Navigating the months ahead:
A working capital perspective

PwC Malaysia's 2020/2021 Working Capital Study

Foreword

Welcome to PwC Malaysia's 4th annual Working Capital Study. Each year, PwC Malaysia analyses the financial performance of over 400 listed companies across 14 different industries in Malaysia, assessing their working capital performance and related key indicators.

What's the story?

As Malaysia gradually emerges from its various lockdown measures, the road to recovery is unlikely to be smooth, and businesses need to be in the best possible shape for the journey. This means a laser-like focus on liquidity, including the optimisation of working capital, is vital to navigating the months ahead.

Our report this year, titled '**Navigating the months ahead: A working capital perspective**' is focused on providing key insights on how companies can stay afloat and strive through the global pandemic and beyond.

1. **Overall decline in working capital performance**
   Our analysis shows an increase (i.e. a deterioration) in the Net Working Capital (NWC) days of companies in Malaysia from 53 days in FY19 to 55 days in LTM20*. This increase is attributable to extended receivables and inventory days. Several industries have been hit worse than others, such as engineering, industrial products, trading services, apparel and luxury, oil and gas and consumer products.

2. **Visible cash conservation efforts to manage cash flows**
   As expected, capital expenditure (capex) was the first lever for the companies to conserve cash. Our survey also shows that companies have embarked on other cash conservation efforts including reducing operating expenses such as employee costs and procurement costs.

3. **Keeping the focus on cash will help to protect businesses on the bumpy road ahead**
   There has been a rapid shift in working capital requirements, driven by disruptions in both supply and demand. Normal lead times and replenishment frequencies are elongated, meaning safety stock and inventory policies need to be adapted. Payment morale, as well as credit worthiness, are continuing to impact the ability to get paid or trade especially for SMEs. Looking ahead, many of the 'business as usual' processes to manage working capital will therefore need to be reconfigured.

   In this study, we share our views and recommend several action points for companies to conserve and manage their cash flows. We also supplemented this study with a survey where 17 business leaders in Malaysia shared how they are managing their working capital and cash during the pandemic. We hope you find our latest perspectives useful to your organisation in navigating through the current business climate.

Victor Saw
Deals Leader,
PwC Malaysia

Ganesh Gunaratnam
Working Capital Management Leader,
PwC Malaysia

*LTM20 refers to last 12 months ended quarter 2 (Q2) 2020

At a glance

Revenue declined by 7% in LTM20 from FY19

EBITDA declined by 14% in LTM20 from FY19

Operating cash flows declined by 8% in LTM20 from FY19

Net Working Capital (NWC) days in LTM20 deteriorated by 2 days from FY19

9 out of 14 industries declined in working capital performance in LTM20

Decline in working capital performance is due to increase in receivable and inventory turnover days

What’s in this report

1 **Working capital overview of selected listed Malaysian companies**

2 **Findings from 2020 PwC Working Capital and Cash Management Survey**

3 **Keeping the focus on cash**

1

Working capital overview of selected listed Malaysian companies

Impact of COVID-19 on overall financials

In general, in LTM20 overall revenue, EBITDA, operating cash flows and capital expenditure has declined

Our analysis shows that the global pandemic has resulted in a liquidity squeeze amongst most companies in Malaysia. Revenue has declined by about 7% in LTM20 compared to FY19. This is possibly due to immediate drop in demand or disruptions to the supply chain caused by lockdowns in the country and globally.

Despite the decline in demand, companies had to continue performing their obligations such as paying employee salaries and suppliers to keep operations going at minimal levels as shutting down may not have been ideal. This resulted in further pressures on the bottom line. We noted that EBITDA and operating cash flows declined by 14% and 8%, respectively during the same period.

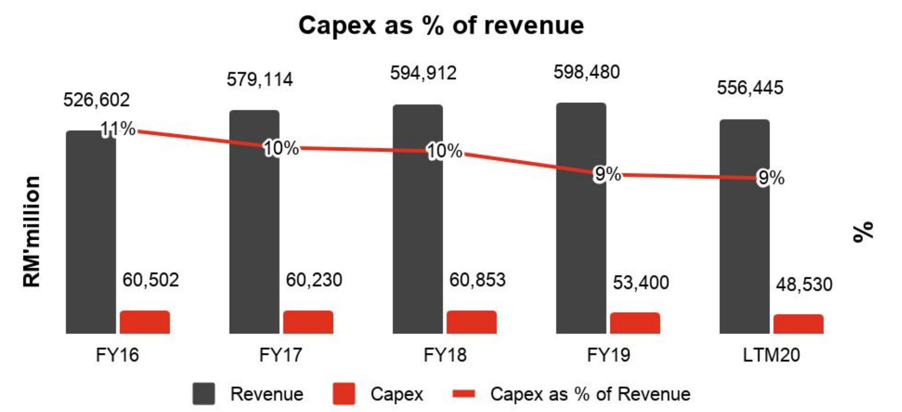
Visible reduction in capex to conserve cash in times of crisis

