

Spare tyre

Stockpiling capital feels good. But FDs must now put it to work to fuel economic recovery, says **Melanie Stern**

It seems that after a decade of spending, businesses have actually got into the habit of austerity and of saving – but perhaps a little too zealously. The latest study of working capital practices by REL, who exclusively provided us with their data, reveals that there is excess capital of €742bn held on the balance sheets of Europe's largest 933 companies by revenue. (REL calculates this by comparing a company's working capital performance to that of the upper quartile performance of the same industrial sector). That is almost exactly the amount that 16 eurozone finance ministers set aside in May for the possibility of a collapse of the euro currency.

"The 2010 number represents 33 percent of the gross working capital figure for all companies within the survey – a number that has not moved significantly in recent years whatever the macroeconomic conditions," Gavin Swindell, managing director for Europe at REL tells *Financial Director*.

Spongy bit

As the cheapest way of financing growth, carrying no rates or terms, this capital is ripe for release. But the term "excess" belies the importance of the challenge in unlocking it: perhaps it should be thought of as a capital spare tyre. Companies sporting this extra spongy bit around their middle must recognise that by using the cash smartly, they can take advantage of market opportunities while their rivals struggle amid the economic downturn. As the threat of sovereign downgrade and record levels of unemployment hangs over increasing numbers of European countries, this is even more urgent.

And as the UK looks for ways to clamber out

of recession, the response its companies make to this challenge is just as important. The 242 largest businesses in the UK by revenue are holding onto €121bn in excess capital, REL finds.

Financial Director pointed out in its May issue cover story that the manufacturing sector is rebounding surprisingly well after years in the doldrums, and is increasingly looked on as one of the potential saviours of the economy. But for this to happen, investment in areas such as research and development must be bold, swift and sustained. Excess capital is there for the using.

Given the scale of economic uncertainty hanging over both the UK and Europe, it is worth reading over the figures on the following pages and considering if your business is hoarding cash when it could be putting it to work.

"Even considering the recession-fuelled difficulties businesses are experiencing in raising external finance, the figures remain shockingly large," says REL's Swindell. "We estimate that eliminating this excess could improve EBIT numbers by as much as 10 percent."



FEATURE Working capital study

EU REL 1000 Overview

	2009	2008	2007	2006	2005	09/08 YOY CH	08/07 YOY CH	07/06 YOY CH	06/05 YOY CH
DSO	54.6	50.7	54.9	53.9	56.5	7.7%	-7.6%	1.8%	-4.6%
DIO	39.2	37.3	38.9	37.3	38.0	5.0%	-4.0%	4.3%	-1.9%
DIO (COGS)	58.5	54.7	58.0	55.4	56.8	6.9%	-5.6%	4.6%	-2.5%
DPO	46.9	43.9	48.2	46.8	47.6	6.8%	-8.9%	2.9%	-1.7%
DPO (COGS)	70.1	64.4	71.9	69.6	71.3	8.8%	-10.4%	3.2%	-2.2%
DWC	46.9	44.1	45.6	44.4	46.9	6.2%	-3.2%	2.7%	-5.4%
Revenue	5,852bn	6,496bn	5,957bn	5,554bn	5,037bn	-9.9%	9.0%	7.3%	10.3%
COGS	3,918bn	4,428bn	3,994bn	3,735bn	3,366bn	-11.5%	10.9%	6.9%	10.9%
Gross margin %	33.1%	31.8%	33.0%	32.8%	33.2%	3.8%	-3.4%	0.6%	-1.2%
EBIT	535bn	713bn	703bn	642bn	577bn	-25.0%	1.3%	9.6%	11.2%
EBIT margin %	9.1%	11.0%	11.8%	11.6%	11.5%	-16.7%	-7.1%	2.1%	0.9%
Current portion of LT-debt	343bn	383bn	283bn	252bn	245bn	-10.6%	35.2%	12.6%	2.5%
ST-debt	129bn	176bn	166bn	122bn	133bn	-26.7%	6.2%	36.3%	-8.4%
Total assets	8,612bn	8,490bn	7,926bn	7,385bn	6,892bn	1.4%	7.1%	7.3%	7.2%
Current liabilities	2,485bn	2,873bn	2,588bn	2,382bn	2,238bn	-13.5%	11.0%	8.7%	6.4%
ROCE	8.7%	12.7%	13.2%	12.8%	12.4%	-31.2%	-3.7%	2.7%	3.4%
Accounts receivable	875bn	902bn	896bn	821bn	780bn	-3.0%	0.7%	9.2%	5.2%
Inventory	628bn	664bn	634bn	567bn	524bn	-5.5%	4.7%	11.8%	8.2%
Accounts payable	752bn	781bn	786bn	713bn	657bn	-3.8%	-0.6%	10.4%	8.4%
Net working capital	751bn	785bn	744bn	675bn	647bn	-4.3%	5.5%	10.1%	4.3%
Net working capital as a % of revenue	12.8%	12.1%	12.5%	12.2%	12.9%	6.2%	-3.2%	2.7%	-5.4%

