Optimising Working Capital for Growth

2019 Malaysia Working Capital Study

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Working capital in Malaysia: At a glance

423 Listed companies were studied across 14 industries

8 out of 14 industries improved their working capital performance in 2018

2 industries (apparel & luxury and consumer products) deteriorated the most in 2018

Most working capital improvement potential lies in payables optimisation

RM133bn potential cash release opportunity with better working capital performance

Small companies require **3x** more working capital compared to large companies

Revenue in 2018 increased by **3%** from 2017 but operating profits declined by **20%** due to margin pressures

Return on capital employed (ROCE) declined by **1.5 p.p.** due to decline in operating profits

A Malaysian-centric self-diagnostic tool is available in this study to assess your company's working capital

Source: Capital IQ and PwC analysis

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Foreword

Welcome to PwC Malaysia's 3rd annual Working Capital Study. Our report is titled "Optimising Working Capital for Growth" and aims to raise awareness on the importance of viewing working capital as a source of cash and liquidity.

With the backdrop of the Malaysian economy facing much challenges amidst rising costs of doing business, optimising cash is key to maintaining a steady course in these uncertain times. Having the capacity to turn sales into cash faster ultimately reduces the cost of running a business and is a source of competitive advantage.

Managing cash and liquidity for sustainable growth

We have analysed the working capital performance of over 400 Malaysian companies in 14 different industries for 2018. Our findings show that despite a challenging business environment in 2018, companies were able to convert their sales into cash faster. Cash to Cash cycle improved marginally from 55 days in 2017 to 54 days in 2018.

The improvement in 2018 is primarily influenced by the performance of large companies included in our study. However, the overall performance of small companies and mid-sized companies, shows no improvement and a deterioration respectively from last year.

Despite the marginal improvement, we still see money being left on the table as our study shows a potential cash release opportunity of RM133bn from Corporate Malaysia's balance sheet. This is achievable through better working capital management practices.

Commitment to delivering working capital excellence

At PwC, we are committed to providing you with the expertise to steer your company towards consistent working capital outperformance through a combination of strategy, systems and processes. We hope you find our latest perspectives useful to your organisation in striving through the current business climate.

Tan Siow Ming
Deals Leader

Ganesh Gunaratnam
Working Capital Management Leader

Self Diagnostic Centre

How does my company rate?

Click here or turn to page 16 to compare your performance against your peers in our Self Diagnostic Centre

Working capital overview

Overall improvement in working capital performance by Malaysian companies

Improving Cash to Cash cycle days in Malaysia

Cash to cash cycle (C2C) days of Malaysian companies improved marginally by 1 day in 2018 from 2017.

Companies achieved this by improving their receivable (DSO) and inventory (DIO) days by 3 days and 1 day respectively.

The improvement in 2018 is primarily influenced by the performance of large companies included in our study. However, the overall performance of small companies and mid-sized companies, shows no improvement and a deterioration respectively from last year.

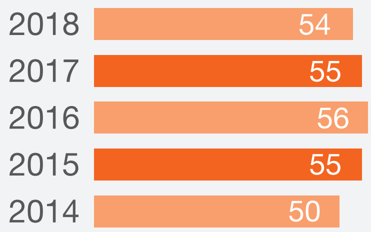
Shorter payable days, influenced by engineering, and apparel & luxury industries

Payable days (DPO) was the only metric that declined in 2018 potentially due to faster payments to suppliers as compared to the previous year.

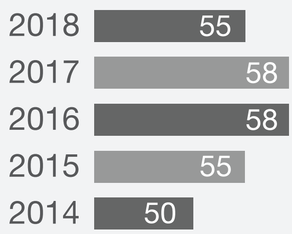
Did you know?

A more innovative way to sustainably manage account payables is to adopt Supply Chain Finance (SCF) (refer to page 20). Suppliers are given the option to receive payments ahead of due dates without pledging collaterals.

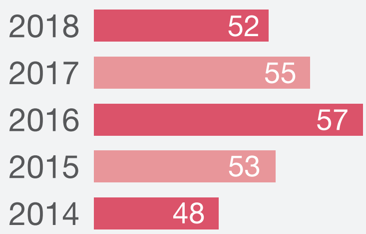
Cash to Cash Cycle Days (C2C)



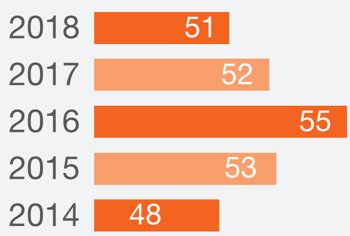
Days of Sales Outstanding (DSO)



Days of Payables Outstanding (DPO)



Days of Inventory Outstanding (DIO)



Source: Capital IQ and PwC analysis

Malaysian companies were faster to convert profits into cash in 2018

Cash flow from operations increased despite lower operating profits

Cash conversion efficiency (CCE) is an indicator of how efficient a company is in converting its profits into cash.

The CCE in 2018 witnessed a sharp increase of 9% despite a marginal 1 day improvement in C2C days. This could be driven by the decline in profits of Malaysian companies.

Large companies are better at managing their working capital than small companies

Large companies have improved their Net Working Capital (NWC) percentage over sales (NWC percentage) in 2018 as compared to 2017.

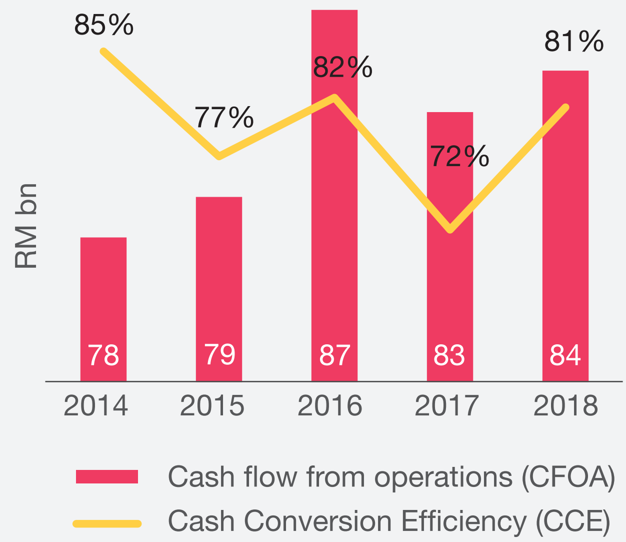
However, mid-sized companies continue to decline driven by an increase in receivable and inventory days.

The NWC percentage of small companies remain unchanged over the past 5 years. These small companies have 3 times more working capital ratio compared to large companies.