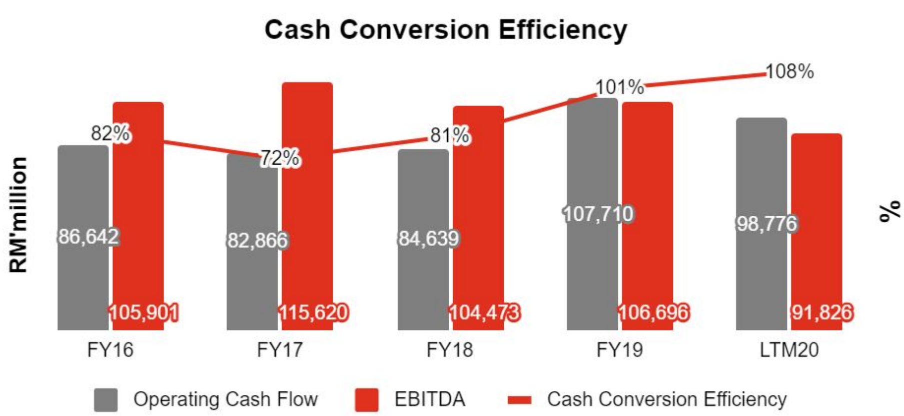
Levels of capital investments declined in LTM20 by 9% in comparison to FY19. By this measure, companies' capital expenditure is now at the lowest level we've seen over a 5 year trend. Companies may be taking a conservative approach to their cash flows due to the lingering uncertainties in the economy.

Improved cash conversion efficiency in LTM20 despite lower EBITDA

The steep decline in LTM20 of 14% and 8% in EBITDA and operating cash flows respectively could have contributed to conservative spending behaviour.

The increased focus on cash flows has resulted in improved cash conversion efficiency (from EBITDA to operating cash flows).





Source: Capital IQ and PwC analysis

Note: LTM20 refers to last 12 months ended Q2 2020

Overall working capital analysis

Overall decline in working capital performance of companies in Malaysia

Working capital performance (NWC days) had shown improvement from FY16 up to FY19. However, the performance in LTM20 has declined by 2 days from FY19.

This decline is attributable to increase in receivable days (DSO) and inventory days (DIO) by 3 days respectively. Both these metrics had shown signs of improvements up to FY19 but could not keep up to their performance in LTM20.This was offset by an increase in payable days (DPO) by 4 days.

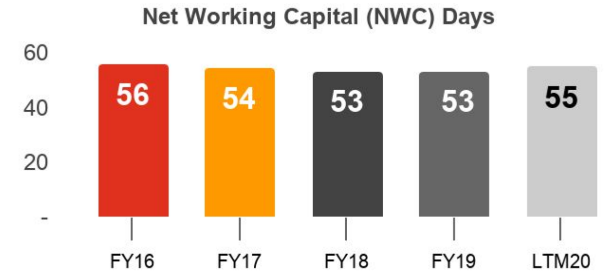
Impact of COVID-19 on working capital performance in LTM20

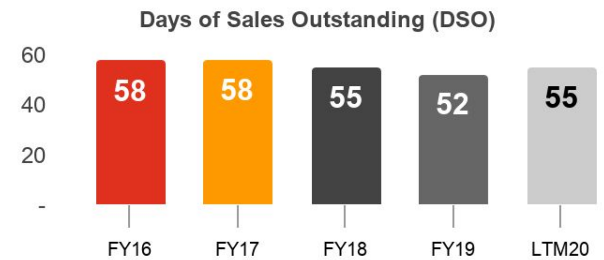
Our analysis has indicated that the pandemic has possibly adversely impacted the working capital performance of businesses in Malaysia.

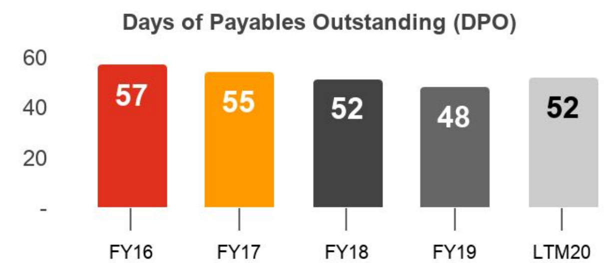
The latest LTM20 results shows that receivable days has increased, signalling delays in collection of payments due from customers and increased inventory days possibly due to loss of sales during the nationwide lockdown.

