

Supply Chain Finance

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Organic cotton

Phase 1

G-Star RAW

10-06-2016

G-Star Confidential

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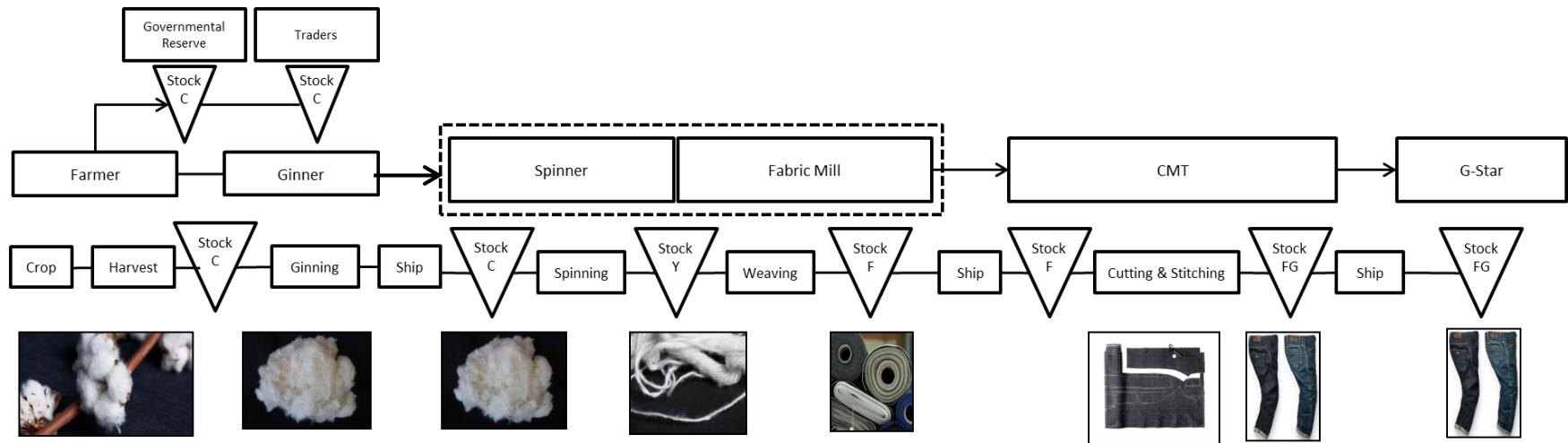
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Introduction

Supply Chain Finance at G-Star RAW

Objective	G-Star seeks security of supply of organic cotton for an optimal price. In this project we investigated how Supply Chain Finance (SCF) structures can be used to achieve these aims to the mutual benefit of G-Star and its Chinese suppliers.
Scope	<ol style="list-style-type: none">1. Organic cotton in Chinese supply chain2. Organic cotton used in denims from Optimal Jeans Wall.

