

Operational Due Diligence Of Leading Cookie Franchiser: Assessing Operations-Related Acquisition Risks

The Challenge: P.E.Brands, a publicly traded holding company focused on acquisitions of brands and franchise-based businesses, had targeted a deal in the baked goods sector. CookieCo was a potentially attractive investment due to its position as a leading retailer of cookies via a franchised network of stores supplied by a dough-manufacturing facility. Ahead of acquisition, P.E.Brands, which did not hold any interests in manufacturing entities, needed an operational risk assessment of CookieCo in order to assure the investment committee and potential lenders of the safety of CookieCo's products and operations. P.E.Brands asked Gotham to review CookieCo operations and assess the risks and opportunities, especially vis-à-vis labor practices, product safety, and inventory practices.

The Partnership:

Analysis: Gotham reviewed all operational information made available to P.E.Brands, which included manufacturing process overviews, batch sheets, production process maps, QA inspection forms, order-to-ship process overviews, and ingredient process diagrams.

To get a first-hand picture of CookieCo's operations, Gotham conducted a 3-day visit to CookieCo's manufacturing facility, with our on-site assessment including:

- A front-to-back walk-through of the manufacturing process and practices
- A product safety review of compliance with FDA and USDA regulations, HAACCP (Hazard analysis and critical control points) process, bacti count procedures, sanitary practices, ingredient and finished product storage/usage guidelines, etc.
- An employee safety review, including physical protection from machine operation and compliance with HAZMAT procedures
- An environmental compliance and sanitation review, with a particular focus on sewage handling and on-site dumping of hazardous material
- A review of labor policies, including basic compliance with overtime, lunch, and break rules, work rules, attendance policies, etc.
- A review of inventory management policies, primarily to validate inventory status and understand disposal practices.

CookieCo Appears To Have Solid Risk Management Performance Vis-À-Vis The Three Areas Of Due Diligence Focus, With Selective Additional Initiatives Possibly Warranted		
Due Diligence Focus Areas	Risk Management Rating Based On 1-Week Assessment	Comments
• Labor Practices	●	• Very low turnover and high average seniority; does not appear to be need for changes/enhancements
• Safety and Environmental Compliance – Food Safety/Quality	●	• Dedicated QA staff should be hired for internal/plant QA and in-store QA (while we did not visit any franchisees, ultimate food safety protection responsibility, in handling and baking, reside in the stores) • Breadth and frequency of microbial testing should be expanded and ought to include inbound RM (currently tested by vendors), FG (not currently tested), and food contact surfaces
– Product Performance (Taste/Aesthetics)	●	• While anecdotal evidence suggests few complaints, we were unable to access relevant information (kept at corporate HQ) • Dedicated in-store QA staff would help ensure product performance
– Employee Safety	●	• Appears to be some room for improvement – mitigation of repetitive lifting activities, additional machine guarding, and pinch point elimination
– Maintenance and Facility	●	• Selected improvements could further reduce the risk of contamination by foreign substances (e.g., dust, paint chips)
• Inventory Practices	●	• Some indication that destruction of out-of-date FG could be more timely

As raw egg products were used in cookie production, it was critical that temperatures were kept below bacteriological growth thresholds to ensure product safety compliance. Gotham reviewed product handling procedures and practices (e.g., storage temperatures, swabs) from the point of raw material receipt to the finished good to validate the mitigation of this risk. Aging inventory practices, notably the rework of existing product into new batches and disposal timelines, were also reviewed. Another area of attention was the facility itself. As the company had spent relatively little in capital improvements over past years, a number of improvement areas were evident, especially ceilings and walls.

Findings: Gotham's analysis revealed no significant problems with regards to labor practices, and only minor improvements needed for safety and environmental compliance and inventory practices, specifically:

- Addition of 2 staff to Quality Assurance dedicated to sustain plant and in-store product quality and performance
- Expansion of breadth and frequency of microbial testing of raw materials, finished goods, and food contact surfaces
- Investment in facility improvements (e.g., renovations and repairs to ceilings) to further reduce risk of contamination
- Improvement of material handling processes, including lifting, machine guarding, and elimination of pinch points
- Implementation of timely disposal schedules and records of the disposals.

The Outcome: Gotham's assessment indicated that CookieCo appeared to have solid risk management performance in the three focus areas: labor, safety and environmental compliance, and inventory practices. Moreover, it would take little time for CookieCo to address the minor improvement issues that Gotham documented. P.E.Brands leveraged Gotham's findings and recommendations in the successful acquisition of CookieCo.