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Working Capital Insights 2022

ASX Update and Sector Deep Dive
December 2022

Our 2022 Working Capital Report profiles working capital performance of ASX listed companies across key sectors.

Consider how your business is performing relative to peers and learn how a successful working capital management strategy can increase your cash position, enabling better use of capital for other opportunities.

Introduction

What's the state of Working Capital in our markets?

Our report indicates that whilst 55% of companies increased earnings in FY22 relative to FY21, 64% of total companies had a corresponding increase in net working capital (Inventory + Debtors—Payables), indicating more businesses increased the cash tied up in their working capital cycles in FY22 than increased their earnings.

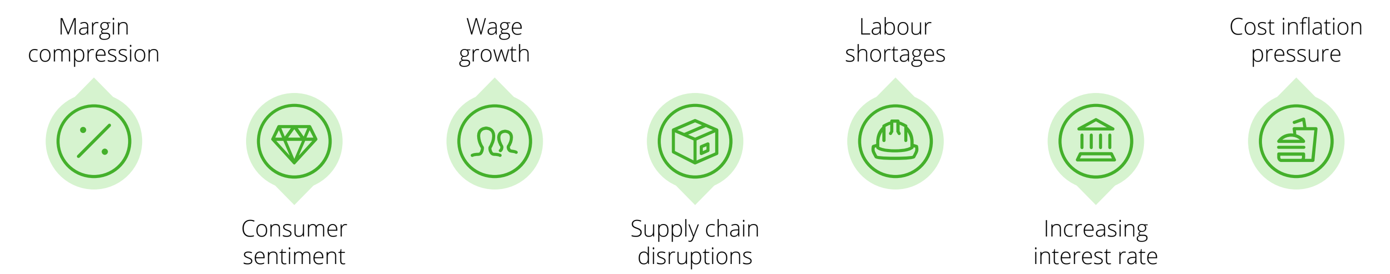
Relative to FY19 (pre pandemic) periods, roughly the same percentage of companies (65%) ended FY22 at higher levels of net working capital than FY19 (pre pandemic), driven in part by an increased and sustained stock build in inventory heavy businesses and a tightening of terms across key supply chains as the impacts of the Payment Times Reporting Scheme compliance plays through.

The Consumer Products sector experienced the largest median decrease (improvement) in cash conversion, resulting from improved inventory management after a challenging FY21 saw increased pressure amid supply constraints.

Conversely, the Homebuilding Materials and Construction sectors experienced the largest median lengthening of cash conversion, as a net result of shorter payment times to suppliers and lengthening days to collect cash and turnover inventory held.

In the Deloitte 2022 Working Capital Report, we provide a snapshot on the cash and working capital performance of ASX listed companies across selected industries, focusing on the individual sectors and identifying key trends across accounts receivable, payables and inventory, and underlying drivers.

Ongoing pressures on cash and working capital



What should you be focused on?

For owners and CFOs, what this means is if you don't have a close eye on cash, you should. A constant reassessment of how your cash is being spent and instilling a cash mindset in your people will be needed.

For key investors, an understanding of where cash is tied up and how well the business can extract it will become increasingly important.

For lenders, gaining increased visibility over working capital risks and extra confidence in current or potential working capital backed lends will be critical as well as ensuring businesses manage liquidity pressures by actively managing working capital requirements and blockages.

How is your business performing?

In this report, we analyse trends across selected sectors in working capital and provide benchmarks for measuring your own company's working capital metrics. Also included are some example cash levers businesses may consider to assist them in dealing with common sectors issues.

To further compare your company's performance relative to ASX-listed or private market peers, and to explore ways to better track, monitor and implement sustainable working capital change in your business, contact Deloitte at any time for a discussion.

What is working capital?

A recap | What is working capital?

Cash is the life blood of every business. Cash tied up in the working capital cycle (which comprises receivables, inventory and payables) can be a drag on business and lead to liquidity pressures. Effective working capital management can release cash which can be used for operations, expansion, capital expenditure, deleveraging and dividends.

Debtors DSO

The process of contracting with customers through to selling goods/services, and eventually collecting cash.

