Pressure in the system

Working Capital Study Region in focus: **The Nordics**

Unlocking enterprise value through working capital management

2017/18





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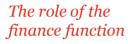
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Executive summary Pressure in the system



Why it matters

Working capital is the cash tied up in the everyday running of a business. The ability of a company to keep low levels of working capital and still satisfy business requirements can result in higher returns on invested capital and more cash to fund growth.

The data shows us that the working capital performance of Nordic companies continues to lag that of their European and North American counterparts. We found that if all companies were to improve their working capital efficiency to the next performance quartile, this would represent a cash release of €24bn. This means that Nordic companies would have enough cash to significantly boost their capital investment without the need to access additional funding or put pressure on cash flows.

What's the story?

Looking at the financial performance of Nordic listed companies, we see familiar themes to those noted in our global study, which presents a cause for concern:

1. Return on Capital Employed (ROCE)

We've seen a reduction in the Return on Capital Employed of Nordic companies, although to a lesser degree as observed in our global study. Improving working capital management (WCM) is one way for Nordic companies to boost returns.

Leverage has actually decreased, going against the global trend, and profitability is at a 5 year high across the region.

2. Capital expenditure (CAPEX)

Capital investment by Nordic companies has been lower than the global level and largely flat for the last 4 years. As observed in our global study, under-investment poses a threat to long term growth.

By optimising working capital Nordic companies can release the necessary cash to fund investment while at the same time managing operating cash flows.

3. Working capital days

Whilst the story on revenues and profitability is positive, Net Working Capital (NWC) days have deteriorated by 3 days across the region. Further deterioration has been averted through companies exerting pressure on their supply chains, consistent with the global trend.

Higher Days Payables Outstanding (DPO) levels may be indicative of increased creditor stretching activity, which might not be sustainable in the long term. Additional focus on the asset side of the balance sheet (receivables and inventory) may be warranted as a means of releasing cash and efforts to optimise payables should consider the impact on the supply chain.

We believe that by focusing on the operational and cultural changes required to improve working capital management, Nordic companies could tap into a long neglected source of enterprise value.

How does my company rate?

Find out how you compare with your peers in our interactive data explorer, with breakdowns by company size, territory and industry:

http://www.pwc.com/gx/en/services/advisory/de als/business-recovery-restructuring/working-capital-opportunity.html#data

NWC performance deteriorated

year on year (YoY) by 3 days with

Denmark showing the greatest deterioration



Investment in *CAPEX* remains flat which could

which could impact future growth prospects`



Nordic companies lag

European and North American counterparts on working capital performance

Chemicals, Energy & Utilities sectors have seen deterioration in both

NWC & ROCE







Inventory & Receivables

performance has deteriorated





Performance has been maintained

by a **stretch** in **payables**







only 24% of time on insight generating activities and could do more to help the business understand the cash impact of operational and commercial decisions



€24bn

could be released from the balance sheets of Nordics listed companies by addressing poor working capital performance



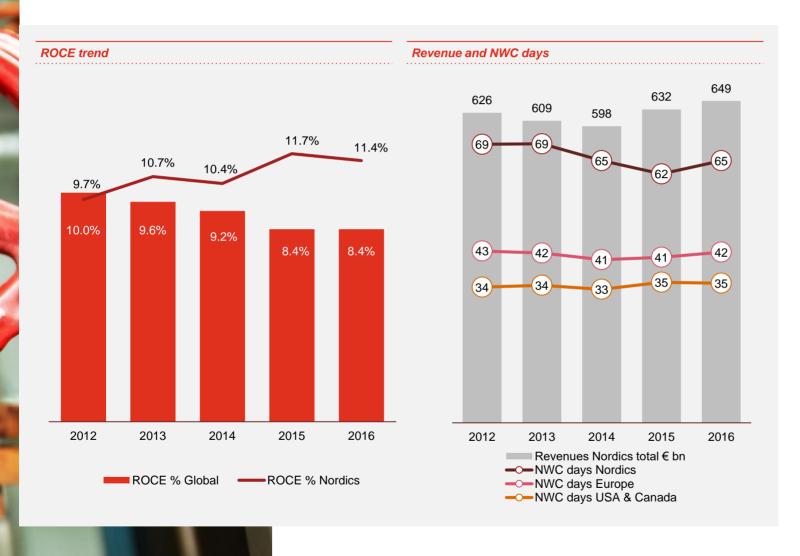
7 out 17
sectors have seen improvement in NWC days since 2012