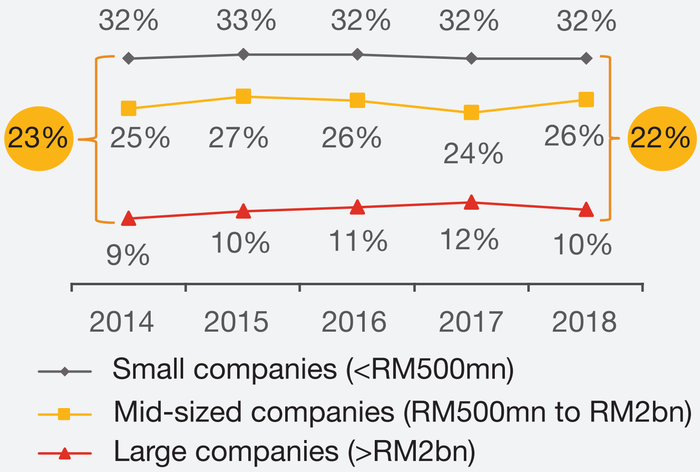
Therefore, there are ample opportunities for small companies to improve their working capital position.

*CCE = Cash from Operating Activities/EBITDA

Cash Conversion Efficiency*



Net Working Capital as % of Sales (NWC %)



Source: Capital IQ and PwC analysis

Cash waiting to be unlocked from Corporate Malaysia's balance sheets

Did you know?

Despite the improved C2C days in 2018, cash release opportunities were 20% higher in 2018 compared to 2017. This could be due to the widening gap between the top and bottom performers in terms of C2C.

The balance sheet of smaller companies continue to be under stress with ample scope to improve their C2C performance.

RM133 billion left on the table

Our analysis indicates a cash release opportunity of RM133bn if companies were to optimise their working capital performance to the top quartile within their industries.

The opportunity is distributed across receivables (RM30.7bn, 23%), inventory (RM35.5bn, 27%) and payables being the biggest opportunity (RM67.1bn, 50%).

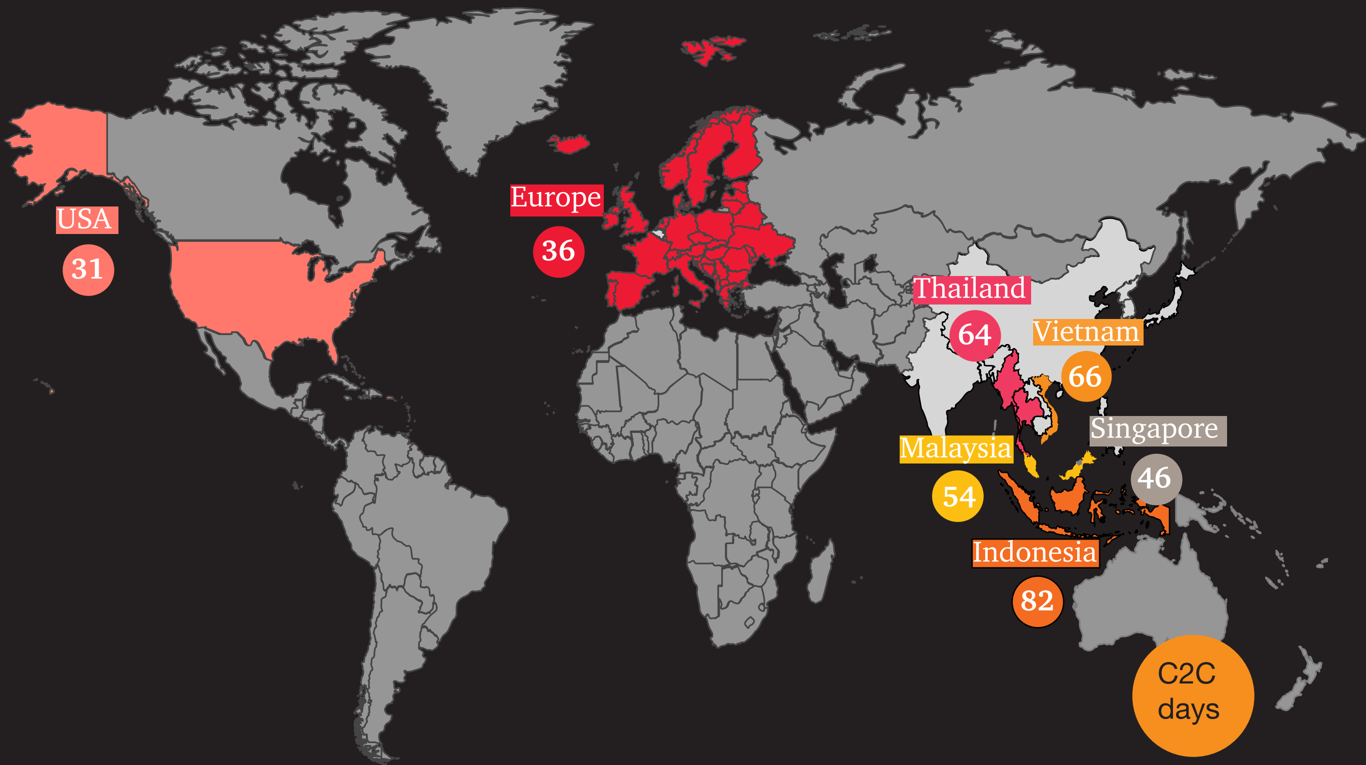
Cash improvement opportunities by industry

Industry	Value (RMbn)	Industry
Oil & Gas	28	25%
Engineering	21	61%
Industrial Products	19	21%
Energy and Utilities	17	24%
Consumer Products	10	15%
Others	38	17%
Total	**133**	**22%**

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.

Source: Capital IQ and PwC analysis

How does Malaysia compare globally?



Source: Capital IQ, PwC SCF Barometer 2018/2019 and PwC analysis

54 days

Malaysia's C2C days performance lags behind Singapore, USA and Europe

2nd best

In terms of C2C days, Malaysia ranks 2nd amongst ASEAN countries

DPO

Room for improvement in payables management amongst Malaysian companies

Malaysia's working capital performance is ahead of other ASEAN countries, yet there is room for improvement

