PwC Malaysia's 2022 Working Capital Study

Working capital management

Fasten your seatbelts,
turbulence ahead

September 2022

Table of contents

Foreword

PwC Malaysia's annual 2022 Working Capital Study provides insights into the challenges facing Malaysian companies in the wake of the pandemic. Inflation, supply chain disruptions and Operational Restructuring are key themes defining this year's landscape and may potentially continue till FY23.

This report analyses 407 listed companies across 14 industries in Malaysia and can be used as a guiding framework on the trends companies need to be vigilant of amidst a turbulent financial year ahead.

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Key highlights for FY21

Malaysian companies in the study saw an overall improvement in FY21 Revenue, EBITDA and net income, as they recovered with the reopening of the economy and gradual lifting of restrictions in 2020. Though overall top and bottom line have improved, Net Working Capital (NWC) and Cash Conversion Efficiency (CCE) have declined from the previous year.

Net Working Capital (NWC) days have increased by 19% from 52 days in FY20 to 62 days in FY21. We note an increase in Days of Inventory Outstanding (DIO) by 6 days from FY20 to FY21 compared to FY19 to FY20. We see more Malaysian companies storing up inventories to tackle global supply chain disruptions with shortages of raw materials across value chains. Days of Sales Outstanding (DSO) has increased as well by an average of 3 days, contributing to increased Net Working Capital (NWC) days. This overall increase indicates a cash trap as companies find ways to adapt to the volatilities associated with globalisation.

Further analysis indicates that out of fourteen industries, engineering has the longest shift in Net Working Capital (NWC) days at an additional 89 days, followed by energy & utilities at 31 days and plastics & packaging at 27 days. Large and medium sized companies experienced an increase in Net Working Capital (NWC) days while small sized companies had similar Net Working Capital (NWC) days to FY20. Malaysian companies are still navigating the ups and downs of the post pandemic era which was further exacerbated by the Russia-Ukraine war.

To sustain business growth amidst this turbulent period of prolonged supply chain woes and inflation, companies need to look into Operational Restructuring options to remain relevant in the recovery phase of COVID-19.

We elaborate further on the subject in our study and hope this can help you build a robust and resilient business to navigate the year ahead.

Highlights

Key statistics from FY20 to FY21

20%

Increase in Revenue

51%

Increase in Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA)

19%

Increase in Net Working Capital (NWC) days

21%

Drop in Cash Conversion Efficiency (CCE)

Working capital overview

1

How Malaysian companies fared in FY21 against FY20

19% increase in Net Working Capital (NWC) days

The 10-day increase in NWC days is primarily driven by the 11% increase in Days of Inventory Outstanding (DIO) and the 6% increase in Days of Sales Outstanding (DSO).

11% increase in Days Inventory Outstanding (DIO)

Pre-pandemic from FY17 to FY19, companies have been limiting inventory. Due to the impact of multiple lockdowns and shortage of raw material supply, we observe an uptick in inventory hold in FY20 moving on to FY21. This is particularly observed in the plastics & packaging, engineering and technology industries.

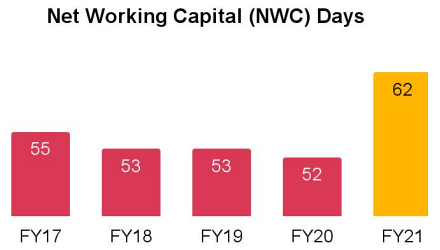
6% increase in Days of Sales Outstanding (DSO)

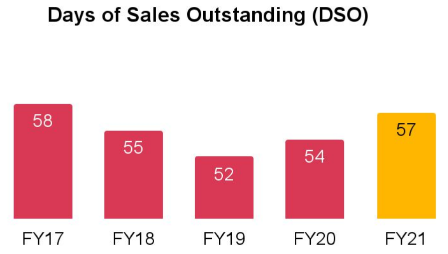
Companies are still recovering from the pandemic which has created longer receivable days in terms of payment collection from clients. This is particularly seen in the transportation & logistics, and engineering sectors.