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Nordic companies have seen a slowdown in value creation and the first deterioration in NWC days in 5 years...



Value

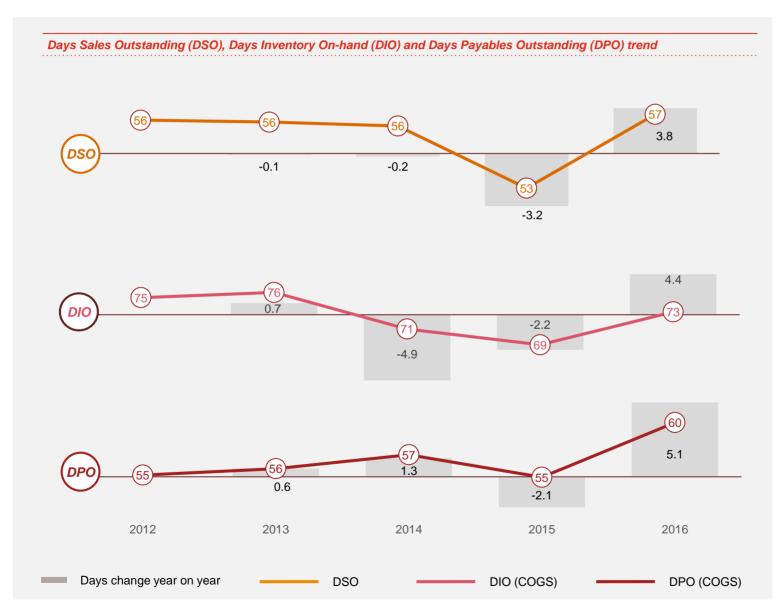
It is no coincidence that the slowdown in ROCE last year came alongside the first deterioration in NWC days for 5 years across Nordic companies.

Revenue continues to grow in the region, however ROCE marginally deteriorated from 11.7% to 11.4% YoY.

Nordic companies continue to tie up significantly more cash in their NWC cycles than their European and North American counterparts. The underperformance against European and North American counterparts is most pronounced in the forecast to fulfil (inventory) and procure to pay cycles (payables).

Key sectors are playing an influential role. Industrial Manufacturing (25% of total revenue of companies sampled in 2016) is the most prominent followed by Communications (13%). Both sectors saw the benefit of a payables stretch offset to some degree by a deterioration in receivables and inventory performance in the recent period.

...and it appears further NWC deterioration has been averted through companies exerting pressure on the supply chain



Components of NWC

Looking deeper into the drivers of working capital performance we see that the most significant change YoY has been the 5 day stretch in DPO. The impact of this change however has been masked by the deterioration on the asset side (DSO and DIO).

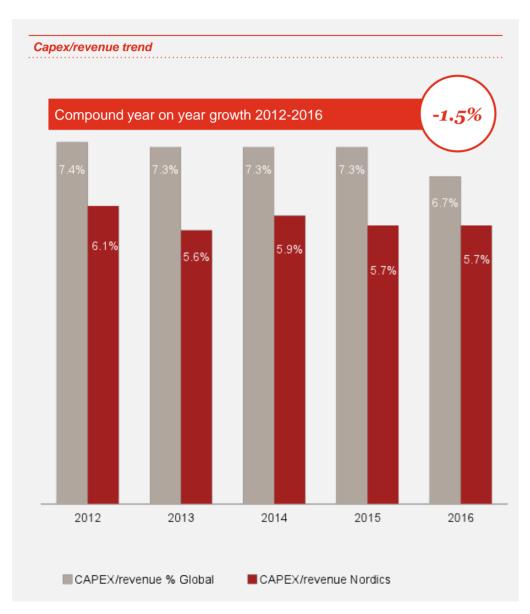
This trend is consistent with the theme observed in our global study and brings into focus the need for Nordic companies to take a closer look at their management of working capital.

