

Trade Finance Case Study

Another way to source overseas.

BY JOSEPH INGRASSIA AND JOHN RICE

Whaling Manufacturing, Inc. has been in the outerwear business for nearly forty years operating from a 120,000 square-foot manufacturing and warehouse facility in Falls River, Massachusetts. During its apogee, Whaling employed 400 workers manufacturing private label raincoats and outerwear for the leading department stores of the era, as well as labels such as Bill Blass.

By the mid-1990s many of Whaling's competitors began outsourcing their manufacturing to lower cost emerging market economies in Asia, but owner Jim Pavao continued to believe that producing a higher quality garment was more important than offering lower priced imported goods to his customers.

What Mr. Pavao failed to recognize at that time was the significant shift occurring in U.S. retail as consumers (and the retailers catering to them) became more interested in lower price rather than higher

quality (at higher price points).

In August of 2005, after having expended all of its equity trying to compete as a domestic manufacturer against imports, Whaling needed to revise its business strategy and funding. Through a financial intermediary, Whaling was directed to Capstone Business Credit, LLC, a New York City-based venture merchant bank.

"We're experienced in a broad range of situations that require a business strategy makeover from off-shore manufacturing to new distribution channels and overall management support," says founding partner Joe Ingrassia. "In terms of the international business environment, the current credit crisis is forcing the market to look at viable, alternative financing and business options that not only provide funding, but strategic business advice enabling companies to improve their operations on an international basis and grow in a sustainable manner," continues co-founding partner John Rice.

Prior to working with Capstone, Whaling relied on a factoring relationship that provided a small inventory advance. "Our system is different in that we will finance pre-sold goods," explains Rice. "Under our scenario, Whaling was able to increase its sales because they could purchase sufficient goods to satisfy demand created by their sales people. In addition to purchasing the pre-sold goods, the firm provided a factoring facility."

Capstone began working with Whaling to structure and fund its offshore manufacturing. Whaling was in a situation not uncommon with being late to offshore manufacturing and forced to pay a premium for goods. For example, when a borrower is perceived to be an uncertain risk, the foreign supplier increases the cost of goods to take into account his cost of capital, the length of time he feels it will take to get paid by the offshore buyer and a risk premium based on historical payments.

When Capstone entered the picture, the borrower instantly becomes a cash buyer, enabling the client to renegotiate the cost of goods sold to strip out the risk premium, cost of capital and the time value of money.

Whaling's portfolio of outerwear includes uniforms for various law enforcement agencies throughout the U.S., including the NYPD, NYFD, Houston Fire Department, Chicago PD, U.S. Border Patrol, U.S. Forest Service, and U.S. Coast Guard.



The current business climate is forcing companies to **re-evaluate their funding, sourcing, and operating strategies.**

The next stage in re-defining the buyer-vendor relationship concerns volume. “Our clients grow between 10 percent and 15 percent per annum and as a result, their purchase volume with their suppliers increases accordingly,” adds Rice. That growth typically results in further price reductions as the manufacturer gets economies of scale due to the increase in volume.

International advisory: sourcing expertise managed

Typically a borrower travels to the foreign manufacturer’s location to make a determination for himself as to the efficiency of the manufacturer. In the Capstone model, the VP of Sourcing will travel and meet with the supplier to make the onsite determination.

Meanwhile, Whaling initially began operating in Korea. Capstone has since transitioned Whaling from Korea to other Asian countries where the labor rate is lower and the quality is as good or better.

Through the issuance of letters of credit and strict quality control, Whaling is now able to compete effectively in the U.S. market.

Relationships: interfacing internationally

In terms of overall manufacturing relationships, the borrower’s goods are reverse engineered in some instances. Capstone’s sourcing professional can determine what the best fit would be from a factory perspective. The finished product is then presented to the potential manufacturer and advised of the cost. A comparison is made between the historical cost data, the cost of the new factory and the existing factory. If the sourcing department approves the old factory, as well as the new factory, then both of the factories are provided the chance to bid on the manufacture of the goods.

A key component to the success of this process is direct interfaces between Capstone’s clients and their overseas sources. “If we can locate a better factory and get the cost of goods down that is a home run,” says Ingrassia. “If we keep the same factory at a lower cost of goods sold that is a success, as well.”

Ninety-five percent of Whaling’s manufacturing is now offshore in China, Cambodia, Vietnam and Thailand. The firm maintains a small domestic manufacturing presence.

Objective set of eyes: sourcing and inspection

As part of Capstone’s performance risk mitigation strategy, a sourcing and inspection service has been devel-



oped in China. These two aspects of the program work hand in hand with the funding of the offshore manufacturers. Through our sourcing department, we are able to determine whether or not the factory selected by our borrower is adequate and can maintain the output required to meet the demand of its customers. Once this is determined, Capstone insures that the pricing of the goods on a cost of goods sold level is appropriate.

Many times there are daisy chains of intermediaries know as agents who add unnecessary costs onto the cost of goods sold thereby reducing our borrowers’ gross margin. Specifically, our sourcing department actually assists in reducing borrower costs at the cost of goods sold level, thereby increasing the gross margin and covering our finance charges in most cases. Higher gross margins for our borrowers translate into less risk for us. The inspection group is intended to be an objective set of eyes for our borrower. They insure that the goods are being manufactured to the standards set between our borrower and the ultimate buyer.

Through the use of the Internet, we can get daily inspection reports from the producer of the raw materials all the way through the entire production process when goods are being loaded into a container for shipment to the U.S. Once the variables of whether or not the factory can produce or the quality of the product are known, we then work out a supplier credit facility of some kind whether that is a letter of credit, a letter of guarantee or a partial or full cash payment against documents etc.

Joseph Ingrassia and John Rice are managing members of Capstone Business Credit, a New York City-based venture merchant banking firm that provides innovative financing for growing businesses within the consumer finished goods and import/export industries.