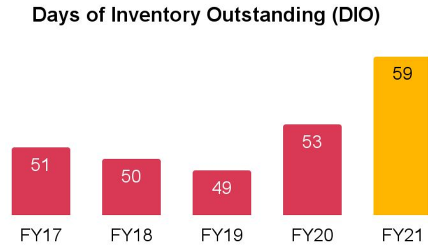
Days of Payables Outstanding (DPO) remains steady

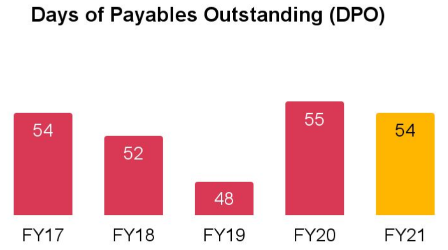
DPO is at a steady level compared to FY20 though it has yet to revert to pre-pandemic levels. Longer payable days are used to better manage cash flow.

Note: Refer to page 19 for calculation methodology.





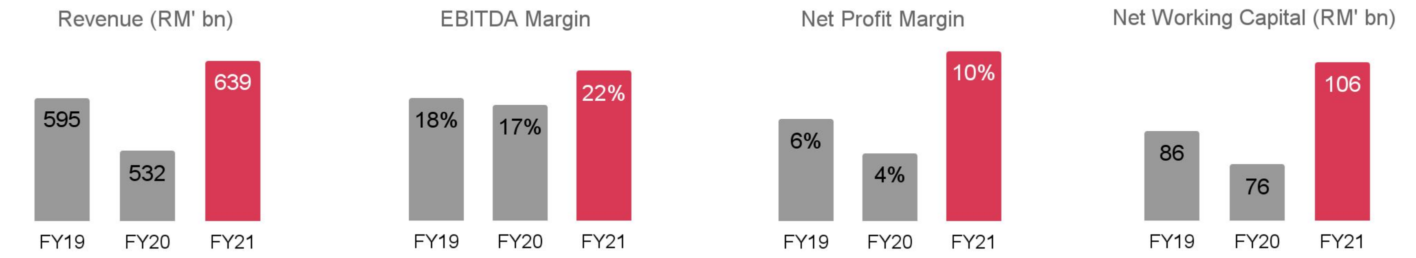




Source: Capital IQ and PwC analysis

How Malaysian companies fared in FY21 against FY20

Overall Revenue, EBITDA and net profit margins have recovered and surpassed pre-pandemic levels. However, the increase in net working capital indicates a cash trap.

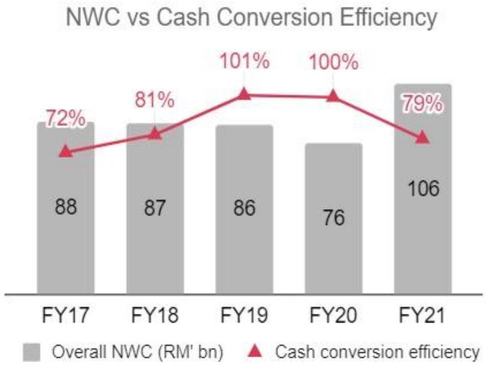


Cash Conversion Efficiency (CCE) returning to pre-pandemic levels

Overall, Malaysian companies faced an increase in NWC, primarily driven by a rise in inventories and trade receivables, indicating that companies are gearing up for a recovery.

However, CCE decreased from 100% in FY20 to 79% in FY21. This indicates that the companies' ability to convert profits into cash has reduced. Though Just-In-Case inventory (JIC) methodology remains a preferred inventory practice, companies will still need to ensure that this does not place a burden on their cash flow.

Companies should practice effective inventory management which takes into account current and potential business sales while managing their suppliers i.e. for raw materials. This is to ensure that cash flow is not affected during the business cycle.



