What the doctor ordered

Funding a growing business is never easy, and getting hold of funding for SMEs has recently been something of a mystery. **Richard Grethe**, finance director of Focus Pharmaceuticals, tells Marc Mullen how he cracked it

IN THE BEGINNING

Back in 2003, what was to become Staffordshire-based Focus Pharmaceuticals sat within ADL Healthcare, and it was not sitting entirely comfortably. Across the rest of the business, ADL management was looking for a return period of a matter of months for any investment. Focus had a very different business model. Between £100,000 and £250,000 was required to get its generic drugs to market, which involves a two-to-four-year development cycle. This investment would take up to two years to make a return.

As a result, a buy-out was on the cards. Plans were set in motion involving three directors at ADL - Mark Cresswell, who subsequently became managing director; Roland Brown, business development and marketing director; and Ray Maginley, medical and regulatory affairs director.

Prior to the buy-out, Richard Grethe was finance director of Celltech in the UK - a branded drugs company. However, he worked up the business plan with the team, planning to join them in the buy-out and knowing the MBO needed funding, because it would be cut loose from the overdraft facility it had under ADL.

"In a way, it did help that I was independent from the team," says Grethe. "There had to be an element of trust between us - I was relying on the numbers the other guys were supplying me.

"As I knew I was going into the business I had to be sure it all stacked up, as well as the business and the management team."