Summary findings preliminary research



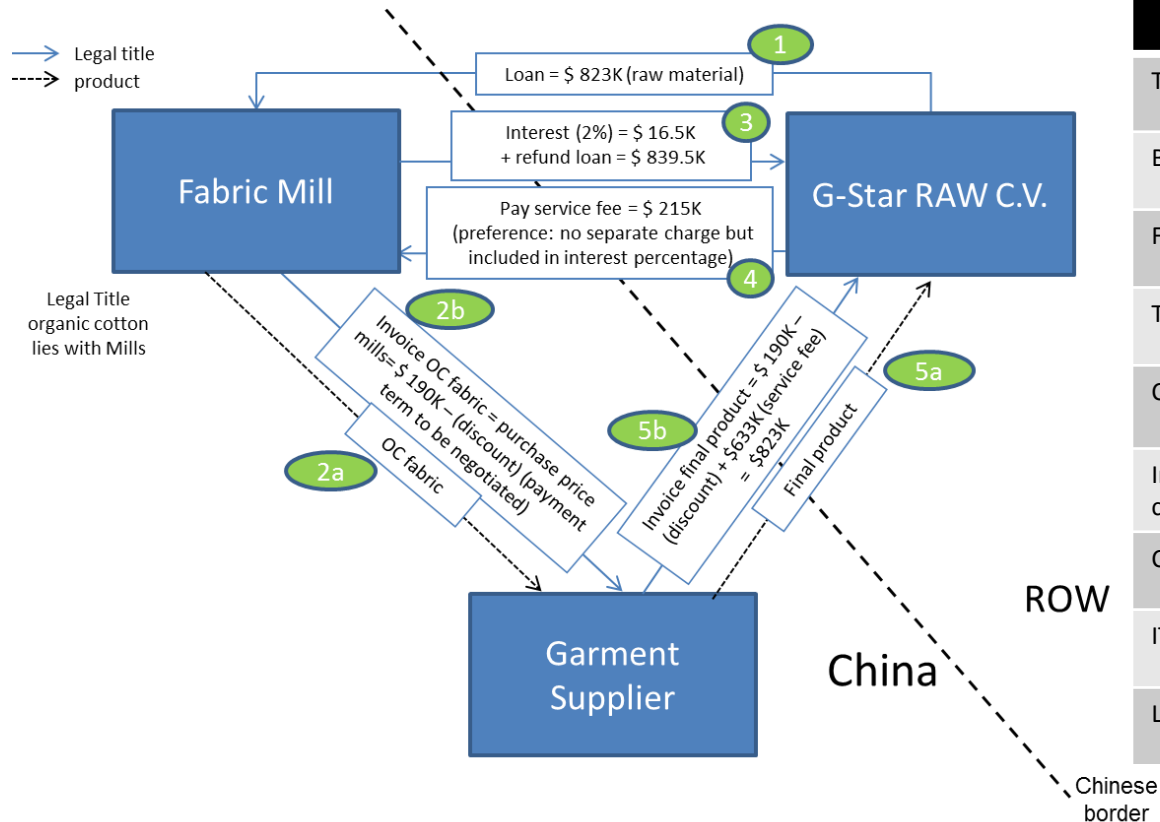
1. Dispersed supply chain
2. Mismatch supply and demand organic cotton
 - a) Biggest issues for farmers in China is that organic cotton has either been left unsold or sold as conventional.
3. Unfair organic upcharge over the value chain
 - a. Negatively affects buyers' interest in long term investment in organic cotton.
 - b. A reduction of premium is required to make it reasonable for buyers to make long term commitments

Conclusion:

Innovative investment models with a collaborative approach amongst supply chain parties should be developed to secure supply of organic cotton at lower costs.

