

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF MARYLAND  
(Baltimore Division)**

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| <p><b>In re</b></p> <p><b>The Boyds Collection, Ltd., et al.</b><sup>1</sup></p> <p style="text-align: center;"><b>Debtors.</b></p> | <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> | <p>Case No. 05-____ (____) through<br/>05-____ (____)</p> <p>Chapter 11<br/>(Jointly Administered under<br/>Case No. 05-____ (____))</p> |
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**DEBTORS’ APPLICATION FOR ORDER AUTHORIZING THE DEBTORS TO  
EMPLOY AND RETAIN HOULIHAN LOKEY HOWARD & ZUKIN CAPITAL, INC.  
AS FINANCIAL ADVISORS AND INVESTMENT BANKERS TO THE DEBTORS**

The Boyds Collection, Ltd., et al., the debtors and debtors in possession in the above-captioned cases (collectively, the “Debtors”), by counsel, file this Application for Order Authorizing the Debtors to Employ and Retain Houlihan Lokey Howard & Zukin Capital, Inc. as Financial Advisors and Investment Bankers to the Debtors (the “Application”), and in support thereof state:<sup>2</sup>

**Jurisdiction**

1. The Court has jurisdiction over this Application pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this proceeding and the Application is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

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<sup>1</sup> The Debtors in the proposed jointly administered cases include: The Boyds Collection, Ltd.; The Boyds Collection, Ltd., LP; Boyds Operations Inc.; The Boyds Collection - Pigeon Forge, LLC; The Boyds Collection - Myrtle Beach, LLC; The Boyds Collection - Branson, LLC; J&T Designs and Imaginations, Inc.; HC Accents & Associates, Inc.; and Boyds Bear and Company, LP.

<sup>2</sup> The facts and circumstances supporting this Application are set forth in the Affidavit of Jan L. Murley in Support of First Day Motions filed contemporaneously herewith.

2. The bases for the relief requested herein are sections 327(a) and 328(a) of title 11 of United States Code (the “Bankruptcy Code”) and Rule 2014(a) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

### **Background**

3. On the date hereof (the “Commencement Date”), the Debtors each filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code (collectively, the “Reorganization Cases”). The Debtors continue to operate their businesses and manage their properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. Contemporaneously herewith, the Debtors requested an order for the joint administration of the Reorganization Cases pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

4. The Boyds Collection, Ltd. (“Boyds”) is a leading designer, marketer and distributor of high-quality, hand-crafted collectibles, gift and other specialty products. Boyds was founded in 1979 and is the parent company, holding direct or indirect ownership interests in eight (8) domestic subsidiaries and four (4) foreign subsidiaries.<sup>3</sup>

5. Boyds operates in two segments: a wholesale gift business and a retail gift/entertainment business. Boyds’ wholesale business designs, imports and distributes plush animals, resin figurines and other specialty giftware via a global network of independent retailers and distributors. Boyds imports substantially all of its products from manufacturers in China through buying agencies. Boyds’ retail business sells plush animals, resin figurines and specialty giftware products and provides a unique interactive entertainment experience at its Gettysburg, Pennsylvania and Pigeon Forge, Tennessee retail stores.

6. As set forth in the Form 10-Q filed by Boyds on August 12, 2005, as of June 30, 2005, the Debtors’ consolidated books and records reflected assets totaling approximately \$66.9

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<sup>3</sup> None of the foreign subsidiaries are Debtors.

million and liabilities totaling approximately \$101.7 million. For the three months ended June 30, 2005, Boyds reported revenues of approximately \$17.1 million and net losses of approximately \$101.3 million.

7. The significant indebtedness of Boyds consists of: (i) approximately \$56.5 million in aggregate principal amount under a senior secured credit agreement, dated as of February 23, 2005 (the “Pre-Petition Credit Agreement”) and (ii) approximately \$34.4 million in aggregate principal amount pursuant to certain 9% senior subordinated notes due in 2008.

8. During 2001, Boyds’ financial results began to deteriorate significantly as a consequence of industry-wide and company-specific factors. Over a period of several years, retail sales of plush toys shifted from small independent retailers, in which Boyds had a leading presence, to large regional and national retailers and mass merchandisers, in which Boyds did not have a meaningful presence. Moreover, the large retailers competed with Boyds’ product line at lower price points. This shift in distribution channels coincided with a general cooling of consumer demand for “collectible” products. As a result, the retail sales of Boyds and its direct industry competitors were negatively affected.

9. In response, during 2004 Boyds began to implement various operational restructuring and cost reduction programs. Such programs focused on (i) redirecting sales efforts towards larger regional and national channels, (ii) developing products specifically targeted to these channels, (iii) selectively expanding distribution to include direct in-home marketing initiatives and (iv) developing co-branding campaigns with well-recognized brands such as NASCAR, Coca-Cola, Crayola and M&Ms. Unfortunately, despite the efforts of Boyds’ management to reposition the business in response to the changing industry sales dynamics, Boyds was not able to increase sales in the new channels quickly enough to offset the decline in sales from the company’s traditional core-market of independent retailers.