Companies that maintain working capital performance at the expense of suppliers, create risks across the value chain. This approach is unsustainable long term.

Nordic companies are increasing payables days in order to maintain operating cash flow performance. This approach to working capital management can be problematic if suppliers aren't supported with suitable supply chain financing.

Rather than passing the cash burden down the value chain, companies should focus on enhancing their own working capital performance and consider ways to foster the financial health of key suppliers. A point that may be particularly relevant for those Nordic companies with global supply chains.

Cash released from working capital could present a lifeline for Nordic companies where capital investment remains stubbornly flat



Investment

Capital investment made by Nordic companies remains lower than the global level and has seen a decrease over the last 5 years.

As noted in our global study, in the long term, this level of under investment will prove problematic as companies curtail innovation, development and ultimately growth. Companies need to choose between continuing to maintain cash flows at the cost of reduced Capex, or releasing working capital to reignite investment.

With persistent high levels of working capital across the region, this could present a vital source of financing for Nordic companies to tap into.

Cash constraints often indicate underlying cost opportunities

"Working capital improvement opportunities are often the tip of the iceberg and we typically find that they are a good indicator for further benefit being available through cost reduction. This is particularly true for businesses that are focused on top-line performance.

Many organisations in the current economic climate have been through a number of "self-help" rounds and so have tackled the easy opportunities. Further cuts risk damaging the underlying business or threatening long term growth.

Targeted cost reduction or cash management programmes need to be re-enforced through business-as-usual activity and every euro spent should have a well understood rationale and be aligned to the strategy of the business."

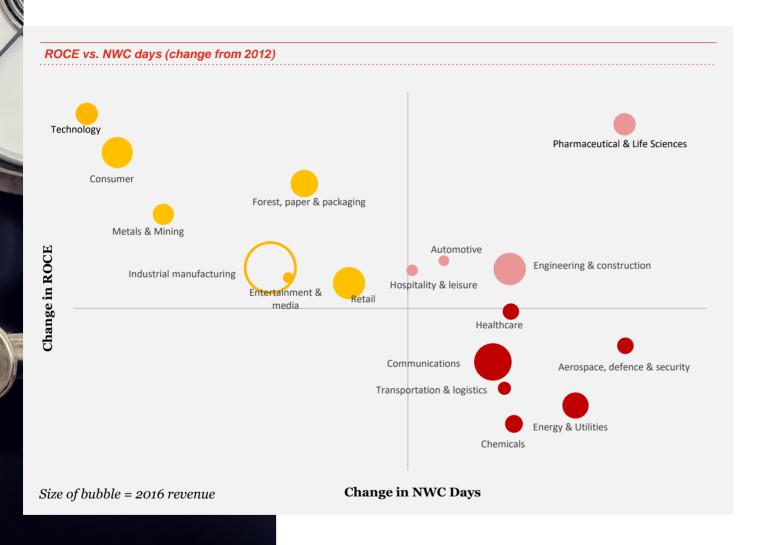
Joanna Walton – Partner, Operational Restructuring



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Improving working capital could release pressure on returns across sectors