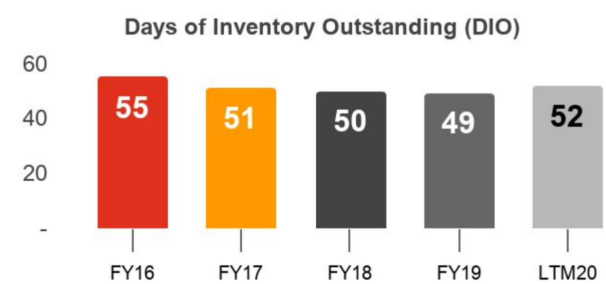
Increase of payable days in LTM20 suggests that companies have been delaying their payments to suppliers.

Note: LTM20 refers to last 12 months ended Q2 2020 extracted from Capital IQ. Net Working Capital days is Days of Sales Outstanding - Days of Payables Outstanding + Days of Inventory Outstanding.









Source: Capital IQ and PwC analysis

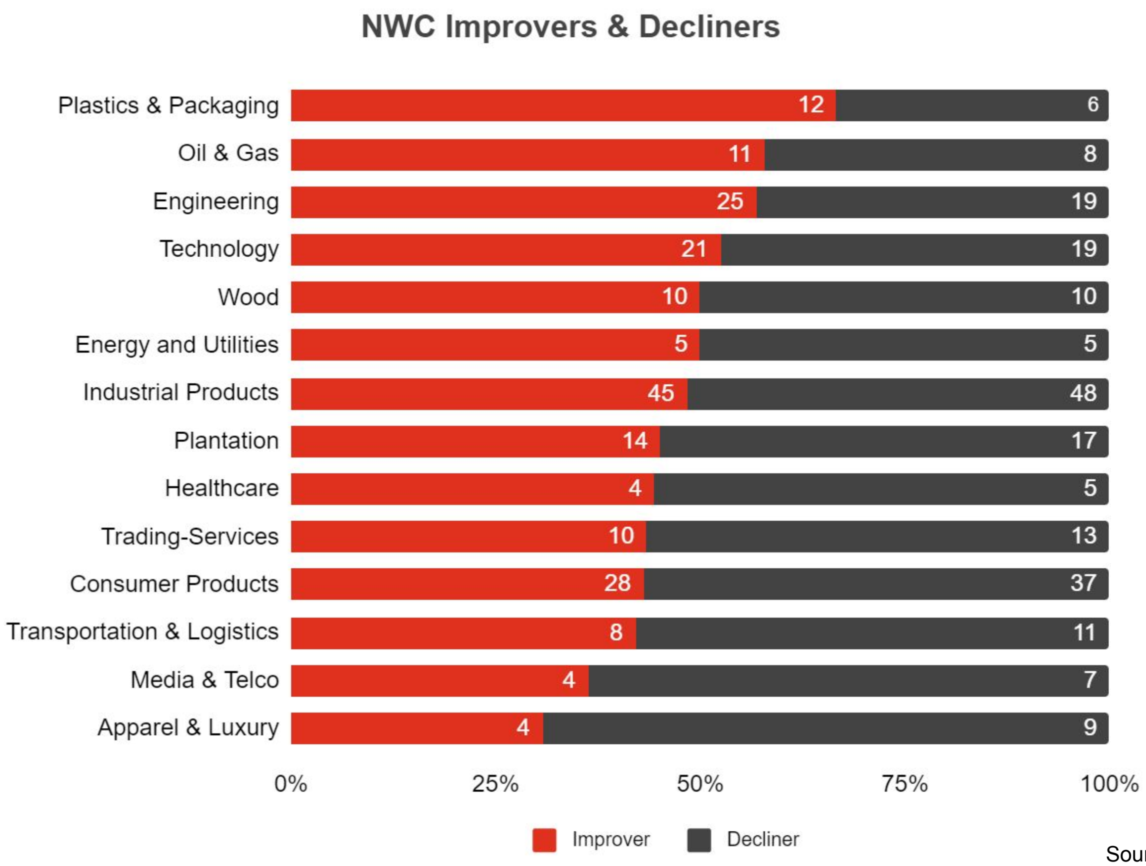
Working capital performance by industries

9 out of 14 industries in Malaysia have shown a decline in working capital performance in LTM20 compared to FY19

Amongst the many industries that have **declined** include **apparel and luxury, consumer products, engineering, healthcare, industrial products,** and **oil and gas**, amongst others. Industries that appeared to perform better despite the pandemic were energy and utilities, media & telco, plastics & packaging and transportation & logistics.

