

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE**

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In re : Chapter 11
HARRY & DAVID HOLDINGS, INC, *et al.*,¹ : Case No. 11-____ (____)
Debtors. : (Joint Administration Pending)
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DECLARATION OF KAY HONG IN SUPPORT OF FIRST-DAY PLEADINGS

1. I am a Managing Director at Alvarez & Marsal in its North America Commercial Restructuring Group and currently serve as the Interim Chief Executive Officer and Chief Restructuring Officer of Harry & David Holdings, Inc. ("Parent"), a Delaware corporation, Harry and David, an Oregon corporation, Harry & David Operations, Inc., a Delaware corporation, and Bear Creek Orchards, Inc., a Delaware corporation (collectively, the "Debtors"). I have held these positions with the Debtors since February 18, 2011.

2. In my prior engagements at Alvarez & Marsal, I have served as an officer at Spiegel, Inc. and Movie Gallery, Inc. and as a financial adviser to Eddie Bauer Holdings, Inc. and the secured lenders of Legacy Estates Group and Oriental Trading Company, among others. Prior to joining Alvarez & Marsal, I served as Director of Finance at Teledesic LLC, a satellite telecommunications company, worked in the Equity Research Division of Goldman Sachs & Co. and served as a Management Consultant with the San Francisco Consulting Group (acquired by KPMG Consulting). I earned a bachelor's degree from Stanford University and a master's degree

¹ The Debtors are the following four entities (the last four digits of their respective taxpayer identification numbers, if any, follow in parentheses): Harry & David Holdings, Inc. (4389); Harry and David (1765); Harry & David Operations, Inc. (1427); Bear Creek Orchards, Inc. (7216). The address of each of the Debtors is 2500 South Pacific Highway, Medford, Oregon 97501.

in business administration from Harvard Business School. I am a member of the Turnaround Management Association and the Association of Insolvency and Restructuring Advisors and am a Certified Insolvency and Restructuring Advisor.

3. On the date hereof (the "Petition Date"), each of the Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"), as well as certain motions and other pleadings (the "First Day Pleadings") with this Court. I am authorized by the Debtors to submit this Declaration on their behalf in support of the First Day Pleadings.

4. The First Day Pleadings are intended to enable the Debtors to operate effectively and efficiently within these chapter 11 cases, as well as avoid certain adverse consequences that might otherwise result from the commencement of such cases. Among other things, the First Day Pleadings seek relief aimed at maintaining: (a) the loyalty of the Debtors' customers; (b) the confidence of the Debtors' various stakeholders; and (c) the morale of the Debtors' employees. Gaining and retaining the support of these key constituencies is critical to the Debtors' efforts to successfully reorganize. I have reviewed the First Day Pleadings, and it is my belief that the relief sought therein is necessary to: (a) avoid immediate and irreparable harm to, and ensure the uninterrupted operation of, the Debtors' business; and (b) maximize and preserve the value of the Debtors' chapter 11 estates.

5. In accordance with these objectives, the Debtors entered into a plan support agreement (the "Plan Support Agreement") just prior to the Petition Date with certain holders of the Debtors' Senior Notes (as defined below). The Plan Support Agreement includes an agreement with those holders to backstop a rights offering that will provide the necessary capital for the Debtors to exit these cases. In addition, the Debtors' existing lenders under their

Prepetition Revolving Credit Facility have agreed to provide similar financing to the Debtors upon their emergence from bankruptcy. In sum, the Debtors have all of the necessary pieces in place to confirm a chapter 11 plan and exit bankruptcy in an expedited manner.

6. In my capacity as Interim Chief Executive Officer and Chief Restructuring Officer, I am familiar with the Debtors' day-to-day operations, financial condition, business affairs and books and records. Except as otherwise indicated, all facts set forth in this Declaration are based upon: (a) my personal knowledge; (b) my review of relevant documents; (c) information supplied to me by other members of the Debtors' management team or professionals retained by the Debtors; or (d) my opinion based upon my experience and knowledge of the Debtors' operations and financial condition. If I were called upon to testify, I could and would testify competently to the facts set forth herein.