OUTSIDE MAIN

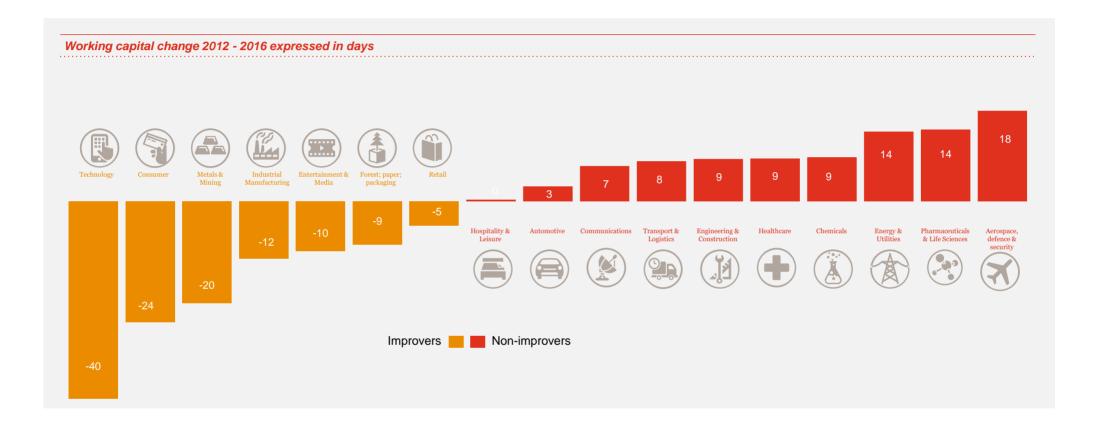
Whilst working capital and return on capital employed ratios will vary by industry, the relative change in these indicators provides an insight into whether companies are utilising working capital as a lever to improve returns. The graph to the left shows how performance across these two measures has evolved since 2012.

In the Nordics all sectors that have seen returns fall, have also seen a deterioration in working capital performance. As such, working capital should present a lifeline for companies in the bottom right quadrant.

Sectors in the top right quadrant have managed to improve returns, however their NWC days have deteriorated (increased). Nordic companies in Pharmaceutical & Lifesciences and Engineering & Construction are examples of sectors that might find value in addressing operational issues that have lead to an increase in NWC days.

In the top left quadrant we see that certain sectors have been able to lift both working capital performance and returns since 2012. Despite this fact, it should be noted that even within a given sector, working capital performance can vary greatly (as explored on p12) and significant prizes could be on offer for those that place greater focus on improving working capital management.

Only 7 out of 17 sectors managed to improve working capital since 2012



When we look at how sector performance has evolved over the last 5 years, some have fared better than others. In fact only 7 sectors out of 17 have shown an improvement since 2012.

Of the companies that showed an improvement over this period, companies in the Technology sector saw the greatest reduction in NWCD. This was coupled with an increase in revenues over the same period, which suggests companies did not take their eye off the ball in pursuit of growth.

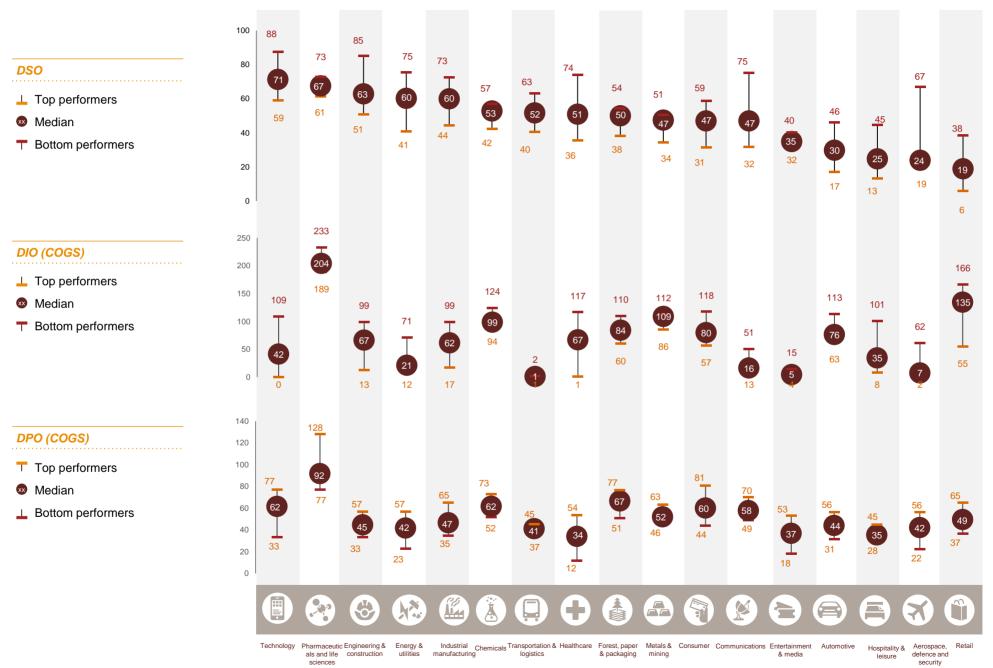
The Metals and Mining sector saw a similar level of improvement in NWCD as revenues deteriorated.