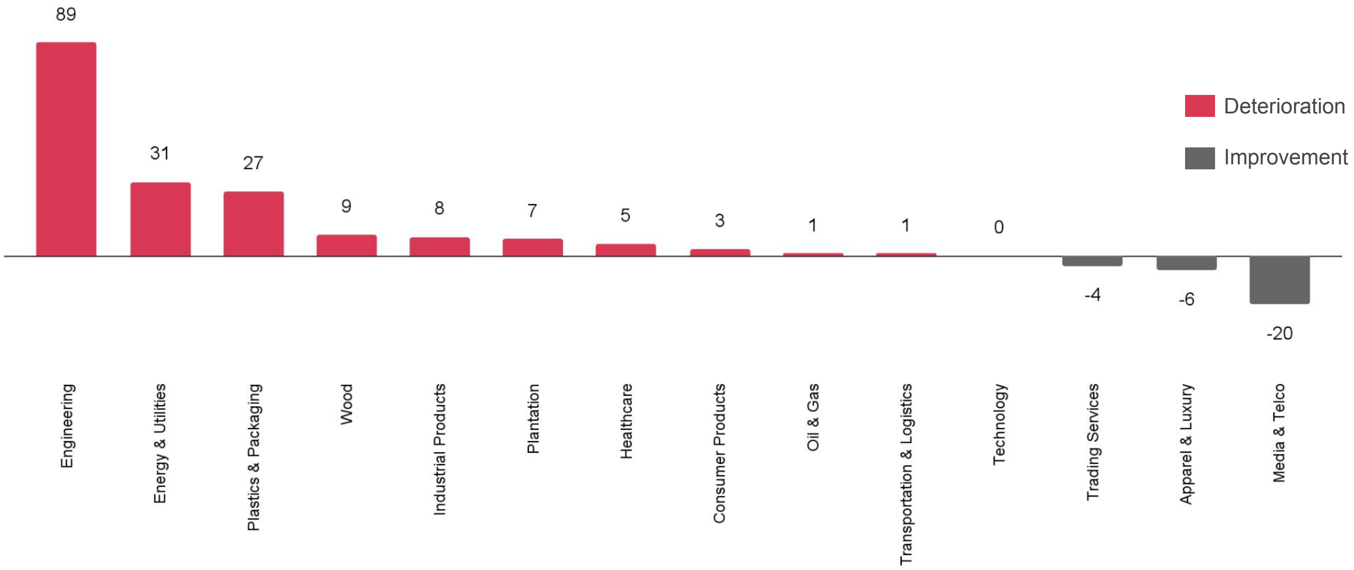
Source: Capital IQ and PwC analysis

How industries adapted to change

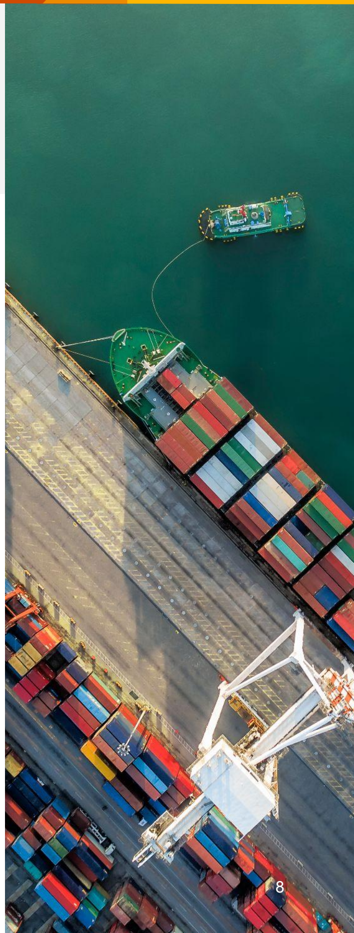
11 out of 14 industries faced a deterioration in NWC days primarily due to increase in DIO

Overall, the industries facing NWC days pressure are engineering, energy & utilities and plastics & packaging at 89, 31 and 27 days respectively. On the other hand, media & telecommunications, and apparel & luxury industries saw an improvement in NWC days at 20 and 6 days respectively. A breakdown of the NWC days can be seen in the following page.

Change in NWC days by industry from FY20 to FY21



Source: Capital IQ and PwC analysis



Changes in NWC days by industry

Industry	DSO	DIO	DPO
Engineering	+39 days	+33 days	-17 days
Energy & Utilities	+6 days	+1 day	-24 days
Plastics & Packaging	+9 days	+24 days	+6 days
Wood	-5 days	+7 days	-7 days
Industrial Products	-3 days	+13 days	+2 days
Plantation	0 days	+5 days	-2 days
Healthcare	-2 days	+6 days	-1 day
Consumer Products	-6 days	+10 days	+1 days
Oil & Gas	+12 days	+1 days	+12 days
Transportation & Logistics	+23 days	+2 days	+24 days
Technology	-6 days	+15 days	+9 days
Trading Services	+1 days	-9 days	-3 days
Apparel & Luxury	0 days	-4 days	+2 days
Media & Telecommunications	+5 days	0 days	+25 days

Source: Capital IQ and PwC analysis

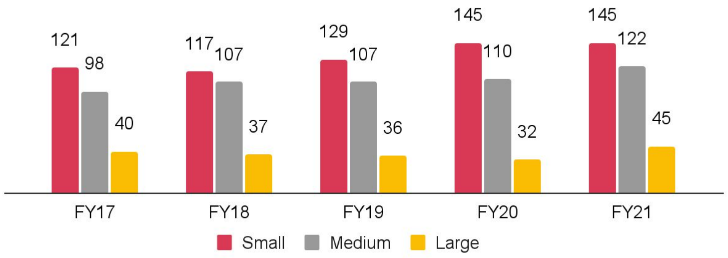
How companies of various sizes fared

All companies, small, medium and large faced a gradual increase in NWC days from FY17 to FY21

