

Disrupt or Be Disrupted

2018 Malaysia Working Capital Study



At a glance...



Malaysian companies experienced a **5% decline** in operating cash flow despite a **10% growth** in revenue

RM11obn

of trapped cash could be released from the balance sheets of the sampled companies with better working capital performance

10% drop

in cash conversion efficiency (CCE) vs. 2016 and is now the lowest in the last 4 years.

A low CCE indicates profits are not converting to cash efficiently



At a glance... (cont'd)

A mixed result with only
7 out of **14**
sectors improving their
working capital performance
in 2017



The Energy & Utilities
and Engineering sector
experienced the
largest NWC days
deterioration in 2017

Innovations such as
Supply Chain Finance and
Robotic Process Automation will

disrupt

how companies manage their
working capital

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Foreword



Tan Siew Ming
MYVN Deals Leader



Ganesh Gunaratnam
Working Capital Advisory
Leader

Welcome to our second study for the Malaysian market. The aim of this study is to raise awareness about Malaysia businesses' performance around working capital and potential areas where it is being disrupted.

Every business needs working capital, regardless of its stage in its lifecycle. However, we see different levels of maturity and approaches to managing it across industries. Whilst your company needs working capital to manage your day to day needs, not optimising it would mean reduced returns for your shareholders.

Optimising working capital translates to higher cash flows

To grow, businesses need to maintain sufficient and sustainable cash flow to meet their operating costs and short term liabilities, reinvest cash to expand capacity, invest in technologies or expand into new markets. Working capital management helps businesses do just that. Effective working capital management can help companies reduce overall financing costs and release working capital for strategic investments for growth. With stronger balance sheets, companies will be better positioned to improve earnings and stay resilient in times of economic uncertainty.

Disrupt or be disrupted

In today's world, businesses are continuously being disrupted by new business models and technologies. This has changed how traditional businesses operate and manage their working capital. Globally, innovations such as Supply Chain Finance and Robotic Process Automation are helping companies collect their cash faster, manage their supply chains more nimbly, and drive costs down. Malaysian companies will need to embrace these innovations to keep up with global trends.

Lastly, our study encapsulates detailed analysis of the **over 400 companies**, across **14 sectors** listed on the Bursa Malaysia stock exchange. Our findings indicate a potential **RM110bn** of cash waiting to be tapped in corporate Malaysia's balance sheets.

We hope you find our latest perspectives insightful to your organization.

RM110bn of trapped cash could be extracted from the working capital of sampled companies

Innovations such as Supply Chain Finance and Robotic Process Automation are helping companies collect cash faster, manage supply chains more nimbly and drive costs down

How does my company rate?
Find out how you can compare with your peers in our self diagnostic centre on page 15