10. By the fall of 2005, it had become apparent that Boyds could not avoid a financial restructuring. From September to the Commencement Date, Boyds engaged in discussions with the lenders (the “Pre-Petition Lenders”) under the Pre-Petition Credit Agreement regarding the

terms of a comprehensive plan to restructure Boyds' operations and existing debt obligations. Though Boyds and the Pre-Petition Lenders made substantial progress in these negotiations, as of the Commencement Date, negotiations were still ongoing. The Pre-Petition Lenders were unwilling to extend the waiver or commit to providing any further liquidity outside of a reorganization. On the Commencement Date, the Debtors, in the exercise of their prudent business judgment, determined that it was in the best interest of all their stakeholders to commence the Reorganization Cases, continue negotiations with the Debtors' creditor constituencies and consummate a restructuring under the auspices of this Court.

**Proposed Employment of Houlihan Loken Howard & Zukin Capital, Inc.**

11. By this Application, the Debtors seek to employ and retain Houlihan Lokey Howard & Zukin Capital, Inc. ("Houlihan Lokey") pursuant to sections 327(a) and 328(a) of the Bankruptcy Code and under the terms of the Retention Agreement, as defined below, effective as of the Commencement Date, as their financial advisors and investment bankers in these Reorganization Cases. Submitted herewith as Exhibit A is the Affidavit of Bradley Jordan, a vice-president of Houlihan Lokey, in support of the Application (the "Jordan Affidavit").

12. As set forth in the Retention Agreement, the Debtors wish to retain Houlihan Lokey as its investment banker in this matter to represent the Debtors in connection with pursuing a potential Restructuring Transaction<sup>4</sup> or a Sale Transaction. In connection with this role, Houlihan Lokey shall provide investment banking services including but not limited to the following:

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<sup>4</sup> As defined in the Retention Agreement, "Restructuring Transaction" shall mean (a) any modification or amendment to, or other change in, any instrument or term which reduces, defers, or converts to equity, debt or other security, the principal of or any debt service requirements of any Company Obligations that allows the Company to restructure (either in-court or out-of-court) on a stand-alone basis; (b) any exchange of Company Obligations for equity or other securities in the Company; (c) any transaction in which the requisite consent to a reorganization or restructuring is obtained either in-court or out-of-court pursuant to applicable law or pursuant to a plan under the Bankruptcy Code; and/or (d) any other going concern exit from a proceeding under chapter 11 of the Bankruptcy Code.

- Evaluate the Debtors' strategic options;
- Advise the Debtors as to available financing and capital restructuring alternatives, including recommendations of specific courses of action;
- Advisory assistance in connection with the development and implementation of key employee retention and other critical employee benefit programs;
- Assist the Debtors with the development, negotiation and implementation of a restructuring plan, including participation as an advisor to the Debtors in negotiations with creditors and other parties involved in a restructuring;
- Advise the Debtors as to potential mergers or acquisitions, and the sale or other disposition of any of the Debtors' assets or businesses;
- Continue to assist the Debtors, as and if required, in connection with a sale process including updates to the marketing materials and due diligence information, as well as coordination and evaluation of indications of interest;
- Assist the Debtors with the design of any debt and equity securities or other consideration to be issued in connection with a Restructuring Transaction;
- Assist the Debtors in communications and negotiations with its constituents, including, creditors, employees, vendors, shareholders and other parties in-interest in connection with any Restructuring Transaction; and
- Render such other financial advisory and investment banking services as may be mutually agreed upon by Houlihan Lokey and the Debtors.

13. The Debtors are familiar with the professional standing and reputation of Houlihan Lokey, and are hiring Houlihan Lokey because of Houlihan Lokey's knowledge of the Debtors' business and financial affairs as well as expertise in restructuring advisory roles and sale transactions. Houlihan Lokey is a nationally recognized investment banking/financial advisory firm with ten offices worldwide and more than three hundred (300) professionals. Furthermore, Houlihan Lokey is one of the leading investment bankers and advisors to debtors, bondholder groups, secured and unsecured creditors, acquirers and other parties-in-interest involved in financially distressed companies, both in and outside of bankruptcy. Houlihan

Lokey's Financial Restructuring Group has over one hundred (100) professionals dedicated in this area. Houlihan Lokey has served as a financial advisor in some of the largest and most complex restructuring matters in the United States, including serving as the financial advisor to the debtors in the chapter 11 proceedings of In re XO Communications, Case No. 04-10214 (PCB) (Bankr. S.D.N.Y. 2004), In re HQ Global Holdings, Inc., Case No. 02-10760 (MFW) (Bankr. D. Del. 2002), In re AmeriServe Food Distrib., Inc., Case No. 00-358 (PJW) (Bankr. D. Del. 2000), and as the advisor to the official creditors committees in In re Trump Hotels & Casino Resorts Development Company, Case No. 04-46909 (JHW) (Bankr. N.J. 2004), In re Mirant Corporation, Case No. 03-46590 (DML) (Bankr. N.D. Tex. 2003), In re WorldCom, Inc., Case No. 02-13533(AJG) (Bankr. S.D.N.Y. 2002), In re Enron Corp., Case No. 01-16034 (AJG) (Bankr. S.D.N.Y. 2001).