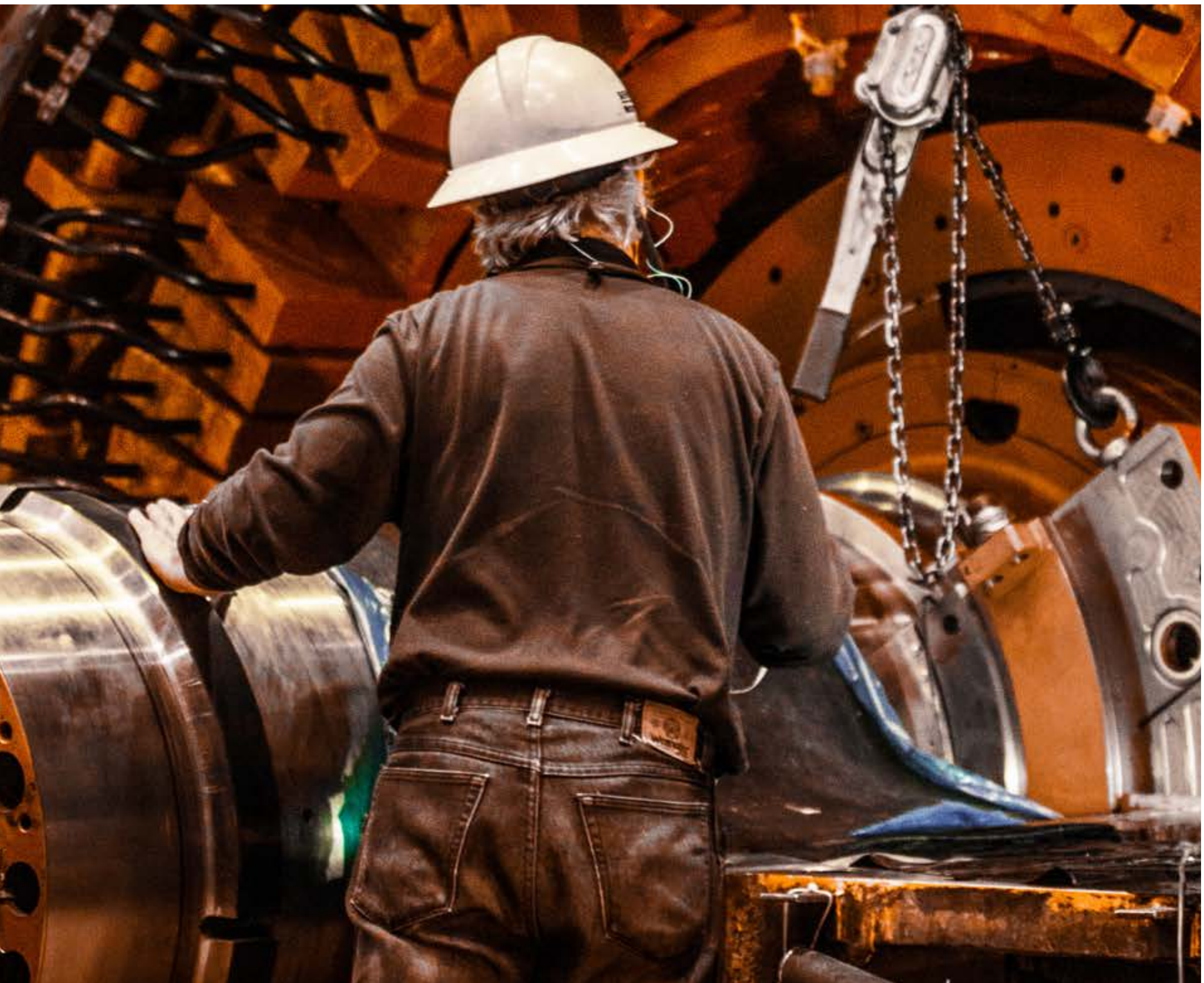
Although Malaysian companies appear to have shorter C2C days relative to other ASEAN countries, it still lags behind developed markets such as the USA and Europe. When analysed further, major improvements are apparent in managing payable performance.

C2C days in the USA and Europe could be lower due to higher adoption rate of Supply Chain Finance (SCF) programmes. As the SCF market is more mature in the USA, more buyer-led programmes are being rolled out by both large multinational companies and small and medium enterprises (SMEs). The coverage of SCF in Europe has also increased with higher numbers of participants due to more SCF offerings by fintech companies as well as by European and multinational banks.

It is evident that Malaysian companies should explore further the available SCF options to release cash trapped in their payables.

Working capital performance across industries

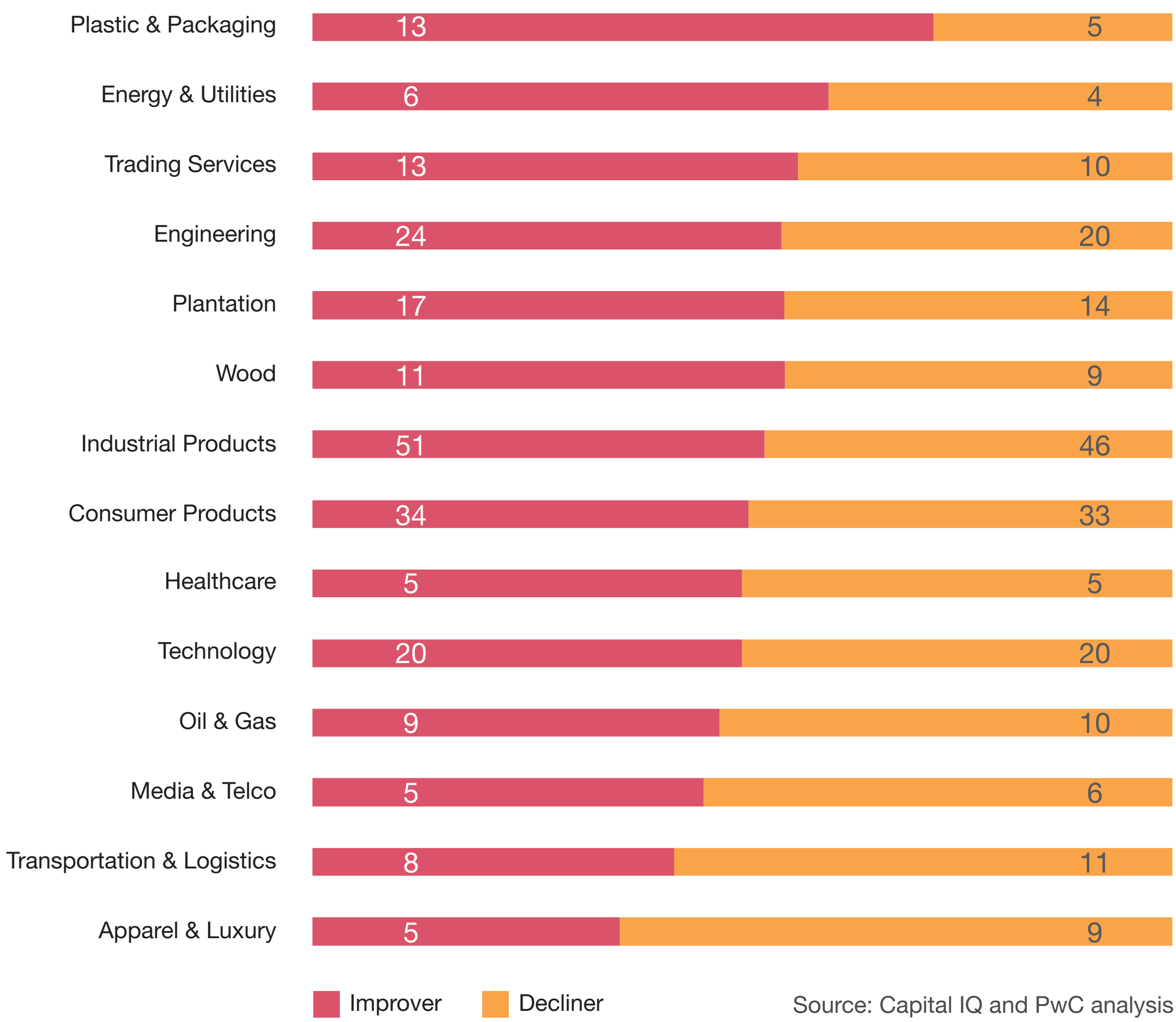
How did industries perform in 2018 in comparison to 2017?