 **Self Diagnostic Center**



2018 Findings

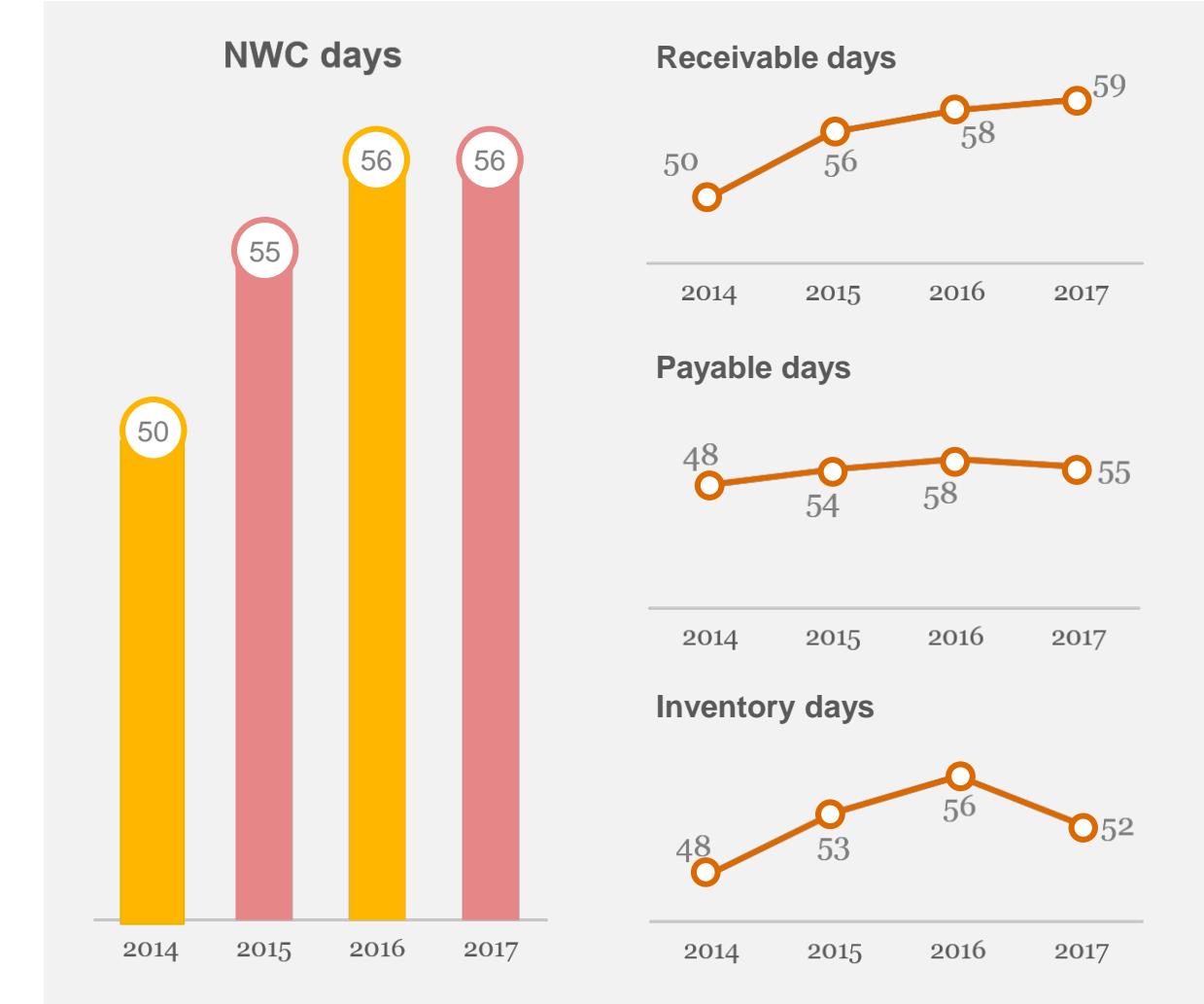
Malaysian companies NWC days continue to remain at a 4 year high

Malaysian companies have continued to struggle to improve their working capital performance. Net working capital days has remained at 56 days for the second year consecutively. Whilst there was a 4 days improvement in inventory days, this has been offset by the deterioration in DSO and DPO level.

Of all three working capital components, receivables management continues to be a challenge for most Malaysian companies. Our experience indicates that this is typically the result of process inefficiencies, lack of proactive collection management and lack of visibility over customer payment behaviour. In 2017, the sector with the largest decline in DSO performance was the engineering and trading-services sector.

On the other hand, the spike in DPO from 2014 to 2016 can be largely attributed to companies stretching their payables - mainly driven by the deterioration of oil price and the weakening of local currency. In 2017, there were signs of "catch-up" in payables in the Energy and Utilities sector as well as the Apparel and Luxury sector.

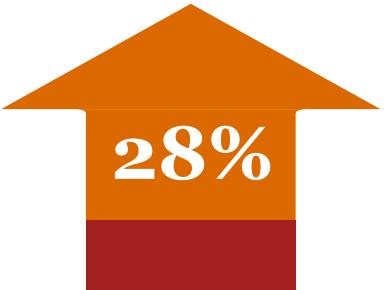
After three years of consecutive declines, there was a significant improvement in inventory management (DIO). 12 of 14 sectors studied have seen an improvement in their DIO level especially in the Apparel & Luxury sector. Only Engineering and Media & Telco sector has seen a decline in their DIO level.