7. Part I of this Declaration provides an overview of the Debtors' business. Part II provides a description of the Debtors' corporate and capital structures. Part III provides a discussion of the events that compelled the commencement of these chapter 11 cases. Part IV sets forth the Debtors' plan for these cases, including details regarding a plan of reorganization support agreement the Debtors entered into with certain of their public noteholders and the financing arrangements the Debtors have finalized to meet their capital needs during these cases and after the Debtors exit from bankruptcy. Part V affirms and incorporates the facts that support the relief requested in the First Day Pleadings.

Part I

Overview of the Debtors' Business

8. The Debtors are a leading multi-channel specialty retailer and producer of branded premium gift-quality fruit, gourmet food products and other gifts marketed under the

Harry & David®, Wolferman's® and Cushman's® brands. Signature products and offerings marketed under the Harry & David name include Royal Riviera® pears, Fruit-of-the-Month Club® products, Tower of Treats® gifts and Moose Munch® caramel and chocolate popcorn snacks. Products marketed under the Wolferman's brand include specialty English muffins and other breakfast products, and the Cushman's product line includes Cushman HoneyBells® citrus, among other products. The Debtors' marketing channels include direct marketing (via catalog, phone, Internet, mail/fax and telemarketing), business-to-business, Harry and David stores, seasonal Cushman's stores, and wholesale distribution through select retailers.

9. The Debtors grow, manufacture, design and package products that account for the significant majority of their annual sales revenue. The Debtors own approximately 3,400 acres of land in Oregon, of which approximately 1,900 acres are planted orchards geographically dispersed throughout the Rogue Valley of Southern Oregon at varying elevations and micro-climates. Also included in the 3,400 acres is the Debtors' 93 acre campus in Medford, Oregon, which houses: (a) a 54,000 square foot bakery, confectionery and chocolate complex dedicated to the production of baked goods, chocolates and confections; (b) a 646,000 square foot fruit packing and gift assembly complex, including cold storage; (c) a 72,000 square foot year-round call center and various other distribution and storage facilities. The Debtors owned acreage in Rogue Valley further includes housing for their seasonal agricultural workforce. The Debtors also own a 51-acre campus in Hebron, Ohio that houses a 275,000 square foot fruit packing and gift assembly complex, including cold storage and a 55,000 square foot call center and office space.

10. The Debtors' owned real property and other manufacturing related assets have enabled them to create a substantial and scalable infrastructure in their production,

fulfillment and distribution capabilities, information technology systems and retail stores network. The Debtors maintain vertically integrated operations that allow them to efficiently monitor costs, quality and manufacturing processes and inventory. This vertical integration further allows the Debtors to maintain a high degree of control over product quality compared with that of the Debtors' competitors, as the Debtors rely less heavily on third-party suppliers.

11. The Debtors sell their products primarily through direct marketing and retail stores. The Debtors direct marketing consists of the distribution of various catalogs, other direct mail and the Internet. The Debtors also operate approximately 70 permanent retail stores. The Debtors' stores are located generally in leading outlet and lifestyle centers, specialty malls and other high traffic shopping areas throughout the United States. In addition, the Debtors operate a single flagship Country Village store in Medford, Oregon, which offers the full selection of Harry and David retail products as well as expanded offerings consisting of fresh fruit, vegetables and produce, gourmet specialty foods and wine selections.

12. A significant portion of the Debtors' net sales, earnings and cash flows are generated during the holiday season from October through December. Accordingly, the Debtors' annual operating results and their liquidity are materially impacted by the holiday season. For example, in fiscal 2010, as is typical for their businesses, over 60 percent of the Debtors' revenues were generated during the holiday season and that was the only fiscal quarter during which the Debtors generated positive cash flows or operating income.