An analysis of the working capital performance metrics of over 400 companies in Malaysia in 2018 indicates that half of the companies studied improved their C2C days. 8 out of the top 14 industries studied experienced an improvement in their working capital performance relative to 2017. Industries that declined were Trading Services, Consumer Products, Heathcare, Oil & Gas, Transportation & Logistics and Apparel & Luxury.

Our analysis shows the overall C2C improvement is due to 11 out of 14 industries improving their receivable days. This is offset by decreasing payable days trend with 10 out of 14 industries declining. Should payable days be managed more efficiently, more cash can be released internally for companies to improve their liquidity.

52% of companies analysed had improved their C2C days in 2018



Source: Capital IQ and PwC analysis

Note: The companies are classified based on their 2018 C2Cs."C2C improvers/decliners" are companies with their C2Cs in 2018 lower/higher in comparison to their C2Cs in 2017; the stacked bar chart illustrates the breakdown of companies whose C2C have improved/deteriorated for each industry

Engineering

2nd largest industry in terms of cash trapped as working capital

There is an approximately RM21bn cash release opportunity within the engineering industry.

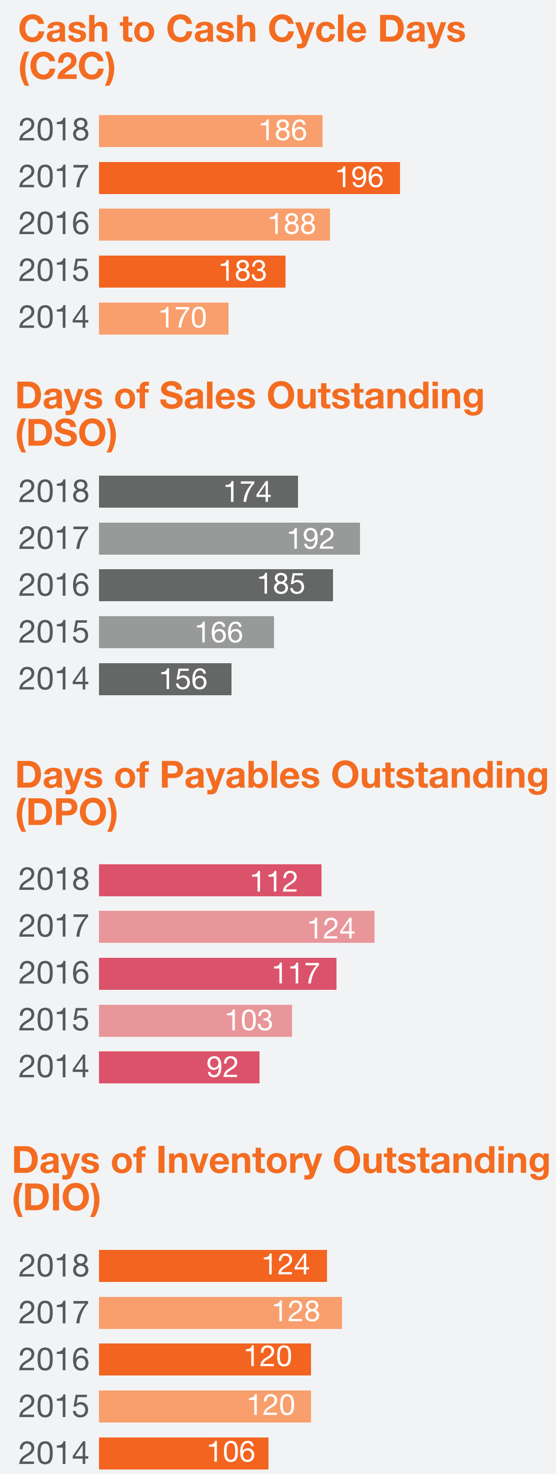
Overall, the industry has improved its C2C days by 10 days. This could be influenced by the improvement in receivable and inventory days by large companies. Small companies continue to experience deterioration in their working capital performance.

Large companies improved in receivables performance but was offset by a decline in payables performance

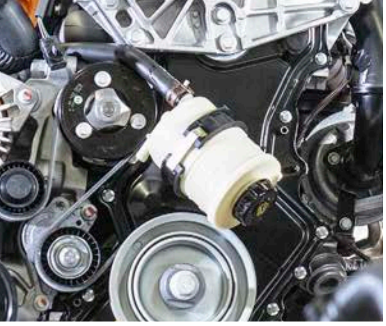
The decline in payable days by 12 days could be due to declining payables performance (faster payments) amongst the larger companies.

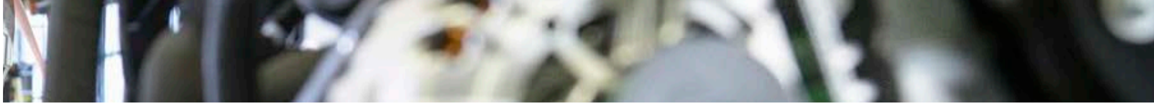
As large players in the industry, these companies should consider implementing SCF options by leveraging on their higher credit rating.

Better payables management could possibly release cash up to RM5.7bn from the balance sheets of engineering companies included in our analysis.



Source: Capital IQ and PwC analysis





Smaller companies continue to deteriorate in terms of receivables performance

Though larger companies showed improved performance, the smaller players continue to experience deterioration in their receivable days in 2018.

With the most cash being tied up in inventory (RM8.1bn), it will be beneficial for these engineering companies to consider supply chain improvement initiatives like sales and operations planning (S&OP) to better manage their inventories.

Did you know?

With the recent revival of mega projects in Malaysia, engineering companies now require substantial amounts of cash for initial working capital purposes.

Instead of relying on external borrowings, releasing trapped cash through better sub-contractor management and payables optimisation can lead to substantial benefits.