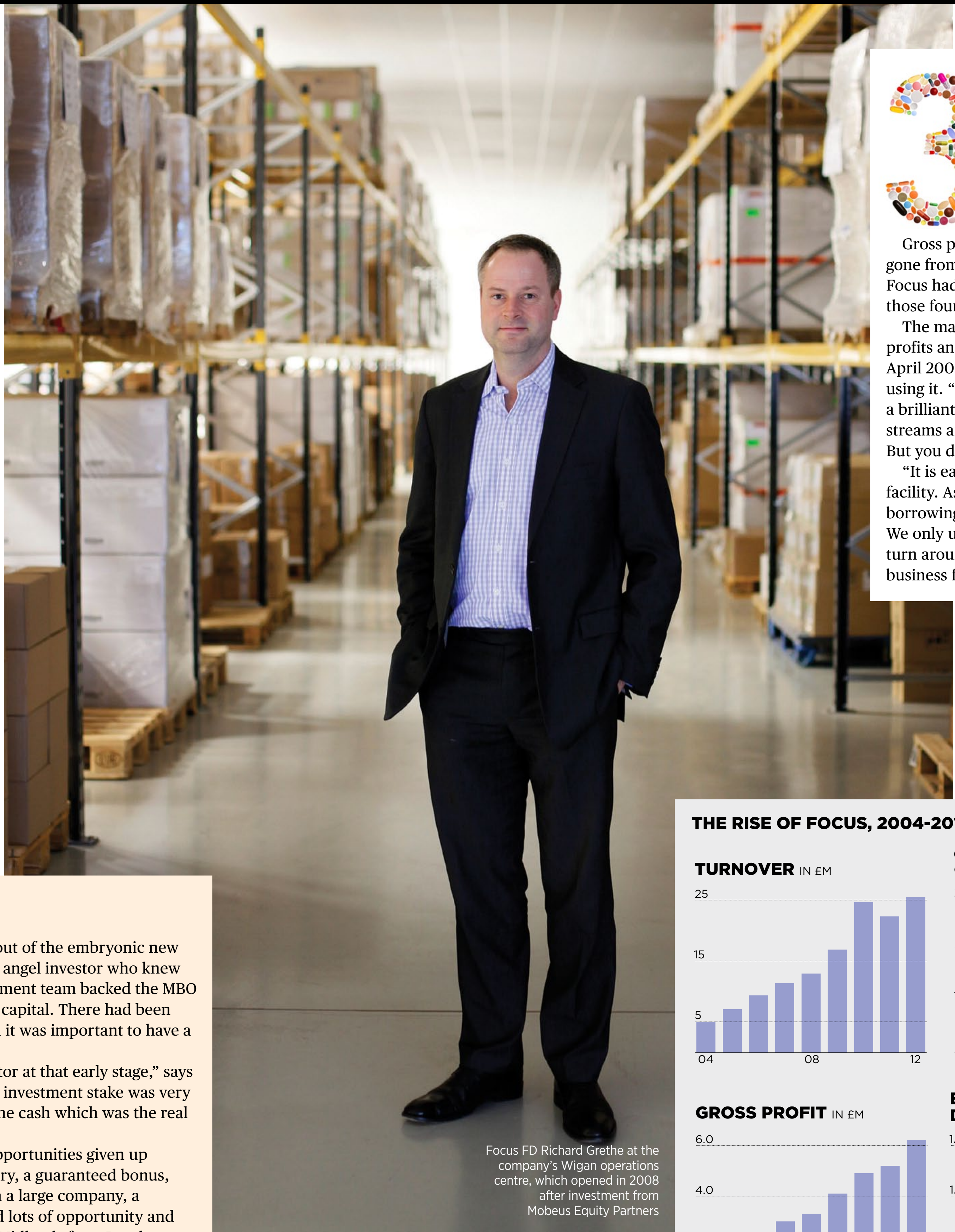
THE BUY-OUT

In November 2003, the buy-out of the embryonic new company was completed. An angel investor who knew the business and the management team backed the MBO and provided the initial seed capital. There had been other offers, but for the team it was important to have a backer they knew and trusted too.

"You need understanding from an investor at that early stage," says Grethe, who joined the board in 2004. His investment stake was very small, but for him and the team it wasn't the cash which was the real skin in the game.

"The real risk we were taking was the opportunities given up elsewhere," he says. "I gave up a great salary, a guaranteed bonus, career progressions in a secure business in a large company, a wonderful final salary pension scheme and lots of opportunity and travel, for a twice-a-week commute to the Midlands from London - with all due respect to the Midlands. It might or might not come off.

"We all gave up a lot, but that was quite invigorating. It really made us work. You do not want to be part of a failed business - you put everything into making it work."



Focus FD Richard Grethe at the company's Wigan operations centre, which opened in 2008 after investment from Mobeus Equity Partners

MISHKA HENNER

FUELLING THE GROWTH

With £1m of funding in place, the plan gave Focus three years to grow before it had to raise £3m to buy out the angel investor, who held the majority stake. In its first year post-MBO, Focus's turnover was £5m. By 2007, when it was looking for a new backer, it had more than doubled to £11.4m.

Gross profit had grown from £1.2m to £3m, but operating profit had gone from breaking even to just over £0.4m, the reason being that Focus had invested £2.4m in external product development during those four financial years. It had been investing for future growth.

The main fuel for this R&D growth had been the reinvestment of profits and also invoice discounting, which the business has used since April 2005. You have to be confident that the business will grow before using it. "We have used it every day since April 2005," says Grethe. "It is a brilliantly flexible tool for a growing business with stable revenue streams and a solid customer base, really easy to use and good value. But you do have to be disciplined in your approach.

"It is easier for banks to get their heads around it as an asset-backed facility. As your invoice book and turnover grows, so too does your borrowing ability. We started out with £1.5m facility, but now it's £4.5m. We only use a few hundred thousand at the moment, but I know I can turn around and press the button and produce another £3m-£4m if the business finds a good use for it."

