

Financing the Supply Chain... A Little 'Charm & Luck' Goes a Long Way With Venture Merchant Banking

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By Joseph Ingrassia

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Explosive Growth & the Cash Crunch

In late 2003, two sisters founded Charm and Luck with a few sketches and sample products. Within one year, the firm became an internationally recognized, fun-loving luxury handbag and accessory company. The products are located in more than 1,000 stores in more than 24 countries and have been featured in fashion magazines worldwide.

In 2004, sales were approximately \$200,000 and by the end of 2005, sales had grown to \$4 million — a 2000% growth rate. However, their success as a brand and a product line almost put them out of business. In order to service increased orders and continue to fill the supply chain while providing terms to their luxury retailers who were accustomed to generous terms from their vendors, the firm needed additional working capital.

Lucy Orozco, vice president of Business Development at Capstone Business Credit, LLC, initially met the company founders at a trade show. She was so impressed with the principals, the brand and the product line that she maintained a relationship with the company for more than one year before the first funding occurred in 2005. "It was very evident from on-going conversations with the principals and through Charm and Luck news announcements that it was just a matter of time before things really took off for the firm," says Orozco. At first, the company's business volume was too small to finance. But, as the success of the brand became apparent, the principals began working with Orozco to complete the due diligence process so that Capstone could begin funding both manufacturing and accounts receivable.

Growing Pains: Financing the International Supply Chain

The due diligence process, along with coordinating supply and logistics on four separate continents, put as much stress on the nascent company as one could imagine. The results were predictable: suppliers were being paid late, manufacturers were not able to manufacture without experiencing production delays due to a shortage of raw materials/trim and orders were being shipped dangerously close to being late. To coordinate all of this, the principals were crisscrossing the world to get Italian leather shipped to China and to get Chinese component suppliers to ship to Chinese manufacturers in different provinces. Moreover, the principals had to convince the manufacturers they would be paid by the time the goods arrived on the West Coast.

All of the difficulties and issues described above are typical of most growing companies in today's marketplace. With the consolidation of the retail sector and offshore manufacturing a reality, most companies need significant amounts of equity to finance the supply chain. The typical wholesale distributor must be able to handle multimillion-dollar orders from their customers and then give them payment terms of up to 60 days, which actually translates into a trade cycle of 150 days. In the meantime, they must continue to pay the rent, employees, suppliers and the utility bill. During the trade cycle, the company continues to receive new orders

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from their valued customers that must be filled as part of the “just-in-time” inventory system most wholesalers are part of. This cycle can turn dreams into nightmares, killing firms by their own success.

A Dutch Treat: Supporting Growth With a Vertically Integrated Structure

Luckily for Charm and Luck, in the 1500s the Dutch figured out a way to finance all of this chaos. The Dutch system is slowly taking root in the U.S., but has been a proven methodology in Europe since the beginning of international commerce. There are a select number of firms that finance companies that are growing rapidly and lack assets required by typical asset-based lenders. Asset-based lenders lend on the historical performance of most companies. Their suitability as a borrower is typically

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demonstrated by a review of their balance sheet. Normally, companies that are in a position to borrow from an asset-based lender are mature, have significant equity and are stable with solid corporate infrastructure. On the other hand, merchant banks fill a void by funding their clients on their potential, not assets. That potential is communicated by purchase orders with an acceptable gross margin from creditworthy account debtors who will pay for merchandise if delivered on time and according to predetermined quality standards and sophisticated and capable suppliers who can deliver a quality product on time and within budget.

For Charm and Luck, a trade finance facility was set up that provides for the purchase of pre-sold merchandise from creditworthy account debtors and then factors those account receivables once the pre-sold merchandise is delivered to the approved account. This system greatly reduces the amount of working capital that the principals need to operate their business because the merchant bank assumes the responsibility of paying Charm and Luck’s manufacturers and material suppliers. In many cases, the fact that Charm and Luck can now pay for the manufacturer on time and without risk of loss to the manufacturer enables Capstone’s clients to negotiate discounts with the manufacturer thereby improving gross margin and profitability. To ensure that the supplier maintains a high level of quality control, the merchant bank imposes third-party

quality inspections on the manufacturer. This frees up time the principals normally spend flying across the world to check on production to ensure that their goods are being produced to the appropriate standard. The manufacturer understands that passing the quality control standard now becomes a condition of payment by Charm and Luck. Once the goods arrive in the U.S., they are placed in a third-party warehouse where they remain until the shipping date required under the account debtor purchase order. The goods are released by the warehouse to the account debtor and Charm and Luck issues an invoice for the goods delivered. The invoices are factored by Capstone. This is a liquidity event for Charm and Luck in that they receive the difference between the cost of goods and the factor advance made by the merchant bank, adding to their working capital reserves.

Principals Focused on Business: Operations and Growth

This vertically integrated system allows the principals to do what they do best: design, market and operate their business without worry of where the next dollar is going to come from to support their growing company. This vertically integrated merchant banking system ensures that all sales opportunities that meet predetermined gross margin and delivery terms can be financed without the need to negotiate terms with Capstone. The focus of the principals remains running their business, designing new products and styles and

servicing their accounts. No incremental sales opportunities are lost and the profit from these sales goes right to the bottom line.

Operating within the venture merchant banking model designed by Capstone, Charm and Luck sales are expected to reach \$12 million for the 2006 calendar year. Christine Syquia, president of Charm and Luck, says, “Factoring and trade finance has provided us [Charm and Luck] the ability to keep up with our explosive growth. Within 18 months, we were in 1,500 stores in 24 countries, and thanks to Capstone we now have the cash flow to keep up with our orders and intently focus on our new designs.” **abfj**

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