Anchin Alert

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## Financing Options for Emerging Brands

Emerging brands are constantly looking for ways to make their mark on the consumer product industry, but it can be challenging for these businesses to rely strictly on funding from founders, friends and family, and cash flow from operations to increase brand awareness. For the best opportunities for success, emerging brands have to make tough financing decisions to promote company growth. Both debt and equity financing are great options for consumer product brands to raise additional capital. Whether a brand just landed its first national account or is about to launch in major retailers, founders need to assess the pros and cons of each option to determine what is most suitable for their company.

The type of financing that will be most practical for a consumer product brand often depends on the company's current stage of growth. Companies that are spending significantly more than revenues may find it difficult to obtain lending from a major financial institution, but hybrid arrangements or alternative lenders may be a viable option.

Equity financing helps to provide increased resources and growth potential to expand your business. It also gives founders access to industry-specific insight from active investors in the space and provides for increased networking opportunities, which can lead to valuable relationships with key industry players. Equity financing also offers much higher amounts for early stage companies, which are not required to be repaid should the business fail.

Many early stage brands start with convertible debt financing, which is a quasi-equity instrument. The investors in convertible notes are lenders who receive an accumulating interest rate of return, but they are committed to convert their loans to equity upon pre-defined events, including a qualified subsequent equity financing. The main advantage to this vehicle is there is no need to agree on valuation. The notes and accumulated interest convert at an agreed upon discount to the subsequent equity round pricing, often subject to a maximum valuation or cap. Founders can retain some flexibility by giving the company the option to pay out the accumulated interest from the subsequent financing round proceeds instead of issuing more equity.

It is important to consider the needs of the company because equity financing also has potential disadvantages. Because equity investments involve giving up some ownership of the company, this can be much more costly in the long run as a brand grows. With this option, business owners may have less control over operations since they often must consult with investors on major company decisions. Due to enterprise valuation and preferred stock terms considerations, equity financing from institutional investors may be much more difficult to secure than debt financing.

Alternative lending usually becomes easier to obtain when the brand reaches approximately $2M of sales. At this point, venture capital seed rounds also typically become available. Founders need to assess whether their growth potential and cash burn rates allow for repayment of debt financing, or if industry insight and connections from VC investors is more important. When a brand reaches the $5M–$10M sales level, private equity preferred series investment typically becomes available. Greater investment in brand marketing and promotion is usually needed at this stage, which may be easier to fund through equity financing.

As an alternative to equity financing, debt funding allows the founder to retain more ownership of the company. This method provides more flexibility with running the daily operations and controlling business spending. Budgeting is easier since there are established payment terms, and the loan interest is tax deductible when paid. The large variety of lending facilities allow founders to find one that works best for their company.

Founders need to examine the profitability potential of their company to determine whether obtaining fairly priced debt funding is possible. Once the brand reaches $10M+ in sales, traditional bank lending at market rates becomes more readily available. Depending on the brand's history, further dilution of ownership through institutional investment may not be as attractive as bank borrowing.

Cash flow can be both intensive and restrictive, as earmarking funds for interest and other facility fees can make it more difficult for brand growth in the early stages. If the lending institution includes financial reporting and covenant requirements, compliance can be costly and time consuming. Alternative lenders tend to charge higher interest rates than traditional banks, although securing lending with a traditional bank is extremely difficult for early stage companies. If the business fails, the loan and all required interest and facility fees must be repaid.

Both equity and debt financing are important vehicles for emerging consumer product brands. These funding methods will help provide the necessary capital to support the brand's operations. Important decisions such as these will help shape the future success of your brand. For more information, contact your Anchin relationship partner or one of our Food & Beverage Industry Group members at 212.840.3456 or info@anchin.com.

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