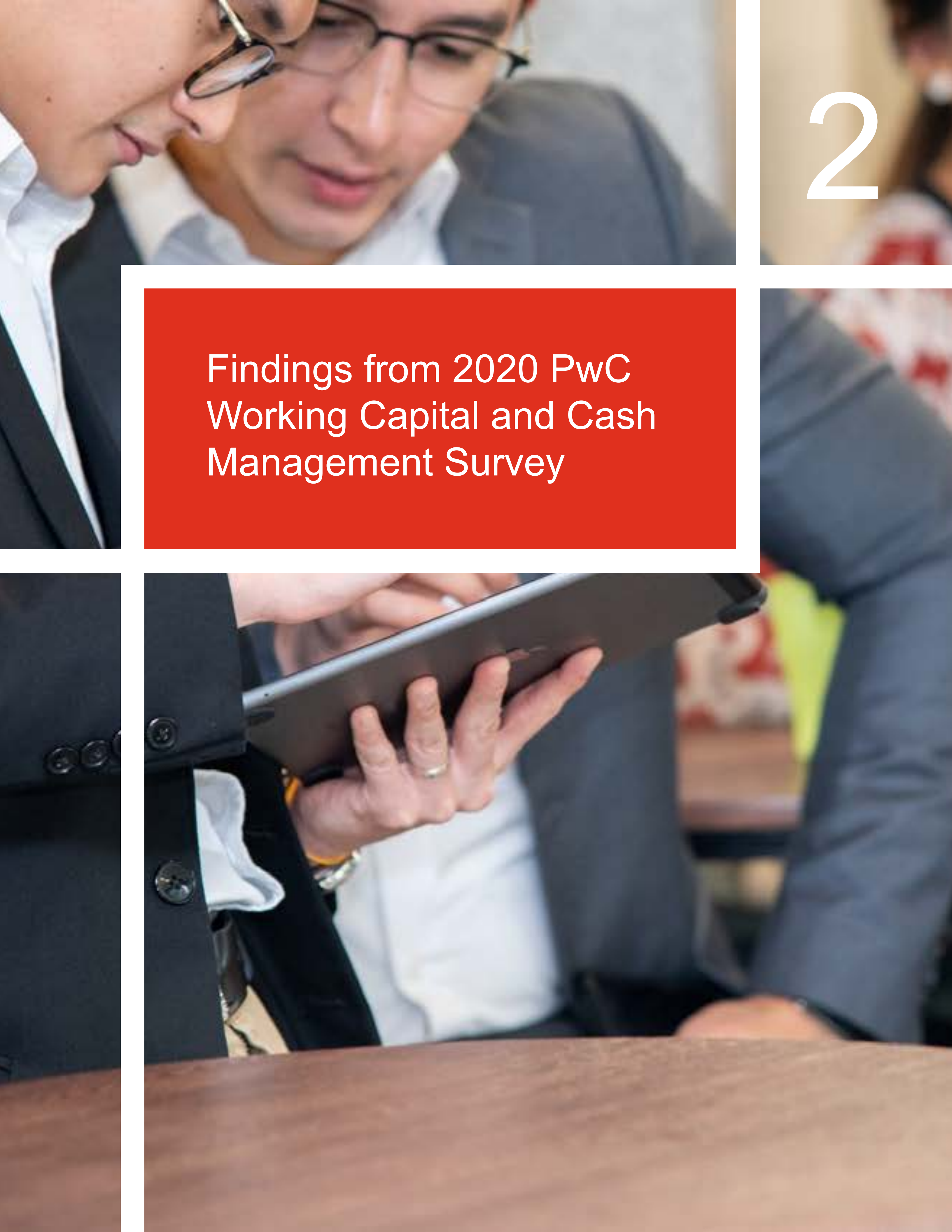
In LTM20, within most industries (8 of out of 14) there were more companies that declined in their working capital performance compared to FY19

Out of the 415 companies analysed, 214 companies (52%) lengthened their NWC days from FY19. Sectors with the majority of decliners were apparel and luxury, media & telco, and transportation & logistics, with almost 60% of companies in these industries having lengthened their NWC days.