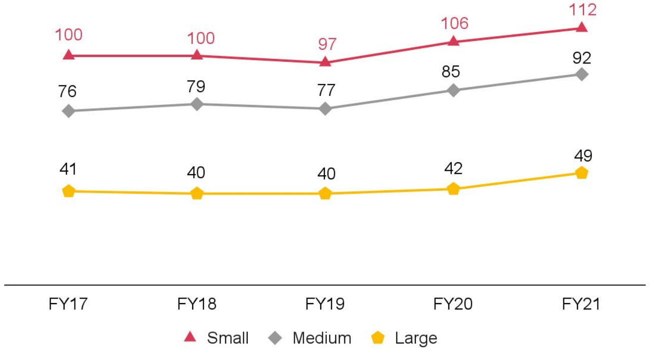
- For the purpose of this study, we pooled together 407 companies comprising small (55%), medium (24%) and large (21%) sizes from various industries.
- Small and medium sized companies have the longest NWC days in FY21 at 145 and 122 days respectively.
- Medium sized companies saw an 11% increase in NWC days from FY20 to FY21 due to longer DIO and shortening DPO.
- Large sized companies faced a 41% deterioration in NWC days to 45 days in FY21 due to lengthening DIO and DSO.
- The primary contributor to lengthened NWC days is an increase in DIO. From FY17 to FY19, DIO has remained steady across all company sizes. However, we observe an increasing trend from FY20 to FY21.

Note: Large companies; RM1.5 billion (bn) or more in Revenue, Medium companies; more than RM500mn and less than RM1.5bn in Revenue, Small companies; RM500mn or less in Revenue

NWC days by company size



DIO by company size



Source: Capital IQ and PwC analysis

Market trends

2

Increasing inflationary pressure on businesses and communities

Global inflation is at its peak since 2018 and is expected to rise further in 2022

Inflation rose steadily in 2021 and shows an upward trend in 2022. It rose to 4.4% in July 2022 due to persisting geopolitical conflicts and worsening supply chain disruptions. In addition, the ongoing labour shortages and rising raw material prices have led to an increase in consumer goods prices despite the government's provision of subsidies. Based on recent Bank Negara Malaysia Monetary Policy statements, Malaysia's headline inflation in 2022 is projected to average within the 2.2% to 3.2% forecast range for the year. NWC days may shift further as companies' receivables and payables would be extended due to the need to preserve cash.

Impact of changes in inflation levels on the economy from 5 different perspectives

Rising raw material prices
Pent up consumer demand led to a supply crunch in the aftermath of the pandemic.

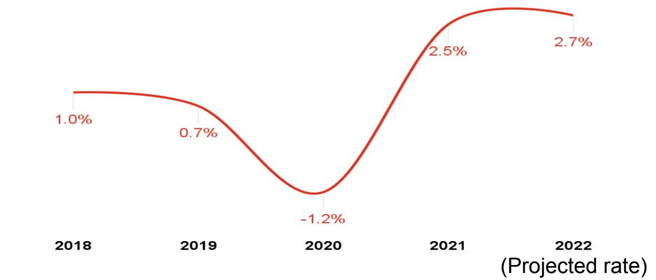
Labour shortages
The Malaysian government put a freeze on foreign workers coming in to Malaysia to curb the spread of COVID-19 in 2020, which was lifted since 19 August 2022.

Russia-Ukraine war
The Russian invasion of Ukraine and sanctions imposed by the North Atlantic Treaty Organization (NATO) has created a ripple effect on prices of commodities like oil, fertilizer and wheat.

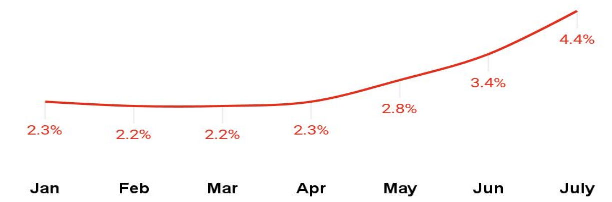
Rise in minimum wage
A 25% increase in minimum wages from RM1,200 to RM1,500 was gazetted in the Minimum Wages Order on 27 April 2022, which came into effect on 1 May 2022.

