Chapter 4: Manufacturing Businesses

The manufacturing division includes establishments engaged in the mechanical or chemical transformation of materials or substances into new products. These establishments are usually described as plants, factories, or mills and characteristically use power driven machines and materials handling equipment. Establishments engaged in assembling component parts of manufactured products are also considered manufacturing if the new product is neither a structure nor other fixed improvement. Also included is the blending of materials, such as lubricating oils, plastics resins, or liquors.

Commercial Bakeries

SIC: 2051 NAICS: 311812

Description of Business

Establishments primarily engaged in manufacturing fresh or frozen bread and bread-type rolls and fresh cakes, pies, pastries and other similar "perishable" bakery products.

General Industry Information

The commercial bakery industry is quite sizeable, accounting for nearly $24 billion in production during 2002. There were approximately 2,500 commercial bakeries in operation that same year, which is an 8% decline from the total operators in commercial baking during 1997, with average annual sales being $9,600,000 per business. Generally, commercial bakeries are located close to their clients (often in large municipalities), in an effort to maintain freshness of the product.

Commercial bakers sell their products to restaurants, hotels, other food manufacturers, along with food markets. Often, a contract is negotiated specifying term and fixed price of the product. Existing contracts are a strong positive for firms looking to sell their businesses. Indirect competition has been eating away at this industry for the last few years. Rather than engaging the services of commercial bakeries, some retailers have opted to bake their own bread utilizing dry mixes, or to purchase large quantities of bakery products from warehouse stores.

This business is associated with thinning profit margins. Companies in a good financial position are opting to buy poorer performing operations, and expanding the parent unit's distribution base. The acquisition and subsequent industry consolidation trend is especially apparent during recessionary periods.

Licenses to produce bakery goods are necessary, and any industrial space occupied by bakers must be zoned appropriately. It is important to comply with Clean Air and Water regulations, which affect this industry in several respects. Oven emissions and wastewater are the primary materials of concern to regulators.

Financial Performance Ratios

Table 4-1: Commercial Bakeries

Margins	
Cost of Goods (% of revenue)	55 - 60%
Manager/Owner Salary (% of revenue)	+/- 20%
Operating Expenses (% of revenue)	2-4%
EBITDA/Operating Margin (% of revenue)	2 - 4%
Ratios	
Working Capital (% of revenue)	2 - 3%
Current Ratio	0.75 - 1.40
Quick Ratio	0.75 - 0.95
Inventory Turnover (per year)	> 20 times

Business Valuation Formulas

30-45% of annual revenues
2 to 3 times ODCF

Equipment Valuation and Real Estate Rental Formulas

Equipment:
OLV is typically at 10-15% of retail value, depending upon quality and condition.
Real Estate:
Rent as a% of Sales: less than 6%. The typical square footage occupied is between 25,000-105,000 sq ft, with a median of 30,000 sq ft. The most typical lease is a gross expense lease.

Financing

Financing is generally unavailable, unless there is a hefty down payment involved (>60%). Terms and interest rates are variable.

Red Flags and Risks

Operators of this type should be very concerned about competition from similar commercial bakers. The loss of a large client can be devastating, so buyers should carefully examine existing contracts. Similarly, a buyer should check on any lease agreements. Leases are particularly important in this business, as it may be difficult to secure a rental location that permits a commercial bakery. Potential on-the job injury can include burns or other body harm caused by baking and large kneading equipment. Safety precautions should be employed and enforced to minimize worker injury. Lastly, this business can face trouble if the product's input costs rise. Recently, bakers have struggled to pay the higher prices of wheat flour, after a drought cut raw supplies. Some larger companies purchase futures contracts with the hope of stabilizing volatility in the prices for