

M&A Academy

How can working capital optimisation mitigate part of the financial risks?

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January 2011

Agenda

Highlights from European Working Capital Study 2010

Working Capital Optimisation in Transactions

Q & A

European Working Capital Study 2010

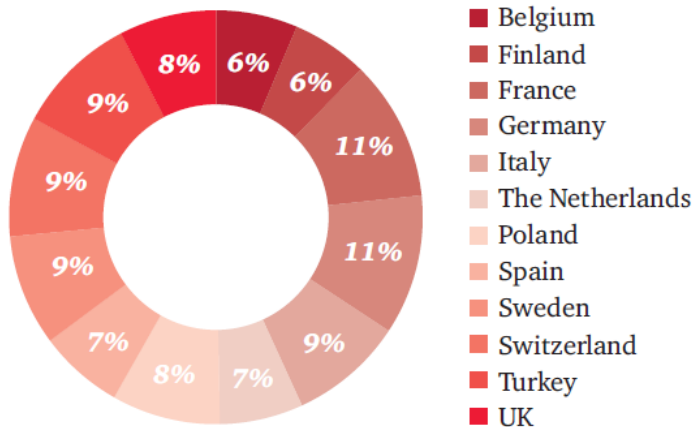
Promises, promises?



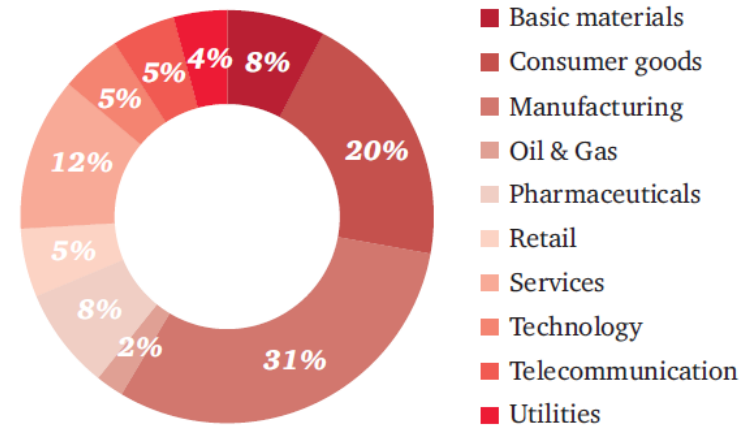
Scope of European study

Over 1200 publicly listed companies of 12 countries sampled

Population distribution by country



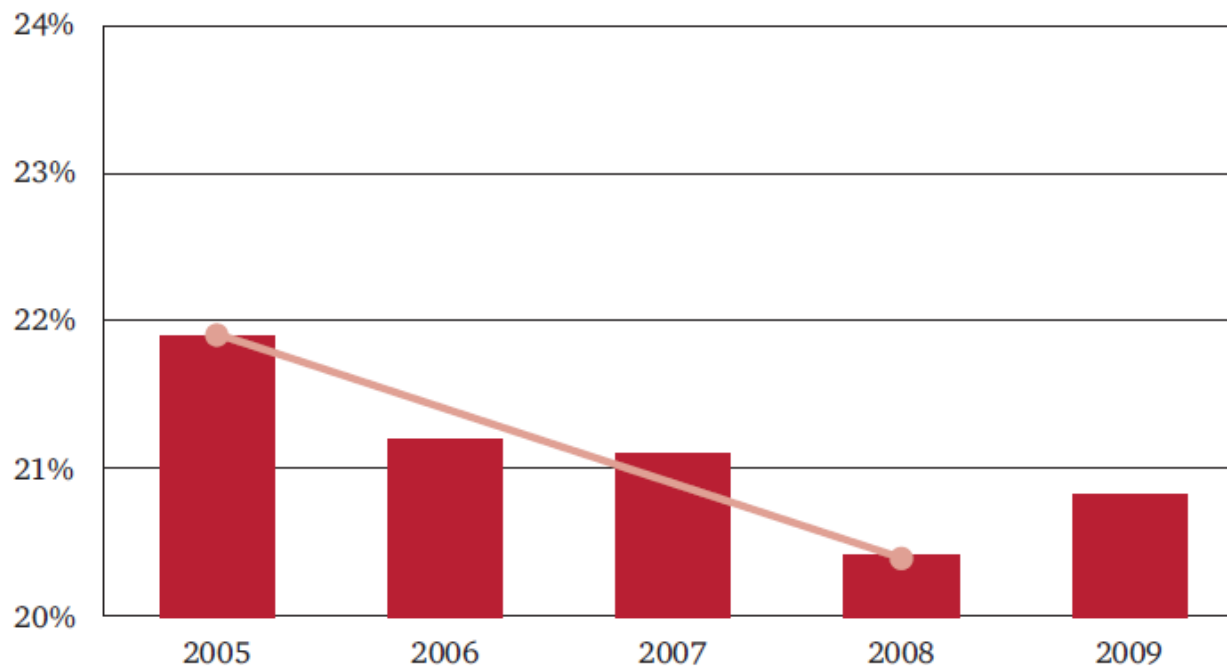
Population distribution by industry



Key objective of the study is understand working capital movements in the context of the financial crisis, across different countries, across different sectors

