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Trading bread for dough

After building Ace Bakery into one of the biggest indie brands in baking, the founders opted against steering it through the next stage. They'd tried selling before. This time, they would do it right

By CRAIG SILVERMAN

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Sometimes a husband and wife don't need to say anything to know they're both thinking the same thing.

Martin Connell and Linda Haynes were on the phone in the kitchen of their Toronto home. On the other end of the line were representatives of a food company that had made an offer for Ace Bakery, the artisanal bread-maker the couple had started a decade earlier. The company grew to become one of Canada's top independent bakeries, with restaurants, supermarket chains and consumers stocking up on the more than 25 varie-ties of its European-style breads. Ace had recently begun shipping partially baked and then flash-frozen bread to grocery stores in Ontario, New York state and Michigan, but the couple knew further expansion would require more capital, more time and more sacrifice. They weren't sure they were up for it. And here was a keenly interested buyer that needed an answer. Now.

Connell and Haynes said no. "We just knew it wasn't going to be the right deal," says Haynes.

But that was five years and millions of dollars in sales ago. Since that tense phone call, the business has doubled in size, with 300 employees, seasoned managers, and annual revenues approaching $50 million and growing at a double-digit rate. What's more, Ace has become a major supermarket brand. So when the couple found themselves facing a similar dilemma last year--whether to inject the cash and effort needed to penetrate more markets in North America--they knew they were sitting on a much more valuable asset. They were also approaching retirement age (she's now 60, he's 66). "It was going to take a heck of a huge push to get the business to the next level," says Haynes.

It was time to sell. The trick was to get the deal done this time.

Ace was born out of Connell's habit of spending weekend mornings at the couple's country house near Caledon, Ontario, baking bread with his young daughter. It soon turned into a hobby, then a passion, with Connell striving to create the perfect baguette. The couple built a small bakehouse on the property and, after visiting bakeries in North America and Europe, started to think about launching their own bread-baking business.

In 1993, they opened a small bakery on the western edge of downtown Toronto using about $250,000 of their own money. Initially, the duo just wanted to raise funds for Calmeadow, their microlending charity. But Ace was a smash hit with Toronto gourmands and, four years later, they relocated to a 23,000-square-foot facility (which has since doubled in size) in north Toronto. Haynes, a former television producer, focused on product development and marketing while Connell oversaw operations. Within a decade, Ace's breads were being sold in grocery chains such as Loblaws in Canada and A&P in the United States, served in many of Toronto's best restaurants, and shipped partially frozen to luxury resorts in the Bahamas and elsewhere.

After the aborted sale in 2003, Connell and Haynes brought in Birch Hill Equity Partners, a Torontobased private-equity firm, as an investor to help finance the ongoing expansion. Then, two years ago, they hired Philip Shaw, an experienced bakery operator from California, to take over the management of the business. His arrival allowed the founders to step further back like they'd wanted to, and Haynes threw herself into writing cookbooks while Connell grew increasingly involved with various charities.

But as Ace's growth continued unabated, the pair was soon back at a crossroads. By the summer of 2007, Ace needed a new capital injection to stay on its expansion path, and Haynes and Connell just didn't want to take on that gruelling task. The distribution and product mix were well established, and Ace was a household name with consumers in several North American cities--a rarity for a specialty bakery. "Most artisan bread companies end up being suppliers to private labels," says Connell, "but we were able to maintain our brand presence [in stores]. That's very attractive to buyers."

The first sale attempt had taught the pair some pitfalls to avoid. Back then, they simply started negotiating with the one company that had approached them. "It was just the three of us [including the general manager] involved in the conversations with the buyer," says Connell. "When you're a private company managed by the proprietors, there's a much more intense relationship that develops in a transaction." This time, Ace would formally put itself on the block to solicit competing offers, and it would bring in advisers to guide the sale.

Haynes and Connell also made sure to keep the process confidential internally until the deal was done. On the previous go-around, some managers were told about the impending deal, and anxiety spread through the office. When the sale fell through, many were relieved, but some worried about the company's fate.

