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The secrets of See's Candies

PHOTO: GREGG SEGAL

See's CEO Brad Kinstler selects a Toffee-ette at the See's store at its Los Angeles plant. Photo by Gregg Segal for Fortune

By **DANIEL ROBERTS** August 22, 2012

The plant workers of See's Candies start arriving each day at 4 a.m.

In Los Angeles and San Francisco they stand at their stations and drizzle fondant onto maple pecan bonbons or count the nuts in each almond royal. They spread rum nougat into flat pans or break up chunks of cashew brittle by hand. All the while, they wear the signature white lab coats with their first names embroidered on the front in black stitching — similar to the ones in the famous 1952 *I Love Lucy* episode, for which Lucille Ball trained at See's. By 9 a.m., many of the workers break for lunch.

Meanwhile, in the Kiewit Building on Farnam Street in Omaha, Warren Buffett is largely unaware of what is beginning at See's. His Berkshire Hathaway group (BRKA) acquired the little candy company in 1972 — exactly 40 years ago — for

$25 million. The boxed-chocolate industry is small, with total sales estimated at just under $2 billion a year in the U.S., and does not often grow year to year, although it is up 4% in 2012. See's, which had sales of $376 million in 2011, $83 million of it profit, represents an infinitesimal drop in the bucket of Buffett's other holdings, which include fat stakes in American Express (AXP, -0.56%), Coca-Cola (KO, -0.04%), and IBM (IBM, -0.11%). But of all his investments, the regional candy maker remains Buffett's fondest.

Of course, the Oracle doesn't worry himself with the day-to-day management of companies he owns; his biggest act of participation in four decades was in 2006 when he installed longtime Berkshire insurance man Brad Kinstler to run things after Chuck Huggins, who had been with the company 54 years and was CEO for 33 of them, retired.

Now Kinstler, 59, is embarking on a plan to spread out across the country. You may know See's from airport kiosks on trips to the West Coast, but of the company's 211 shops, none are east of Chicago. In the next three years See's plans to open stores in states like Florida, Georgia, Pennsylvania, and Maryland, and in Washington, D.C. Whether it will be successful is uncertain; past attempts have not worked that well. The plan means risk — though measured — for a business that, like Buffett himself, is usually about patience and caution. But Kinstler is more determined than anyone before him to make it happen.

Charles A. See, a salesman from Ontario, opened the first See's shop in 1921 in Los Angeles. With its now iconic black-and-white tiles, it was made to look like the kitchen of his widowed mother, Mary. Today the shops still offer the same experience: walk-in customers can sample any piece. "That's the best marketing we have," says chief financial officer Ken Scott, who has been at See's 34 years. "If people try it, they'll love it." It's true. Maybe it's the fresh ingredients (See's uses no added preservatives) or the California water, but there is something about See's. The candy tastes exceedingly good.

Warren Buffett has loved See's since he first tried it in 1971, after hearing about it from his West Coast colleague Charlie Munger, who in turn heard about it from Robert Flaherty, an outside investment counselor at Blue Chip Stamps, a trading-stamp company Berkshire had invested in the year before. Munger and Buffett now say they were stingy in their initial offer, but Munger's friend Ira Marshall convinced him it was an unusual company, worth spending more to get. "Ira really shamed us," admits Munger. "Warren and I were too cheap." So Munger persuaded Buffett to buy. They paid up.

Munger, sitting in the reading room of his L.A. home — the 88-year-old is currently enjoying a biography of Deng Xiaoping — ticks off a lot to like about See's from a management perspective. The company has changed very little in 91 years, incurs low overhead, and can raise prices by up to 5% each year, thanks to brand loyalty. People are fanatical about See's (read the reviews of any of its candies on its website), and Buffett is no exception. "When you were a 16-year-old, you took a box of candy on your first date with a girl and gave it either to her parents or to her," he says. "In California the girls slap you when you bring Russell Stover, and kiss you when you bring See's."

Over the years Buffett's strategy had often been to invest in undervalued "cigar stub" companies. See's was different: a strong brand that Californians loved. He has called See's a "dream business," one capable of greatly increasing its profits without needing much new capital. Berkshire is therefore able to allocate most of See's profits to whatever businesses or investments Buffett thinks best.