Recap: Supply Chain Finance-structures

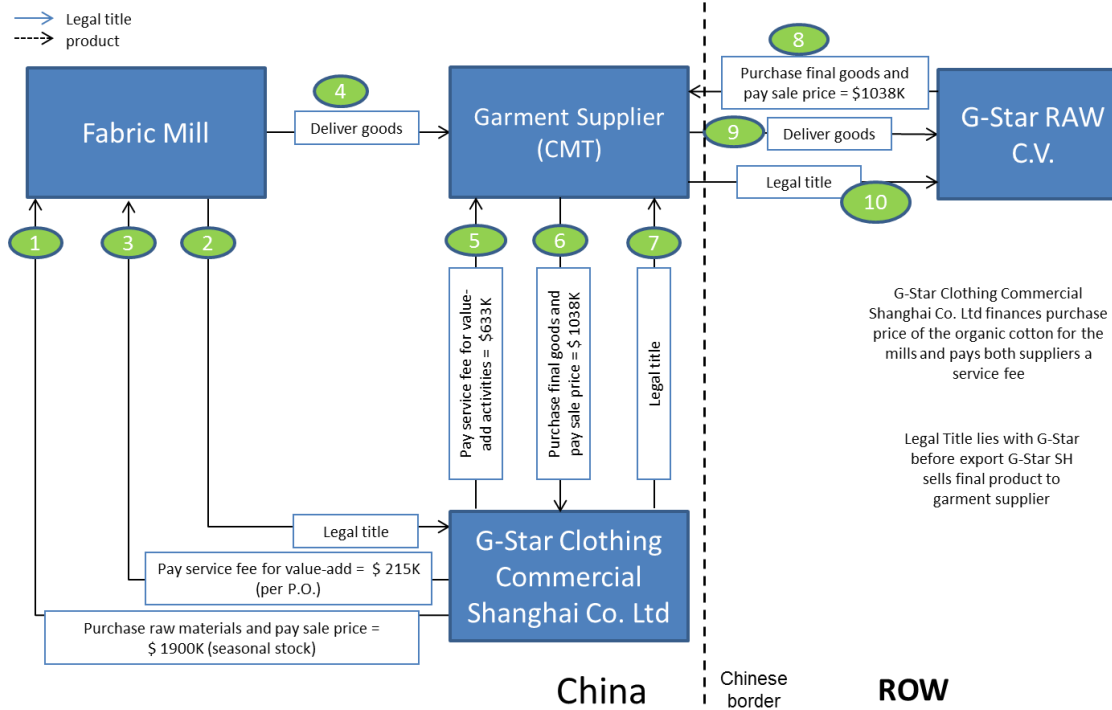
Loan structure



Loan structure	
Tax	-
Balance sheet impact	Loan
Funds availability	Group funds
Transfer pricing	-
Cash flows	Repayment loan netting with order flows
Implementation complexity	Chinese regulations applied to loan.
Change infrastructure	-
IT	No IT Impact
Legal	Complex legal structure

Recap: Supply Chain Finance-structures

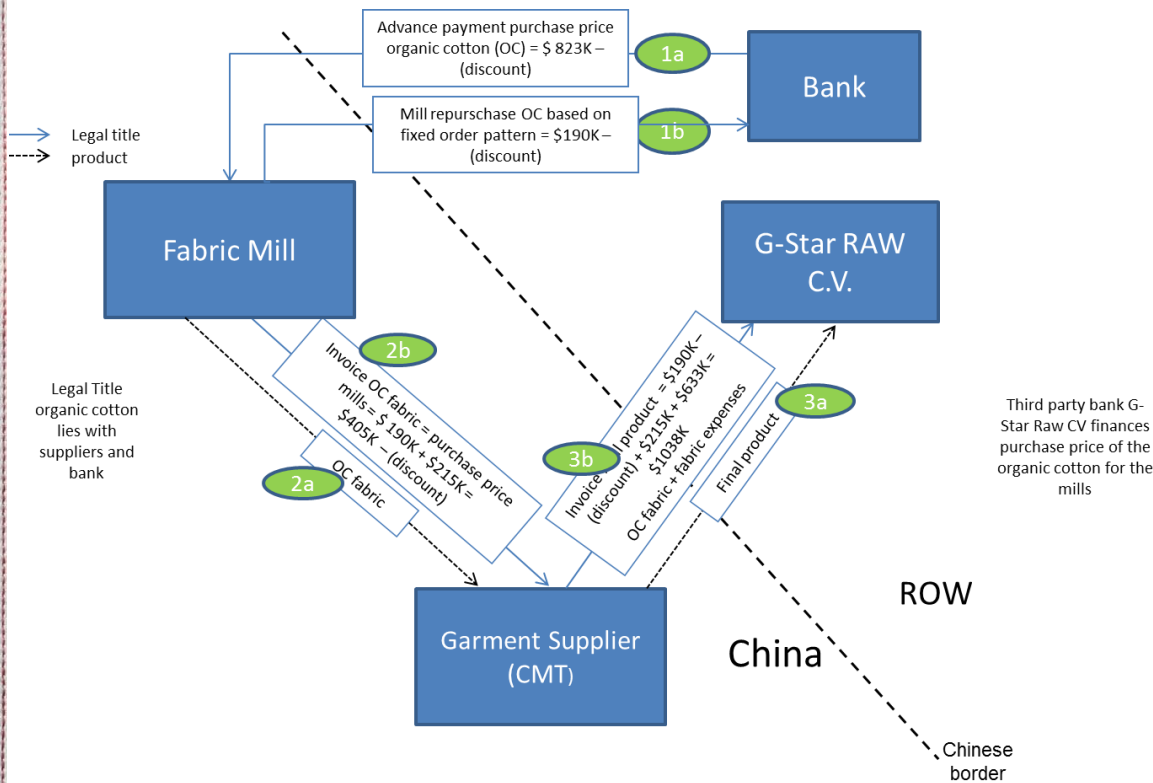
Hard-tolling (Sale & Repurchase):



Hard-tolling	
Tax	Tax compliance due to local entity
Balance sheet impact	Inventories + accounts receivable
Funds availability	Onshore funds
Transfer pricing	<ul style="list-style-type: none"> Repatriating cash Higher profitability PRC
Cash flows	Multiple invoicing moments materials and value-add
Implementation complexity	Significant change in business processes: IT, Tax, Finance, Legal, Sourcing infrastructure
Change infrastructure	Local entity required
IT	ERP from wholesale to production
Legal	Entity function local ownership