Top 10 UK companies

Company name	Industry	2009 DWC	09/08 YOY CH	2008 DWC	2009 DSO	09/08 YOY CH
BP	Oil, gas and consumable fuels	37	74.2%	21	37	52.1%
Tesco	Food and staples retailing	1	107.8%	-10	15	780.2%
Vodafone Group	Wireless telecommunication services	9	-11.1%	11	34	-7.9%
Unilever	Food products	18	-30.7%	25	21	-15.5%
BHP Billiton	Metals and mining	34	-32.5%	51	27	-45.2%
GlaxoSmithKline	Pharmaceuticals	99	-19.8%	123	71	-11.7%
Rio Tinto	Metals and mining	57	25.9%	45	31	16.8%
Scottish & Southern Energy	Electric utilities	16	48.0%	11	48	-2.1%
Centrica	Multi-utilities	44	-19.6%	54	50	-29.4%
BT Group	Diversified telecommunication services	-39	9.4%	-43	34	2.7%
UK (overall performance)		39	-1.8%	38	40	-8.5%

Country comparison

Country	Sum of 2009 revenue	2009 DWC	09/08 YOY CH	2008 DWC	2009 DSO	09/08 YOY CH	2008 DSO	2009 DIO	09/08 YOY CH	2008 DIO	Sum of 2009 excess WC (bn)	Excess working capital*
Austria	69,467	58.0	0.1%	58.0	49.6	-1.9%	50.6	48.7	7.2%	45.4	9bn	33%
Belgium	78,181	20.3	-38.0%	32.8	32.1	-20.7%	40.5	30.2	-16.8%	36.3	7bn	30%
Denmark	88,988	40.2	0.1%	40.1	48.5	4.7%	46.3	30.7	3.5%	29.6	8bn	29%
Finland	141,909	66.0	0.2%	65.8	56.2	6.8%	52.6	42.4	1.8%	41.7	17bn	34%
France	1,171,439	36.3	-0.5%	36.4	64.0	-1.1%	64.7	39.5	3.0%	38.4	162bn	29%
Germany	1,208,000	58.5	11.7%	52.4	54.4	17.0%	46.5	44.5	3.7%	42.9	178bn	39%
Ireland	102,801	39.5	-13.9%	45.9	65.0	-7.6%	70.3	24.8	-10.3%	27.7	11bn	27%
Italy	376,665	41.8	13.2%	36.9	73.4	4.2%	70.4	38.3	2.5%	37.4	55bn	29%
Luxembourg	69,160	64.5	7.1%	60.2	35.4	39.9%	25.3	77.3	19.8%	64.5	9bn	28%
Netherlands	465,954	50.1	34.7%	37.2	44.8	26.3%	35.5	47.0	45.2%	32.4	51bn	30%
Norway	111,873	49.2	-1.6%	50.0	45.7	3.9%	44.0	25.7	1.1%	25.5	12bn	41%
Portugal	11,030	47.5	2.0%	46.6	64.5	5.4%	61.2	26.5	-11.9%	30.1	1bn	36%
Spain	255,473	31.6	33.9%	23.6	74.5	17.7%	63.2	24.7	0.1%	24.6	38bn	33%
Sweden	169,020	72.9	-10.4%	81.3	60.9	-5.8%	64.6	46.8	-14.2%	54.6	24bn	37%
Switzerland	386,616	63.0	5.1%	59.9	57.6	9.4%	52.7	39.8	3.1%	38.6	39bn	28%
UK	1,145,028	38.5	1.9%	37.8	39.7	2.8%	38.6	32.9	3.5%	31.7	121bn	36%
Europe	5,851,605	46.9	6.2%	44.1	54.6	7.7%	50.7	39.2	5.0%	37.3	742bn	33%
US - 1000	8,690,371	38.3	8.2%	35.4	37.7	10.4%	34.2	32.3	8.8%	29.7	\$740bn	31%