13. The Debtors employ approximately 1,950 full-time employees. The Debtors also typically employ thousands of seasonal employees. For the twelve months ending December 25, 2010, the Debtors generated approximately \$416 million in revenue. As of

December 25, 2010, the Debtors had approximately \$304 million in assets and approximately \$361 million in liabilities.

Part II

Corporate and Capital Structure of the Debtors

Corporate Structure

14. The Parent is a holding company that owns, directly or indirectly, each of the other Debtors. In general, Wasserstein & Company, LP, or affiliates thereof ("Wasserstein"), own approximately 63 percent of the Parent's outstanding shares. Affiliates of funds sponsored by Highfields Capital Management LP own approximately 34 percent of the Parent's outstanding shares. Employees or former employees of the Debtors own the remaining outstanding shares of the Parent.

15. The Parent holds 100 percent of the outstanding shares of Harry and David. In turn, Harry and David owns 100 percent of the outstanding shares of Harry & David Operations, Inc. and Bear Creek Orchards, Inc. Harry and David functions as the Debtors' primary marketer and seller of products. Harry and David Operations, Inc. is responsible primarily for the manufacture of goods sold by the Debtors. Bear Creek Orchards, Inc. holds legal title to the Debtors' orchards.

Prepetition Capital Structure

16. As of the Petition Date, the Debtors' primary liabilities consisted of:
(a) two series of senior unsecured notes; (b) pension obligations; (c) unsecured trade debt; and
(d) lease obligations.² These liabilities are described in more detail below.

² The Debtors are party to a Credit Agreement, dated March 20, 2006 (as amended) with GMAC Commercial Finance LLC, as Collateral Agent and Documentation Agent, UBS Securities LLC, as Arranger, UBS AG Stamford Branch, as Issuing Bank, Administrative Collateral Agent and Administrative Agent, and UBS Finance LLC, as Swingline Lender, that provided the Debtors with a \$105 million

Senior Unsecured Notes

17. The Debtors had approximately \$58 million of Senior Floating Rate Notes due March 1, 2012 and \$140 million of Senior Fixed Rate Notes due March 1, 2013 (collectively, the "Senior Notes") outstanding as of the Petition Date. A single indenture (the "Indenture"), dated February 25, 2005, governs both series of Senior Notes and Wells Fargo Bank, N.A. is the indenture trustee.

18. The Senior Notes represent senior unsecured obligations of Harry and David and are guaranteed by the other Debtors. The Senior Floating Rate Notes accrue interest at a rate per annum equal to LIBOR plus 5 percent calculated and paid quarterly. The Senior Fixed Rate Notes accrue interest at an annual fixed rate of 9 percent, with semiannual interest payments.

19. In fiscal 2008 and fiscal 2009, the Debtors repurchased approximately \$34.8 million of then outstanding Senior Fixed Rate Notes and \$11.8 million of the then outstanding Senior Floating Rate Notes. The Debtors officially cancelled \$22.2 million of the repurchased Senior Fixed Rate Notes and \$2 million of the repurchased Senior Floating Rate Notes, and the Debtors hold the remaining repurchased notes. The amounts listed in this paragraph are in addition to the \$198 million of outstanding Senior Notes described above.

(continued...)

revolving credit facility (the "Prepetition Revolving Credit Facility"). Borrowings under the Prepetition Revolving Credit Facility are secured by substantially all of the Debtors' assets. As of the Petition Date, the Debtors had no outstanding borrowings under the Prepetition Revolving Credit Facility.

Pension Obligations

20. As of June 26, 2010, the Debtors had listed in their books and records approximately \$30 million in obligations relating to the underfunding of the Harry and David Employees' Pension Plan (the "Pension Plan"). Effective June 30, 2007, the Debtors froze benefit accruals under the Pension Plan. The Debtors fund the Pension Plan in accordance with statutory funding requirements; as such, the timing of any future payments is subject to a number of factors and uncertainties and could change. For instance, the Debtors' required level of funding of the Pension Plan changes each year depending on the funded status of the pension plan, applicable interest rates and actuarial factors applied by the Debtors' actuaries.