11 days

Overall improvement in C2C days in this industry

RM8.1bn

Cash release opportunity through inventory optimisation

RM21bn

Industry with 2nd largest amount of trapped cash in working capital

Source: Capital IQ and PwC analysis

Consumer Products

4 days

Steep increase in overall C2C days in 2018 from 2017

3 days

Increase in inventory days for the consumer products industry

RM10bn

Cash to be released from companies in this industry

Industry-wide decline

The consumer products industry's C2C days declined by 4 days in 2018 from 2017. This was largely driven by the increase in inventory days.

Cash trapped in inventories and payables

This industry has seen a decline in inventory performance with DIO deteriorating by 3 days. Large and small companies experienced a 4 and 10 day deterioration in their inventory performance respectively.

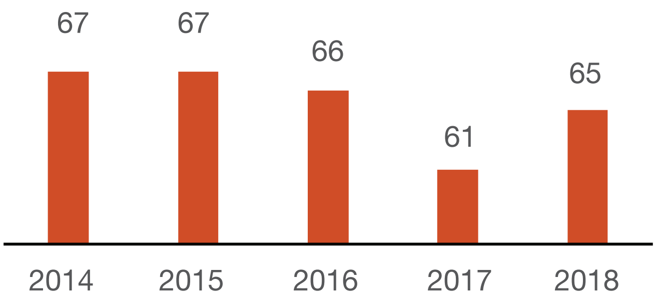
In terms of DPO, small companies had shortened their payable days by 1 day from 2017. Large companies performed better by extending their payable days by 1 day in 2018.

A potential RM10bn can be released from the balance sheets of companies within this industry, with the highest potential of RM3.4bn coming from improving payables performance.

Did you know?

PwC has a global network of working capital and procurement specialists with a proven track record of helping companies identify and unlock EUR31bn of working capital benefits across the globe.

Cash to Cash Cycle Days



Source: Capital IQ and PwC analysis

Industrial Products

Overall improvement in C2C days

The industrial products industry's C2C days improved by 5 days reverting to its 5 year historical best of 106 days. This could potentially be influenced by improvements in receivable days amongst the large companies within the industry.

Small companies continue to deteriorate in working capital performance

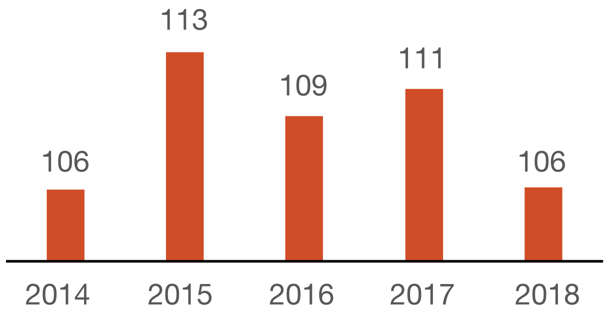
Though the industry shows an improved working capital performance, the small companies continue to extend their C2C days. The C2C days for small companies increased by 9 days from 2017 whilst large companies shortened their C2C days by 9 days.

Increasing DIO trend amongst small companies

The overall increase in inventory days within the industry was largely contributed by a 15 day increase in inventory days by small companies in 2018 compared to 2017. The inventory days of large companies also extended slightly by 4 days in 2018.

There is a cash release opportunity of RM7.1bn out of RM18.9bn should companies improve their inventory management performance.

Cash to Cash Cycle Days



Source: Capital IQ and PwC analysis

106 days

C2C days in 2018 at its 5 year historical best

15 days

Longer inventory days amongst small companies

RM18.9bn

Cash trapped in working capital

Did you know?

Industry 4.0 allows for inventory optimisation through cross- functional synergies between inventory management, production planning and transport logistics.

An Industry 4.0-enabled business has real-time visibility and a dynamic demand forecasting that can help mitigate both overstocking and under-stocking.

Self-Diagnostic Centre – C2C days in 2018

How does your company rate in working capital performance?

Industry (no. of companies)	Upper Quartile	Median	Lower Quartile
Apparel & Luxury (14)	11 days	214 days	380 days
Consumer Products (67)	24 days	88 days	174 days
Energy & Utilities (10)	(81 days)	10 days	99 days
Engineering (44)	(51 days)	138 days	327 days
Healthcare (10)	(9 days)	79 days	220 days
Industrial Products (97)	37 days	124 days	205 days
Media & Telco (11)	(90 days)	4 days	73 days
Oil & Gas (19)	(57 days)	67 days	120 days
Plantation (31)	(40 days)	31 days	87 days
Plastics & Packaging (18)	62 days	89 days	133 days
Technology (40)	(28 days)	70 days	222 days
Trading Services (23)	(79 days)	63 days	171 days
Transportation & Logistics (19)	6 days	42 days	97 days
Wood (20)	23 days	74 days	122 days

Source: Capital IQ and PwC analysis

Industry perspectives

Industry perspectives

In the Oil & Gas industry, where you see multi-million dollar investments, sufficient cash flow to cover this spend is critical. The industry has been facing increasing project risks, tighter regulations, geo-political uncertainties - all leading to volatile oil and gas prices.

Due to this volatility, players in the entire supply chain are disciplined in managing overall business health. Customers and suppliers are more prudent over inventory levels, tightening supply chain processes and focusing on effective contract payment terms to ensure sufficient cash to operate in today's environment surrounding the oil and gas industry.

Working capital is the lifeline of the business. Weak processes in the business will result in your company running out of cash to manage basic operations such as paying salaries, rent, utilities, vendors, etc.

Cash is cheaper than external sources of financing. Thus, good working capital management (WCM) to ensure the cash generated is effective and working as productively as possible is vital if you are looking for faster and bigger returns on investment.

Technology is critical as effective working capital management relies on good data. Having accurate and up-to-date data gives visibility over various liquidity components (accounts receivable, accounts payable, inventory, etc.). Self-analysis can be done quickly to assess how your working capital balances are trending, and what to watch out for.

Without robust data, the analysis is less insightful, less accurate and will not be able to effectively identify pain points in the operations which could cause your business to run into cash flow problems.

Everyone in the organisation has a part to play in driving effective WCM. It has to be personal. When everyone understands their role in WCM, just as they understand their role in managing their own personal finances, that is when you start embarking on a cash-focused culture.

Alicia Chin
APAC Finance Leader,
Baker Hughes GE

Industry perspectives

Working capital management within the business services and logistics industry is crucial to ensure continued operations.

Typically this is a low margin, high volume, contract business, dependent on a large workforce. Therefore the majority of cash outflow is in the current month due to the nature of spend with customer credit terms at 30 days. This results in a very tight working capital margin and requires heavy focus on the entire Order to Cash Process.

The challenges in managing liquidity is the manual processes within the Order to Cash (O2C) and Procure to Pay (P2P) cycle and “out of the norm” invoicing requirements which results in delayed invoicing, extended invoice verification and sign off and ultimately delaying payments.