The couple turned the process over to Shaw, who'd been through it before when he managed the sale of a Los Angeles bakery to a multinational. During that transaction, Shaw had hired Houlihan Lokey, an L.A.-based investment bank that closely tracks the food and beverage industry, to spearhead the sale and find interested buyers. Ace chose the bank, too, after hearing its pitch. Jay Novak, head of the consumer, food and retail unit at Houlihan Lokey, thought buyers would see potential to replicate Ace's rapid niche dominance in Canada in the larger U.S. market.

Once on board, Novak's team first prepared a one-page deal memo outlining the opportunity without revealing the company's name; potential buyers would know only that a bakery with a given market presence, sales and growth prospects was up for sale. "We went to a fairly broad group [of prospective buyers] because the story is one of potential growth," says Novak. "A lot of investors in the food industry and in private equity would appreciate that." He says "at least a couple of dozen" companies expressed interest, but the board quickly culled a few candidates from the list, including some competitors. "We didn't want to be in a situation where someone would come in and get rid of a whole bunch of people and put in their own team," says Haynes. "You only have to pick up the financial pages to see that it happens." Houlihan Lokey sent packages of more detailed information, including financials, to those still in the running. From there, the list of suitors was whittled down to roughly 15.

By the fall of 2007, potential buyers started arriving in Toronto for tours of Ace's facilities. Naturally, the team worried about something going wrong during these inspections. "It's like selling a house: You worry about the fridge conking out the day before closing," Connell says. Adding to the tension was the fact that, with the cost of flour soaring and bakers' margins dwindling, this wasn't an auspicious time to go into the baking business. "We were in an [economic] environment where things were tense," says Connell. For Shaw, who led suitors on tours and delivered presentations on the company's plans, it was like having a second job. "You're doing this while still running the business. And you're simultaneously trying to do it quietly."

One potential buyer who visited Ace was Jason Duzan, a principal at Glencoe Capital, a Chicago private-equity firm. His company had pegged the artisanal bread market as an investment niche even before hearing about Ace. "The market is fairly well established in Canada, but in the U.S. there's quite a bit of availability for further penetration," he says. Duzan estimates he visited Ace half a dozen times in 2007 to analyze its operations and get to know the management. He also ate a lot of Ace bread.

In the end, when the Ace board met in late 2007, it had four or five firm offers to consider. The choice was clear, says Connell. Glencoe offered a "fair price" (Connell won't say whether it was the highest) but, more importantly, the owners felt confident that, being an investor rather than a manager, the firm would retain the staff and keep Ace on its current path.

After signing a letter of intent that outlined the deal and the closing schedule, Glencoe's team dug deeper into Ace's operations and finances. "Due diligence can be intense," says Duzan, noting some entrepreneurs get cold feet when they realize they're about to let go of the business they have built. Few surprises popped up, though, and the deal closed as planned. Nearly nine months had passed since the board first decided to sell.

On March 3, Shaw held a meeting with line-level staff and broke the news. Only the CFO and a few workers whose involvement had been necessary had known anything about the sale, so the announcement came as a shock to most. The prospect of the founders' departure left some long-time employees visibly saddened. (The couple did not attend the meeting so that Shaw, who'd be remaining with the company, could take the lead.) "A lot of people had been there when we were a very small team," says Haynes. "It was the end of an era."

Inside a Toronto photo studio, a food stylist and a photographer are adjusting plates, lights and cameras in preparation for the next shot. It's mid-April and Haynes is at a shoot for her third cookbook, which she is writing with her 26-year-old daughter, Devin.

Selling the company they built from scratch was a lengthy and at times stressful process. But now, weeks after the closing, Haynes and Connell have no regrets. "I think 15 years is a good run," Connell says. "If I were 15 years younger I might well have wanted to stay the course, but at a certain point in your life, you look for opportunities to diversify your interests as the clock moves along."

Though the sale agreement prevents the pair from entering the baking business for three years, Haynes has signed a professional services contract with Ace that will see her advise on marketing and PR. The sale does require Haynes to give up one of her favourite daily chores, however. Every morning for years, she received a basket of fresh Ace bread at home to sample. If she found anything not to her satisfaction, she would phone the bakery. Asked if she'll miss her daily bread delivery, Haynes leans forward and offers a wry smile.