Note:
LTM20 refers to last 12 months ended Q2 2020. The companies are classified based on their LTM20 NWCs."NWC improvers/decliners" are companies with their NWCs in LTM20 lower/higher in comparison to their NWCs in FY19; the stacked bar chart illustrates the breakdown of companies whose NWC have improved/deteriorated for each industry

Source: Capital IQ and PwC analysis



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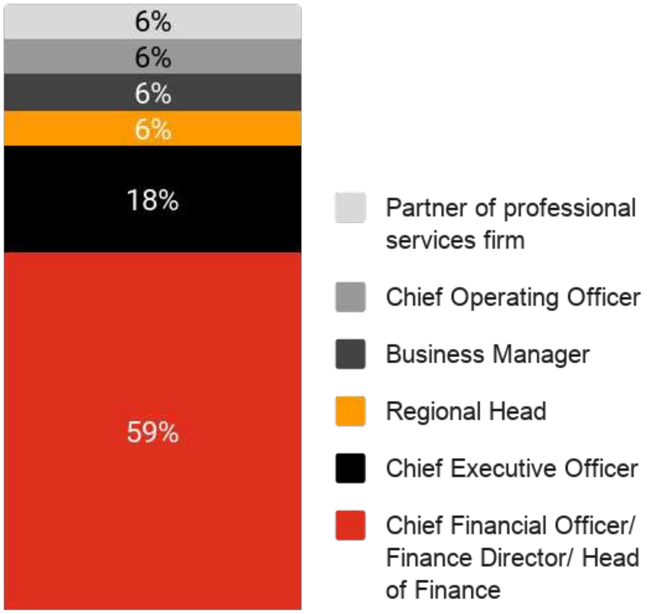
Findings from 2020 PwC Working Capital and Cash Management Survey

2020 PwC Working Capital and Cash Management Survey

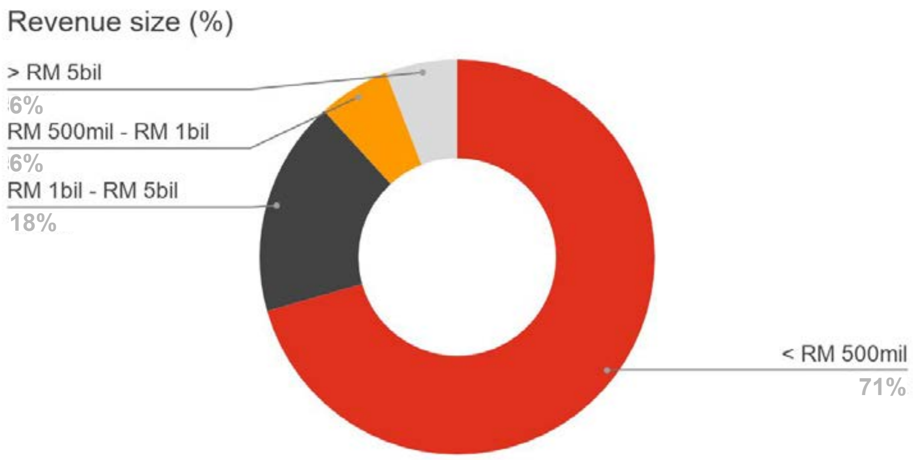
This section details the findings from the survey we conducted amongst organisations from various industries in November 2020. This survey set out to understand how Malaysian businesses are managing their working capital and cash during the current pandemic.

Survey Demography

Respondent position (%)



Revenue size of respondents (%)



2020 PwC Working Capital and Cash Management Survey

Respondents' industry profiling (%)

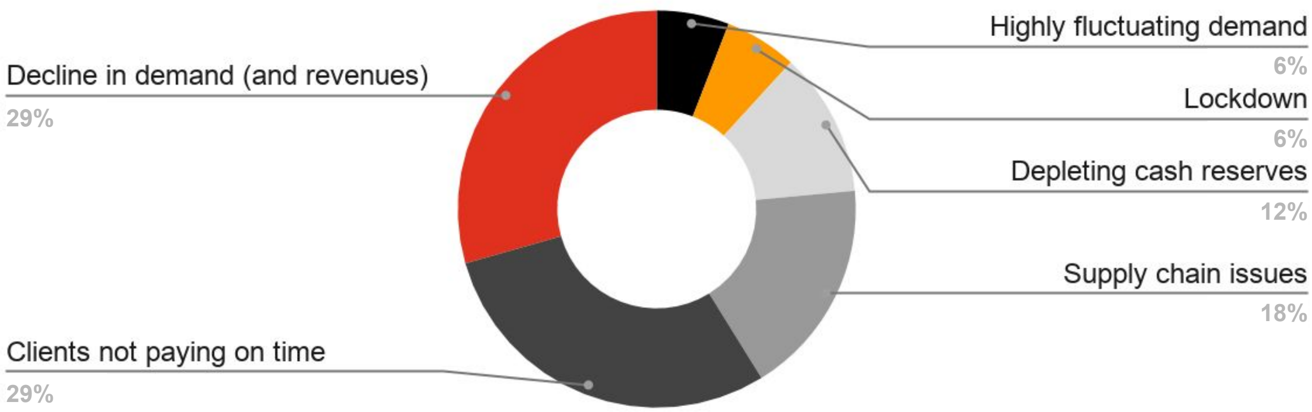
Consumer Products	18%
Construction	12%
Industrial Products	12%
Healthcare	12%
Trading Services	12%
Financial Services	6%
Education	6%
Professional Services	6%
Facilities Management	6%
Real Estate	6%
Consultancy	6%