Higher profits did not translate into higher operating cash flows for Malaysian companies



Revenue growth(y.o.y)^a

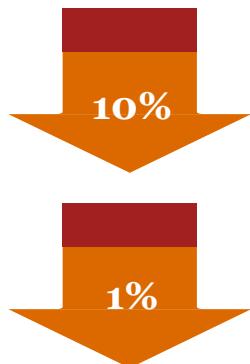


Net Profit growth(y.o.y)^a



CFOA growth^b (y.o.y)

| | 2016 | 2017 |
|----------------------------|------|------|
| Cash conversion efficiency | 82% | 72% |
| CAPEX / Revenue | 11% | 10% |



Malaysian companies have achieved a 10% (RM52bn) and 28% (RM12bn) growth in Revenue and Net Profit respectively in 2017. However, despite this improvement, Cash Conversion Efficiency (CCE) which is an indicator of how efficiently a company is able to convert profits into cash has declined by 10%. This is the lowest CCE achieved in the last 4 years under our review.

This has also resulted in a 5% or RM4.2bn year-on-year decline in cash generated from operations in 2017. Consequently, companies have also spent less in their CAPEX.

Should the CCE performance continue to deteriorate, companies will have to rely on other sources of funding for their CAPEX commitments.

^a The changes of Revenue and Net Profit between 2016 and 2017

^b Cashflow From Operating Activities

Malaysian companies had mixed results with only 7 out of 14 sectors improving their working capital performance in 2017

2017 and 2016 Net Working Capital Days by Sector



Only 7 out of 14 sectors managed to improve their working capital days. Apparel & Luxury (A&L) and Technology did so by improving their inventory days (DIO) and stretching their payable days (DPO).

The Apparel & Luxury had a 15 days reduction in Net Working Capital Days, which was the highest improvement among all sectors. This improvement was driven by reduction in inventory held on hand even as their sales volumes grew higher in 2017.

The Technology sector showed a reduction of 11 days of Net Working Capital Days. This reduction was very significant considering the growth in sales for the year.

A detailed study of the 40 companies in the Technology sector revealed that the technology sector had a 10 day increase in DPO from 65 days in 2016 to 75 days in 2017. This increase is therefore not sustainable and could potentially jeopardise relationships with their suppliers if done repeatedly.

The sectors which deteriorated most in their working capital days are Energy & Utilities (E&U) and Engineering sector. E&U's decline is mainly driven by their payables.

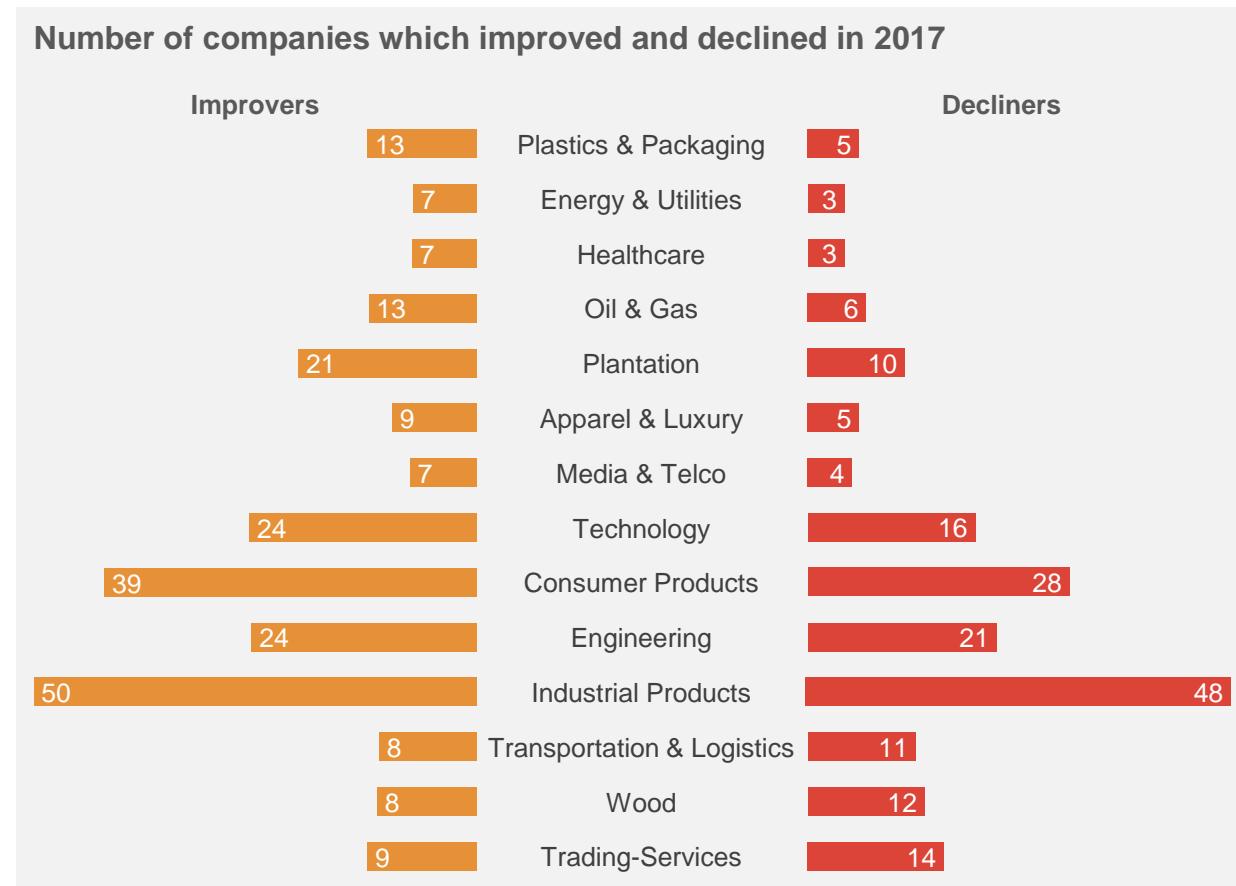
As for Engineering sector, their working capital days increase were contributed by a deterioration in collections. A common issue faced by Engineering companies is inefficient billing resulting in accumulated unbilled receivables. It is essential to have a standardised and efficient process in place to ensure amounts due from customers are billed and collected on time.