For the first time since 2005, European working capital levels deteriorate

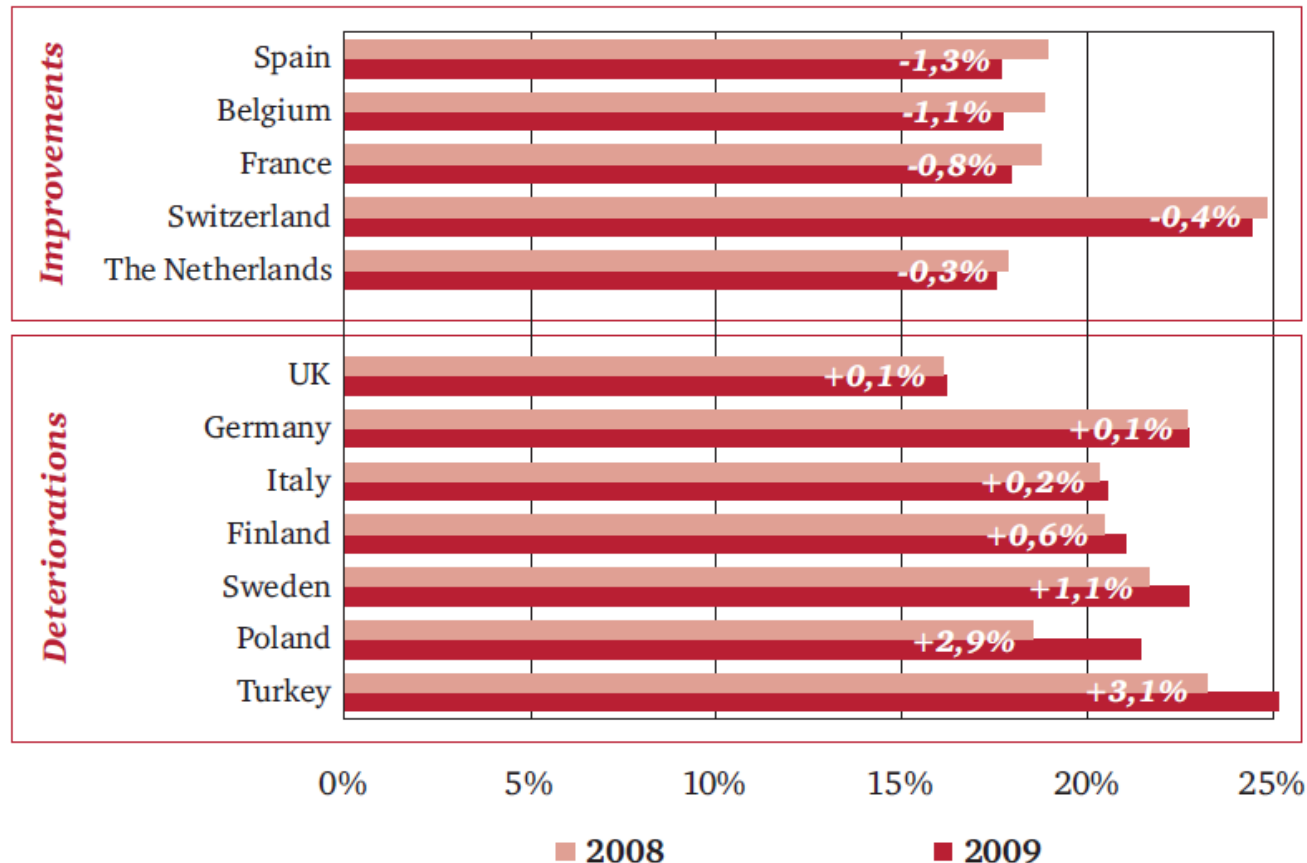
European average working capital ratio



Working capital ratio defined as net working capital/annual turnover

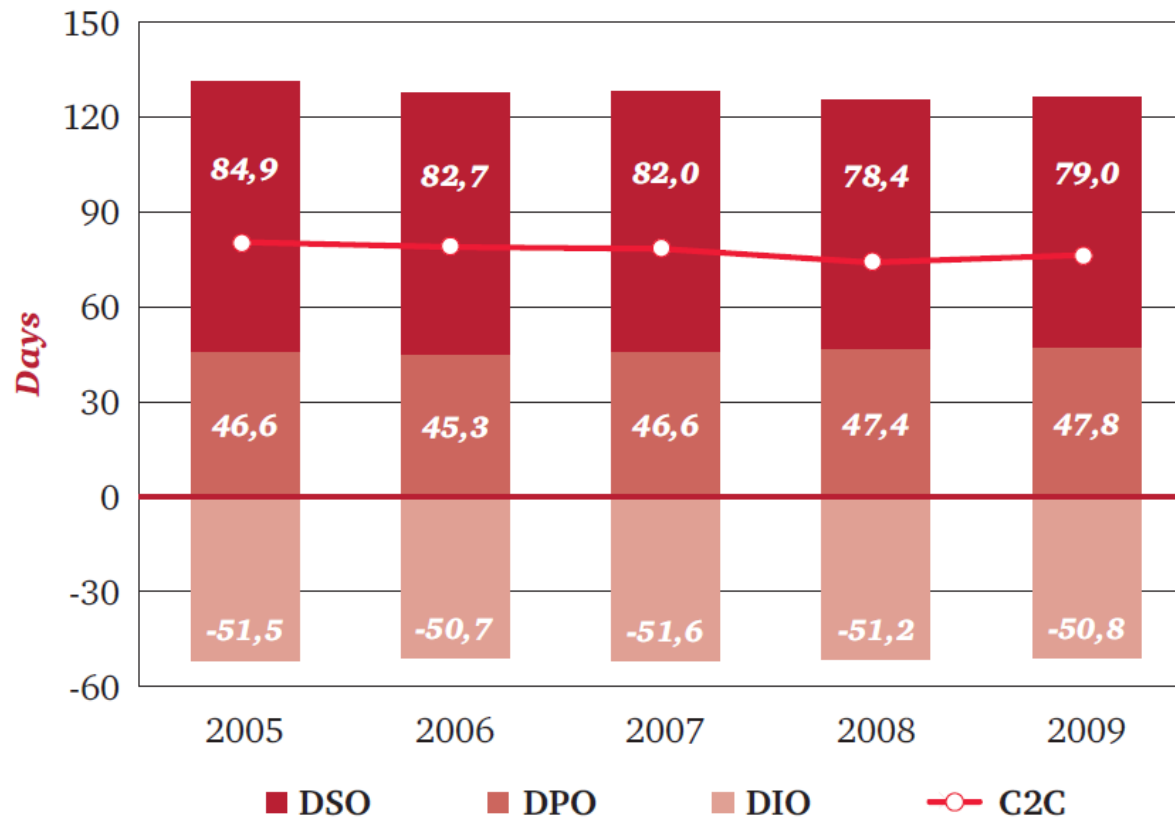
Large differences in overall country performances

Average working capital ratio by country



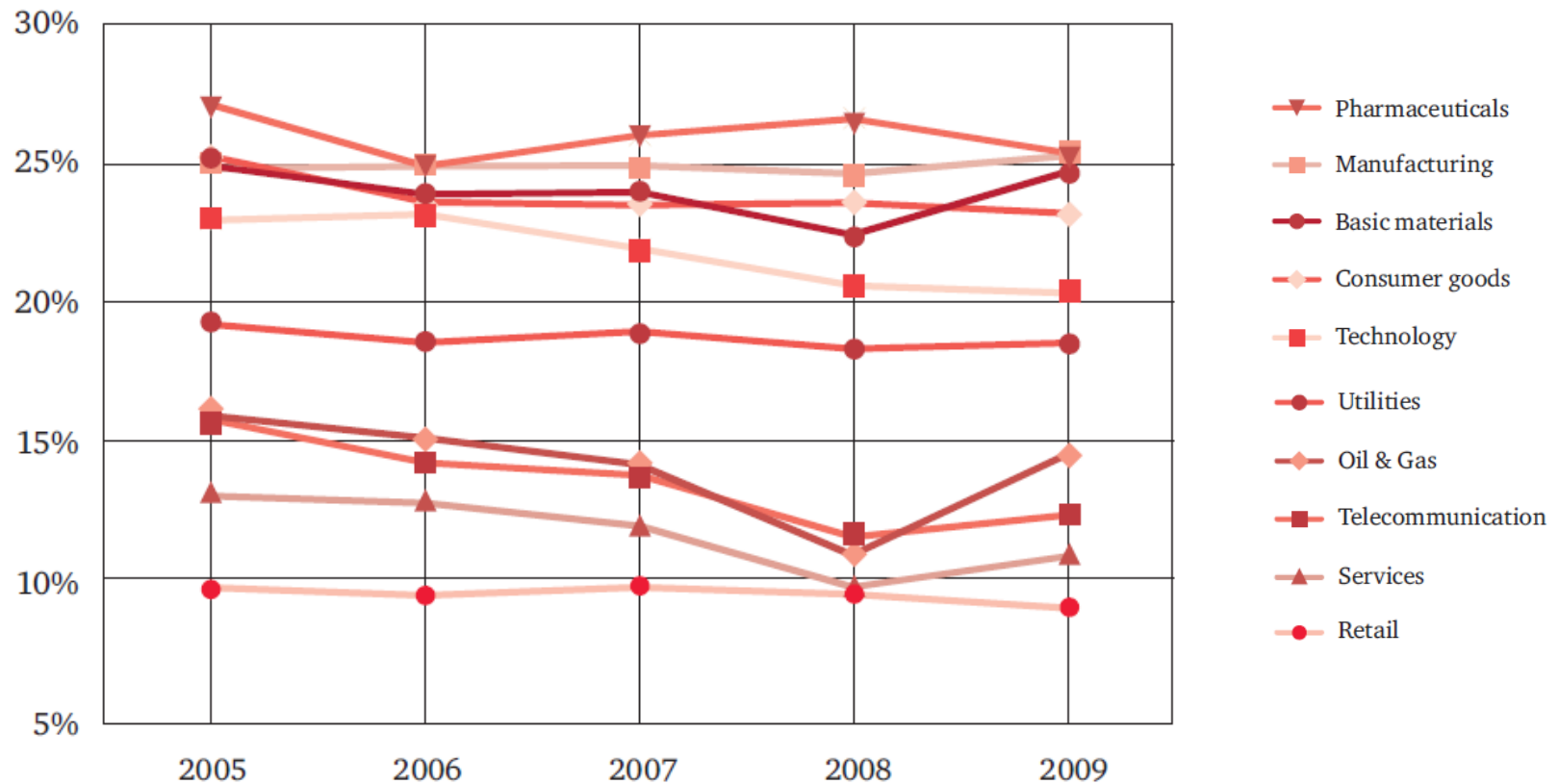
Overall European cash conversion cycles have increased by 1,5 days