For space reasons, this chart does not display figures for 2009 DPO, 09/08 YOY CH and 2008 DPO

* as % of working capital

UK 242 Overview

	2009	2008	2007	2006	2005	09/08 YOY CH	08/07 YOY CH	07/06 YOY CH	06/05 YOY CH
DSO	39.7	38.6	42.1	42.3	43.8	2.8%	-8.1%	-0.4%	-3.6%
DIO	32.9	31.7	35.6	31.4	33.1	3.5%	-10.9%	13.5%	-5.2%
DIO (COGS)	49.0	46.8	52.9	47.2	50.0	4.7%	-11.6%	12.2%	-5.6%
DPO	34.0	32.5	36.3	35.4	38.3	4.6%	-10.2%	2.5%	-7.8%
DPO (COGS)	50.7	47.9	53.8	53.1	57.8	5.8%	-10.9%	1.3%	-8.2%
DWC	38.5	37.8	41.4	38.3	38.6	1.9%	-8.7%	8.2%	-0.8%
Revenue	1,145bn	1,244bn	1,191bn	1,131bn	1,044bn	-7.9%	4.4%	5.3%	8.4%
COGS	768bn	844bn	802bn	753bn	692bn	-9.0%	5.2%	6.5%	8.8%
Gross margin %	32.9%	32.1%	32.6%	33.4%	33.7%	2.5%	-1.6%	-2.4%	-0.9%
EBIT	138bn	174bn	168bn	163bn	145bn	-20.5%	3.2%	3.3%	12.2%
EBIT margin %	12.1%	14.0%	14.1%	14.4%	13.9%	-13.7%	-1.1%	-1.9%	3.6%
Current portion of LT-debt	44bn	65bn	52bn	53bn	46bn	-32.3%	23.7%	-1.2%	14.6%
ST-debt	20bn	21bn	28bn	15bn	17bn	-7.3%	-23.6%	85.2%	-13.9%
Total assets	1,520bn	1,499bn	1,473bn	1,372bn	1,377bn	1.4%	1.8%	7.4%	-0.4%
Current liabilities	389bn	419bn	410bn	378bn	369bn	-7.2%	2.4%	8.4%	2.4%
ROCE	12.2%	16.1%	15.8%	16.4%	14.4%	-24.1%	1.6%	-3.4%	13.8%
Accounts receivable	125bn	132bn	137bn	131bn	125bn	-5.4%	-4.1%	4.8%	4.5%
Inventory	103bn	108bn	116bn	97bn	95bn	-4.7%	-7.0%	19.5%	2.7%
Accounts payable	107bn	111bn	118bn	110bn	110bn	-3.7%	-6.3%	7.9%	0.0%
Net working capital	121bn	129bn	135bn	119bn	110bn	-6.2%	-4.6%	14.0%	7.5%
Net working capital as a % of revenue	10.6%	10.4%	11.4%	10.5%	10.6%	1.9%	-8.7%	8.2%	-0.8%