And Buffett finds additional lessons in See's. For starters, it has taught him about branded goods. "It's one thing to own stock in a Coca-Cola or something, but when you're actually in the business of making determinations about opening stores and pricing decisions, you learn from it," he tells *Fortune*, sitting in his office with a box of See's chocolate lollipops (his favorite) on his desk. "We have made a lot more money out of See's than shows from the earnings of See's, just by the fact that it's educated me, and I'm sure it's educated Charlie too."

See's employees feel the same kind of affinity for the company. Most have been there for decades, and they get so delighted talking about working there that they make Google (GOOG) employees look like detainees. Beatriz Romero has been wrapping Scotch kisses (a fresh marshmallow covered in caramel and wrapped tightly like taffy) for 41 years, and she is not an unusual case. The upper-level team is also made up of See's lifers. Eileen Duag (pronounced doo-ag), vice president of product, has been there 32 years. Johnnie Woods, "customer centricity" director, for 24. Dan Dias, who runs order processing, has 17. They consider Kinstler, with his almost seven years, brand-new.

Kinstler began his career at Cornhusker Casualty, an Omaha insurance company Berkshire opened in 1970. In 1991 he went to run Cypress Insurance in San Mateo, Calif., for nine years before moving on to Fechheimer Brothers, a Berkshire-owned, Cincinnati-based uniform maker. In 2005, Buffett and Munger tapped him to move back to California and take over See's. Kinstler says he knew little about the business, but jokes, "As soon as I found out I get free candy ..."

MORE: Warren and Charlie and the chocolate factory

That vanilla sense of humor belies the ambitious steps Kinstler is now taking to bring Mary See's recipes to the rest of the country. Until the early 2000s, See's stayed west, except for a brief stint in the '80s when Huggins opened a few stores in St. Louis and Texas. They struggled because of competition from the likes of Fannie May (no, not mortgage giant Fannie Mae) and because the company opened them too quickly in untested markets. See's had to retreat. Today it remains a Western phenomenon; 110 of its 211 stores are in California.

See's does, however, open seasonal carts in shopping malls all across the country — called "holiday gift centers" (HGCs) — that are around only for Christmas (a few reopen for Valentine's Day and Easter). It uses their success to measure where a permanent shop might do well. Based on HGC performance, See's opened its first two stores in Dallas this summer and will open three more in Texas this year. It is slowly moving across the country. In 2012 it is on track to open five stores in Texas, one in Oklahoma, one in Wisconsin, and one in Indiana. Next year it plans to open in Missouri, Ohio, Michigan, Kentucky, Tennessee, and Pennsylvania. For 2014, Kinstler envisions stores as far east as Florida and Washington, D.C.

While the plan is ambitious, it is measured. With each store requiring less than $300,000 to build out, “it’s not even a rounded decimal point in Berkshire’s financials,” Kinstler says. Even as he tries to open more than 30 new stores in three years, he’ll do it cautiously, watching how the stores perform in each new market before opening more: “Until I’m very comfortable and convinced, the foot’s always ready to be on the brake as opposed to the gas.”

Nevertheless, to help usher this plan along, last October Kinstler hired a new VP of marketing: Tracy Cioffi, who had previous marketing stints at the Sports Authority and Gap (GPS, -0.88%). (When she took the See’s job and updated her profile on LinkedIn, she says many of her contacts expressed surprise. “I just wrote back, in bullet points: Buffett. Berkshire Hathaway. Made in the USA. Do your homework.”) Cioffi, 36, will spearhead an effort to alert new customers to the brand. “We can’t focus on great-grandma anymore,” she says. Her new bull’s-eye is a thirtysomething mother. How do you pull in new, young customers to a 91-year-old candy company that packages its sweets in black-and-white boxes with a kindly old woman on the front? “Usually I’m tasked to make it up … create the brand,” says Cioffi. “I don’t need to do that here — the story is there, the heritage is there. I need to package it and tell it.”

Part of that storytelling will happen in the digital sphere, which seems like a natural home for a brand with the cultlike appeal of See’s. Cioffi touts the company’s Facebook page and its 880,000 “likes.” On sees.com — which Buffett himself pushed to create in 1998 — most pieces have 800 reviews or more, and almost all have an average rating that is close to five stars. The brand’s web presence will be increasingly vital, as 65% of consumer orders now originate online (the rest come via phone, and a tiny portion by snail mail). See’s logs an average 250 online orders each day just for “special packs,” the make-your-own-box option. During peak holiday time, that balloons to 2,200 each day. It makes sense: Boxed chocolate is a highly seasonal business — See’s makes 90% of its money in only four months of the year. To combat the lulls, See’s puts out seasonal flavors, like tropical tango, a refreshing coconut piece, in the summer.