Average evolution of C2C, DSO, DPO and DIO



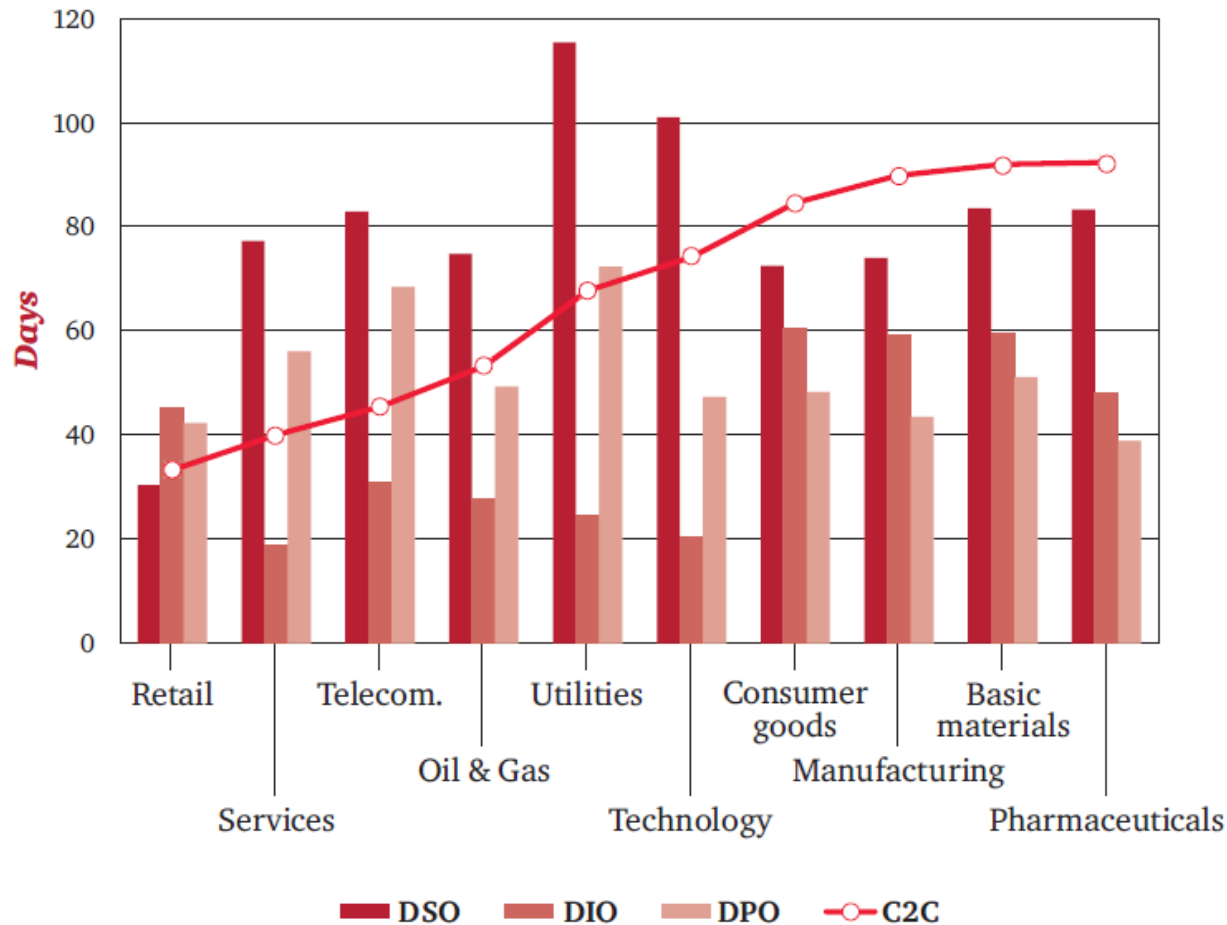
Pharma and retail companies show biggest overall improvements

European working capital ratio per industry



Oil & Gas and basic material companies show biggest deteriorations

Cash-to-cash cycles by sector (2009)