Unsecured Trade Debt

21. In the ordinary course of operating their direct marketing and retail business, the Debtors have historically purchased raw materials and other goods and services from over 1400 vendors. Significant raw materials the Debtors purchase from third party vendors include paper for the Debtors' catalogs, corrugated paper for delivery needs, and chocolate, butter, cheese and certain fruit that the Debtors do not produce or grow themselves. In addition, the Debtors outsource some of their products, including selected fresh produce, meats, certain confections, snacks, condiments and tabletop, entertaining and home décor accessories. As of the Petition Date, the Debtors estimate that they owe approximately \$37 million for raw materials and other unsecured obligations for goods and services.

Lease Obligations

22. The Debtors operate approximately 70 stores in leading outlet and lifestyle centers, specialty malls and other high traffic shopping areas throughout the United States. In addition, the Debtors are responsible for lease payments with respect to 52 other store locations where the Debtors' ceased operations prior to the Petition Date. The Debtors are seeking to

reject the leases for these store locations as of the Petition Date. The Debtors also lease storage or warehouse space at approximately 12 locations. Prior to the Petition Date, the Debtors approximate annual expense for leased properties was approximately \$19 million.

Part III

Events Leading to the Commencement of These Cases

23. For nearly 75 years, the Debtors thrived as an industry leading catalog retailer. Over the course of this time, the Debtors developed significant brand equity, high customer awareness and distinctive ownership of fruit gifting. The Debtors further benefited from the high barriers of entry for potential competitors that resulted from the expenses associated with printing and mailing catalogs and the length of time necessary to develop a profitable customer base. Over the course of the last several years, however, various external market factors have diminished the Debtors' competitive advantages and, correspondingly, revenues and profitability.

24. Specifically, the Internet has allowed numerous additional direct competitors to enter the Debtors' market. Unlike the Debtors, who manufacture approximately 85 percent of their own products in house, these new entrants typically outsource non-proprietary products from cost-advantaged manufacturers. As such, these new entrants generally possess lower overhead costs than the Debtors.

25. "Big box" retailers also have begun to sell products that compete with those of the Debtors. Similar to the Debtors' new direct competitors, the "big box" retailers possess certain cost advantages over the Debtors, and the addition of the "big box" retailers have further increased competition for the Debtors, placing more downward pressure on pricing.

26. Recognizing the existence of an emerging number of low cost competitors, the Debtors focused on the quality of their products. However, consumers have

become extremely price conscious following the beginning of the 2008 recession, and this consciousness continues to materially impact the Debtors' ability to maintain higher selling prices. The Debtors' financial performance over the past three years is a reflection of this trend, as consumer price consciousness caused the Debtors to discount their products more significantly than they had expected previously. Additionally, during the 2010 holiday season, the Debtors expected a significant improvement in sales performance, which ultimately did not materialize. In order to clear inventory purchases, the Debtors were forced to discount even more heavily than anticipated.

27. As a result, the Debtors failed to generate enough cash flow during the 2010 holiday season to satisfy the minimum available cash covenant contained in the Prepetition Revolving Credit Facility, and the Debtors were unable to continue borrowing under the Prepetition Revolving Credit Facility.³

28. After losing the ability to borrow under the Prepetition Revolving Credit Facility and facing a significant liquidity shortfall as a result of their 2010 holiday season results, the commencement of these cases became necessary to (a) address the Debtors' liquidity needs and (b) provide the opportunity to, among other things, right-size the Debtors' business through (i) structural improvements and (ii) the evaluation and elimination of liabilities that only serve as a drain on the Debtors' profitability. In accordance with these objectives, the Debtors closed 52 unprofitable stores just prior to the Petition Date. The Debtors have filed a motion to reject each of the closed stores' leases, effective as of the Petition Date. The closing of unprofitable stores and rejection of the associated leases will result in immediate cost savings in respect of overhead,

³ Specifically, the Prepetition Revolving Credit Facility required that the Debtors maintain an available net cash balance (defined as cash, cash equivalents and short-term investments, minus accounts payable) of at least \$50 million as of December 31 of each year.

rent and other payments and represents one step in the Debtors' efforts to streamline their operations.