Recap: Supply Chain Finance-structures

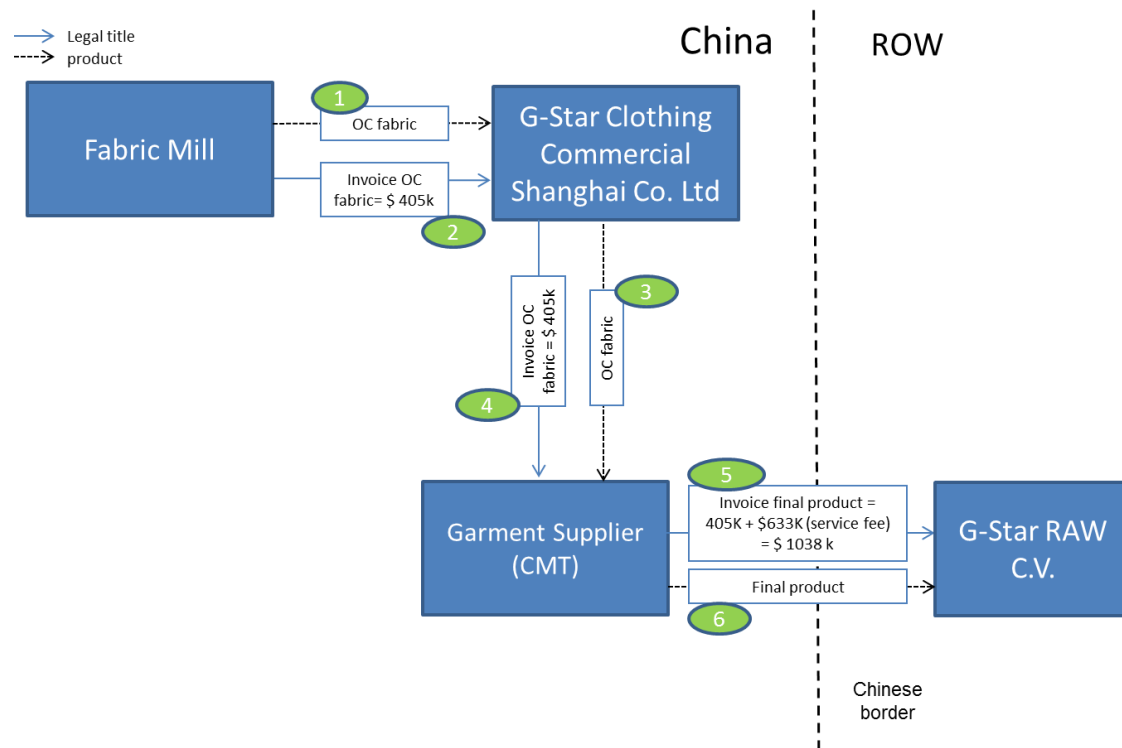
Inventory finance:



Inventory finance	
Tax	-
Balance sheet impact	Off balance
Funds availability	Financial institution
Transfer pricing	-
Cash flows	No changes
Implementation complexity	Requirements banks
Change infrastructure	Interception of financial institution
IT	Link between ERP and financial institution
Legal	Four-party agreement