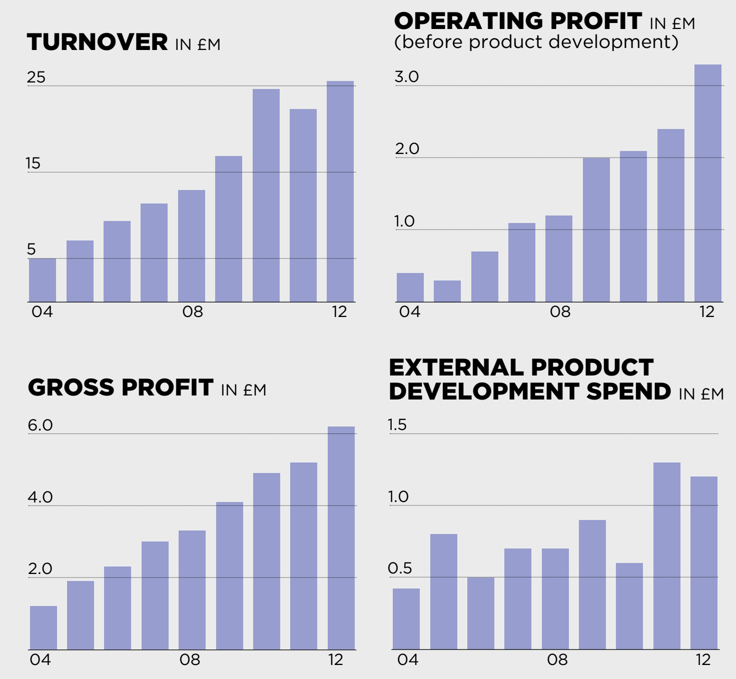
ALWAYS LISTENING

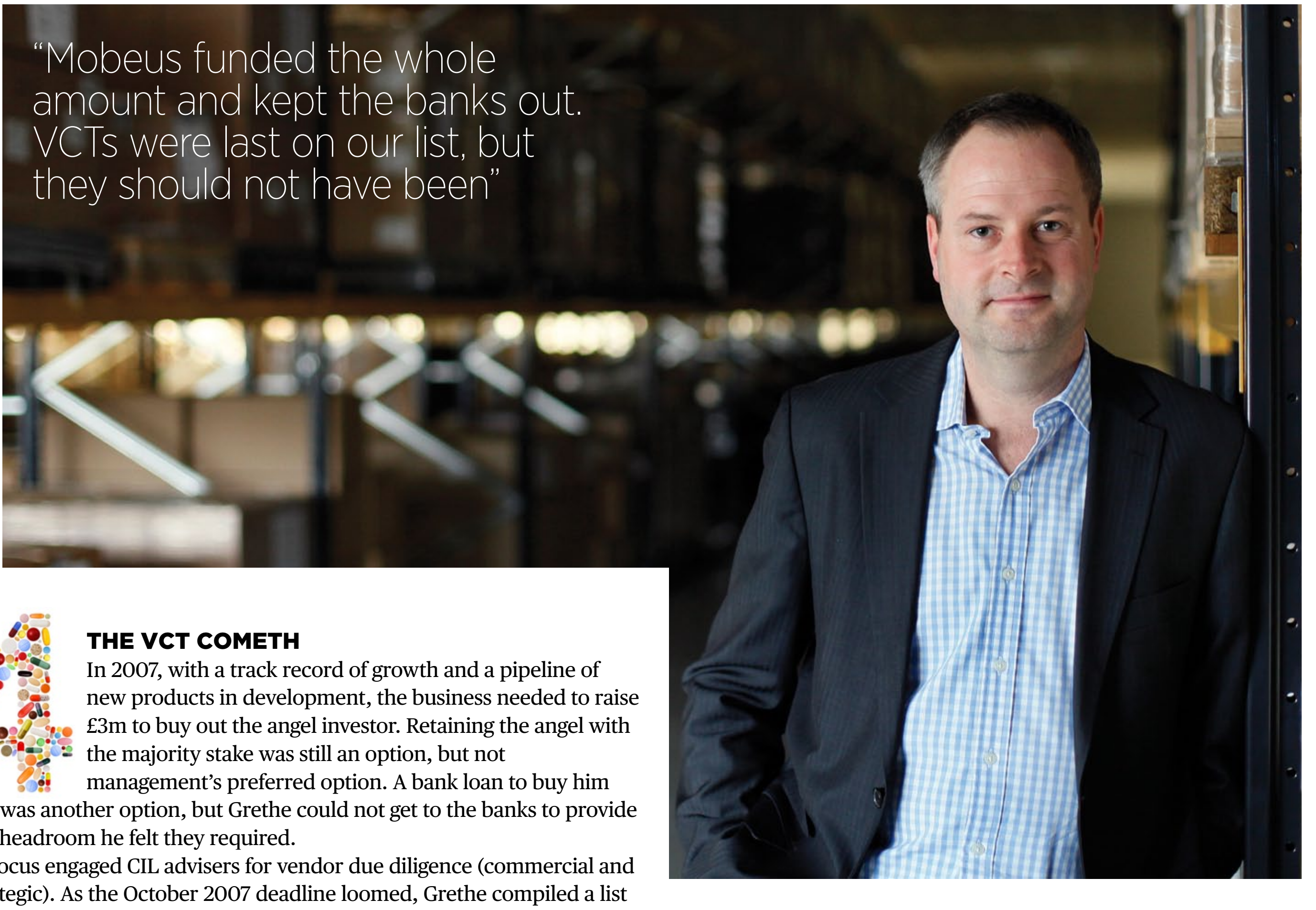
"I don't think you can ever be equipped with full knowledge of the markets for financing your business. The best thing you can do is be open-minded," says Grethe.