(There is a mincemeat flavor for Christmas, and an Irish potato piece for St. Patrick's Day.)

The logistics of distributing a perishable product are complicated. To truly expand, See's will have to open up a new plant. That will mean finding new suppliers for all the fresh local ingredients it uses. A big selling point of See's is that all its ingredients, from Guittard chocolate to Mariani shelled walnuts, are fresh and local; the only items from outside the country are pine nuts and vanilla. Thus, the ingredients don't travel far to get to the cold lockers where "nut meats" are stored, or to the giant outdoor vats that house milk chocolate and dark chocolate. (In 1994 a driver delivering a bulk order of chocolate fell asleep while his truck was hooked up to one of the vats and pumping; the streets flooded with chocolate and, once the fog cooled it, workers had to shovel it away from the storm drains.) The lack of any added preservatives is a draw for consumers but can make stocking See's a hassle for its licensees; the candy has a very short shelf life. Scotch kisses, for example, can stay on shelves only 25 days because the caramel isn't coated in anything.

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See's pushes the "no added preservatives" line hard. Employees like to point out that Godiva boxes can stay on shelves much longer (Godiva declined to comment for this article). That See's would try to appeal to new customers by stressing old values matches up nicely with its plants, which run on a balance of automation and live labor. Men in aprons and goggles churn at giant, steaming cauldrons of caramel. Someone stands and shoots vegetable oil onto a sheet of rum nougat so that it won't stick to the slicer. A handful of the machines are nearly 100 years old and still going, like the "tinner" that sorts Toffee-ettes into tins, which is from 1919. In other sections brand-new machines roar along, like the flashy robots that make peanut brittle — one stretches out the sheets of brittle, the other flips them — and are nicknamed Tweety and Sylvester. By the time production stops at 2 p.m., marshmallow drips from machinery and a dusting of nut shavings coats the floors. The sanitation crews that come at 3 p.m. are often there for eight hours. In some areas extra chocolate is collected and mixed in with raw food material that ends up feeding farm animals. “We used to call the extra chocolate ‘hog food,'” says L.A. plant manager Gary Gitch.

Though See’s doesn’t officially give public tours of its plants, well-known fans like Cher — who worked at See’s before she achieved fame — have come by, and Buffett once brought Bill Gates for a tour. Buffett says that when his 5-year-old grandson took a tour years ago and gorged on samples, “he was with a couple little buddies, and [after the tour] he gets out of the car and just throws up all of it.”

See’s faces obstacles before it can get kids on the East Coast hooked too. Boxed chocolates is a crowded field: At the high end there’s Godiva, as well as newer boutique brands that have emerged in recent years. Below See’s there is an abundance of what Duag calls “pharmacy candy,” a market dominated by Russell Stover. According to data from research firm Symphony IRI, in the past year through July 8, Russell Stover’s sales were $90.1 million, Whitman’s Samplers (which Russell Stover owns) did $38 million, Hershey’s (HSY, +0.59%) gift boxes did $20.4 million, Lindt’s boxed chocolates did $11.9 million, and Fannie May did $4 million.

For See’s to win the race in new territories, Cioffi says branding will be key. She hopes to change the voice of See’s. “Right now, I would say we’re sweet,” she says. “I want to get us to where we’re sweet with a wink.”

Bernard Pacyniak, editor of *Candy Industry* magazine, thinks it may take more than a wink for See’s to break through on the colder coast. “I don’t think See’s means anything to people on the East Coast, where people are also exposed to higher-end chocolate products,” he says. “Their base is still very much the loyal West Coast customers, and on the East Coast they’ll have to start from scratch.” Chip Huggins, who is the son of the company’s longtime CEO and who began working at See’s for his father at age 14 and eventually left to run Joseph Schmidt Confections, asks, “If you put See’s everywhere, what makes it so special anymore?”

It’s a fair question. Like many products with a fervent fan base, the scarcity of See’s provides a large part of its appeal. Kinstler isn’t too worried. He thinks that if the company does lose some customers as it becomes more readily available, the exposure to new people will be worth it. He points to Coors as an example: “When I was growing up, you had to go to Colorado to get it, and that made it very cool,” he says. “But I think Coors is much better off today, now that they expanded and are widely available.”

Most beer drinkers would probably agree. And See’s is betting that most fans of Mary See’s recipes will too.

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