European companies carry over €475bn excess cash in working capital

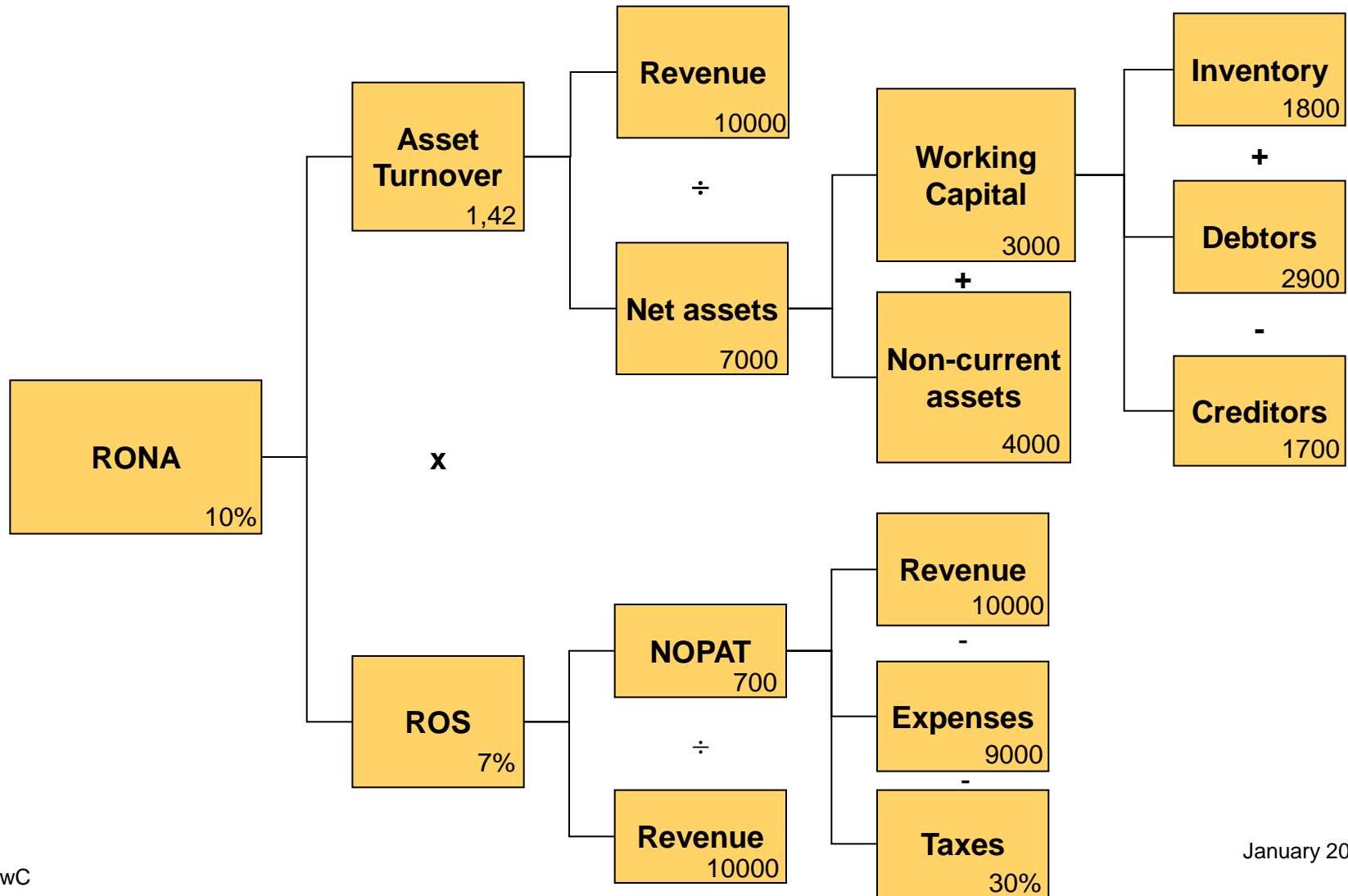
Large spread across sectors show difference in performance

Working capital ratios per industry

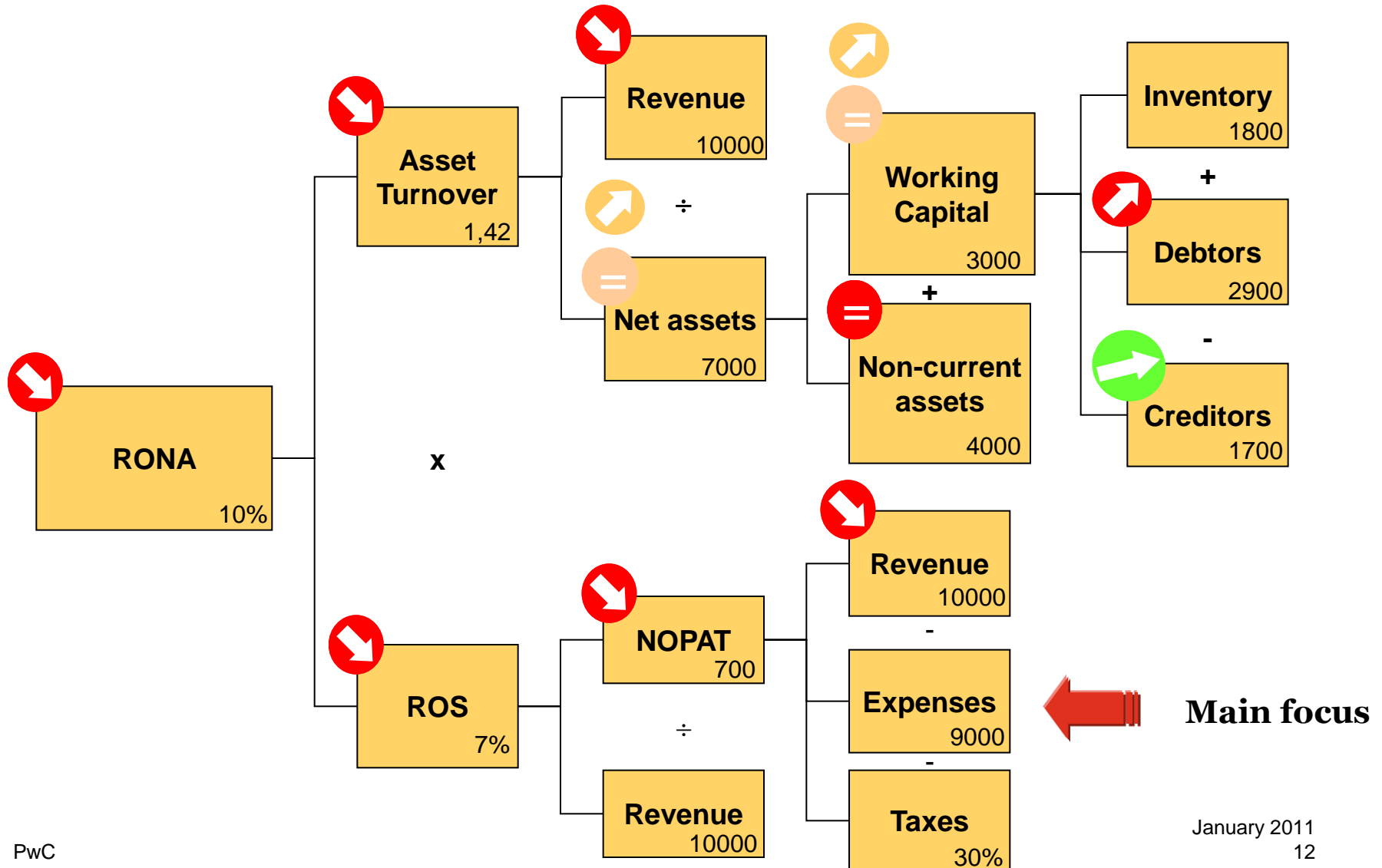
Sector	Number of companies	Lower quartile	Median	Upper quartile	Difference upper to lower quartile
Consumer goods	247	32,0%	21,0%	12,1%	19,9%
Manufacturing	375	34,0%	22,8%	14,3%	19,7%
Services	147	18,3%	9,1%	0,8%	17,5%
Pharmaceuticals	97	32,4%	24,0%	14,9%	17,5%
Utilities	51	24,0%	12,7%	6,6%	17,4%
Telecommunication	61	19,4%	10,8%	3,0%	16,4%
Technology	58	25,8%	19,1%	12,3%	13,5%
Basic materials	94	30,9%	22,9%	17,4%	13,5%
Retail	66	14,8%	9,0%	2,7%	12,1%
Oil & Gas	27	20,2%	11,5%	8,4%	11,8%

Return on Net Assets (RONA)