2020 PwC Working Capital and Cash Management Survey

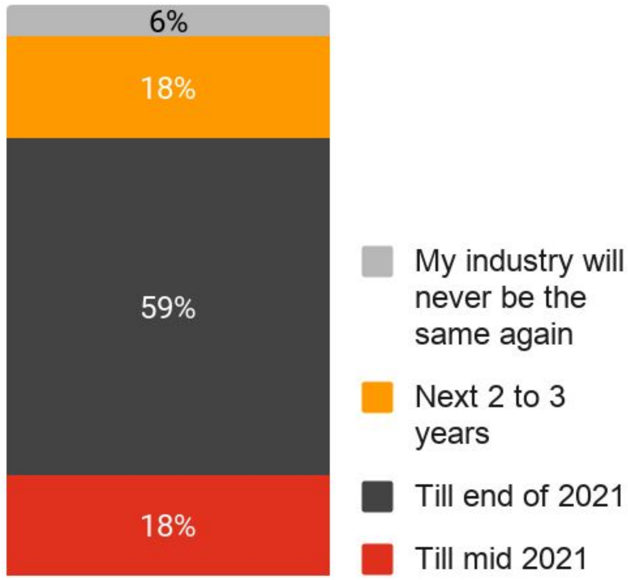
Key insights

- The pandemic's single biggest impact on business has been decline in revenue and cash flows resulting in inability to meet payment obligations in time.
- More than 50% of our respondents have cash reserves limited to 6 months, beyond which cash flow issues could impact their businesses.

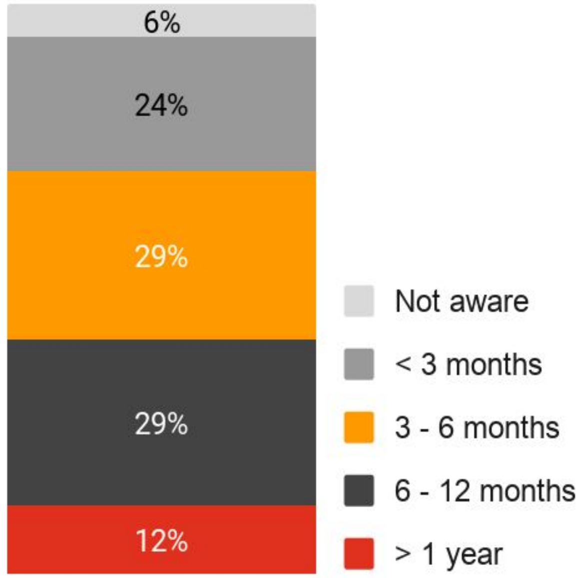
1. What is the single biggest impact of the pandemic on your organisation? (%)