There is a combination of NWC days improvers and decliners in each sector

Quality vs Quantity

When assessing the overall performance of each industry, in addition to overall quantum of improvement, it is beneficial to examine how the individual industry players are performing. This may yield insight to possible trends within the industry landscape.

Number of companies which improved and declined in 2017



Our analysis produced some interesting insights:

1. In Plastics and Packaging, despite 72% of all businesses improving their NWC days, the poor performance in inventory management for the remaining 27% of contributed to the overall increase in NWC days for the sector
2. In Energy & Utilities, overall NWC days deteriorated year on year from 3 days to 15 days. However, this was mainly driven by the poor performance of only 3 of the 10 listed companies in the sector. In reality, majority of the businesses in this sector recorded improved performance
3. The overall performance of the Engineering sector was dragged down by the poor performance of 21 of the 44 companies, some of which saw their NWC days more than double or triple year on year. Over half of the businesses in the sector actually managed to improve their NWC days year over year
4. After a difficult past few years, the Oil & Gas sector is showing signs of recovery, with NWC days reducing 10 days. In addition, a significant majority (68%) of the industry players improved compared to their prior year performance
5. 61% of Trading and Services companies are experiencing year on year deterioration of their NWC days. The industry has also in aggregate added 6 days to its NWC days. This is the second year in a row that the sector saw more decliners than improvers
6. While 51% of companies in the Industrial Products sector improved, it should be noted that this sector has the second highest NWC days at 111 days. Furthermore, the NWC days increased by 2 days, year over year

Large companies have lower working capital requirements (13% NWC/Sales) vs. Small companies (33% NWC/Sales)

Our study reveals that large companies have shorter working capital (WC) cycles than smaller companies. This efficiency gave large companies a multiplier effect which allowed them to earn a return on capital employed (ROCE) of 9 times greater than smaller companies.

Nevertheless, in FY17, the working capital performance for medium and small companies improved by 15 days and 8 days respectively. However at an overall level this improvement was entirely offset by the accumulation of 3 additional days worth of working capital from large companies.

Net Working Capital performance by company size

| | Small | Medium | Large |
|-----------|-------|--------|-------|
| NWC/Sales | 33% | 24% | 13% |
| ROCE | 1% | 6% | 9% |
| DSO | 100 | 80 | 52 |
| DPO | 71 | 70 | 51 |
| DIO | 100 | 82 | 44 |
| NWC Days | 129 | 92 | 45 |

Note:

Small companies defined as having revenue no greater than RM500 million

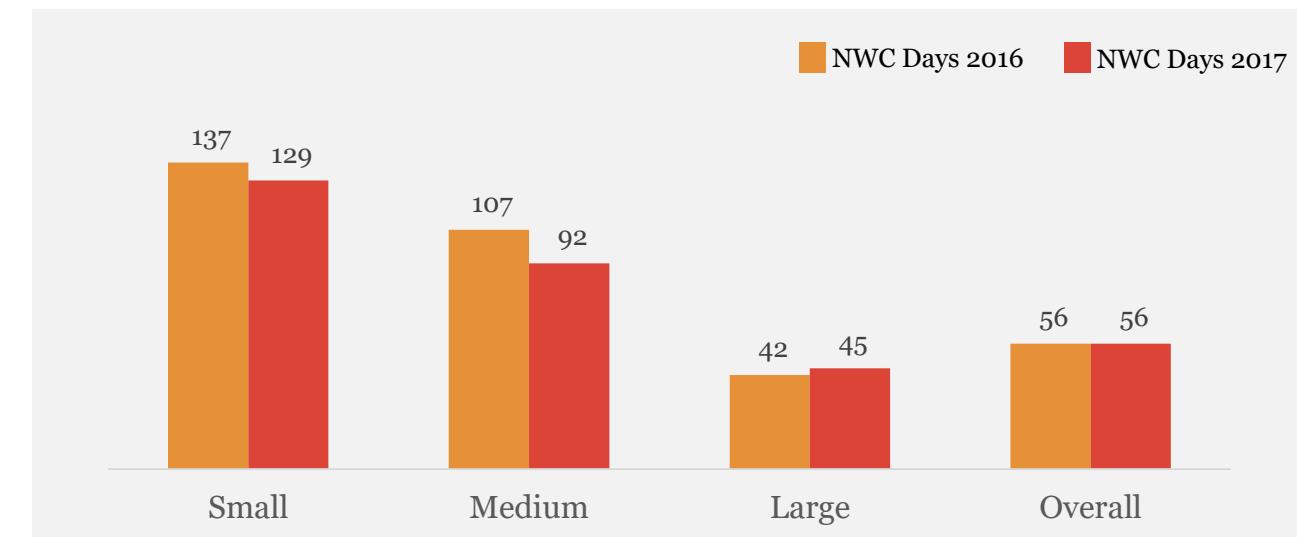
Medium companies defined as companies with revenue greater than RM500 mil but less than RM1 billion

Large companies defined as companies with revenues greater than RM1 billion

Factors that contribute to these differences include:

- Organizational scale provides more opportunities to negotiate favourable payment terms with customers and suppliers
- Nimble supply chains which are agile and responsive to demand and supply variations
- Geographical footprint which allow purchasing from vendors with beneficial terms
- Enablement of efficient systems leading to improved visibility and control
- Accuracy of demand forecasting which enables managing optimal inventory levels

Net Working Capital Days by company size



Cash Release Opportunity

GROWING BROKE?

PROFITS ↑

REVENUE ↑

CASH ↓

PROFITS ≠ CASH \$

missing link....

Growing Broke?

RM in millions

Revenue

Net Profit

+ Cash
capital

Operating Cash Flow

Operating Cash Flow / Net
Profit

90%

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There is a total of RM110bn of cash release opportunity across all sectors, with 38% opportunity coming from payables optimisation

Cash improvement opportunities by sector

| Sector | Value (RM) | | % of sales | |
|---------------------|---------------|-------------------|---------------|-------------------|
| | Top performer | Average performer | Top performer | Average performer |
| Oil & Gas | 26bn | 7bn | 24% | 8% |
| Engineering | 18bn | 12bn | 58% | 40% |
| Industrial Products | 17bn | 9bn | 20% | 11% |
| Plantation | 12bn | 5bn | 18% | 9% |
| Consumer Products | 9bn | 4bn | 14% | 7% |
| Others | 28bn | 11bn | 12% | 5% |
| Total | 110bn | 48bn | 19% | 9% |

The cash opportunity is illustrative and based on an external view of each company's working capital performance within its industry (based on publicly available numbers). This illustration does not take into account the commercial and operational strategies undertaken at the company level.

Our research in working capital performance reveals significant potential for improvement amounting to a total of RM110 billion of cash across 424 companies listed on Bursa Malaysia.

This cash opportunity has been calculated at a company level by benchmarking individual working capital components (AR, AP and Inventory) against both the upper quartile (Top) and median (Average) performers in each industry peer group.

The 424 Malaysian companies included in this research would have in total between RM49 billion and RM110 billion of cash unnecessarily tied up in working capital, approximately 9% - 19% of total sales.