"I think I know where to buy it."

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HOW TO SELL YOUR BUSINESS:

Step-by-step advice from the experts for cashing in on what you've built

WHEN TO SELL

Entrepreneurs tend to sell out because they've lost their passion, lack capital to fund growth or just want to retire. These are all potentially good reasons, says Pino Bacinello, president of Vancouver's Sunbelt Business Brokers Pacific, which helps companies manage sales and acquisitions. But they're often trumped by economic factors--or should be.

To determine if the moment is right for a sale, Bacinello takes clients through 50 "value drivers," from market penetration to inventory. "It may be wiser to hold and grow rather than sell and go," he says. "Or, if the reason for selling is lack of capital, financing may be the better option." Ask yourself, he advises, if you can deliver the four things buyers seek: a reasonable wage for the owner, a decent return on investment, a growth path for the business and enough cash flow to meet debt obligations. Then, if you still want to sell, heed these commandments:

Don't sell when you're down. "A buyer is buying the earnings stream," warns Bacinello. If your business is on a downswing, you'll get less than the company is worth. Best to hold on and work through the slump.

Plan ahead. An owner should start preparing for a sale two or three years in advance. It takes time to spruce up your warehouses and storefronts, and address such deficiencies as poor tax planning.

Respect the buyer. "Buyers are every bit as smart and astute as the seller," he says. "Don't think you're gonna find some dumb schmuck to buy your business."

Avoid surprises. Come clean with all pertinent information and make sure it's accurate. Any undisclosed financial or management issues will come out during the buyer's due diligence.

Get it done fast. "I've seen owners plan a vacation during the sale process," marvels Bacinello. "Every day that passes between an offer and closing diminishes the chance of the deal surviving." Buyers will move on if the seller is unfocused.

Don't forget to run the business. Bacinello sees it often: "The moment they put it up for sale, they take their eye off the ball." Remember that a sale is a lengthy process; a revenue drop even two quarters down the road may affect the sale price.

MANAGING THE MESSAGE

Mississauga communications expert Joyce Hansen, who frequently advises companies going through sales or mergers, lays out how to keep things hush-hush--then spread the word.

DURING NEGOTIATIONS Tell only those who need to know. Maintain confidentiality during discussions in order to prevent rivals, suppliers or customers from using knowledge of the sale as leverage.

Inform only those staffers whose help is required, and ask them to sign confidentiality agreements.

Take it off-site, off-hours. Hold conversations about the sale outside the office. "Employees don't like suddenly seeing strangers and closed doors," says Hansen. "It reduces productivity and entices gossip." When it's time to give interested buyers a tour of the facilities, do it after hours.

Offer incentives. Tell staff involved in the sale that their extra work will be considered in their next performance evaluation, to motivate them and encourage secrecy.

Plug leaks. If word gets out even to one employee, news will travel fast. Quickly assemble the team and stress the importance of discretion in order to curb business disruption. If suppliers or rivals already know, hire PR consultants to devise a strategy for explaining how the business, clients and other stakeholders could benefit if ownership changes hands.

Martin Connell and Linda Haynes: ready for their next careers

GETTING YOUR BOOKS IN ORDER

Sloppy record-keeping is one surefire way to kill your chance of a sale. Henry Balazs, executive secretary of the Society of Professional Accountants of Canada, says a big mistake that owners often make is to manage their books to show a loss or reduced profit in order to minimize taxes, a strategy that can result in a lower sale price. The buyer's accountant will also check that you've been paying the appropriate provincial sales tax, have a history of filing on time and are up to date with payroll withholdings. Bill Macaulay, a tax partner with Smythe Ratcliffe LLP in Vancouver, says accounts receivable are important as well. "A buyer wants to know if you're being paid on a regular basis." Buyers are also looking for "unrecorded liabilities"--such as lawsuits or patent infringements--that they can use as negotiation tools.