2. How long do you think the impact of the pandemic will last in your industry? (%)



3. How long will your current cash reserves last?

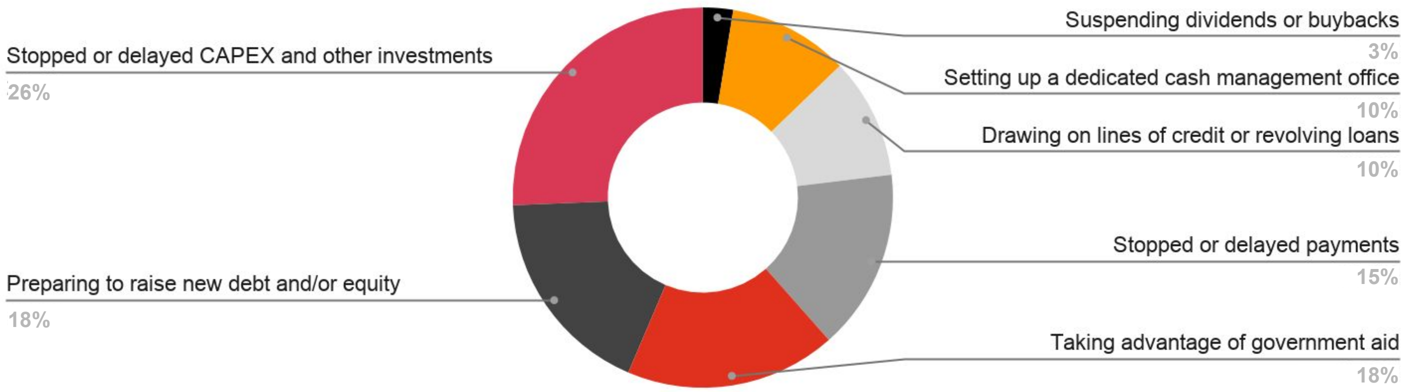


2020 PwC Working Capital and Cash Management Survey

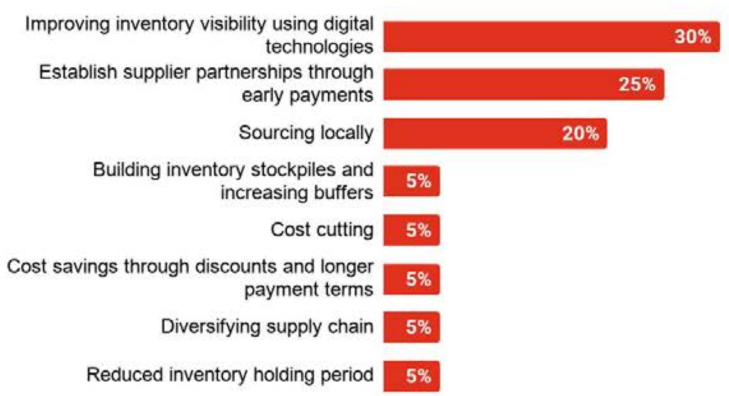
Key insights

- 26% of survey respondents have resorted to deferred or reduced capex spend to sustain liquidity positions and 18% are taking debts to raise cash to meet business obligations.
- 30% of our respondents have improved inventory visibility using digital technologies during the pandemic.

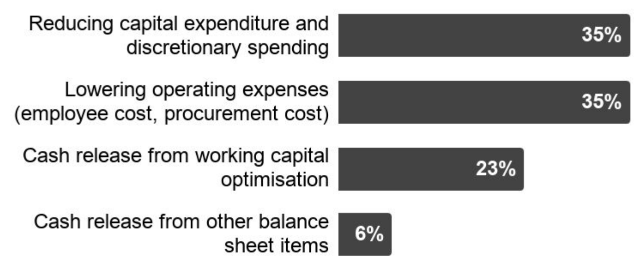
4. What are the immediate steps your company has taken to protect your liquidity position? (%)



5. What changes have you brought into your supply chain as a result of the pandemic? (%)



6. Which of the following do you see as the main levers for optimising cash in the short term? (%)



A few strategic considerations..

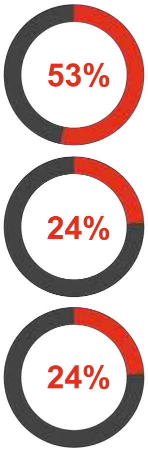
- **Manpower optimisation**: In the new normal, workforce requirements have morphed significantly. Organisations must look at upskilling employees to efficiently manage manpower. Implementing flex workforce models will also help manage salary expenses in the short term whilst retaining the workforce in the long run.
- **Restructuring of non performing assets (NPA)**: COVID-19 has fundamentally changed the operating models of several businesses, rendering multiple assets not being used optimally. Restructuring such lagging assets and legacy NPAs will unlock much needed cash.

2020 PwC Working Capital and Cash Management Survey

Key insights

- More than 40% of respondents believe that their sales will drop by more than 20% in the next 12 months.
- 53% of respondents foresee a K-shaped recovery, 24% expect an L-shaped recovery and another 24% expect a U-shaped recovery equally.

7. What recovery do you expect to see in the Malaysian economy post pandemic? (%)

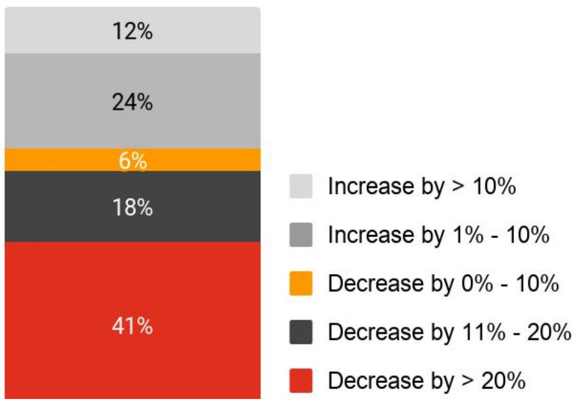


K-shaped - Different parts of the economy recover at different rates, times, or magnitudes

L-shaped - The economic level and growth remain at lower rates

U-shaped - A longer decline before recovering to pre-shock economic level and growth rates

8. What is the estimated impact of the pandemic on the next 12 months sales (vs pre COVID-19)? (%)



9. What are your medium term action plans? (%)

What should be the next steps ?

