

Nick Thorne writes on doing as well as advising – he’s combined two loves (international business and wine) and invested in a start-up in the wine cork business.....

Bacchus and me: the start of a journey together

Going concerns

My first boss after my MBA, the Chairman and CEO of a listed paints group in the UK, had a framed quotation in his office that proved highly pertinent to my job as Business Development Director:

“Before you invest in a going concern, make sure you know where it’s going”.

When I first saw it, I laughed. But that aphorism has resonated for me throughout my career as an executive with corporations ranging from Cadbury Schweppes to Total Oil to BIC, as well as in my consulting practice. Especially, because I have often been involved with identifying, negotiating and integrating acquisitions – one of the higher-risk areas of management activity.

Considerable research indicates that most acquisitions disappoint the acquiring company and destroy shareholder value. My experience is that this mainly happens when more attention is paid to the “deal” than to understanding where a target business is really headed, to how it can best be integrated into the business of the acquirer, and to actually implementing those plans.

Judging where a business is going can seem straightforward. Common sense suggests that mature and substantial businesses should be fairly predictable. But even oil tankers, requiring miles to start, stop or change heading, need a captain and crew and good systems if they are not to hit rocks – or in our “modern” times, get boarded by pirates !

More often, it’s tough to be sure where a business is going. Even solid performers appearing set on a smooth course might be concealing underlying problems. Ask your banker friends. And anyhow, businesses are like living beings, with a tendency for their faculties to decline over time. It takes good management to keep them on their toes and aligned with their changing environment.

So it was some 35 years after first laughing at my boss’ quotation, and frequently experiencing its serious side in the intervening period – mainly using that wonderful resource OPM (Other People’s Money) – that I found myself bravely investing my own money in a “going concern”.

Except this one wasn’t even going.....

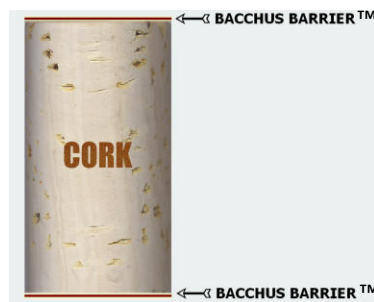
Bacchus

Bacchus Wine Closures, a tiny UK company (www.bacchuswineclosures.com), had invented and patent-protected a brilliantly simple way to make a traditional, but relatively unreliable product – a wine cork – perform more consistently, and offer much more performance for a given price.

Wine corks do a vital but only partly-understood job of protecting wine. They allow some oxygen – but not too much – to get to maturing wine, something that modern alternatives in plastic or screwcap form struggle with.

However, cork is a natural product with inherent variability. It can also be prone to a problem that really hurt the cork industry in the 1980s and 1990s – the chemical trichloroanisole (TCA), which can cause an off-taste in a bottle of wine. Estimates of the extent of the TCA problem range up to 7% of wine spoiled, so it is a huge and costly wastage issue.

Treating corks with our Bacchus Barrier™ involves applying a thin polymer coating to the ends of the corks. This coating is a specially-designed transparent and elastic film comprising layers of a high performance barrier polymer, Ethylene Vinyl Alcohol (EVOH), sandwiched between other polymers such as polyethylene and bonded to the cork with a special hot melt adhesive.



The Bacchus Barrier™ slows the rate of migration of TCA and any other off-flavours present in a cork, so that wine is protected for way longer than without it. It also makes for a consistent rate of oxygen transmission, irrespective of the quality of the cork itself. And the end-product remains recyclable, with a very low carbon footprint compared to synthetic closures.

So Bacchus had a great idea and a great product, but no money, no manufacturing capacity and no customers.

Not yet a “going concern”, so how did we get it going ?

Getting going

The key was to identify the preferred route to market and the volumes that might plausibly yield, at what sort of selling prices and with what costs.

To limit our capital investment and risk, my co-investors and I wanted the business to remain a low-overhead, low-investment operation. We therefore favoured trying to enter the market through a licensing deal with a major cork manufacturer. This would leverage their sales coverage, credibility as a supplier and manufacturing and administrative infrastructure, and potentially rapidly build volume for us. Then we could expand from there...

This route meant we needed to model not only our own business, but also at least this part of the candidate cork manufacturers’ businesses, to ensure they had strong profit motivation to make the necessary capacity investment and sales effort.

We also looked at the economics of our proposition from the viewpoint of the wineries, so that we understood the components of the value chain and ensured each participant would be motivated to make Bacchus-coated corks work.

Getting to find the right partner and land the right licensing deal took more time, money, energy and resilience than we had ever expected. The cork industry is conservative and slow to adopt change. Plus it works in seasons relating to the wine harvest and wineries' buying cycles, so you only have certain "windows" in which their management feels ready to consider major innovation.

But finally we reached agreement with our preferred partner, a Portuguese company with worldwide presence and the world's #2 or 3 wine cork supplier. They share our belief in the product and are excited by its profit potential for themselves and its value for their customers.