"The first deal I did, venture funding and venture debt were looked at, which have now gone by the wayside.

"Now we have crowdfunding, which you look at and say 'I don't know about that'. You have to keep speaking to the banks and the funders and the debt funders and consultants to find out what is out there."

THE RISE OF FOCUS, 2004-2012





"Mobeus funded the whole amount and kept the banks out. VCTs were last on our list, but they should not have been"

4 THE VCT COMETH

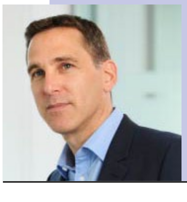
In 2007, with a track record of growth and a pipeline of new products in development, the business needed to raise £3m to buy out the angel investor. Retaining the angel with the majority stake was still an option, but not management's preferred option. A bank loan to buy him out was another option, but Grethe could not get to the banks to provide the headroom he felt they required.

Focus engaged CIL advisers for vendor due diligence (commercial and strategic). As the October 2007 deadline loomed, Grethe compiled a list of buy-out houses from the BVCA's website. He spent two weeks with the business plan in a rucksack, knocking on doors.

After whittling it down to about four potential private equity investors, Grethe and the team decided that an original recommendation from CIL best fitted the bill - Matrix Private Equity Partners (now Mobeus Equity Partners). Focus ticked all the boxes for the investor - good growth prospects, a unique selling point, strong management team and willing to sell an appropriate amount of equity. "Ashley Broomberg drove the deal through pretty quickly - the financial and commercial due diligence, the legals and the tax. The plan was they would fund the deal providing the equity and the banks funding the debt. In the end [Mobeus] funded the whole amount and kept the banks out. VCTs were last on our list, but they should not have been."

THE VIEW FROM MOBEUS

Ashley Broomberg, partner at Corporate Finance Faculty member firm Mobeus Equity Partners, (pictured below) says: "We were attracted by the strong growth and ultimate exit prospects for the business, as well as the strength of the management team. We felt there was significant security value in the portfolio, which underpinned our investment and enabled us to offer attractive equity terms. The business easily serviced the VCT loan obligations. We were comfortable extending the terms of our original investment to provide the company with a flexible platform to continue to drive growth."



5 KEEP ON GROWING

The debt provided by Mobeus came as a loan note with five-year bullet maturity. Focus's profit continued to grow through to 2010, when operating profit was £1.5m. In 2011 it dipped as sales dropped slightly due to some third-party supply issues and the business ramped up its product development spend. But last year it grew again, with the business delivering £2m operating profit.

In January 2012, £1m was repaid and with £2m falling due in June, Grethe looked at the options. He called on the banks. RBS and Lloyds - now able to see a healthy track record of growth and a plan for further growth - offered the full amount.

"I think the banks are genuinely open for business. Clearly you have to get fundamentals right and once you do they are actively trying to lend. They definitely wanted our business."

In the end, Grethe decided to leave the loan notes with Mobeus - which varied the conditions of the loan - as he felt this offered the business more flexibility for the future. The next stage will no doubt be a secondary buy-out or a trade sale, although these are not options for the real near term. Grethe's initial investment has turned into something in the region of £4m - not a bad return.

"It feels really great to have created that equity value," says Grethe. "We feel successful and lucky that we are where we are now, rather than working in a big corporate environment. That 'lovely safe environment' is maybe not such a safe place anymore. It has been quite a long slog, but we are certainly not finished. There is still a lot of value to be created as the products come on stream from the increased R&D investment."