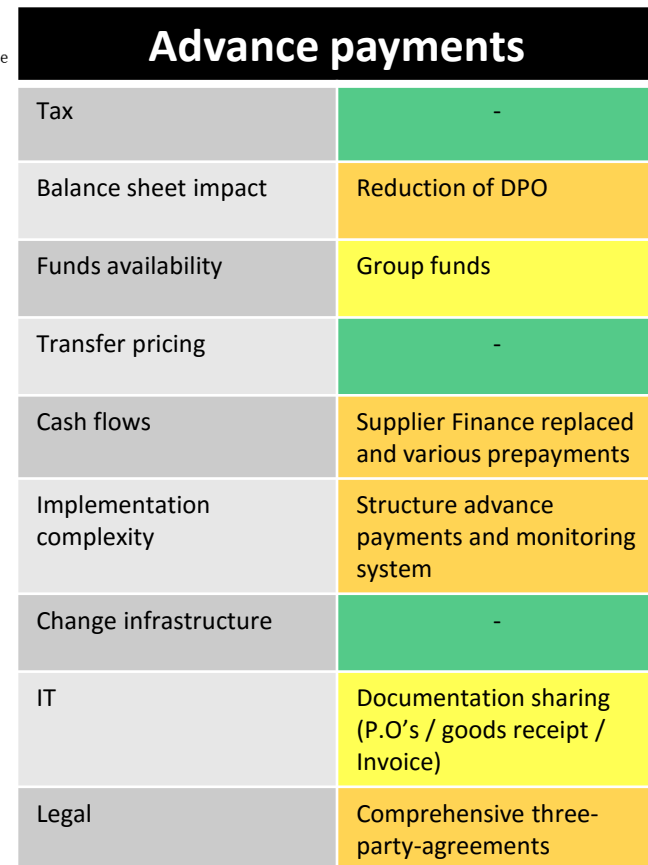
Recap: Supply Chain Finance-structures

Buy-Sell (Flash title)



Buy-sell	
Tax	Tax compliance due to local entity
Balance sheet impact	Account receivables
Funds availability	Onshore funds
Transfer pricing	<ul style="list-style-type: none"> Repatriating cash Higher profitability PRC
Cash flows	One extra invoicing moment
Implementation complexity	Registration of entity
Change infrastructure	Local entity required
IT	Financial administration semi-finished products
Legal	Entity function local ownership

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Strategic choice

Factor		Option 1 (Loan structure to second-tier supplier)	Option 2 (Hard-tolling Sale & Repurchase)	Option 3 (Inventory finance w/ third party bank)	Option 4 (Buy-Sell P.O finance – flash title)	Option 5 (Advanced payments via CMT)
Benefits* (maximum)		\$65.000 – \$80.000	\$368.000	\$80.000	P.O. \$95.000 Invoice: \$30.000	\$110.000 – \$275.000
Costs	Tax	-	Set up: SH: \$15.000 HK: \$40.000 Recurring: \$25.000	-	Set up: SH: \$15.000 HK: \$40.000 Recurring: \$25.000	-
	Legal	Set up: \$50.000	Set up: \$10.000	Set up: \$10.000	Set up: \$10.000	Set up: \$10.000
	Finance			Recurring: \$20.000 (fee 1% on spend)		
	IT	-	Set up: \$500.000	-	Set up: \$100.000	-
Labor intensity		Low	High	Low	Medium	Low
Overall risk profile		Low - Medium	High	Low	High	Medium

Short-term: Advance payments

This is the most feasible SCF solution on the short-term. It is easier to implement and can yield substantial financial benefits.

Long-term: Hard-tolling

This structure provides highest degree of benefits among all structures and is more attractive from strategic perspective as it provides greater control of the supply chain.