As revenues have risen in the Pharmaceutical & Aerospace sectors, working capital performance has suffered.

The Energy & Utilities Sector is also seen to be lagging on working capital performance as it saw increases in NWCD over the period.

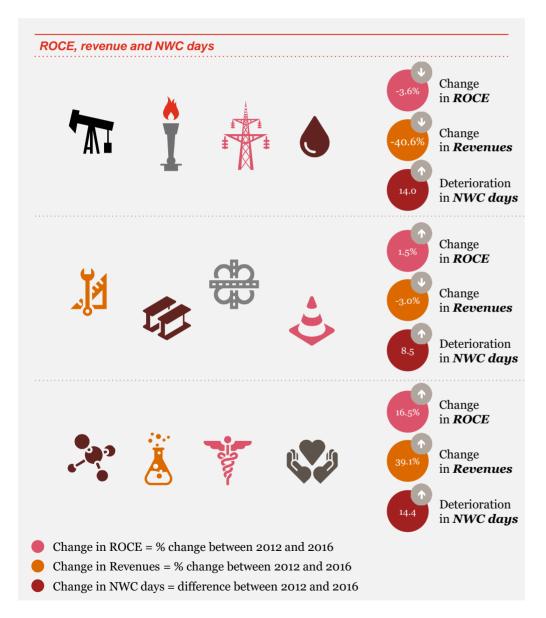
Whilst sector level trends give us an indication of the challenges facing certain industries, there is a wide spread of performance within any given sector which we've broken down further on the next page.

Industry Performance





Our clients in the following sectors are increasingly seeking to optimise working capital management as a vital driver of enterprise value



Energy and Utilities

- As the industry continues to suffer from low commodity prices, working capital has become an increasingly important topic.
- Companies across the industry are having to cultivate a cash culture as the economic backdrop now demands more discipline in this area.
- Upstream majors continue to pass the pain on to their supply chain and oil field services companies are having to pay far more attention to the operational processes surrounding DSO management in response.
- Developing the capability to proactively manage working capital is often now an imperative for survival.

Engineering & Construction

- The sector is seeing pressure on revenues as companies look for growth in large infrastructure projects and, for example, in the development of old harbour industrial areas into private homes and offices.
- This top line focus often comes at the expense of working capital performance (particularly DSO) as commercial decisions often neglect the full cash investment required to undertake certain big revenue projects.
- Suppliers to the sector are increasingly attentive to their own working capital needs which adds to the pressure on cash throughout the supply chain and has contributed to the increase in NWC days since 2012.

Pharmaceuticals and Life Sciences

- This high margin sector has seen strong revenue growth and historically had a low level of focus on working capital, as evidenced by the large increase in NWC days since 2012.
- Companies are exerting pressure on the supply chain through extending DPO to alleviate the continued deterioration in DSO and DIO across the sector. This approach may be storing up risks for the future.
- Generic competition continues to squeeze margins and management are seeking other ways to boost ROCE. Working capital is therefore rising up the corporate agenda.



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The role of the finance teams in working capital management

Only **24% of finance time** is

spent on insight-generating activities







How leading finance functions are pulling ahead:

Building a clear role for business partners with the right skills to impact business decisions.