Our "cash potential" analysis reveals that the RM110 billion opportunity is distributed across receivables (30%), inventory (32%) and payables being the biggest opportunity (38%).



Did you know?

Prioritizing Procure to Pay (PtP) improvements can yield high returns on investment. Sourcing strategically can help rein in excess spend, reduce payment complexity and escalation, and release cash. Sourcing initiatives typically pays for itself in the way of larger and sustainable profits for many years.



Self Diagnostic Centre

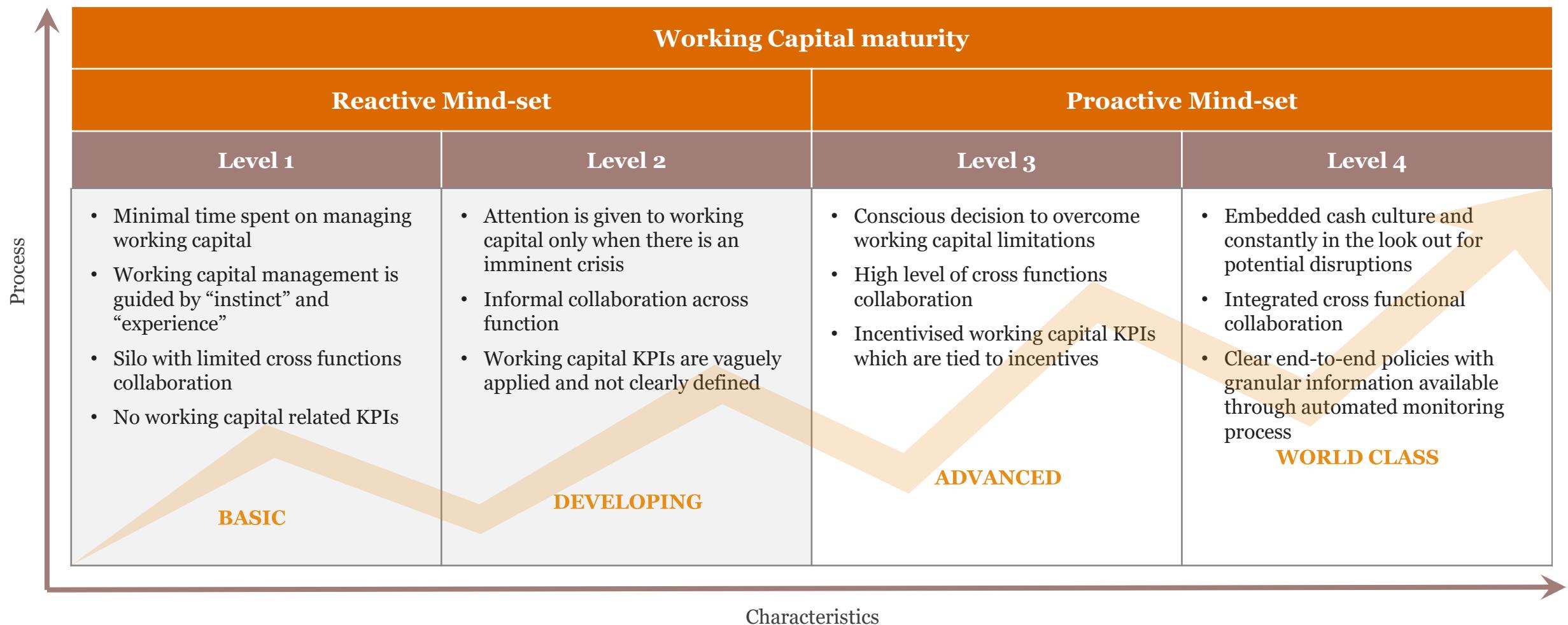


Self Diagnostic Centre: Understanding your working capital performance

| Sector | No of companies | NWC Days | | |
|----------------------------|-----------------|----------------|-----------------|----------------|
| | | Upper Quartile | Median Quartile | Lower Quartile |
| Apparel & Luxury | 14 | 14 | 212 | 323 |
| Consumer Products | 67 | 21 | 88 | 175 |
| Energy and Utilities | 10 | (1) | 51 | 136 |
| Engineering | 44 | (15) | 120 | 295 |
| Healthcare | 10 | 0 | 72 | 218 |
| Industrial Products | 98 | 46 | 117 | 199 |
| Media & Telco | 11 | (107) | 13 | 73 |
| Oil & Gas | 19 | (62) | 64 | 137 |
| Plantation | 31 | (14) | 38 | 75 |
| Plastics & Packaging | 18 | 69 | 91 | 127 |
| Technology | 40 | (10) | 80 | 208 |
| Trading-Services | 23 | (65) | 59 | 176 |
| Transportation & Logistics | 19 | (1) | 48 | 96 |
| Wood | 20 | 3 | 70 | 160 |
| Total | 424 | | | |