2008 DSO	2009 DIO	09/08 YOY CH	2008 DIO	2009 DPO	09/08 YOY CH	2008 DPO	2009 REVENUE	09/08 YOY CH	2008 REVENUE
24	34	102.6%	17	35	71.4%	20	167,325	-35.3%	258,688
2	18	-4.4%	19	32	5.0%	30	61,112	-2.6%	62,737
37	4	-14.5%	4	28	-7.8%	30	44,309	-0.5%	44,528
25	33	-6.4%	35	36	4.6%	35	39,823	-1.7%	40,523
49	35	14.8%	30	27	-3.5%	28	36,049	-5.1%	38,001
80	52	-14.0%	61	24	38.1%	17	31,974	25.9%	25,392
27	43	13.1%	38	17	-11.6%	19	29,183	-24.9%	38,834
49	5	-12.4%	6	37	-15.5%	44	27,465	43.4%	19,148
71	6	-11.9%	7	13	-46.2%	24	24,755	13.7%	21,763
33	2	-4.0%	2	75	-4.2%	78	23,107	-11.1%	25,985
39	33	6.5%	32	34	-7.5%	33		-1.5%	

Top UK improvers

Company	2009 Revenue	2009 DWC	2005 DWC	2009/05 DWC % CH	2009 DSO	2005 DSO	2009/05 DSO % CH	2009 DIO	2005 DIO	2009/05 DIO % CH	2009 DPO	2005 DPO	2009/05 DPO % CH
BT Group	23,107	-39	-18	-121.2%	34	38	-12.1%	2	2	-1.7%	75	58	28.8%
Wolseley	16,914	36	77	-53.3%	41	63	-33.8%	41	55	-25.8%	47	41	13.1%
British American Tobacco	16,014	23	38	-40.5%	60	62	-2.4%	84	89	-5.9%	121	113	7.6%
Balfour Beatty	10,092	27	44	-38.4%	70	76	-9.0%	4	6	-29.8%	46	38	22.4%
DSG International	9,389	11	23	-52.3%	12	15	-20.3%	42	45	-6.1%	43	37	17.2%
Bunzl	5,240	33	38	-11.4%	43	46	-6.0%	34	34	-0.8%	44	43	2.9%
Cable & Wireless Communications	3,939	10	50	-79.0%	63	100	-36.6%	2	3	-28.5%	55	53	3.4%
Tomkins	2,918	73	85	-14.0%	58	63	-8.2%	52	55	-5.8%	37	33	10.6%
Kier Group	2,479	31	38	-19.0%	45	50	-9.4%	73	76	-3.0%	87	87	0.5%
DS Smith	2,356	36	60	-40.8%	56	73	-22.5%	29	36	-18.8%	50	49	3.1%
Game Group	2,221	-3	12	-127.9%	3	6	-47.2%	34	40	-15.6%	40	34	19.0%
Cookson Group	2,210	71	79	-10.1%	65	67	-2.8%	41	45	-8.1%	36	33	7.4%
Whitbread	1,501	-52	-11	-386.0%	10	18	-45.4%	5	6	-22.0%	67	34	93.5%
Melrose	1,464	33	97	-66.3%	60	101	-40.7%	63	76	-17.4%	90	80	12.4%
Intercontinental Hotels Group	1,073	-83	41	-300.2%	80	84	-5.1%	1	2	-39.6%	163	44	271.2%
St. Ives	453	21	50	-57.7%	57	59	-3.6%	10	12	-13.5%	46	20	126.3%

All data supplied by REL and correct at time of publication

Get capital working

Gavin Swindell on Europe's lack of capital efficiency and the need to put money to work

Europe's biggest companies by revenue are stockpiling €742bn in cash. In our latest annual survey of the working capital performance of Europe's 1,000 largest public companies excluding the financial sector, it is clear that recession has already hit hard. The companies featured posted like-for-like deterioration in year-on-year sales of some 10 percent, while their working capital performance deteriorated by 6.2 percent. The average number of days it took for companies to convert working capital into revenue increased by three days during the recession, moving from 44 to 47 days' worth of sales – a five-year high.

