expected big things from the Oprah deal, former employees say. The project got started in August 2009, when Broadley, who had just started her Centerville Pie company with longtime friend Laurie Bowen, heard that Oprah Winfrey was on Cape Cod for Eunice Kennedy Shriver's funeral. Broadley found Winfrey's hotel and dropped off two pies—one peach and

LEFT: TRISHA LEEPER/GETTY IMAGES; GAIL OSKIN/GETTY IAMGES



one chicken. Winfrey loved them, Broadley says.

Months later, Winfrey's producer called to invite the pie maker to appear on the show on Sept. 17, 2010. Winfrey surprised them by announcing a deal for Harry & David to distribute the pies as part of her Ultimate Wildest Dreams program. Viewers ordered 280,000 pies via Harry & David. That was good for Centerville Pie, but it missed Harry & David's projections, two former employees say. At the time of its bankruptcy, Harry & David owed Centerville $279,000, Broadley says.

Heyer had been CEO for 10 months when the 2010 holiday selling season arrived. It didn't go well. When the company reported earnings for the quarter in February, Heyer warned that it couldn't finance operations without new capital.

Ten days later, Jones and Wasserstein President George Majoros ousted Heyer as CEO. They brought in Hong, a turnaround expert from Alvarez & Marsal, a New York–based management firm.

Heyer worked extremely hard to try and fix Harry & David, says Jones, who insists the moves Heyer made were the right ones. "We think very highly of Steve," Jones says. "He's extraordinarily smart."

Hong, who had experience reviving Eddie Bauer Holdings Inc. and Spiegel Inc., took the company into bankruptcy a month after arriving. One of her first tasks was to deal with investor demands that she get $23.6 million in unfunded pension liabilities off Harry & David's books.

Wasserstein had purchased Harry & David debt when it fell in price after the 2008 holidays. It joined other bondholders in an agreement to invest an additional $55 million after the company emerged from bankruptcy, Harry & David said in court documents. Wasserstein wouldn't put up the money unless the retirement benefits were turned over to the U.S. Pension Benefit Guaranty Corp., a move that a federal judge would have to bless. U.S. Bankruptcy Judge Mary F. Walrath in Delaware did so in August, and Harry & David's unfunded liabilities will now be covered in part by premiums paid by all companies that have defined-benefit pension plans.

The PBGC had argued that the move was unjustified because Harry & David's survival wasn't at issue. "PBGC fought to keep the Harry & David pension plan going because the agency's analysis found that the company could afford it," PBGC spokesman Marc Hopkins says in an e-mail. "The plan was terminated largely to increase investor returns, not out of necessity to emerge from bankruptcy."

When Harry & David came out of bankruptcy on Sept. 14, Wasserstein remained an owner. That means Jones and Majoros will still have a say in how the company is operated in the future. For the citizens of Medford, Oregon, the question remains whether what's best for Bruce Wasserstein's heirs is also good for the thousands of people who depend on Harry & David for jobs.

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**Bloomberg Tips**

## COMPARING RETAIL BUYOUTS


You can use the Merger and Acquisition Search function to compare the Harry & David deal with other retail buyouts. Type **MA <Go>** and click on Advanced Search on the red tool bar. Click on Sector/Industry, then on the plus sign to the left of Consumer, Cyclical and finally on Retail. Click on the boxes to the left of Seller and Acquirer to remove the check marks and then on Update. Click on Deal Type, then on the box to the left of Private Equity and finally on Update. Click on Deal Status, then on the box to the left of Completed and finally on Update. Type 1 <Go> for the results. **BETH WILLIAMS**

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