Part IV

The DIP Credit Facilities and Restructuring Support Agreement

29. After determining that the commencement of these cases was necessary, the Debtors, with the assistance of their professional advisors, explored various options with respect to postpetition financing. After engaging in productive discussions with potential investors and lenders, the Debtors determined that financing proposals by the existing lenders under their Prepetition Revolving Credit Facility and a proposal by an ad hoc committee of holders of the Senior Notes (the "Ad Hoc Committee") and Wasserstein, also a holder of Senior Notes, provided the Debtors with the best opportunity to emerge from these cases in a timely manner and maximize the value of their estates. In combination, these proposals provide the Debtors with the necessary access to working capital during these case as well as financing to exit these cases. In addition, the Debtors have obtained the agreement of a significant number of their public noteholders for the structure of a chapter 11 plan, as set forth in the Plan Support Agreement with the Ad Hoc Committee, to exit these chapter 11 cases.

Postpetition Financing

30. The Debtors' proposed postpetition financing consists of a first lien and a separate second lien credit facility. The first lien credit facility (the "First Lien DIP Credit Facility") is a \$100 million revolving credit facility provided by the Debtors' existing lenders under the Prepetition Revolving Credit Facility (the "First Lien DIP Lenders"). Borrowings under the First Lien DIP Credit Facility will be secured by a first priority lien on substantially all of the Debtors' assets, with the exception of funds held in a single bank account that holds proceeds from the Second Lien DIP Credit Facility (as defined below). The First Lien DIP

Credit Facility will enable the Debtors to purchase necessary inventory later in the year as they work towards the 2011 holiday season. In addition, the First Lien Revolving Credit Facility essentially will act as the Debtors' exit facility, as the First Lien DIP Lenders have provided a commitment to provide a similar revolving credit facility to the Debtors upon their emergence from these chapter 11 cases.

31. In addition to the First Lien DIP Credit Facility, members of the Ad Hoc Committee (the "Second Lien DIP Lenders") and Wasserstein, also a holder of Senior Notes, will provide a \$55 million second lien term loan (the "Second Lien DIP Credit Facility") to the Debtors. Borrowings under the Second Lien DIP Credit Facility will be secured by a lien on substantially all of the Debtors' assets, and such lien will be subordinate only to the lien granted under the First Lien DIP Credit Facility. The Second Lien DIP Credit Facility will provide the Debtors with the necessary working capital to operate during the course of these cases as they work towards the confirmation of a plan of reorganization.

The Plan Support Agreement

32. The Debtors, the Ad Hoc Committee and Wasserstein, also a holder of Senior Notes, entered into a plan support agreement (the "Plan Support Agreement") just prior to the Petition Date that sets forth the structure for a plan of reorganization that will allow the Debtors to emerge from these cases on an expedited basis. A copy of the Plan Support Agreement is attached hereto as Exhibit A.

33. The Plan Support Agreement contemplates that the holders of the Senior Notes will receive a pro rata share of approximately 166,667 shares of the reorganized Debtors' common stock. Unsecured creditors, other than holders of the Senior Notes, may elect to receive: (i) the same pro rata share of the reorganized Debtors' common stock as the holders of Senior Notes; (ii) subject to the availability of necessary cash, a cash distribution, equal to 75

percent of the plan value of the unsecured creditors' pro rata share of the reorganized Debtors' common stock; or (iii) a promissory note that would (a) equal the value of the unsecured creditors' pro rata share of the reorganized Debtors' common stock (based on the plan value thereof), (b) accrue interest at 6 percent per annum and (c) mature on the date that is 7 years after the effective date of the Debtors' chapter 11 plan.