Dupont model

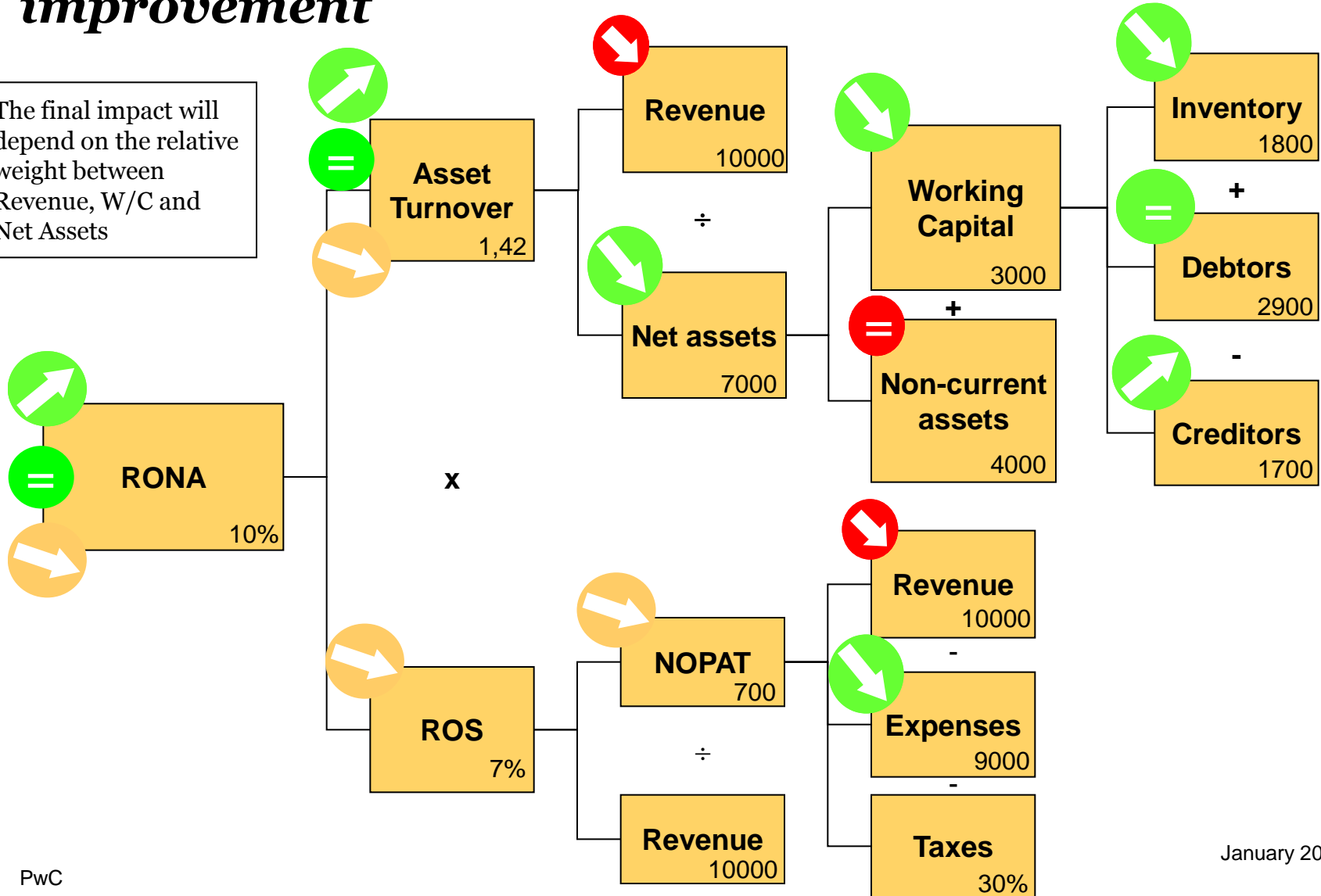


Return on Net Assets (RONA) – Crisis impact



Return on Net Assets (RONA) – ST and LT improvement

The final impact will depend on the relative weight between Revenue, W/C and Net Assets



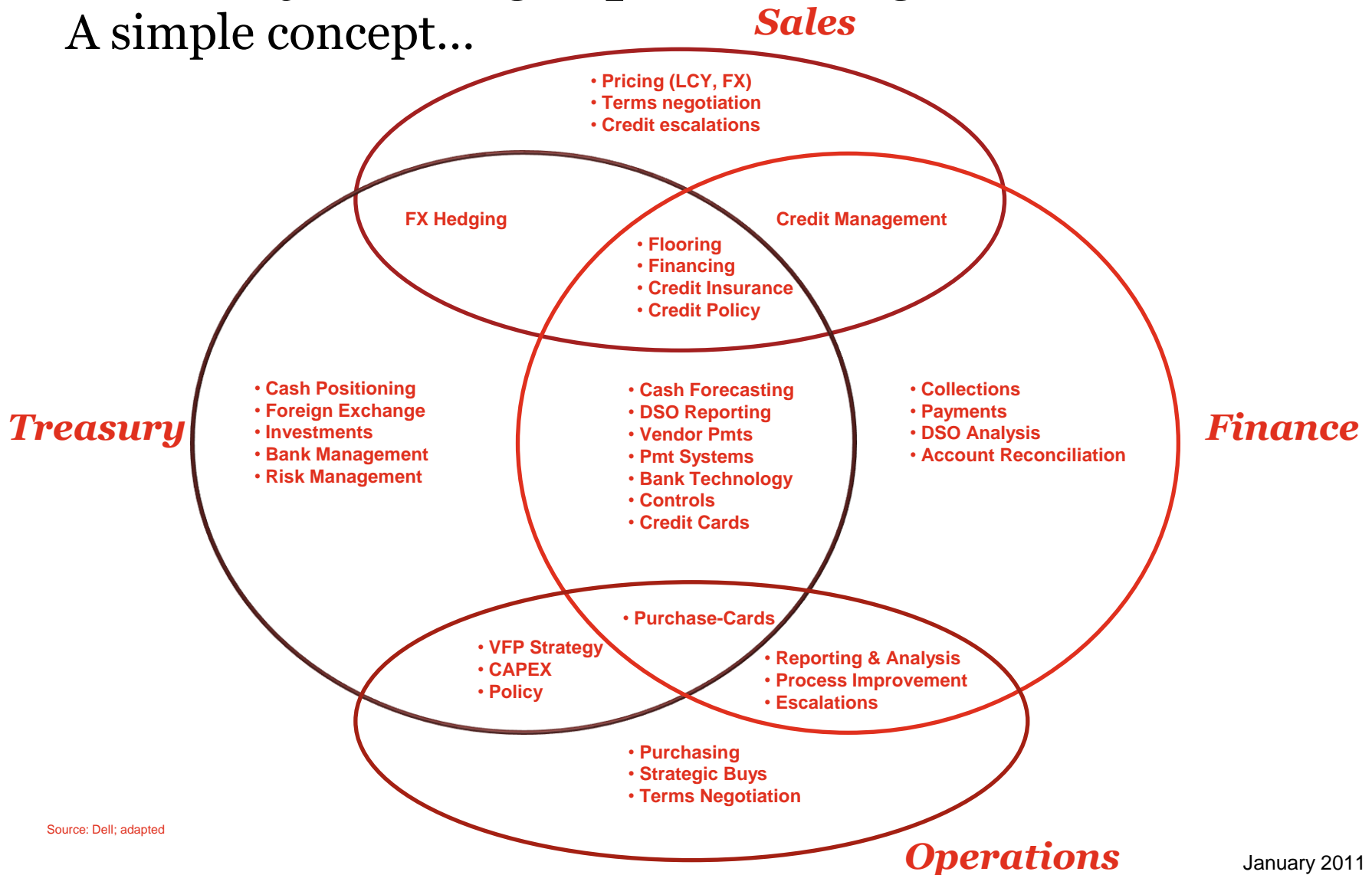
Potential impact on profitability

Profit impact simulation by industry

Sector	WC ratio- median (%)	WC ratio upper quartile	WC improvement (€m)	Impact on RONA (%)	Equivalent NOPAT improvement (%)
Retail	9,0%	2,7%	548,9	1,6%	14,1%
Technology	19,1%	12,3%	36,7	1,6%	10,0%
Services	9,1%	0,8%	195,8	1,7%	9,5%
Manufacturing	22,8%	14,3%	180,2	1,3%	9,4%
Consumer goods	21,0%	12,1%	440,7	1,3%	9,2%
Pharmaceuticals	24,0%	14,9%	261,3	1,6%	7,1%
Telecommunication	10,8%	3,0%	661,4	1,1%	5,7%
Basic materials	22,9%	17,4%	169,1	0,5%	4,1%
Oil & Gas	11,5%	8,4%	668,4	0,6%	3,6%
Utilities	12,7%	6,6%	737,6	0,6%	3,5%

Nature of working capital management

A simple concept...