Price controls and subsidies
Subsidies on fuel and other commodities continue to be provided by the government though there are indicators of a review of these subsidies.

Malaysia's inflation rate from FY18 - FY22

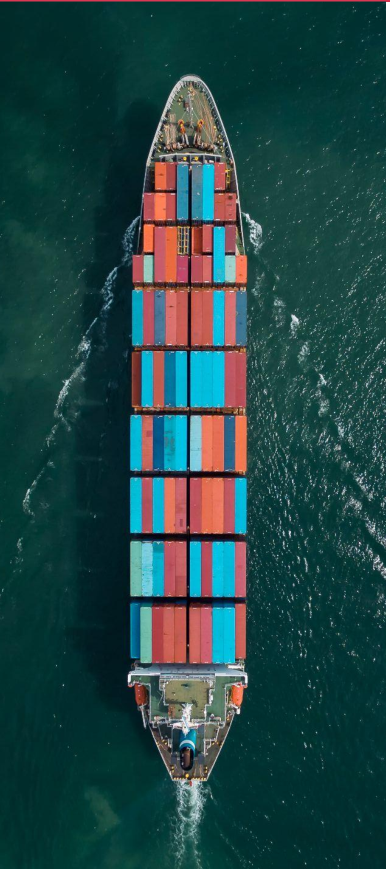


Malaysia's inflation rate YTD 2022



Sources: Department of Statistics Malaysia 6-July-22 : Bank Negara Malaysia 8-Sept-22 : Bank Negara Malaysia

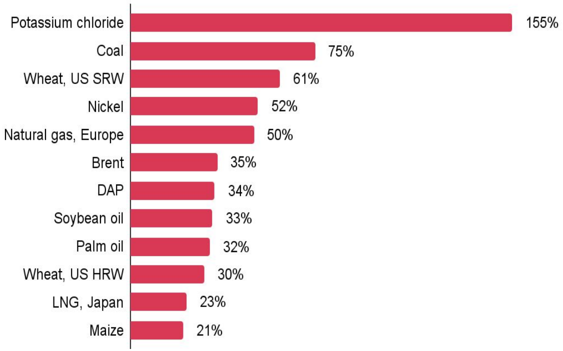
Supply chain disruptions are a catalyst for inflationary pressure



In FY21, companies faced turbulence from all sides of the supply chain, from raw material and commodity supply to logistical issues and increasing customer demand. These issues are expected to continue in FY22. Companies need to reassess and revamp their entire supply chain to create resilience in meeting customer demands.

1. The surge in demand for goods amidst the relaxation of COVID-19 measures have caused a mismatch between supply and demand. Globally, suppliers are facing bottlenecks in raw materials, causing prices to inflate. Companies across industries face intense pressure from rising commodity prices.
2. During the pandemic, companies reduced their workforce to operate at a minimum. Now, companies (both in the goods and services sector) are facing intense pressure to beef up demand. However, the issue is exacerbated by both labour shortages and rising labour costs which also cause production and manufacturing delays.
3. Oil prices are at an all time high which increases delivery costs. Freight rates are expected to rise further in FY22 and as the Malaysian government discusses a more targeted fuel subsidy approach, this is expected to increase prices for businesses.
4. Customers face the burden of rising cost of living as costs are generally passed on to consumers. Companies, on the other hand, face pressure to maintain prices at current levels and this is expected to remain difficult in the long term.

Global commodity prices % change (Jan - Mar 2022)



Source: The World Bank

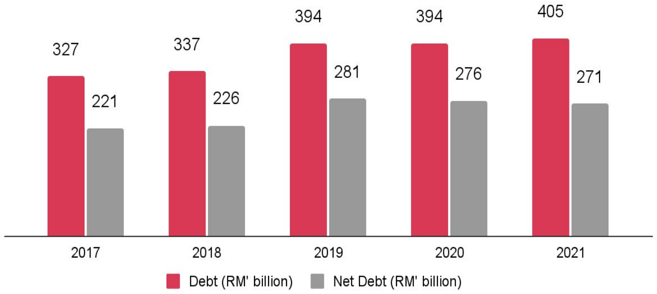
Operational restructuring remains a high priority in navigating an increasingly complex business environment

1. **Total Debt** has increased at a 5-Year CAGR of 5.5% where a spike was seen starting FY19 and remains high till FY21. A similar trend is noted for net debts from FY17 to FY21 which has remained high.
2. There was an improvement in **gearing ratio** from 0.71 in FY20 to 0.68 in FY21 though it has yet to recover to pre-pandemic levels. 4 out of 14 industries saw a decline of debt to equity which are energy & utilities, oil & gas, plastics & packaging and transportation & logistics. These industries face higher impact due to the nature of the business which is highly capital-intensive.
3. **Accounts Receivable** which stood at a 5-year high at RM100 billion in FY21 is also an indicator of lengthier receivable days. From FY20 to FY21, 13 out of 14 industries faced an increase in receivables.
4. These are indicators that **Operational Restructuring** still remains a high priority and companies should get ahead of the game to manage these rising debt levels.