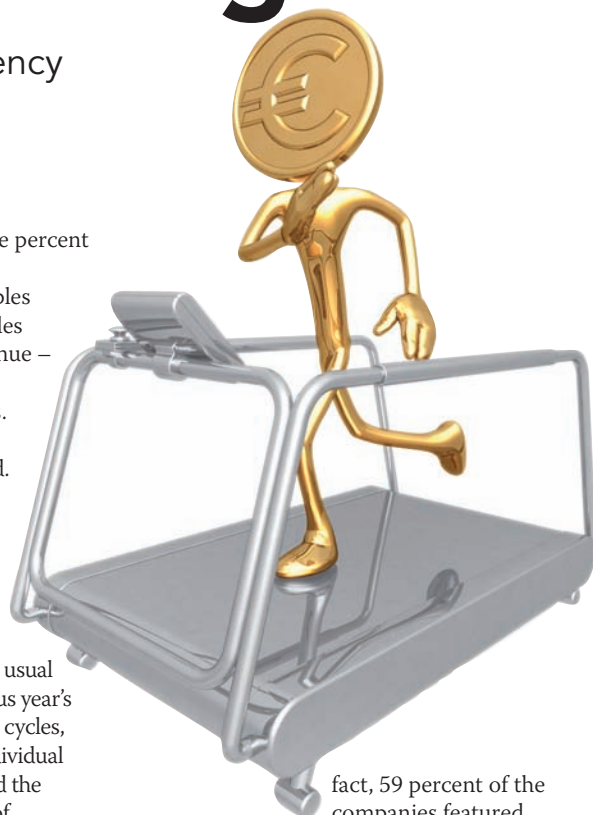
The results imply that companies anticipated a heavy recession in their 2008 results, as an overall reduction of working capital was observed. But their 2009 results show a significant deterioration. Looking at the underlying components that make up their number of days of working capital, the figures for number of days of sales outstanding deteriorated by nearly eight percent, down to 2.8. The figure for days' inventory on hand (DIO) – year-end inventory divided by one day of average revenue, in which a decrease is an

improvement and an increase a deterioration – deteriorated by five percent to 3.5 percent.

Only their number of days payables outstanding (year-end trade payables divided by one day of average revenue – for the purposes of the survey, payables exclude accrued expenses. An increase is an improvement, a decrease a deterioration) improved. This was because companies took longer to pay bills and suppliers, resulting in an increase of nearly seven percent.

Net working capital as a percentage of revenue returned to 12.8 percent, though this follows the usual pattern of bouncing back the previous year's gains. Another key factor is industry cycles, which can significantly influence individual company performance. We observed the effect on working capital efficiency of dramatic swings in the oil, gas and consumable fuel industries in 2008 and 2009.

Short-termism still dominates with very few companies managing to sustain a longer-term improvement trend – sometimes referred to as a cash culture – hoarding money instead of using it efficiently to build, expand and grow. In



fact, 59 percent of the companies featured did improve their days' working capital in 2009 but, based on the previous results, only about 40 percent can be expected to sustain this improvement in 2010.

Only 56 companies – just six percent – achieved upper quartile performance within their own industry and managed to improve in all three working capital elements over a five-year period to 2009. As many as 39 are in the lower quartile for their industry and have actually deteriorated in all three areas over the same period.

Meanwhile, we found that just two companies within the survey – French automotive components maker Valeo and Dutch cable manufacturer Draka Holding – improved their number of days' working capital every year for the past five years and are in the upper 50 percent in all three elements of working capital.

Gavin Swindell is managing director for Europe at REL, a working capital research and consultant group that is part of the Hackett Group

HOW TO READ THE STUDY

For comparability, all financial figures throughout are expressed as euros, including those for UK companies.

Days sales outstanding (DSO) Year-end trade receivables net of allowance for doubtful accounts, divided by one day of average revenue. A decrease in DSO represents an improvement, an increase a deterioration.

Days inventory outstanding (DIO) Inventory divided by one day of average revenue. A decrease in DIO represents an improvement, an increase a deterioration.

Days payables outstanding (DPO) Year-end trade accounts payable divided by one day of average revenue. An increase in DPO represents an improvement, a decrease a deterioration.

Days working capital (DWC) Year-end net working capital (trade accounts receivable + inventory - trade accounts payable) divided by one day of average revenue. The lower the number of days, the better. A negative change in DWC is an improvement.

Methodology provided by REL