With approximately 39% of respondents already focusing efforts on optimising working capital and reducing cost, the next section of our report details several cash optimisation recommendations for companies to act upon.

3

Keeping the focus on cash

Keeping the focus on cash will help to protect businesses on the bumpy road ahead

Cash conservation and management is key to overcome uncertainties during a pandemic. A **13-week cash flow forecasting** allows for **visibility of cash position** and **identification of cash zero day**. This allows companies to take control of operations and source for additional funding requirements, where necessary.

13-Week Cash Flow	Business as Usual (BAU) mode	Crisis mode
Operating Cash Flow	Assumptions based on past data	Data-driven based on new realities
	Prepared mainly by Finance	Cross-functional inputs are critical
Investing Cash Flow	Monthly/quarterly cash visibility	Drill down to weekly cash position
Financing Cash Flow	Cash flow forecast used primarily for treasury management	Integrated purpose; to identify cash burners & cash generators

Cash Conservation and Management Office (CCMO)

- Visibility on cash
- Cross-functional
- Single source of truth
- Warning and alerts
- Informed decision-making

Setting up a CCMO immediately is critical to prepare for, respond to, and ultimately emerge stronger from this "new normal"

The CCMO's immediate tasks includes;

1. Develop a **dynamic, rolling 13-week Short-Term Cash flow Forecast ("STCF"**) and ongoing process.
2. Flex the STCF to model various **scenarios and mitigating actions** including the impact on cash position and covenants. Develop a list of mitigating actions that could be taken.
3. Identify **any net funding shortfalls** from the STCF.
4. Review **current cash and reporting processes and controls** (e.g. authorisation limits, payment approval processes, hedging strategies).
5. Prepare a list of **key suppliers and critical payments** that must be made to ensure operational continuity.
6. Establish **cash conservation levers**, including existing purchase order review and purchasing needs to assess the ability to cancel or defer.
7. Develop a clear **communications plan** for external stakeholders to accompany any potential ask.
8. Establish **inventory flow visibility** and **optimise stock management** in the face of potential lead time changes and demand volatility.
9. Identify **pockets of excess working capital** and establish initiatives to quickly convert this into cash.
10. Identify **surplus assets** / tax measures or incentives that could provide short-term liquidity.

The road ahead: Cash must become a longer-term prerogative

Wave of Crisis Response

	1. Repair	2. Rethink	3. Reconfigure
Key Focus Area	• Understand impacts • Ensure business continuity • Short term cash forecasting • Engage stakeholders	• Protect liquidity • Manage supply impacts • Short term payment controls • Bolster credit collection efforts	• Identify forward looking working capital profile • Ensure processes are fit for purpose • Implement necessary infrastructure & controls • Ensure business continuity across the supply chain

Where and how we could help you to release cash from Working Capital

Accounts receivable

- Tailored, proactive collections
- Credit risk policies
- Aligned and optimised customer terms
- Billing timeliness & quality
- Contract & milestone management
- Systematic dispute resolution
- Negotiation strategy and support

Inventory

- Lean & agile supply chain strategies
- Global coordination
- Forecasting techniques
- Production planning
- Inventory tracking
- Balancing cost, cash and service level considerations
- Inventory parameters & controls defining target stock

Accounts payable

- Consolidated spending
- Increasing control with centre-led procurement
- Helping avoid leakage with purchasing channels
- Helping eradicate early payments
- Payment methods
- Negotiation strategy and support

Cash & treasury

- Short-term cash forecasting
- Monitor expenditure incurred with proper controls

Supply Chain Finance (SCF) Feasibility

- SCF benefits assessment & implementation
- Quantitative analysis to estimate SCF opportunities

Our Working Capital improvement approach

Quick scan → Deep-dive analysis → Design → Implementation

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 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 415 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, FY16 to FY19 figures are financial year-end figures. LTM20 refers to last 12 months ended Q2 2020. 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.

We also surveyed C-suites and representatives in leadership/managerial positions. 17 organisations from various industries in Malaysia responded. Their identities were kept anonymous.

Limitations

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