[Allocators Podcast 1 - Juan Lopez]

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Sheret R.: Hi everyone, and thanks for joining us for the first episode of the Allocator podcast. Where we're going inside the minds of financial decision makers. I'm your host, Sheret Ross, and today, I'm joined by Juan Lopez, CFO of MycoWorks, a biotech company. Thanks for joining us, Juan. Great to have you here.

Juan L.: Thank you for having me. Super excited to be here.

Sheret R.: Beautiful. Can you give us a bit of a background or your role, your experience with finance that would be probably a good place to start.

Juan L.: Absolutely. So, as you said, I'm the CFO of MycoWorks, which is a biotech company focused on alternative materials. I've been in a company, in this role for the last four months.

Prior to joining MycoWorks, I spent most of my career in two companies, right? On is Anheuser-Busch Inbev, which is the largest Brewery in the world, where I went through different financial roles, from head of audit to CFO and COO of the biotech business unit.

Prior to AB Inbev, my first company was General Electric. Where I spent 10 years in different financial positions, including audit, M&A integration as well as strategy. Looking forward to this chat, Sheret. Nice to meet you.

Sheret R.: Yes, you too. All right, well, I have a list of questions I'm just kind of curious to get your perspective on. Really, the goal is to understand how you approach being a CFO of a company, and understand how you think about Capital allocation strategies. So just kind of kick it off, how are you thinking about Capital allocation for 2023 just given the economic climate that we're facing right now?

Juan L.: Yes. So look, how I think about Capital allocation is we need to think about it in a dynamic way. It's not something you set in January on the stone, and then you just put it in a drawer and then everybody's going to follow it as robots, right?

So we need to remain flexible, first of all, and you need to balance your capital allocation and align them with your priorities as they evolve, right? So to me, at this point in time, for sure we need to think about paying down debt, right? If you have variable rate debt and that rate is going up, you need to allocate some money to reduce your cost of capital. You need to, of course, invest behind organic growth, and the organic operation of your business.

And then you always need to be having a look out for potential M&A, right? Is there any target company that could be interesting to acquire, that gets to, that it can travel due to the environment and could be a good target at a good price. So those are the three things in my mind. From a financial standpoint, and an operation stand point, of course, investing in the operation, investing in the organic growth is what takes most of my time.

I'll say paying down the debt is a decision we made quarter after quarter, and we check with the board, we monitor that closely, of course, to make sure capital doesn't go too high. And then the M&A, it's based on, I'd say ad hoc, right? It's based on opportunities that arise, and given discussions I have with banks and other investors.

Sheret R.: Are you seeing a lot more activity or opportunities available today than you were maybe a year ago? Or has activity dropped off, just given where market is at?

Juan L.: I see more coming, and I see a lot of Bank approaching us saying hey, would you be interested in acquiring this company or this other? So I see a lot of companies starting to be in travel. There's less liquidity than let's say six, twelve months ago. The cost of capital is going higher, investors are keeping their money on the sidelines, right? There's a lot of dry powder waiting to be deployed.

So I think so, I think there's more opportunity today and I think there's going to be even more, right? As I think 2023 evolving, second half, there's going to be a lot of opportunity and activity happening in M&A.

Sheret R.: Are you seeing, I mean, I'm less familiar with the biotech Community. But are you seeing valuations remain strong? Or are you seeing market multiples decline just given where the public market is?

Juan L.: Declining a lot. So as you saw in the public market, I mean, 30, 40% decline year and year is the norm. For biotech specifically, in the private market, what I see is even larger drops. So up to 50, 60%. We monitor our competitors and we monitor many other private companies, and we see in big drops. Also because they would inflated, right? You see some unicorns that were 1, 1.5 billion dollar valuation a year, two years ago. And now are below 500 million dollars.

In our case, we've been lucky, we've raised two rounds, well, one round early last year and a round extension let's say early this year, with a small optic on valuation. But I think it's because our valuation was pretty reasonable all the way through, we never really went up too much.

Sheret R.: Just going back to your additional note on Capital allocation. So debt is obviously a hot topic right now, just given where interest rates are. Is there a target that you're trying to get to from a capital structure standpoint?

Or is it one of those things where you're just reviewing a quarter over a quarter, and see where cash flow is at, and taking it more opportunistically? Or is there a target that you're trying to get to?