14. The Debtors understand that Houlihan Lokey has a wealth of experience in providing financial advisory services in restructurings and reorganizations, and enjoys an excellent reputation for services it has rendered in complex Reorganization Cases on behalf of debtors and creditors throughout the United States. Based on this, the Debtors believe that Houlihan Lokey is duly qualified to render investment banking and financial advisory services to the Debtors in these Reorganization Cases.

#### **Terms of Retention**

15. Effective June 15, 2005, Houlihan Lokey was retained by the Debtors pursuant to a letter agreement dated June 20, 2005 (the "Original Agreement"), as the Debtors' exclusive financial advisor to provide financial advisory and investment banking services in connection with the potential sale of the Debtors' businesses. On September 12, 2005, Houlihan Lokey and the Debtors executed an amendment to the Original Agreement (the "Retention Agreement"), which was effective August 8, 2005 (the "Effective Date"). The Retention Agreement expanded the scope of services to be provided by Houlihan Lokey to include representing the Debtors in connection with pursuing a potential Restructuring Transaction. A copy of the Retention Agreement, setting forth the terms and conditions of Houlihan Lokey's retention and its

compensation is attached hereto as Exhibit B. Under the terms of the Original Agreement, Houlihan Lokey received payments totaling \$29,212.73 from the Debtors in respect of fees and expenses incurred.

16. As reflected in the Retention Agreement, Houlihan Lokey has stated its willingness to provide such investment banking and financial advisory services as Houlihan Lokey and the Debtors deem appropriate and feasible in order to advise the Debtors in the course of these Reorganization Cases. Pursuant to the terms of the Retention Agreement, Houlihan Lokey was paid an initial non-refundable fee payment of \$250,000 by the Debtors, which fee was deemed fully earned upon receipt, to induce Houlihan Lokey to continue to work for the Debtors in the Reorganization Cases as their investment banker and financial advisor. As part of signing the Retention Agreement, Houlihan agreed to waive all outstanding fees owed and unpaid under the Original Agreement.

17. As set forth in the Retention Agreement, subject to the Court's approval, Houlihan Lokey's fee for services provided is \$100,000 per month plus reimbursement of any out-of-pocket expenses incurred in connection with the Reorganization Cases. In addition to the monthly fee, upon the consummation of a Sale Transaction that is a Restructuring Transaction, as such terms are defined in the Retention Agreement, the Debtors shall pay Houlihan Lokey, subject to the Court's approval, a cash fee equal to \$1,500,000.

18. The terms of the Retention Agreement were negotiated between the Debtors and Houlihan Lokey, and reflect the Debtors' evaluation of the extensive work to be performed by Houlihan Lokey and the firm's financial advisory expertise. As described more fully in the Jordan Affidavit in support of this Application, the terms of the Retention Agreement are similar to the terms, both financial and otherwise, agreed to by Houlihan Lokey and other investment bankers in similar engagements, both in and outside of bankruptcy.

19. The Retention Agreement provides that Houlihan Lokey will be retained pursuant to section 328(a) of the Bankruptcy Code which provides, in relevant part, that a debtor, "with the court's approval may, employ or authorize the employment of a professional person under

section 327 . . . on any reasonable terms and conditions of employment, including a retainer....”  
11 U.S.C. § 328(a). Section 328 reflects a significant departure from prior bankruptcy practice relating to the compensation of professionals, as it permits the compensation of professionals, including investment bankers and financial advisors, on more flexible terms that reflect the nature of their services and market conditions. As the Fifth Circuit recognized in In re National Gypsum Co., 123 F.3d. 861 (5th Cir. 1997):

Prior to 1978, the most able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done. That uncertainty continues under Section 330 of the Bankruptcy Code, which provides that the court award to professional consultants reasonable compensation based on relevant factors of time and comparable costs, etc. Under present Section 328 the professional may avoid that uncertainty by obtaining court approval of compensation agreed to with the trustee (or debtor or committee).

Id. at 862 (citations omitted).