The Anglo-Portuguese Alliance signed in 1373 makes Portugal and UK the longest-standing allies in the world. So our UK company's tie-up with our Portuguese partners 636 years later certainly has considerable history behind it, and hopefully a bright future ahead of it.

Conclusions to date

What I have I learned so far about getting involved in a start-up ?

Firstly, **choose your investment well** – one that you understand and can believe in through thick and thin. With my background in consumer packaged goods manufacture and marketing, I could see that Bacchus' technology addressed a problem with a critical packaging component, offering significant cost saving and increased performance, using Intellectual Property that was distinctive and patent-protected.

We believe the demand for our product will be recession-proof. Global wine consumption in volume terms is on a long-term growth trend of 1-2% pa. Even if there is some consumer trading-down during the recession, we expect volume (number of bottles and therefore corks) to be largely unaffected. Anyhow, in a tough economy wine producers will be even keener to get the cost/performance benefits of our product. The deficiencies of alternative closure types such as screwcap and plastic corks are becoming more widely known. And our market share ambitions to yield very acceptable profits are modest.

Second, **decide if you are going to be an active or passive investor**. And if, like me, you are going to supply some of your time and expertise to help create and make a success of the venture, be prepared for peaks when much more of your time will be demanded, because without it the business will hit the wall. So to keep sane, set some limits and do other things in business and personal life – otherwise obsession and 24-hour days could easily follow.

And then there's the **range of tasks**. Start-ups need everything done by normally a very small team. From grand strategy to the smallest, mundane detail. Ensure if possible that your team has a good mix of skills and experience, and all members a "shirtsleeves rolled up" attitude. With no support staff to help with filing, business trip planning and the like, and a huge range of activities and

subjects to be covered, each member needs also to have good personal organisation and be able to prioritise tasks.

We supplement our own team by **value-for-money or incentivised advisers**. Our lawyers have accepted capped fees, even when the scope of work has increased, excited by the Bacchus adventure. And our local Portuguese consultants, who opened so many doors for us and facilitated every step of the negotiations, did so for no immediate return but a generous share of our revenue when it starts.

Third, you may find it hard to be sure where a “going concern” is really going, but with start-ups you enter a whole new world of unpredictability. The best business plans are wrong, but not usually *that* wrong !

So, in a start-up you need to **stay flexible, but stable**. *Taipei 101* at 509 metres is currently the world’s tallest building. It’s built in a region vulnerable to both typhoons and earthquakes. So it employs special earthquake-resisting foundations and building techniques. It can flex in high winds – but not too much, thanks to special pillars set near the external walls, inspired by boat outriggers. And so that the flexing doesn’t give you seasickness or Miso soup in your lap as you sit in the Japanese restaurant on the 86th floor, there is an 660 tonne pendulum suspended from the 92nd floor that serves as a tuned mass damper, evening out the swaying motions so they are not noticeable.

With Bacchus we try to stay flexible yet stable as we encounter and manage surprises and problems, while remaining focussed on the objective. I think we’ve already discarded plans A and B, but C looks pretty darn good...

Most “angel” investors concur however that their start-up investments are uncomfortably predictable in two key respects – **they take longer and more money to get off the ground** than any initial investor, let alone the folks promoting the new venture, ever thought possible !

The “angels” of course adjust their required returns to match, often looking for around a ten-fold return on their money in 5 years. That sort of target return (equivalent to an IRR of almost 60%) is enough to allow for a fair few surprises along the way, and some outright failures in an investment portfolio.

This highlights a key point I make to my students in *Finance for Non-Financial Managers* seminars that I run: **Cash is not the same as Profit**. I make the analogy that if Profit is like food, Cash is like oxygen. The human body can last about a month without food, but only 5 minutes without oxygen. A business can last years without Profit, but not even 5 minutes without Cash. We concentrate on building revenue and ensuring we control our rate of cash “burn”, especially while revenue remains low, and that we do not risk running out of cash. Profits can look after themselves....later !

In this connection, we just closed a £ 300K (US\$ 430K) capital raise in what is a very difficult financial market. This should ensure we have the cash we think we need, plus a substantial cushion so that we can handle surprises and delays.

When we set out to raise that new money we hoped to do so without significant dilution for existing shareholders. But circumstances didn’t permit us to get the money in on that basis. Another learning

– **don't be too greedy** – a smaller share of a big cake is preferable to a larger share of what could turn out to be no cake at all.

Finally, although this sounds a bit cold, like negotiating a prenuptial agreement, **plan your exit**. We have taken care that our shareholder objectives for exit timing and manner are covered by suitable provisions in a Shareholders' Agreement, including mechanisms for resolving any future differences of view. And we have set up key commercial contracts so that they will not obstruct, and may even facilitate, our exit.

Where's this "going concern" going ?

It's still very early days. We have started introducing the product to some major wineries around the world, and interest is strong. We think the Bacchus Barrier™ has huge potential, with economic, consumer and environmental factors all favouring its adoption.

So watch this space – and check those bottles you open. We hope that in a year or two a suitably modest portion of them will have Bacchus Barrier™ protecting the contents you will enjoy. If so, you will be happy, and we will be happy – and maybe rich !

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