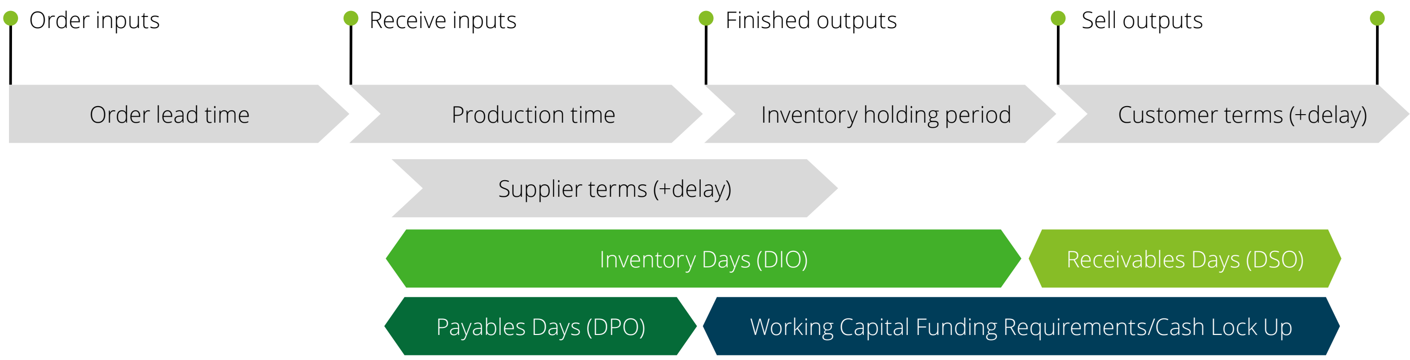
Inventory DIO

The process of converting raw materials into finished goods, including the ownership of goods until they have been sold.

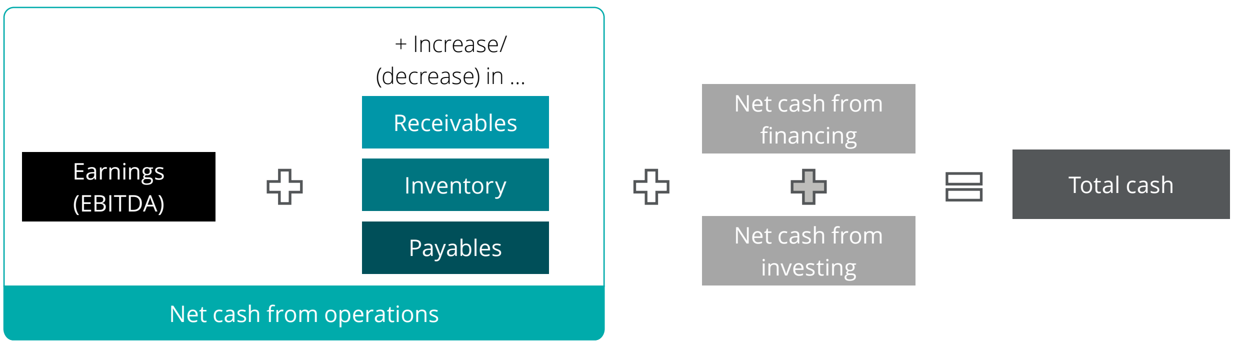
Payables DPO

The end-to-end process, from contracting with suppliers to receiving products/ services and ultimately paying.