20. Notwithstanding any provision of the Retention Agreement to the contrary, Houlihan Lokey will file fee applications with the Court pursuant to the Bankruptcy Code, the Bankruptcy Rules, Local Bankruptcy Rules for the District of Maryland, the United States Trustee’ Guidelines and Orders by this Court. Contemporaneously herewith, the Debtors have filed a motion for an order establishing interim compensation procedures for the professionals retained in these Reorganization Cases. If approved by the Court, the proposed compensation procedures will require Houlihan Lokey to file fee applications pursuant to such procedures, notwithstanding the terms of the Retention Agreement to the contrary; provided, however, that Houlihan Lokey shall submit with its fee applications a detailed daily time entries for each individual in one (1) hour increments explaining the services provided, as well as a categorized summary of all disbursements and expenses for which Houlihan Lokey is seeking reimbursement.

21. To the extent that this Application is inconsistent with the Retention Agreement, this Application shall govern.

### **Indemnification Provisions**

22. As set forth in Schedule A to the Retention Agreement, the Debtors shall indemnify, hold harmless and defend Houlihan Lokey and its affiliates, directors, officers, shareholders, employees, agents and controlling persons (collectively, "Indemnified Parties") under certain circumstances. In particular, the Retention Agreement provides that the Indemnified Parties are entitled to be indemnified by the Debtors, to the fullest extent of the law, from and against any and all losses, claims, damages, or liabilities, and reasonable legal or other expenses, arising out of or related to the engagement, any actions taken or omitted to be taken by an Indemnified Party or any transaction contemplated hereby.

23. The Debtors request that the indemnification provisions of the Retention Agreement be approved, subject to the following:

- (a) subject to the provisions of subparagraph (c), *infra*, the Debtors are authorized to indemnify, and shall indemnify Houlihan Lokey, or any other Indemnified Parties, in accordance with the Retention Agreement for any losses, claims, damages, or liabilities, joint or several, arising out of or related to the Retention Agreement, any actions taken or omitted to be taken by an Indemnified Party (including acts or omissions constituting ordinary negligence) in connection with the Retention Agreement, but not for any claim arising from, related to or in connection with Houlihan Lokey's post-petition performance of any services other than those services described above unless such post-petition services and indemnification therefor are approved by the Court;
- (b) notwithstanding any provision of the Retention Agreement to the contrary, the Debtors shall have no obligation to indemnify Houlihan Lokey, or any other Indemnified Parties, or to provide contribution or reimbursement to Houlihan Lokey, or any other Indemnified Parties, for any losses, claims, damages, liabilities, or expenses that are (i) finally judicially determined to have resulted from, or (ii) agreed by such Indemnified Party to have resulted from, the reckless or willful misconduct, gross negligence, breach of fiduciary duty, bad faith, or self-dealing of any Indemnified Party;
- (c) if, before the earlier of (i) the entry of an order confirming a chapter 11 plan in the Reorganization Cases (that order having become a final order

no longer subject to appeal) and (ii) the entry of an order closing the Reorganization Cases, Houlihan Lokey believes that it is entitled to the payment of any amounts by the Debtors on account of the Debtors' indemnification, contribution and/or reimbursement obligations under the Retention Agreement, including, without limitation, the advancement of defense costs, Houlihan Lokey must file an application therefor in this Court, and the Debtors may not pay any such amounts to Houlihan Lokey before the entry of an order by this Court approving payment of such amounts. This subparagraph (c) is intended only to specify the period of time under which the Court shall have jurisdiction over any request for fees and expenses by Houlihan Lokey for indemnification, contribution, or reimbursement and not to limit the duration of the Debtors' obligation to indemnify Houlihan Lokey; and

- (d) a claim under the Retention Agreement for indemnification, contribution, and/or reimbursement arising from Houlihan Lokey's pre-petition performance of the services described in the Retention Agreement or otherwise shall not be entitled to administrative expense priority.

24. The Debtors believe that the indemnification provisions contained in the Retention Agreement (as modified by the provisions of paragraph 23 above), viewed in conjunction with the other terms of Houlihan Lokey's proposed retention, are reasonable and in the best interests of the Debtors, their estates and creditors. The Debtors believe that the indemnification terms are similar to provisions agreed to by Houlihan Lokey and approved by the bankruptcy courts in like engagements. See, e.g., In re United Artists Theater Co., 315 F.3d 217 (3d Cir. 2003) (finding that the subject indemnification agreement was reasonable and, therefore, permissible under the Bankruptcy Code).

#### **Houlihan's Disinterestedness**

25. As evidenced in the accompanying Jordan Affidavit, Houlihan Lokey is not connected with the Debtors, its creditors, other parties in interest or the office of the United States trustee (the "U.S. Trustee") or any other person employed by the U.S. Trustee. To the best of Jordan's knowledge, after due inquiry, Houlihan Lokey does not, by reason of any direct or indirect relationship to, connection with, or interest in the Debtors, or other parties in interest, hold or represent any interest adverse to the Debtors, their estates, or any class of creditors or