Juan L.: Yes. I'm a big fan of having guard rails, right? So as I think about the maturity of a company, you need to have those guard rails evolve as well. So in a company like

MycoWorks that is in early stages, that say scaling up and trying to make it let's say at a large commercial scale. We need to keep our debt pretty low, right? So I always say between 1 and 2x EBITA, it's a sweet spot.

Anything higher than that, you are in red zone, because when an investor or a bank is going to look at your balance sheet, they're going to think this is too much debt, especially at the cost of capital and the rate, how they are today, right? So I try to keep it between one and two. I'll say closer to one if possible at this moment in time, and that's how I think about it, right? Obviously, we need to balance that with the liquidity and our cash flow needs.

But I think so far, we've been successful keeping it below. When I think about larger companies, right? Where I came from, I think it's always good to be between two and three. So you graduate to the next level, you can afford a bit more depth, because also, you get better deals, better cost of capital due to your size, to your credit rating Etc. So that's how I think about it, and that's what I've been executing with my team towards.

Sheret R.: Have you seen Banks and private lenders apply additional diligence requirements in order to qualify for certain levels of debt? Or are the funds available for companies of your size?

Juan L.: No, the market is drying up big time. I'll say a lot of the credit that was available each nine months ago is going away, and the one that is there, available, it has many more covenants, much more scrutiny. You get real grilled about what what's your financial position, and how you're going to pay that back, right? So yes, the answer is its tougher today than six nine months ago, for sure.

Sheret R.: Yes, okay. So just to pivot to how you purchase or procure in the business today. Would you be able to walk me through the last major supplier purchase you made at the company? And how did that process flow?

Juan L.: Yes. So on MycoWorks, during the process of building our large scale facility in South Carolina, and so we are spending a significant amount of money, and so, the largest purchases will be making are equipment purchases, right? So what we do is we basically start with engineering, we understand the equipment we need be it robots or different types of equipment that we use in our process. We identify with a procurement team, two or three suppliers that could be a potential companies that we partnered with, to procure these equipment.

And then we enter in a negotiation, right? Typically, we try to yes keep it to two to three because if you go more than that, you get too many and the process takes too long, right? So when we get there, we, of course, ask for, requests for proposals. We try to negotiate all in type of agreements where we negotiate the equipment, purchase and equipment, service installation and potentially the maintenance as well.

And then we compare as a team finance engineering and supply chain, and make a decision, right? So yes, the latest one has been some equipment from Korea, that it's been installed actually next week already. So we've been lucky that we were able to procure that within I think a couple of months since we cut the deal.

Sheret R.: And how would it usually work? Like usually, you would have the budget or plan in place and then you task procurement to go source vendors? Or what's that flow look like?

Juan L.: Correct. So we have the budget in place, I'd say build it on an annual basis, right? For projects that are multi-year, we have the project budget defined in advance as well. And then we have procurement within this budget go find suppliers that could be within the range, right? Let's say 10, 15% within that range maximum. I got to tell you, we picked their work year in history I think to build a factory, 2022, right? With all the COVID disruptions, inflation and you name it.

So I'd say overall, we've been able to keep the budget in check, but it's been super challenging, right? We've been reworking the plan, re-working, value engineering the whole plant and in the end we're going to be within budget on time, but it's been really challenging.

Sheret R.: And what was an effective tool that procurement used beyond RFP to force vendors that could meet that budget? Was there anything specific that the company did?

Juan L.: For equipment's, specifically no. Honestly, you cannot do things that you can do, for example, for commodities. For commodities, you typically could do a reverse auction or an e-auction that you ask these vendors to beat their vast numbers. For these equipment, honestly, it's very unique, there's not that many vendors that can do this. And so, it was a bit tougher to do, right? It was more of a negotiation that we said this is our first large-scale facility, we have plans to build three more in the next five years.

So if you come along with us and give us a good price, we'll get back to you with the larger order, right? Again, the first one, the next one is going to be a bit larger, and then the others will be even larger, that's our plan, right? So it's kind of putting the card ahead of them, and telling them hey, if you come along with that and we're successful, we will be coming back to you for more.

In some of the large equipment as well, we put on the table potential warrants or stock based compensation for some of the vendors as well, to lower some of the cash needed as well. So that's the tool we use as well.