A strong cash culture is encouraged through active involvement throughout the entire organisation along with clear and visible ownership and accountability at all stages within the working capital cycle.

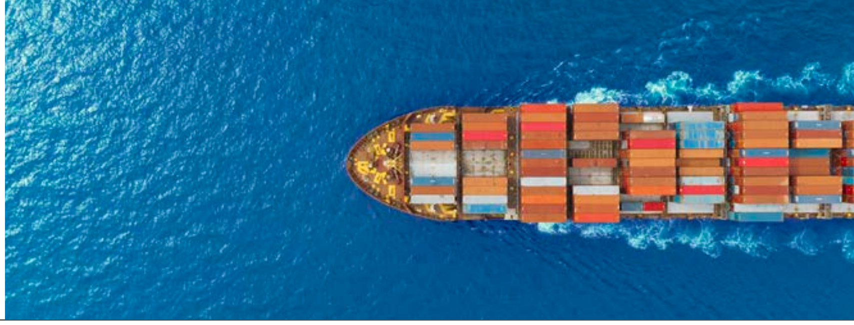
Transparency of operational cash targets, DSOs and DPOs at all levels creates awareness and engagement throughout the organisation.

The introduction of technology has enabled organisations to create process efficiencies, reducing lead times. Automation has also allowed users to devote less time on transactional processes and instead focus on the human-centric side of the accounts payable and accounts receivable process that are necessary in the more developing markets.

With the increasing use of technology and automation, working capital management is likely to become more transparent in all processes and result in a more rigid adherence to parameters set by organisations.

Dipesh Patel
Finance Director,
Asia Region at Volvo Cars

Supply Chain Finance



Supply Chain Finance

SCF is an alternative way of financing working capital and improving cash flow.

SCF constitutes an arrangement between a buyer, a supplier and a financial intermediary where the credit standing of the buyer is leveraged to improve the working capital of a supplier.

Suppliers send their invoices to the buyer which authorises the financial intermediary to pay the invoice on behalf of the buyer often within 15 days. The buyer reimburses the bank after an agreed period that often exceeds 60 days.

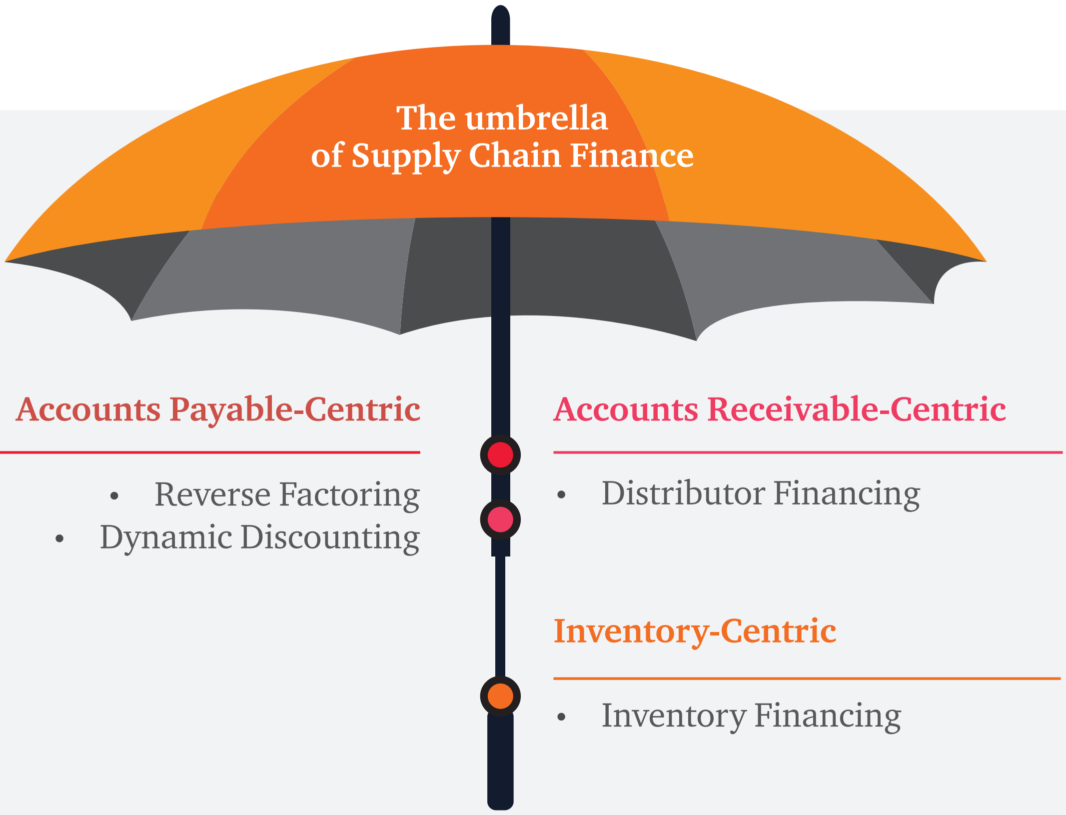
In this manner, SCF allows buyers in a supply chain to postpone the payment of invoices, while suppliers see their invoices paid earlier.

Technology is an important enabler of SCF

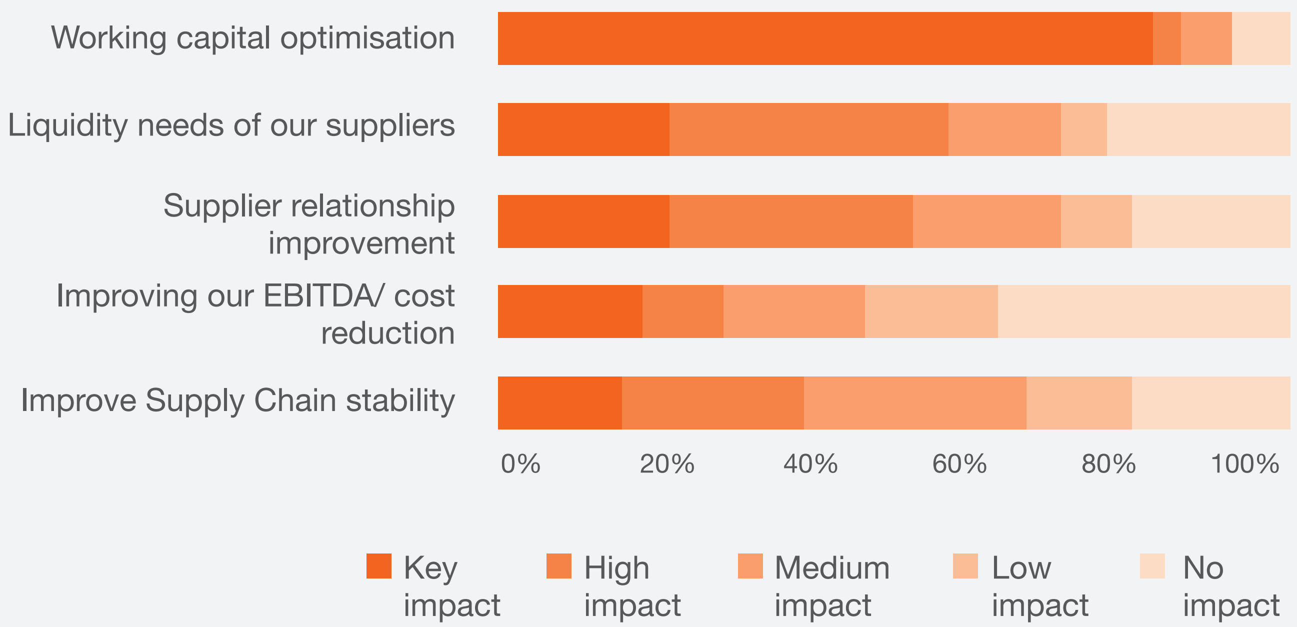
Globally, the adoption of SCF solutions are on the rise, driven primarily by the increase in fintech and third party technology providers. However in Malaysia, the awareness levels are still low.