Source: Dell; adapted

Key trends in underlying drivers impacting management of working capital

Order-to-Cash

1. Progress in technology

led to mature systems to support, automate and professionalise various activities in managing receivables

2. Consolidation of disparate systems

increases transparency in dispersed organisations

3. Increased collaboration

and cross-departmental interaction leveraging existing information

Purchase-to-Pay

1. Reverse factoring sees come-back in the light of tightening liquidity and more difficult access to credit for SME's.

2. Supplier risk management

led to monitoring of suppliers and more collaboration and support of strategic ones

3. Payment term

regulation in several European countries has passed in and is likely to be adopted elsewhere over the long-term

Forecast-to-Fulfil

1. Further globalisation of supply chains leading to additional complexity

2. Lean methodologies and concepts are rolled out further into non core-operational processes

Working Capital Optimisation in transactions



Working Capital within due diligences and SPA's


Typical consideration points

- **General issues:**
 - Average / Normalised / sustainable working capital
 - Sustainability
 - Seasonality, Inter and intra month swings
 - Quality and value
 - Cut-offs
- **Definition of (normalised) working capital:**
 - agree on common definition
 - Exclusion of non-trade items
 - periods
- **Sale and Purchase Agreement:**
 - definition of adjustment mechanisms
- **Funding:**
 - Average, minimum and maximum levels required
 - Asset-backed lending
- **Materiality:**
 - Actual/forecast levels
 - WC relative to total deal size/funding
- **Reporting:**
 - Composition of balance
 - Value and quality of cash flows


Working Capital within due diligences and SPA's

Normalised working capital as baseline

- Backward-looking analysis usage and performance
- Based on pre-integration operations
- Objectives:
 - Define sufficient level for 'ordinary trading'
 - Assess (and limit) risk of additional funding requirements for continuing operations



Provision for WC adjustment. The cash value of the WC adjustment will directly affect the price paid and the acquisition funding requirement



What is the potential scale of cash release from working capital improvements in short & medium terms?

Working Capital within due diligences and SPA's

Assessing upside potential

Objectives

- Quality of assets acquired (for example, conversion stock and debtors into cash)
- Cash generation through improved management of working capital
- Impact of growing business on WC

Rewards

- Post acquisition WC strategies and facilities support future business growth and minimise WC requirements

Risks

- Acquire assets we don't need and liabilities we don't want
- Insufficient facilities to grow business
- 'Current' assets difficult to convert to cash

Example: €100m normalised WC



From an investor perspective

Value enhancement

Key levers for valuation

- Reduction of working capital will reduce net debt and increase valuation by a factor of 1
- Increase of EBIT will improve valuation by a multiple factor (7.5)
- Topline growth and technology will drive the multiple

Other benefits from reducing WC requirement

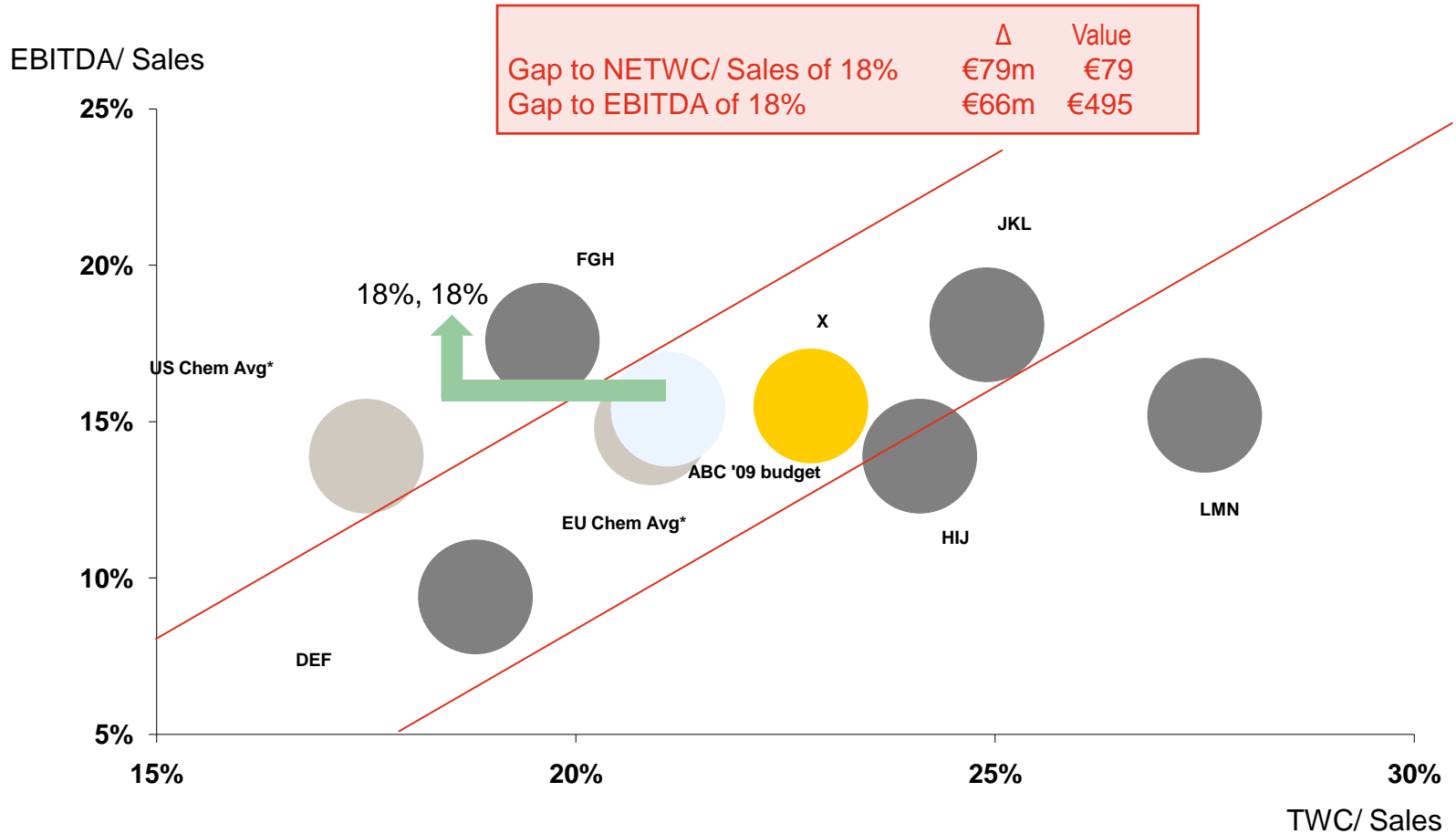
- Reduces borrowings and improves profitability
- Frees up cash for new initiatives / projects
- Helps provide flexibility to meet new constraints
- Improves customer service levels and supplier relationships
- Reduces reserves for bad debt and obsolete inventory
- Better processes require less costs to manage