Working capital maturity

A myriad of factors drives working capital maturity. Size of operations, business lifecycle, organisational KPIs and IT systems are some of the key drivers in working capital maturity. In order to achieve working capital excellence, companies will first have to identify their current maturity level.



Potential Disruptions



Innovations are disrupting corporate working capital practices

In this section, we present innovations that are changing the way companies manage their operations and their working capital. These innovations improve customers' buying experience, the company's operational efficiency and ultimately the company's bottom line.



Supply Chain Finance



Supply Chain Finance (SCF) also known as reverse factoring, improves cash flow by allowing businesses to lengthen their payment terms to their suppliers while providing the option for their suppliers to get paid well in advance before the invoices are actually due.

It is an innovative way for companies to improve their working capital position and strengthen supplier relationships, thus a Win-Win solution for trading partners.

Furthermore, SCF leverages the buyer's credit rating and does not require any collateral from suppliers or buyers.

Benefits

- Buyer gets extended payment terms
- Suppliers get paid faster
- No collateral required
- Lower cost of financing for suppliers

Robotic Process Automation



Robotic Process Automation (RPA) is the use of software 'robots' to replicate human actions within digital systems to complete a business process.

One of the applications of RPA is the elimination of human intervention within the Accounts Payable processes. The RPA robot can access multiple systems, read invoice images, conduct data entry into the ERP, perform data validation, and determine whether to post or block the invoice.

This frees up to 75% of man hours spent on invoice processing and only exceptions are handled manually.

Benefits

- Improvement in employee productivity
- 24 x 7 operations with higher accuracy
- Ability to handle large volumes of data
- Elimination of time spent on manual data entry

Innovations are disrupting corporate working capital practices

Industry 4.0



Industry 4.0 also known as the fourth industrial revolution, represents the trend of automation and data exchange in manufacturing and industrial environment.

One example of Industry 4.0 is automated warehouses. These warehouses are controlled by algorithms which dictate the location of each stock (SKU) and are moved around the warehouse through robot shelves.

Warehouse managers will have complete visibility on the location of each SKUs on a real time basis. Automated data capture, analysis and action through automated systems enables warehouse managers to make decisions based on real time data.

Benefits

- Inventory optimization
- Long term cost savings
- Increased space utilization
- Real time inventory tracking

The “New Retail” Model



“New Retail” as popularized by Alibaba, improves the customer buying experience by integrating online retail convenience into the offline retail experience.

One example is “Virtual Shelves”. If the customer’s preferred size or colour is not in stock at the store or supermarket, they can order through their smartphone by scanning a QR code, and have the item delivered directly to their home.

Through “New Retail”, merchandisers will be empowered to analyse customer’s spending patterns and tailor their replenishment and marketing strategy to meet customer demand.

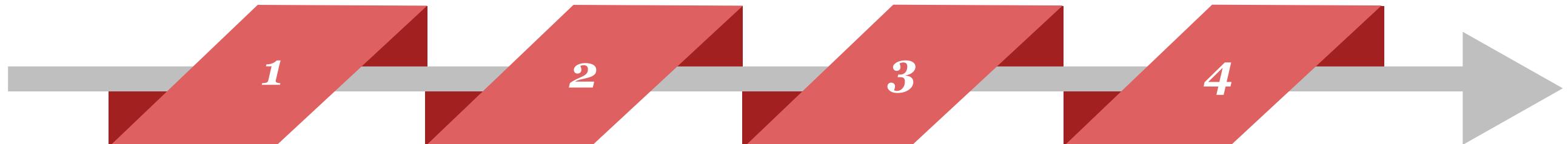
Benefits

- Reduced lost sales for retailers
- Improved customer experience
- Improved replenishment and management of inventory