Fintech players offering SCF platforms such as reverse factoring and invoice discounting solutions will help spur the adoption of SCF and facilitate its implementation.

Source: Supply Chain Finance, European Union, 2019



Principle reasons for implementing an SCF programme



Source: PwC SCF Barometer 2017/2018

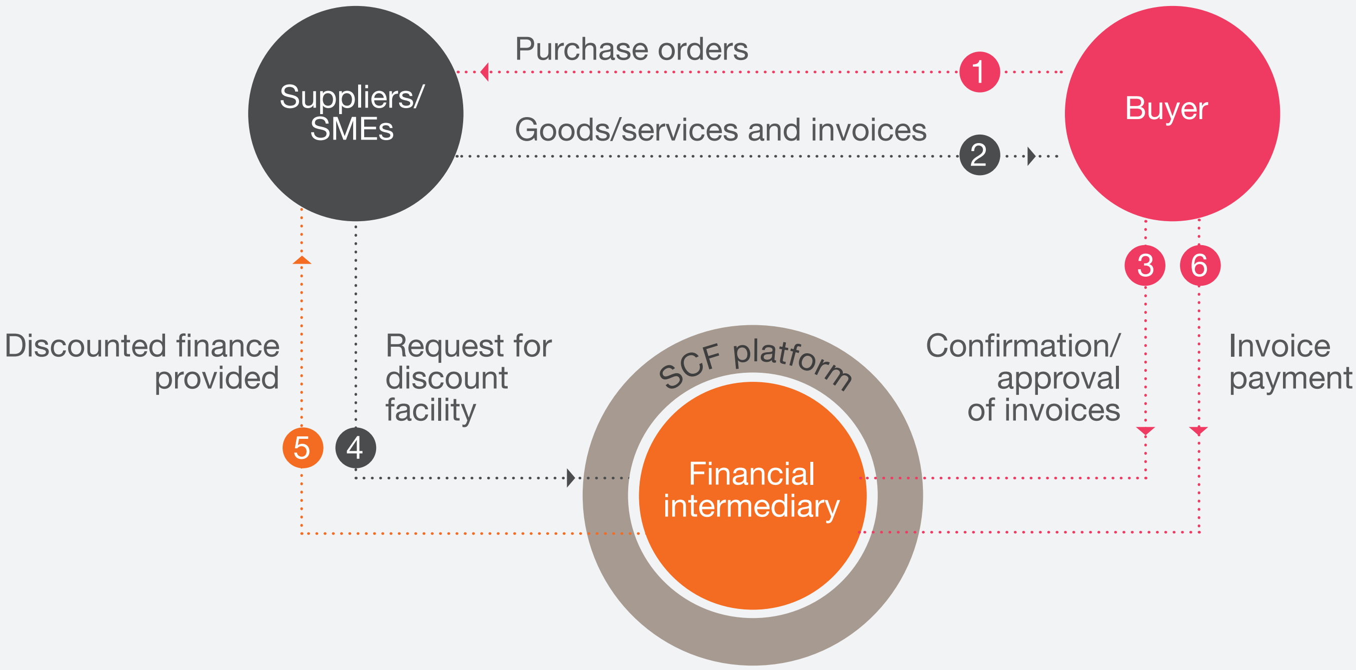
Working capital optimisation is the key consideration for companies adopting SCF, followed by improving supplier relationships

According to PwC's SCF Barometer 2017/2018, more than 80% of the respondents stated working capital optimisation as a key impact of implementing SCF.

Payables finance is the most popular SCF option implemented

According to PwC's SCF Barometer 2018/2019, payables finance is the most preferred SCF solution globally. Payables finance is a buyer-led programme, where sellers of goods and services are provided with the option of receiving the discounted value of receivables by the finance provider such as banks before payment is actually due. The payable to the buyer remains to be due at its original due date.

Mechanism of Payables Finance



PwC SCF Barometer 2018/2019

Want to know more about SCF?

Scan the QR code or **click here** to read our thought leadership on Supply Chain Finance

Insights from SCF platform providers - CapitalBay

CapitalBay is a multi-bank Supply Chain Finance platform that facilitates smart business financing by leveraging on existing trade data and relationships. On CapitalBay's bank-grade platform, businesses can obtain short-term financing from multiple banks within 24 hours, and without collateral.

A word from CapitalBay

SCF combines financing techniques and technology to enable all trade partners in a supply chain to optimise their cash flow. With SCF, businesses can lengthen payment terms to their suppliers, while providing their suppliers with the options to get paid earlier.

SCF would suit a company where buyers and suppliers are mutually dependent up or down the value chain. Some examples include construction, retail, automotive, logistics, utilities and manufacturing – where companies are under pressure to extend payment terms with suppliers.

It used to be that SCF would have traditionally only been worthwhile for large suppliers selling more than USD25mn worth of goods to a top tier buyer organisation with a single A rating or annual revenue of more than USD1bn. However, improvements in technology have now made SCF possible for mid-tier buyers with annual revenues of as low as USD100mn.

An SCF programme can potentially improve a company's operating cash flow by as much as USD80mn per billion (8%) in procurement spend.

Furthermore, buyers can potentially also expect margin improvements of 0.3% due to improved operational efficiencies and lower cost of supply.

C-level executives face certain common challenges when implementing SCF. It may be a cumbersome process to on-board suppliers onto an SCF programme. Strategy changes or downsizing of SCF business by the sponsoring bank may cause major disruption to the supply chain.

A lack of resources in the buyer organisation also poses a challenge for C-level executives to commit to a decision to implement SCF. Despite the challenges, we have seen SCF gain traction in the market.