Sheret R.: You're giving out equity options as a means of compensation?

Juan L.: Yes, small amount. Yes, small amounts of that. We got to beat the, it may sound sub-optimal, but in a way, we said look, if the company is successful, we will share some of the upside with you. For some of the most expensive equipment, we've done some of that.

Sheret R.: That's interesting. So for in that case, just given the limited number of vendors likely capable of producing the equipment that you'll require. What's kind of the view on RFP versus non-RFP? Like I think this is a pretty hot topic right now in procurement. Are we able to go direct to the two or three vendors that we know, and directly negotiate and do kind of like a loose RFP? Or are you seeing more full-blown RFPs in market today?

Juan L.: No. We've been, especially for the equipment that is very specific, we know exactly what we want. It's more the loose RFV, right? That's where we go to the two or three, we have an informal chat within a very generic RFP, not very detailed, right? We want to optimize for speed and getting those quotes, and being able to have discussions back and forth, rather than a super detailed RFP that get us a lot of detail and takes in a couple of months to do, right?

So that's kind of what we've done for those. For the more commodity side, I'd say yes, we do a bit more of a specific RFP with more details, and we'll try to beat it out a little bit more. But yes, for the equipment, it's a bit more loose.

Sheret R.: So what are you valuing? I mean, beyond price, because obviously in today's market, that's pretty critical. But is there any other elements in working with the supplier that you're looking for beyond price and technical capabilities?

Juan L.: Yes. What we've been talking about is for strategic suppliers, we want to partner with them, right? We want to grow with them and we want to share the upside of what we're doing, right? We will be successful if they support us and they want to come along with us, right? And this applies to both equipment, but also the raw material side, the indirect side as well and some instances.

So we've been trying to build partnerships for those suppliers we believe it's worth doing, and that we believe they can scale with us. So there's a handful of them, again, this topic of equity or potential warrant, is something we use not many times. It's not something we do with every supplier, but a couple of them we've done and they love that, right? And that's where we show them that we really want to partner. We put that on the table and they really liked it. And then they have a skin in the game to come along with us, and make this a success.

Sheret R.: Yes. It's an interesting concept, I don't think I've ever heard of companies providing warrants to suppliers, so that's pretty innovative. So following from that, I mean, beyond this factory, because it sounds like this factory is a pretty critical function for the team right now. Is there anything else keeping you up at night that is top of mind?

Juan L.: Well, of course, I'm always with an eye on the bank account, looking at the cash balances. The one thing I tell you that it was a big opportunity that we took was improving and optimizing our cash management. As you know interest rates are higher that's bad for that, but it's good for yield, right? So if you are able to invest and you have a large amount of cash, and you can do sweet type of strategies where you move money around to high yield accounts.

Like money market accounts, or other like private debts or some activity you can get in the short term that it still gives you some liquidity. You can get a good like four or five percent return on that cash, right? And if you have a good amount of cash in your balance sheet, and again, if you manage it and schedule it very well, you can get quite a bit of return.

So we've been very successful on that in the last couple of months, and super happy with how we executed. Partnered with our bank, and of course, with my team and we're getting a very good return. I mean, this is going to be potentially an extra amount of runway. When I think about it a year or two out, if things continue to be like this, and we continue to dispute well, we'll extend the runway by a month just by being smart on our cash management.

Sheret R.: I'm asking all our guests, but if you had a crystal ball for next year, where do you think interest rates are going up? Down? Sideways?

Juan L.: For the next year, so I think we're going to see a couple more hikes, then it's going to stay flat for, I'd say a couple of quarters. So I'd say we're going to end up the year near six percent, probably between five and a half and six. And then I think in 2024, we will start to see interest rates going lower.

So I'd say the long-term rate that we are using in our financial models to forecast the next six, seven years, it's more four to four and a half percent. The question is how fast this is going to drop, right? It's going to go down. But yes, I think it's going to go higher before it goes down.

Sheret R.: Yes, that's interesting. Well, thank you, Juan, for joining us, for sharing your tips. I appreciate the time today. That's all the time we have for now. This is Sheret Ross and we'll see you next time on the Allocators podcast. Thanks.

Juan L.: Excellent, thank you.

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