Illustrative example—Manufacturing

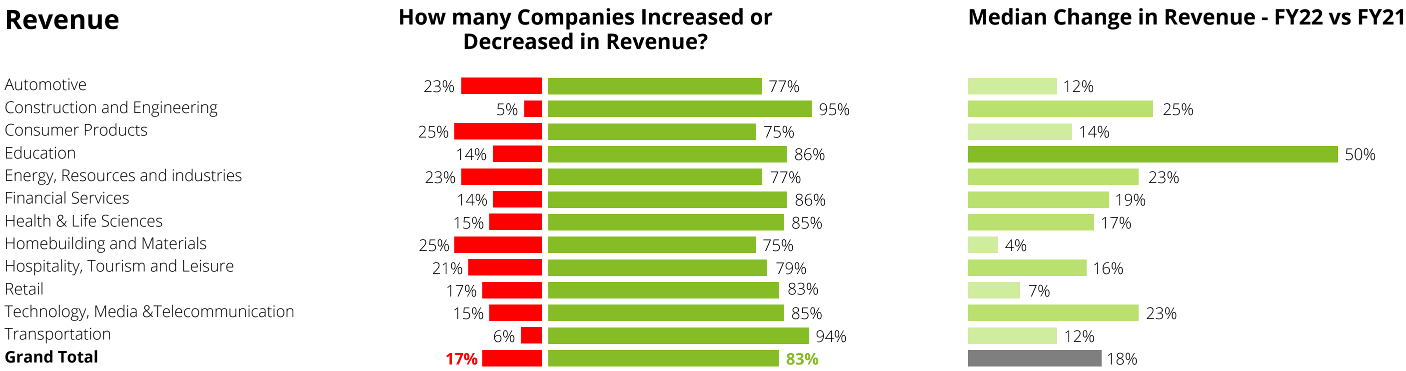


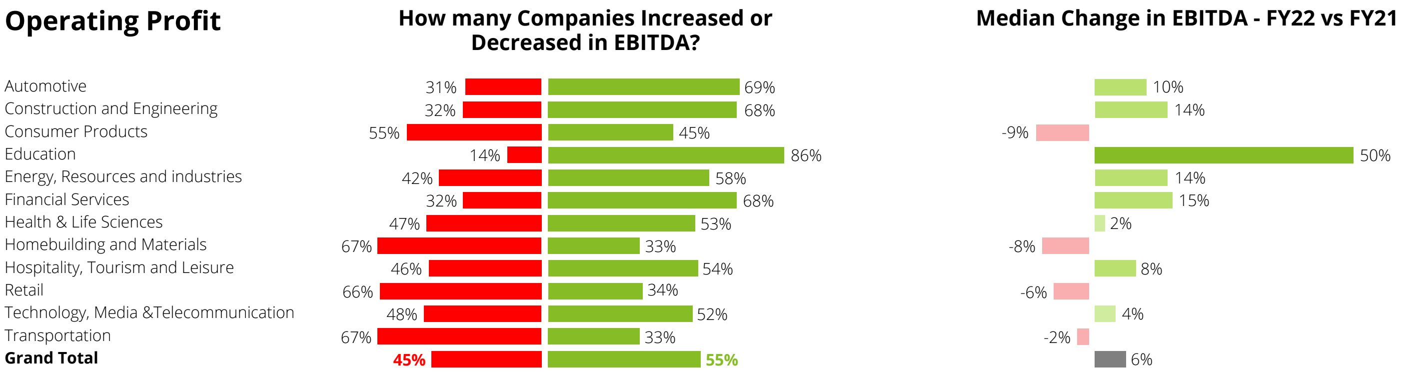
To maximise financial Value, businesses must strive to convert hard earned profits into cash.

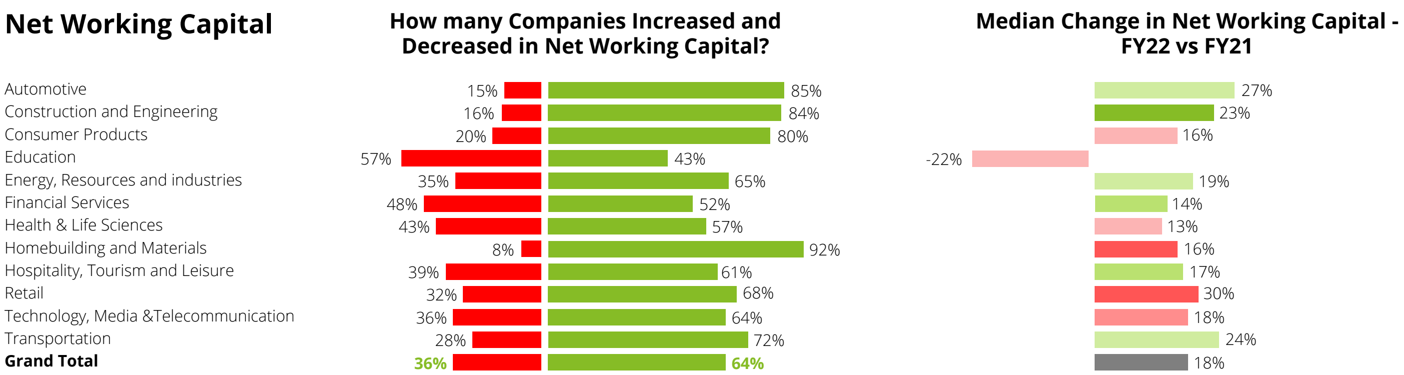


ASX Overview

Strong FY22 revenue growth didn't fully translate into profit, putting pressures on cash, with most ASX companies having more cash tied up in working capital in FY22 than FY21. Going in to FY23 with less available cash, and facing into headwinds of rising inflation and interest rates highlights the critical importance of focusing on cash and working capital.