Ang Xing Xian
CEO & Co-founder,
CapitalBay

Insights from SCF platform providers - Kyriba

Kyriba is a Software as a Service (SaaS) company which provides clients with a secure, cloud-based liquidity platform to manage their cash, payments, risk and working capital. Kyriba supports over 2,000 clients across 100 countries.

A word from Kyriba

Supply Chain Finance, or Reverse Factoring helps to unlock free cash flow for both buyers and suppliers. It facilitates term extensions on payables and preserves cash for longer on the balance sheet for buyers while reducing receivables and converting sales into cash faster for suppliers.

SCF is a good solution for industries and businesses with high net working capital days, in need of capital for growth, debt reduction, or to increase shareholder value.

Alternatively, SCF can also play an important role when strategic suppliers are the ones in need of the capital to support your business growth.

In the past, only multi-billion dollar investment grade companies were implementing SCF programmes. However, advanced technology is changing this scenario today. More and more mid-sized companies are implementing and benefiting from SCF providers' technology and funding network.

What are the common pitfalls of any SCF programme?

Common pitfalls of SCF programmes are lack of cross-functional alignment, lack of clear objectives, unclear communication, poor programme strategy or poor execution.

A good programme strategy requires the right incentives, a Champion (typically from Finance) and Spine (typically from Procurement) who can drive the whole programme in an organisation with the SCF partner to overcome these challenges.

Furthermore, SCF is a multi-year project rolled out to different supplier categories progressively. A buyer can unlock considerable capital when it extends payment terms with the 20% of suppliers that hold 80% of spend during the first year and then gradually expanding the scope to cover further spend.

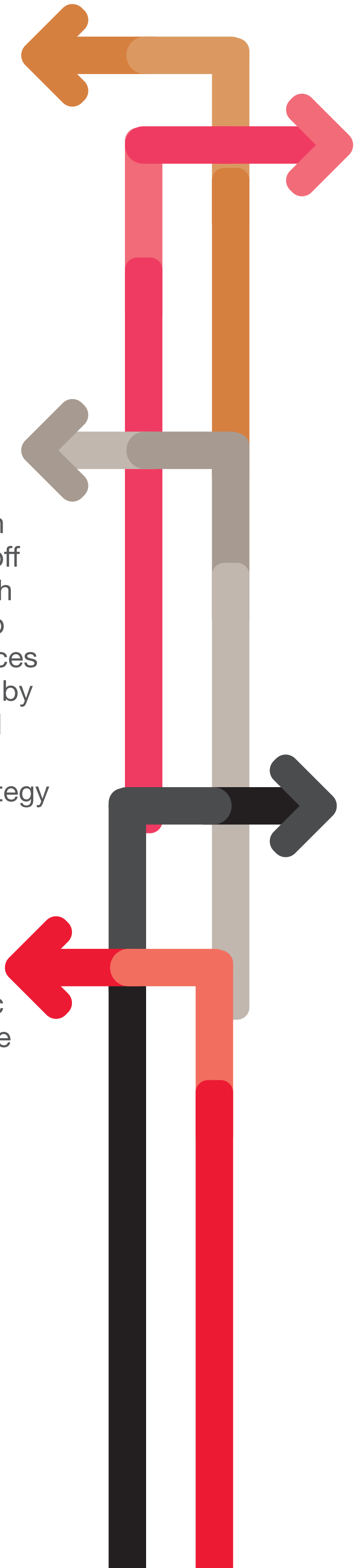
In summary, SCF is a win-win solution that benefits both suppliers and buyer by freeing up cash for further working capital needs.

Edi Poloniato
Global Head, Working Capital Solutions
Kyriba

How we can help

How can PwC support you in optimising your working capital?

PwC assists organisations in articulating, formulating and executing tasks required for an efficient working capital management (illustrative interventions below)



Cash & Treasury

- Avoid excess conversion charges, other related finance expenses and unhedged forex currency fluctuations
- Monitor all expenditure incurred with proper supporting and correct general ledgers

Supply Chain Finance Feasibility Review & Opportunity Estimation

- Quantitative analysis of spend data to estimate SCF opportunities (Cash & EBITDA)
- Supplier-industry specific terms benchmark Performance assessment in invoice processing and approval price
- Assessment of electronic invoicing penetration, non-PO spend

Account Receivables

- Acquire a better understanding of the impact of customer contracts on working capital and conduct trade-off assessments between cost and cash
- Create effective billing processes to minimise delayed or incorrect invoices
- Focus on proactive cash collection by actively keeping track of aging, and sufficient flagging mechanisms
- Follow a segmented collection strategy

Account Payables

- Improve process efficiencies leading to timely payments enhancing the working capital performance and supplier relationships
- Prevent the proliferation of payment terms and misalignment of standard terms based on industries and geography

Inventories

- Involve the supply chain as a strategic function for the organisation to remove excess cushion built up in inventory
- Enhance visibility and alignment of future demand across the company
- Maintain replenishment parameters across the organisation
- Implement a detailed approach towards slow moving and obsolete inventory managements

Companies need to actively manage their working capital elements in order to remain competitive. PwC can assist in aligning and..

Partnering with operational decision makers to improve working capital management

Ensuring that operational decision makers understand the importance of sustained working capital improvement

Utilising the expertise of the finance and operation functions, as well as information and data/systems to support improvement of working capital processes by decision makers

Providing business units with robust, credible information systems/tools to effectively negotiate and collaborate with third parties to decrease working capital within the organisation as well as across the supply chain

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Methodology

Metrics	Overview	Formula
Cash to Cash days "C2C"	C2C days measures the length of time that each net input dollar is tied up in the production and sales before it gets converted into cash received	DSO+DIO-DPO
Days Sales Outstanding "DSO"	DSO is a measure of the number of days that a company takes to collect cash after the goods or services have been delivered.	(Accounts Receivable/ Sales) x 365
Days Inventories Outstanding "DIO"	DIO is a measure of the number of days for a company to hold its inventory before the sale.	(Inventories/Cost of Goods Sold) x 365
Days Payables Outstanding "DPO"	DPO is an indicator of the number of days for a company to pay its trade creditors.	(Accounts Payable/Cost of Goods Sold) x 365
Cash Conversion Efficiency "CCE"	CCE is an indicator of how efficient a company is in converting its profits into cash.	Cash from Operating Activities/ EBITDA
Return on Capital Employed "ROCE"	ROCE is a measure of a company's profitability and efficiency with which capital is used.	EBIT/(Total Assets-Current Liabilities)

This study provides a view of working capital performance based on the data sourced from S&P Capital IQ, across 423 listed companies in Malaysia. Companies operating in the financial services, property developer, and construction industries were excluded from the study.

Limitations

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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