Failure to maintain good corporate records can, at the least, complicate the sale process, says Macaulay. He once worked with a company whose accounting was solid except for some inconsistencies related to the issuance of shares. When the buyer's lawyers found them, the owner not only had to pay legal fees to get the share structure fixed but the deal's closing was delayed by a month.

TAX BENEFIT EVERY SELLER SHOULD KNOW

If your company is a registered small business corporation, you can deduct up to $750,000 of your capital gains when you sell your shares. To qualify, you must have owned the shares for at least 24 months, and 50% of the company's assets must be used for active business within Canada.

NEGOTIATING THE DEAL

It's all about what you do before sitting down to negotiate, according to John Oesch, a professor at the University of Toronto's Rotman School of Management who specializes in negotiation. Use these three steps to prepare.

Set your criteria for a successful sale so you know where you're willing to compromise. "If you don't have those at the top of your mind, you end up giving away stuff you value," he says. Price is usually an important factor, but so, too, can be retaining the existing management. The key is to narrow your focus. Do you really need to demand that the company continue to donate to your favourite charity? "Having two or three criteria is better than seven or eight," Oesch says.

With parameters set, prepare a "best alternative to this negotiated agreement," known in negotiation lingo as BATNA. This is the fallback plan if you can't get a deal that meets your criteria. "A BATNA is your primary source of power when it comes down to a price negotiation, because if you don't have a good alternative, you're not likely to get the price you want," says Oesch. Your BATNA could be bringing in professional management, forging a partnership or getting a loan to continue growing on your own.

Oesch recommends using "interest-based bargaining" in negotiating a sale. Rather than keeping your criteria secret, make them clear right at the start

Then ask the buyer to list his priorities. With this information on the table, you can work toward a deal that gives each of you as much as possible with minimal sacrifices. And when you do yield on an issue, emphasize it, so it boosts your ability to receive something in return.

HIDDEN VALUE BOOSTERS

It typically takes 700 working hours and between nine and 15 months to sell a business

Revenue, profit and debt are the key factors in setting the price, but you can bump it up by tending to some hidden value drivers. Think of it as "staging" your business as you would a house for sale:

Get facilities and processes up to all relevant industry standards

Develop manuals that establish best practices

Ensure all essential equipment is in good working condition

Secure trademarks and patents

Contractually lock in key customers, suppliers and distributors

Bring in competent managers so the business isn't dependent on you

Clean up storefronts, offices and warehouses

SPREADING THE NEWS

Communications expert Joyce Hansen's pointers for getting the word out:

Craft the message. Before sharing news of the sale, develop your key messages about the transaction. Emphasize how it will help the business and why it was the right time to sell. "Provide key people with media training, because they may not know what to say and not to say," Hansen advises.

Avoid a paper trail. Some businesses communicate a sale by internal newsletter. Bad idea, Hansen says, as paper or e-mail newsletters can easily be leaked. You want to be in control of how the message reaches outsiders. Inform staff in person and then equip managers with specific details relating to their departments.

Get face time with clients and suppliers. They need to hear the news from your team. Provide salespeople and supplier contacts with the information and let them deliver it.

Tell the world. Now it's time to take your news public. Use your key messages to create a press release and other bulletins to spread the word to the trade press and local community.

THE HANDOVER

Few owners can sign the sale papers and walk away. Prepare to remain involved in some capacity so you can help train the new owner. "Just because the deal closes doesn't mean the process is over," says Doug Robbins of Robbinex, a business broker in Hamilton. "You must transfer the knowledge that's contained between your ears to the buyer."

Figure out in advance how much you're prepared to be involved after the sale and what you expect to be paid. These elements should be included in the sale agreement or a separate professional services contract, stating the duration of your involvement and the services you'll provide. "This could be spending three months full-time at the business, or three months half-time, followed by remaining available for general information up to five years," says Robbins, an experienced intermediary in sale transactions. "Or maybe they pay you $25,000 a year for five years. The fee is a bit of the sale price that's deferred in order to provide that availability." Bottom line: While compensation methods vary, most buyers need, and will pay for, the knowledge transfer and the goodwill.