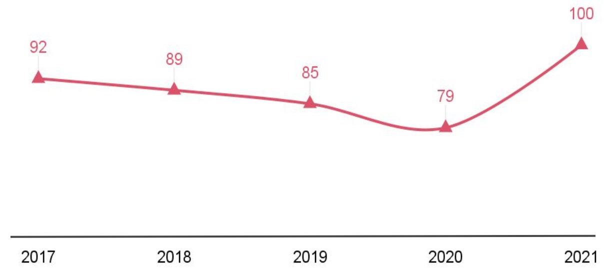
Operational Restructuring remains a high priority for companies to:

- Improve company cash flow and working capital efficiency
- Identify and improve lengthy receivables collection
- Improve debt levels and overall liabilities
- Identify and focus on profitable business divisions
- Rationalise costs and improve process efficiencies
- Improve supply chain operations

Debt and Net Debt (RM' bn)



Accounts Receivable (RM' bn)



Note: Refer to slide 19 for calculation methodology.

Source: Capital IQ and PwC analysis

How we can help

3

Working Capital Management (WCM) is a key element of our Operational Restructuring service offering

Operational Restructuring

Turnaround & Transformation

We design and implement a range of rapid action solutions to improve the operational and financial performance of a distressed business

Project Management Office (PMO)

Agile project management solutions to plan, monitor, report and control key initiatives

Drives pace, rigour and accountability of the initiatives

Working Capital Management

We assess working capital performance through various metrics, followed by opportunity identification and implementation through a deep dive into the operational processes:

- Order to Cash
- Procure to Pay
- Forecast to Fulfil

Cost Reduction

We adopt a zero-based approach to identify and implement opportunities across the client's direct and indirect spend base, with a focus on:

- Process improvement
- Pricing & negotiations
- Consumption reduction
- Specification rationalisation

Cash Forecasting

Provides granular insights into cash flow (cash generators and cash burners), allowing management to take action and realise opportunities to improve their cash position

Our Working Capital Solution helps clients identify and realise cash across the value chain by leveraging data analytics and technology

Working Capital (WC) Solution

- **Review of current and historical WC metrics/ trends and peer benchmarking**
- **Assess WC requirements through a deep dive into the end-to-end value chain**
- **Opportunity diagnosis, implementation and value quantification**

Order to Cash

- Revenue enhancement strategies
- Customer segmentation
- Key account management
- Sales forecast and planning
- Service/ product delivery and monitoring
- Invoicing and collection process
- Dispute management
- Initiatives to reduce Days of Sales Outstanding (DSO) and unbilled Revenue

Procure to Pay

- Consolidated spending
- Increasing control with centre-led procurement
- Assistance in avoiding leakage with purchasing channels
- Payment terms harmonisation
- Supply chain finance benefits assessment, roll-out and ESG considerations
- Eradicating early payments
- Payment cycles and methods
- Negotiation strategy and support

Forecast to Fulfil

- Sales & operations planning
- Lean and agile supply chain strategies
- Geographical footprint and coordination
- Forecasting techniques
- Demand and inventory planning
- Inventory visibility and optimisation techniques
- Inventory parameters and controls defining target stock
- Logistics operations

- Data analytics and digital working capital solutions
- Working capital e-learning and training
- Supply chain financing solutions
- Process mining as a service

Our working capital improvement approach

Quick scan → **Solution design and quick wins** → **Implementation support**

Appendix

4

Methodology

Metrics	Overview	Formula
Net Working Capital "NWC" days	NWC 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 of 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 of 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
Days of 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
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
Gearing Ratio	Gearing ratio is an indicator of the debt levels of the company against shareholders' equity	Total Debt / Shareholders' Equity

This study provides a view of working capital performance based on the data sourced from S&P Capital IQ, across 407 listed companies in Malaysia. Companies operating in the financial services, property developer, and construction industries were excluded from the study.

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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