Investing in emerging technologies (e.g. data analytics, tailored collections pathways and robotic process automation).



Driving behaviour and cultural change across the organisation.



Driving large scale business transformation based upon sound financial analysis and measurable benefits.

The finance function traditionally plays a central role in the coordination of working capital management. In fact, businesses often place an overreliance on finance to solve working capital problems when many of the underlying drivers are operational rather than financial.

Working capital management is a broad topic with commercial and supply chain touchpoints where the value of cash is not always front of mind. Finance has a big role to play in helping the business to make good decisions in the midst of often competing financial

objectives and incentives. The reason that organisations turn to finance to play this central role is that often it's the finance team who are responsible for sourcing, validating and analysing the disparate data sets and inputs to this complex process.

The role of the new breed of finance business partner needs to focus on business outcomes. Working capital improvement is one area where positive business outcomes can really benefit the organisation and the finance team can help cross functional stakeholders to understand the cash impact of commercial and operational decisions.

Stepping up:

How finance functions are transforming to drive business results.

In our 2017 Finance benchmarking study we saw that less than a quarter of finance time is spent on delivering business insight. In order to help different functions to manage complex trade offs and identify improvement opportunities less time needs to be spent on transactional work, such as sourcing and reconciling data and more on these value adding tasks, including analysing data in order to generate actionable business insights.

To overcome this challenge our clients are investing in emerging technologies to increase process efficiency, upskilling business partners and driving behavioural change across the business.

Brian Furness, Finance Partner, PwC UK



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A global view



Within any given territory, there is a wide spectrum of working capital performance. The average performance is not necessarily representative, but analysis by territory can provide excellent insights into the impact of legislation, market trends and myriad factors on company value and financial performance.

A closer look by market reveals a variability in performance



Denmark

The top line picture is generally a positive one in Denmark with both revenues and ROCE moving in the right direction consistently over the past 3 periods. However, working capital performance has slipped to a 3 year low, with companies appearing to have taken their eye off the ball somewhat in pursuit of growth.

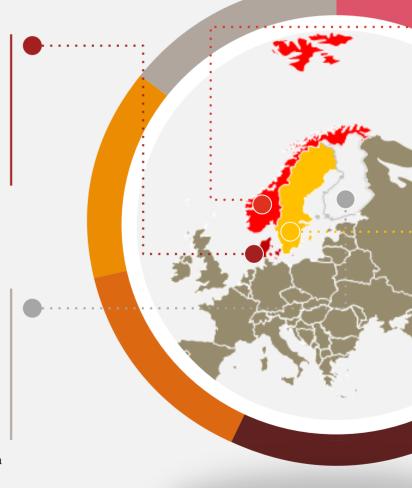
DPO is by far the longest in the region and the "pressure in the system" message is most relevant to Denmark. Companies should be wary of storing up problems in the supply chain and deterioration in both DSO and DIO points to opportunities for more sustainable working capital improvement.



Finland

Returns did not keep pace with revenue growth in Finland over the most recent period which also saw an increase in net debt levels.

With NWC days at their highest level in 5 years and capital investment remaining stubbornly flat. Once again a steep increase in DPO hints at increasing pressure on the supply chains of large corporates. The Communications sector saw the biggest drop in ROCE whilst Industrial Manufacturing showed the biggest improvement opportunity on NWC days. Working capital could provide a lifeline for Finnish companies looking to boost returns and investment.



^{*} change in NWC days YoY 15/16



Norway

Norway was the only market in the region that managed an overall improvement in NWC days YoY, if only a small one. ROCE also continues to move in the right direction for Norwegian companies.

However, challenges are out there as revenues continue to decline driven largely by the Energy & Utilities sector which in Norway did at least manage a reduction in NWC days.

Furthermore, whilst NWC days have improved, the same worrying increase in DPO may be masking underlying issues in DIO which increased significantly YoY.