34. The Plan Support Agreement also contemplates a \$55 million rights offering with a backstop commitment from the Ad Hoc Committee and Wasserstein of \$55 million. Wasserstein has agreed to backstop 40 percent of the rights offering and to provide management services to the reorganized Debtors. The rights offering will provide the Debtors with the required equity financing to emerge from chapter 11 under the plan of reorganization contemplated by the Plan Support Agreement and is intended to be conducted in connection with the solicitation of votes in connection with such plan. All of the Debtors' creditors that qualify as accredited investors under applicable SEC law and possess an allowed claim will have the opportunity to participate in this rights offering.

35. In summary, the Debtors believe that confirming a chapter 11 plan in the form contemplated under the Plan Support Agreement is in the best interests of the Debtors' estates and their creditors. The Plan Support Agreement, however, does not restrict the Debtors from fulfilling their fiduciary duties. Accordingly, the Debtors may terminate the Plan Support Agreement in the event that supporting the plan contemplated under the Plan Support Agreement no longer is in the best interests of the Debtors' estates.

Part IV

Facts Relevant to the First Day Pleadings

36. Concurrently with the filing of these chapter 11 cases, the Debtors filed the First Day Pleadings requesting various forms of relief. Generally, the First Day Pleadings

have been designed to meet the Debtors' goals of: (a) continuing their operations in chapter 11 with as little disruption and loss of productivity as possible; (b) maintaining the confidence and support of their customers, employees, vendors, suppliers and service providers during the Debtors' reorganization process; and (c) establishing procedures for the smooth and efficient administration of these chapter 11 cases.

37. I have reviewed each of the First Day Pleadings filed contemporaneously herewith (including the exhibits thereto and supporting memoranda) and incorporate by reference the factual statements set forth in the First Day Pleadings. It is my belief that the relief sought in each of the First Day Pleadings is tailored to meet the goals described above and, ultimately, will be critical to the Debtors' ability to achieve a successful reorganization.

38. It is my further belief that, with respect to those First-Day Pleadings requesting the authority to pay discrete prepetition claims or continue selected prepetition programs (e.g., those First-Day Pleadings seeking relief related to the Debtors' obligations to their vendors, employees, customers, shippers and other distribution network providers, potential PACA⁴ claimants, foreign vendors, reclamation claimants, taxing authorities and insurers), the relief requested is essential to the Debtors' reorganization and necessary to avoid immediate and irreparable harm to the Debtors and their employees, customers and affected vendors.

39. Impairment of the Debtors' business operations, or of their relationships with their employees, customers or vendors — at the very time when the smooth operation of those operations and the dedication, confidence and/or cooperation of those constituencies is most critical — would clearly imperil the Debtors' chances of a successful reorganization. The Debtors operate in a highly competitive sector of the domestic economy. Any diminution in the

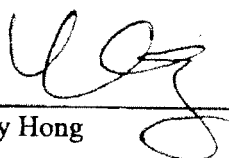
⁴ The Perishable Agricultural Commodities Act of 1930, as amended, 7 U.S.C. §§ 499a et seq.

Debtors' ability to maintain their operations in the ordinary course will have an immediate and irreparable harmful impact upon the going concern value of the estates to the detriment of all of the Debtors' stakeholder constituencies. The Debtors believe that payment of those selected prepetition claims identified in the First Day Pleadings will forestall such irreparable harm and that all creditors of the Debtors will ultimately benefit from the relief requested therein.

40. The Debtors' reorganization depends in large part on restoring vendor, customer and employee confidence and maintaining the operation of their business as they restructure. Accordingly, the Debtors have an immediate need to continue the orderly operation of their business by securing goods and paying employees in the normal course of business. The Debtors' continued operations will enable the Debtors to preserve the going concern value of their estates and re-establish any lost vendor and customer confidence, thereby maximizing recoveries for the Debtors' stakeholders. Further, the Debtors believe that such relief will enable them to stabilize operations and ultimately, in conjunction with a reorganization, restore their profitability.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information and belief.

Dated: March 28, 2011
Medford, Oregon



Kay Hong