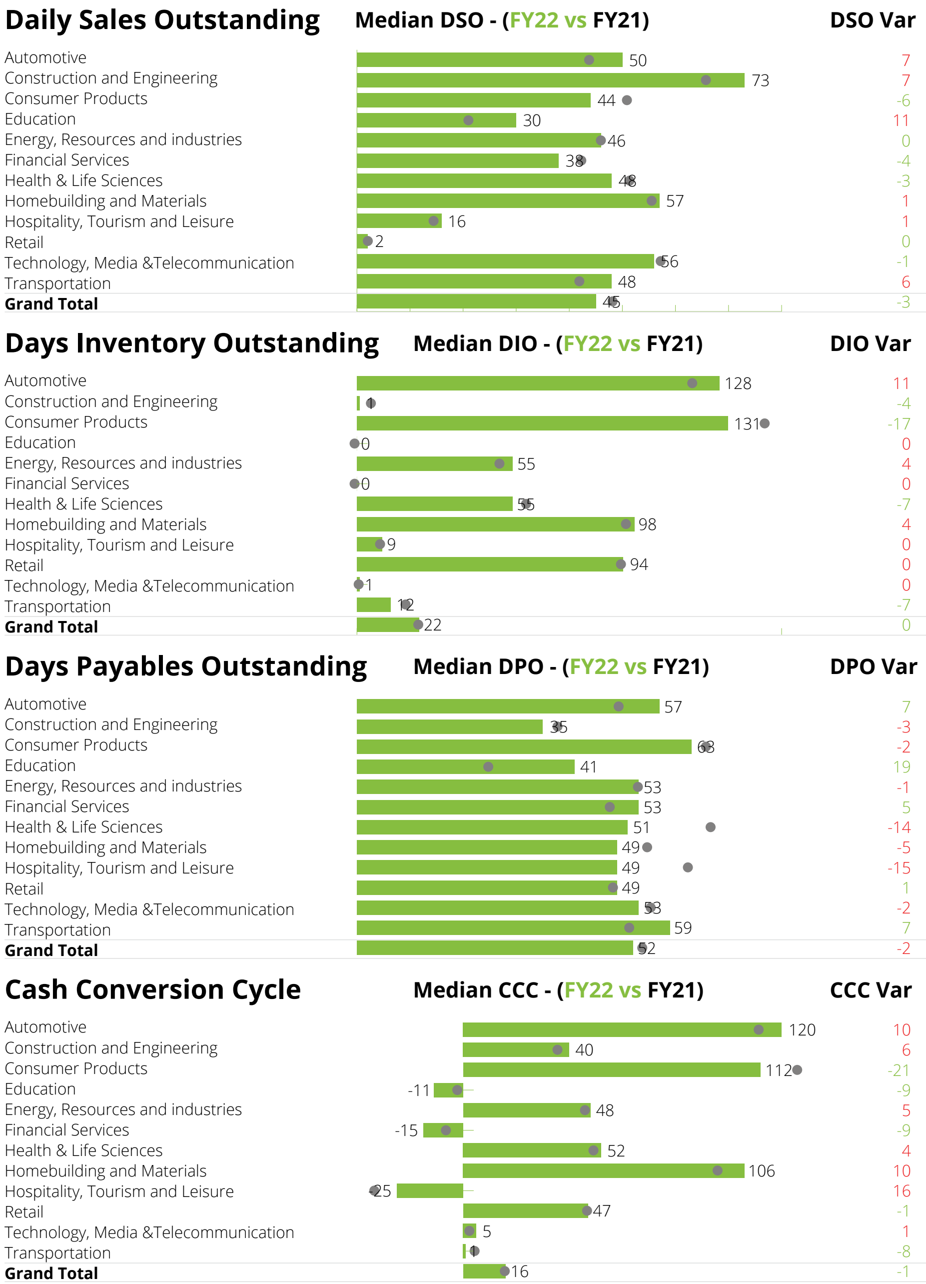
A large majority of ASX businesses experienced revenue growth in FY22 (c.83%), a trend that was fairly consistent across all sectors, with the largest growth in businesses within the Transportation, Building & Construction, Education and Financial Services sectors. Overall, this growth translated to an 18% median increase in revenue.

Profitability was a different story, as a number of ASX companies were battling record FY21 profitability levels, which included, in some cases, the significant benefit of COVID-19 related Government stimulus (JobKeeper). However, our analysis finds that results were still positive, with 55% of ASX businesses building on prior year operating profits (median increase of 6%).

The majority of companies across the ASX increased in net working capital (receivables + inventory—payables) compared to FY21. The largest increases were experienced in the Retail and Automotive sectors, as a result of much larger median inventory balances. Education was the only sector to decrease net working capital due to an increase in median accounts payable.