How We
Can Help



Benchmarking

Complete a working capital benchmarking exercise to compare performance against peers and identify potential improvement opportunities



Diagnostics

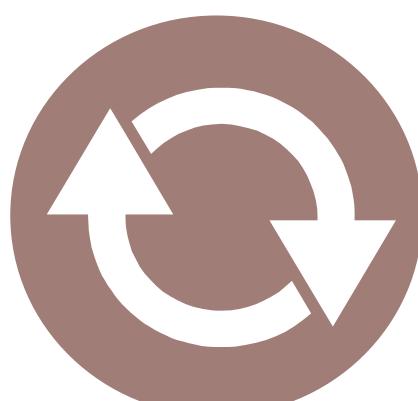
Perform a diagnostic review to identify “quick wins” and longer term working capital improvement opportunities



3

Roadmap Definition

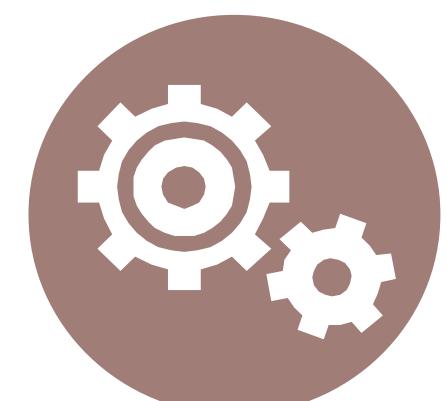
Develop detailed action plan for implementation to generate cash and make sustainable improvements



4

Implementation

Assist the realisation of sustainable working capital reduction by implementing standardized, efficient and collaborative processes





Examples of how PwC could help you to release cash from working capital:

Receivables

- Tailored, proactive collections
- Credit risk policies
- Aligned and optimised customer terms
- Billing timeliness & quality
- Contract & milestone management
- Systematic dispute resolution
- Dispute root cause elimination
- Factoring

Payables

- Consolidated spending
- Increased control with centre-led procurement
- Reducing leakages through contract compliance
- Supply chain finance benefits assessment and implementation
- Systematic payments
- Payment methods and frequency
- Reduced escalation
- Indirect cost reduction

Inventory

- Lean & agile supply chain strategies
- Global coordination
- Demand planning and forecasting
- Production planning
- Inventory tracking
- Balancing cost, cash and service level considerations
- Designing optimal target stock levels
- Reduced inventory write offs



Contact Us





Ganesh Gunaratnam

Working Capital Advisory Leader
+60(3) 2173 0888
ganesh.gunaratnam@pwc.com



Krishna Chaitanya

Associate Director
+60(3) 2173 5399
krishna.chaitanya@pwc.com



Co-authors



David Lim
david.yg.lim@pwc.com



Chin Ren Jun
ren.jun.chin@pwc.com





Appendix

Appendix

| Metrics | Overview | Basis for calculations |
|-------------------------------------|---|---|
| Net working capital days (NWC days) | NWC days indicates the length of time it takes a company to convert resource inputs into cash. This is commonly referred to as the Cash Conversion Cycle (CCC). | DSO+DIO-DPO |
| DSO (Days Sales Outstanding) | DSO is a measure of the average number of days that a company takes to collect cash after the sale of goods or services have been delivered. | (Accounts Receivable / Sales) x 365 |
| DIO (Days Inventories Outstanding) | DIO gives an idea of how long it takes for a company to convert its inventory into sales. Generally, the lower (shorter) the DIO, the better. | (Inventories / Cost of Goods Sold) x 365 |
| DPO (Days Payables Outstanding) | DPO is an indicator of how long a company takes to pay its trade creditors. | (Accounts Payable / Cost of Goods Sold) x 365 |
| CCE (Cash Conversion Efficiency) | CCE is an indicator of how efficient a company is able to convert profits into cash. | Cash Flow from Operations / EBITDA |

This study provides a view of working capital performance based on the data sourced from S&P Capital IQ, across 424 listed companies in Malaysia. Companies operating in the financial services, property developer, and construction were excluded from the study.

Limitation

As the research is based on publicly available information, all figures are financial year-end figures. Due to the disproportionate efforts to improve working capital performance towards year-end the real underlying working capital requirement within reporting periods might be higher. Also, off-balance-sheet financing or the effect of asset securitisation have not been taken into account.

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Thank you



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