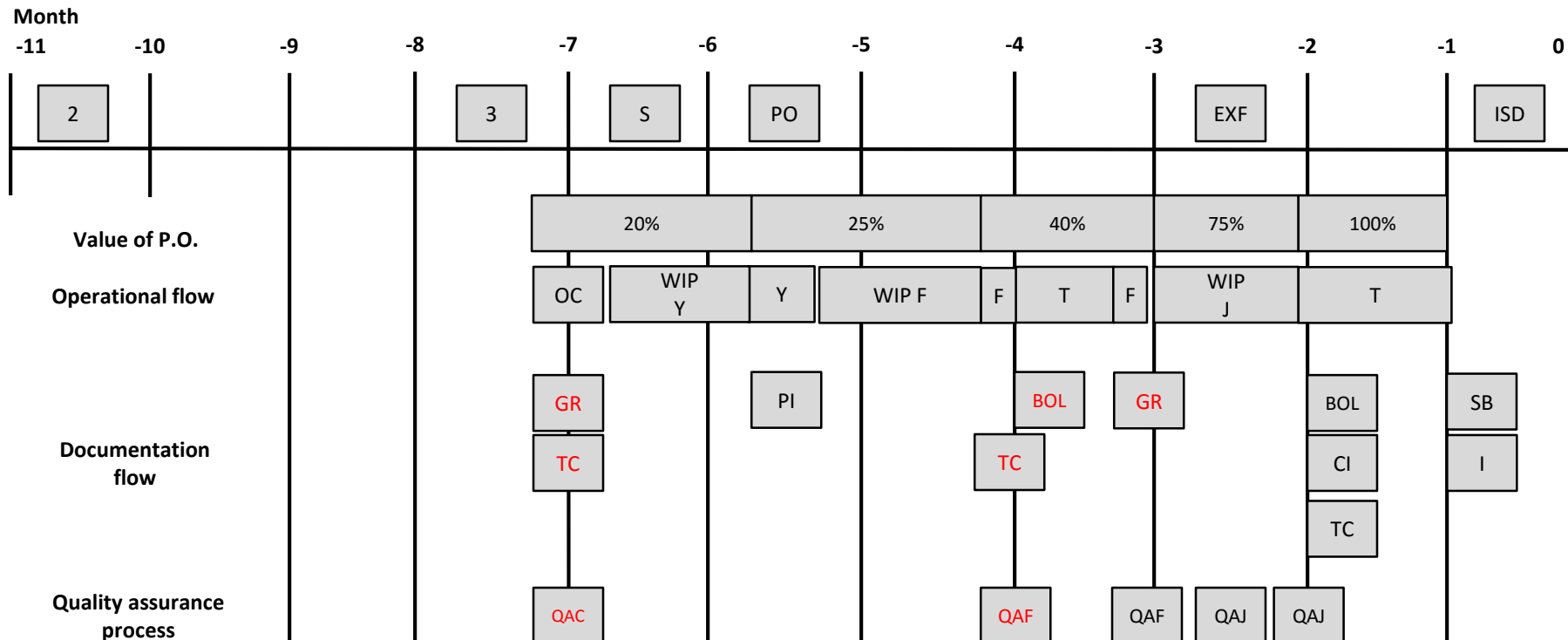
Advance payments

1	Characteristics advance payments
2	Structuring
3	Scenarios
4	Payment methods

Characteristics advance payments

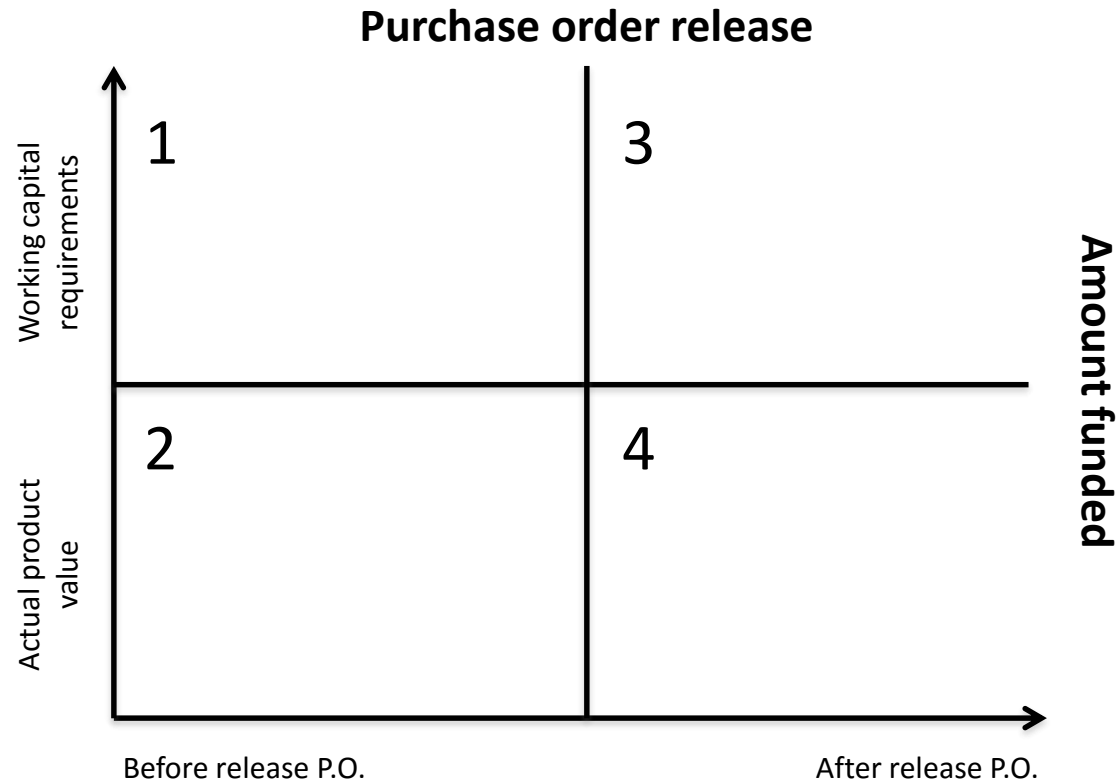
	Explanation
Legal	Purchase: bringing cash against future delivery of products
	No negative pledge issues
	Title of ownership will transfer at the moment of allocation of the products to the shipment. This gives tier-1 supplier or G-Star proprietary rights over the products*.
Tax	Prepayment mitigates withholding taxes compared to pre-export finance (prepayments are deducted from final invoice, so no double tax).
Accounting	Prepayment will be shown as a loan until they are set off against a product delivery
Risk	Risk is mitigated as prepayments are embedded in export contracts.
Requirements	<ul style="list-style-type: none"> • A commitment on specified purchase volumes • Price agreements over the term of contract