Example of how improvements impact both the bottom line and the equity/debt split

€M	2011 budget	Margin ↑ 1%	Overheads ↓ 5.5%	NETWC/Sales to 18%	NETWC/Sales to 10%
Turnover	2,544	2,544	2,544	2,544	2,544
Gross Margin	1,128	1,153	1,153	1,153	1,153
Overheads	737	737	696	696	696
EBITDA	391	416	457	457	457
EBITDA %	15.4%	16.4%	18.0%	18.0%	18.0%
Multiple	7.5	7.5	7.5	7.5	7.5
Enterprise value	2,933	3,083	3,638	3,638	3,638
NETWC	537	537	537	458	254
NETWC/Sales	21.1%	21.1%	21.1%	18.0%	10.0%
Debt	2,051	2,051	2,051	1,972	1,768
Equity	882	1,072	1,376	1,455	1,659

EBITDA margin

Justification for higher working capital?



When could higher working capital levels be justified?

- Over-average operational funding requirements to create additional added value
- This is also recognised by customers willing to pay premiums (e.g. premium brands)
- Result are higher gross margins

Example: Rolls-Royce dashboards

- Wood supply is stored per unique vehicle identification number
- Second layer of the same block of wood is kept for each car in stock in case of replacement for lifetime



Leverage momentum of change of ownership

Reap benefits early in investment period

- Rigorous working capital programmes had always been on the agenda of ambitious owners and investors (PE houses as early adopters)
- Common characteristics:
 - Focus on cash as key scarce resource
 - Seek fundamental change with high impact
 - Create sense of urgency
 - Seek to instil cultural change to embrace cash awareness
- Change management

Thank you!

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Appendix – European study

Sampled companies by industry and country

	Belgium	Finland	France	Germany	Italy	Netherlands	Poland	Spain	Sweden	Switzerland	Turkey	UK	Total	Industry description
Manufacturing	25	32	39	43	26	27	41	22	25	51	27	17	375	Manufacturing of industrial goods, such as aerospace
Consumer goods	11	12	25	27	20	19	21	16	25	14	43	14	247	From clothing and footwear to household and personal products
Services	11	5	20	13	17	11	9	11	11	14	8	17	147	Both industrials and consumer services
Pharmaceuticals	8	2	12	12	8	4	4	9	13	15	3	7	97	All pharmaceutical products
Technology	5	8	5	6	7	4	9	1	8	1	1	3	58	Manufacturing of electronics, creation of software and computers or products relating to information technology
Basic materials	4	5	6	12	6	6	6	6	7	4	21	11	94	Includes the mining and refining of metals, chemical producers and forestry products
Telecommunications	6	5	7	5	4	1	5	6	6	6	5	5	61	Telecommunications and media
Retail	4	2	11	8	4	6	6		8	4	4	9	66	Primarily food retailers, excluding apparel
Utilities	4	1	6	7	13		1	7	1	4	2	5	51	Mainly electric and water firms
Oil & Gas		1	3	1	4	2	2	3	2	2	2	5	27	Oil & gas companies
Total	78	73	134	134	109	80	104	81	106	115	116	93	1.223	

Appendix – European study

DSO - average per sector and country

	Belgium	Finland	France	Germany	Italy	Netherlands	Poland	Spain	Sweden	Switzerland	Turkey	UK
Manufacturing	83,2	65,4	89,1	80,6	113,7	79,4	84,6	110,8	67,1	71,4	101,8	71,1
Consumer goods	55,1	64,0	77,6	59,7	101,2	55,8	65,8	69,0	62,5	59,6	101,6	48,2
Services	107,1	65,1	86,4	63,3	101,0	64,2	78,4	82,3	64,7	66,8	95,8	51,7
Pharmaceuticals	91,2	52,6	71,6	97,6	104,6	67,0	88,6	84,6	76,8	75,1	86,6	89,7
Technology	84,4	91,9	87,6	87,7	150,6	78,0	113,2	202,4	101,2	21,8	78,2	84,5
Basic materials	60,3	61,6	79,6	58,2	80,8	60,0	116,1	99,3	62,8	57,0	81,9	65,8
Telecommunications	65,5	62,3	134,5	42,8	113,6	51,9	71,9	115,2	86,1	62,6	105,5	46,6
Retail	25,7	33,6	35,8	18,5	101,3	10,3	34,2	0,0	27,2	39,1	19,8	18,8
Utilities	63,4	65,9	119,9	112,6	142,4	0,0	257,3	135,5	75,4	120,4	113,6	46,2
Oil & Gas	0,0	27,1	98,4	54,1	77,0	50,1	61,4	89,7	84,5	50,5	23,2	105,9

Appendix – European study

DPO - average per sector and country

	Belgium	Finland	France	Germany	Italy	Netherlands	Poland	Spain	Sweden	Switzerland	Turkey	UK
Manufacturing	58,2	33,5	60,6	41,0	78,6	55,4	50,4	91,7	42,4	31,6	59,8	39,0
Consumer goods	45,6	27,0	53,4	30,0	80,8	47,7	54,6	67,6	35,0	29,2	55,4	40,2
Services	56,4	27,2	67,1	45,7	99,4	33,8	64,6	102,5	33,7	29,7	60,2	30,9
Pharmaceuticals	63,3	60,2	49,4	33,3	61,1	20,4	22,4	53,4	27,6	19,6	48,1	32,6
Technology	68,1	53,2	42,0	21,0	91,1	17,4	50,4	147,1	24,3	18,5	89,7	12,6
Basic materials	50,0	46,2	52,3	30,5	63,1	51,2	63,2	77,4	30,8	32,5	36,9	30,4
Telecommunications	63,1	45,5	140,1	49,5	116,5	108,7	56,5	90,0	32,5	41,2	69,8	32,3
Retail	35,0	25,9	46,6	40,5	90,1	30,4	48,1	0,0	28,9	29,8	69,1	34,8
Utilities	62,6	21,2	93,5	60,0	91,4	0,0	51,0	107,6	32,3	48,8	42,6	27,7
Oil & Gas	0,0	21,8	62,8	28,4	54,9	33,0	52,9	106,9	41,1	29,6	29,0	36,9