Sweden

ROCE of Swedish companies has declined in the recent period as both net debt and NWC days have increased. DSO and DIO deterioration points to a need for companies to look closely at opportunities to unlock cash from operations.

With levels of capex continuing to be flat, companies in Sweden could look to working capital improvement as a welcome boost to investment and returns.

The Industrial Manufacturing, Engineering and Construction sectors both saw a deterioration in ROCE and NWC days.



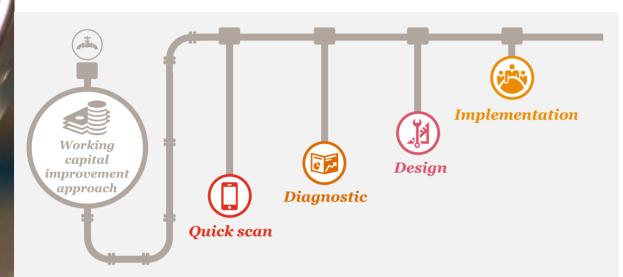
* change in NWC days YoY 15/16



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How we can support you



We help our clients to deliver the following outcomes:

- Identification and realisation of cash and cost benefits across the end to end value chain.
- Optimised operational processes that underpin the working capital cycle.
- Digital working capital solution and data analytics.

- Rapid cash conservation in crisis situations.
- 'Cash culture' and upskilled organisation through our working capital academy.
- Roll-out trade and supply chain financing solutions.

Examples of areas where PwC could help you to release cash from working capital:

Accounts receivable

- Tailored, proactive collections Contract & milestone
- Credit risk policies
- Aligned and optimised customer terms
- Billing timeliness & quality
- management
- Systematic dispute resolution
- Dispute root cause elimination

Inventory

Accounts payable

- Consolidated spending
- Increased control with centre- Eradicate early payments led procurement
- Avoid leakage with purchasing channels
- Payment terms
- Supply chain finance benefits assessment & implementation

- Payment methods
- Supply chain finance
- Payment methods and frequency
- Eradicated early payments

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Basis of calculation and limitations

Basis of calculations

This study provides a view of global working capital performance and is based on the research of the largest **350** listed companies in the Nordics (Denmark, Iceland, Finland, Sweden, Norway). The Financial Services, Real Estate and Insurance sectors are excluded.

Metric	Definition	Basis of calculation
NWC % (Net working capital %)	NWC % measures working capital requirements as a proportion of annual sales.	(Accounts Receivable + Inventories – Accounts Payable) / Sales
NWC Days (Net working capital days)	NWC Days is a relative measure which translates the value of net working capital into days' worth of annual sales	(Accounts Receivable + Inventories – Accounts Payable) / Sales * 365
DSO (Days Sales Outstanding)	DSO is a measure of the average number of days that a company takes to collect cash after the sale of goods or services have been delivered.	Accounts Receivable / Sales x 365
DIO (Days Inventories On-hand)	DIO gives an idea of how long it takes for a company to convert its inventory into sales. Generally, the lower (shorter) the DIO, the better.	Inventories / Cost of Goods Sold x 365
DPO (Days Payables Outstanding)	DPO is an indicator of how long a company takes to pay its trade creditors.	Accounts Payable / Cost of Goods Sold x 365
Investment Rate	Investment Rate measures the amount of investment relative to the revenues of a company	Capital Expenditure / Sales
ROCE (Return on Capital Employed)	ROCE is an indicator of profits as a proportion of a company's capital employed.	EBIT / (Total Assets – Current Liabilities)
EBITDA Margin (Earnings before interest, taxes, depreciation and amortisation)	EBITDA Margin is an indicator of a company's profitability level as a proportion of its revenue	EBITDA / Sales
Net Debt to Sales %	Net Debt to Sales is an indicator of how much debt the company has in relation to its sales.	Net Debt / Sales

Limitations

Companies have been assigned to countries based on the location of their headquarters. Although a significant part of their sales and purchases might be realised in that country, it does not necessarily reflect typical payment terms or behaviour in that country.

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.