Basis for advance payment structuring



Development planning		Operational process		Documentation flow		Quality assurance process*	
2	Sample collection	OC	Organic cotton	GR	Goods receipt	QAC	Quality approval cotton
3	Pricing phase	WIP Y	Work in progress yarns	TC	Transaction certificate organic cotton	QAF	Quality approval fabrics
S	Sales kick off	Y	Yarns	PI	Proforma invoice	QAJ	Quality approval jeans
PO	Purchase order final product	F	Fabrics	CI	Commercial invoice		
EXF	Ex factory date	WIP F	Work in progress fabrics	SB	Self billing document		
ISD	In shop date	T	Transportation	I	Invoice		
		WIP J	Work in progress denim jeans				

Scenario's Advance Payment



Characteristic	Scenario 1:	Scenario 2:	Scenario 3:	Scenario 4:
Timing initial payment	Before P.O.	Before P.O.	At P.O.	At P.O.
Funding	Operational working capital	Product value	Operational working capital	Product value
Risks	High	Medium	Medium	Low
Benefits (max p.a.)	\$275.000	\$135.000	\$230.000	\$110.000

Payment Methods

Buyer perspective

Supplier perspective

Control over cash ↑	Payment method	Involved parties	Risks	Costs	Control over cash ↓
	Documentary collection	Buyer – bank of buyer – supplier – bank of supplier	<ul style="list-style-type: none"> High financial exposure Non-performance 		
	Letter of credit	Buyer – 3 rd party bank – supplier	Non performance risk mitigated through bank guarantee		
	Unconditioned first demand advance payment guarantee	Buyer – bank of supplier – supplier – (bank of buyer)	Non-performance risk is replaced by credit risk		
	Confirmed letter of credit	Buyer- supplier – bank of supplier	Non performance risk mitigated through bank guarantee		
	Blockchain letter of credit	Buyer- supplier – 3 rd party service provider	Non performance risk mitigated through bank guarantee		
	Pure cash in advance	Buyer - supplier	<ul style="list-style-type: none"> High financial exposure Non-performance Non-existence 		

Next steps towards implementation

Activities	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
1. Finalize Advance Payment structure 1.1 Select payment method 1.2 Select specific AP structure 1.3 Make AP contingent on supplier performance (vendor rating) 1.4 Develop monitoring system (i.e. document sharing via supplier portal / bank) 1.5 Quantify risks for specific case and apply mitigation technique						
2. Finalize and approach supplier (Ability) 2.1 Prepare sales pitch for supplier with benefits of structure 2.2 Provide clear explanation of structure to supplier 2.3 Retrieve data of supplier as input for financial tool to calculate benefits and discount						
3. Negotiation on pricing and contract 3.1 Commercial negotiations with supplier 3.2 Reaching agreement on discount 3.3 Contractual set-up of advance payment together with supplier and designated fabric mill 3.4 Dependent on payment method include banking partners or other institutions						
4. Implementation pilot and monitoring system 4.1 Implement advance payment in systems (bank, ERP, other?) 4.2 Implement monitor systems (structured sharing of documents)						
5. Go-live advance payment structure						
6. Monitor program and make improvements 6.1 Evaluate performance of implementation periodically 6.2 Optimize advance payment structure and look for ways to automate this process 6.3 Enhance trust and open collaboration with suppliers 6.4 Intervene in advance payment for specific conditions (quality, bankruptcy, etc)						

Q&A

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