Appendix – European study

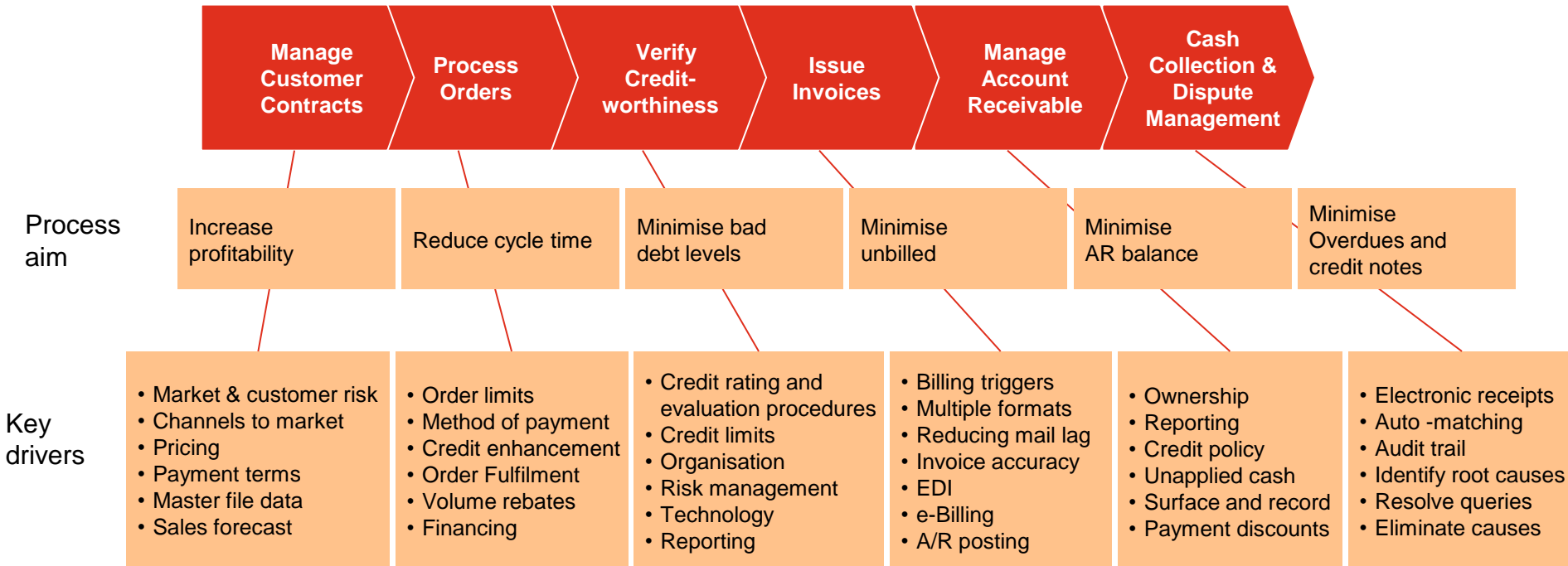
DIO - average per sector and country

	Belgium	Finland	France	Germany	Italy	Netherlands	Poland	Spain	Sweden	Switzerland	Turkey	UK
Manufacturing	51,6	59,6	57,1	67,4	75,0	62,2	54,2	67,7	57,9	57,3	58,6	45,5
Consumer goods	51,6	55,3	61,3	51,7	70,0	53,0	59,2	72,5	62,1	70,7	63,0	50,9
Services	28,4	13,7	9,4	31,0	15,3	11,8	16,1	16,3	26,3	21,6	37,7	11,0
Pharmaceuticals	49,5	59,8	27,8	49,8	42,2	43,9	45,9	62,0	48,6	52,9	50,7	54,5
Technology	47,4	19,5	8,5	5,6	33,1	3,2	25,8	28,7	17,7	20,3	47,0	1,2
Basic materials	64,5	55,8	58,1	54,5	65,1	62,0	53,2	64,4	67,8	84,8	57,7	50,2
Telecommunications	26,8	23,6	52,1	20,0	14,5	2,5	20,8	32,5	33,5	34,8	64,4	10,3
Retail	23,0	24,7	43,2	58,1	60,0	40,0	54,9	0,0	51,5	47,5	51,4	33,0
Utilities	30,3	30,0	56,9	16,5	13,6	0,0	132,3	25,9	67,1	9,1	15,3	4,4
Oil & Gas	0,0	43,5	21,3	46,4	33,7	19,0	53,4	21,2	8,8	27,3	18,1	28,9

Appendix - Order-to-Cash

Optimising receivables is more than just improving collections

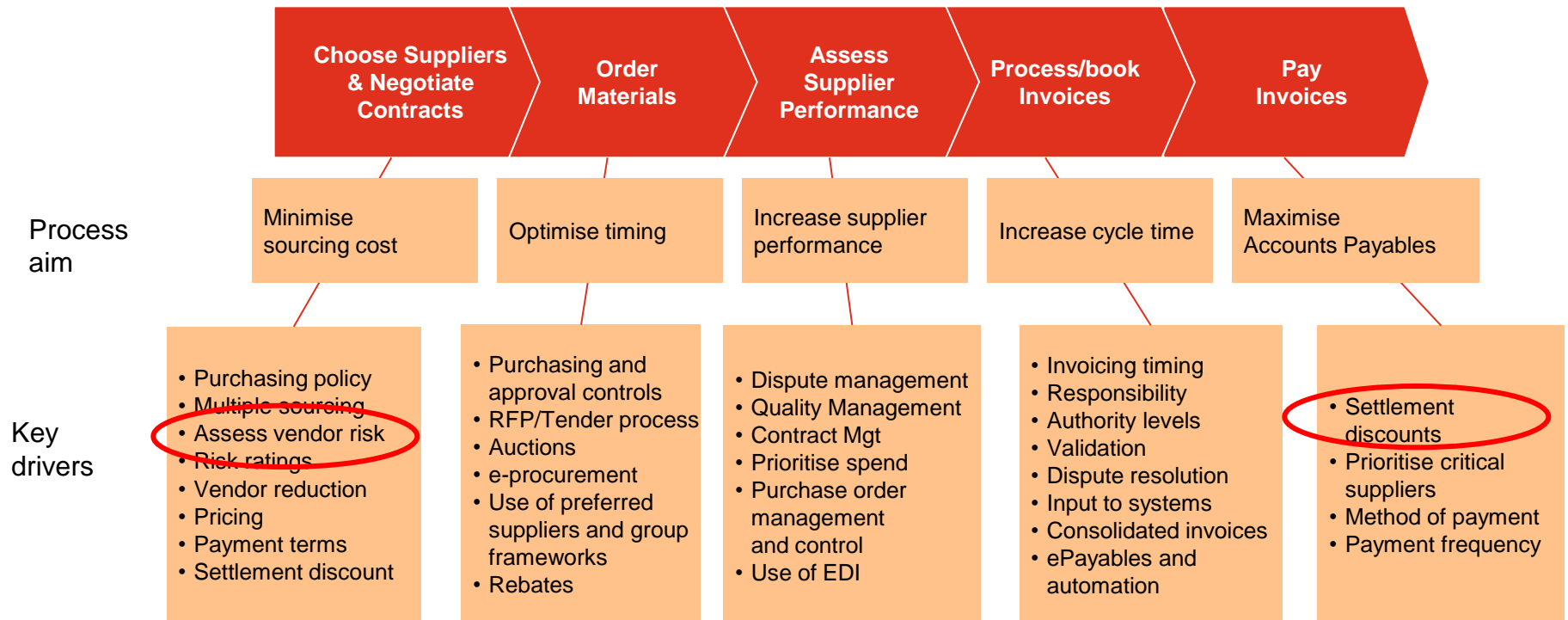
Order to Cash Cycle



Appendix - Purchase-to-Pay

Accounts Payables is more than just paying later

Purchase to Pay Cycle



Appendix - Forecast-to-Fulfil

Reductions in inventory require fine-tuning the entire end-to-end process

Forecast to Fulfil Cycle