ASX Overview

FY22 saw certain sectors experience substantial changes in working capital relative to FY21, reflecting millions of dollars in either investment or improvement—with Consumer showing the largest improvement and Homebuilding Materials the largest deterioration.



Legend:

DSO positive variance = decline | DSO negative variance = improvement
DIO positive variance = decline | DIO negative variance = improvement
DPO positive variance = improvement | DPO negative variance = decline
CCC positive variance = decline | ,CCC negative variance = improvement

- Presented to the left is a snapshot of working capital days for all sectors of the ASX.
- On the pages to follow, we set out a deeper dive into five selected key sectors we see are most impacted by changes in working capital, or have seen changes worthwhile noting. These five sectors or subsectors are as follows:
  - Retail
  - Consumer Products
  - Homebuilding and Materials
  - Construction and Engineering
  - Transportation

Across these sectors, Retail, Consumer Products and Transportation sectors all improved their working capital days on a total basis relative to FY21—reducing the amount of time taken to convert working capital to cash.

The Consumer Products sector experienced the largest median decrease (improvement) in cash conversion, resulting from improved inventory management after a challenging FY21 saw increased pressure amid supply constraints.

Conversely, the Homebuilding Materials and Construction sectors experienced the largest median lengthening of cash conversion as a net result of shorter payment times to suppliers and lengthening days to collect cash and turnover inventory held.

Whilst analysis of year end results are a good indicator of business working capital performance and trends, a balanced and sustainable focus across all working capital levers throughout the year is always recommended.

This will ensure there is a consistent 'year-long', rather than 'year-end', drive to working capital improvement.

Retail

Retailers continue to hold higher amounts of stock as a result of supply chain constraints and prior year safety stock builds. This has resulted in approximately $2.6b of additional cash invested and locked up in inventory alone since FY19.

- The main driver of working capital for retailers is inventory, with payables to a lesser extent. Sales are generally collected immediately.
- Total median cash conversion decreased by one day in FY22, although remained elevated against FY19, driven by faster external payments and longer inventory turnover.
- Median inventory days grew in FY21 and stayed at these levels by the end of FY22 as companies maintained higher stock levels due to long supply chain lead times.

Highlights

Companies within sector	**41**
Change in Revenue (FY22 vs 21)	**7%**
Change in EBITDA (FY22 vs 21)	**(6%)**
Change in CCC (FY22 vs 21)	**(1 day)**
Change in CCC (FY22 vs 19)	**5 days**

Example working capital levers (non-exhaustive)

Inventory

Enable visibility of slow moving stock—better use of data analytics insights.

Prioritise inventory reduction activities—e.g. discounted prices or alternative sale channels

Explore opportunities in consignment stock

Payables

Renegotiation of terms based on changes in order patterns, frequencies or suppliers

Consumer Products

Consumer products businesses generally improved working capital over FY22 (on a median basis), with a shortening of debtor collections seen across the sector more than offsetting a shortening of payments made early.

Median working capital days

- On a median basis, total cash conversion decreased relative to FY21, driven by improvements in DSO and DIO.
- Median receivables days improved across FY22, resulting in cash being collected much faster (c.6 days).
- Median inventory turnover remained elevated against FY19, with the increase in FY21 still present as businesses continue to adjust to longer lead times from suppliers.

Highlights

Companies within sector	**40**
Change in Revenue (FY22 vs 21)	**14%**
Change in EBITDA (FY22 vs 21)	**(9%)**
Change in CCC (FY22 vs 21)	**(21 days)**
Change in CCC (FY22 vs 19)	**6 days**

Example working capital levers (non-exhaustive)

Receivables

Customer segmentation based on collection history, ongoing monitoring, strategies on late payers

Inventory

Rationalise less profitable SKUs and product lines

Prioritise review and reassessment of safety stock levels

Payables

Rationalise supplier base, and seek volume and early payment discounts

Homebuilding and Materials

Days inventory held in the Homebuilding and Materials sector have extended year on year since FY19 (from a median of 81 days to 98 days), which we estimate to be worth approximately c.$510m in cash tied up in these businesses.

Median working capital days

- Total median cash conversion increased throughout FY22 (c. 10 days) and remains elevated against FY19, driven by increased inventory days, despite faster cash collections.
- Median inventory days grew across FY21 and continued increasing into FY22, likely as a result of supply constraints experienced.
- On a total cash basis, the upper quartile of homebuilding and materials companies were able to achieve 32 total days whilst lower quartile were 181 total days.

Highlights

Companies within sector	**12**
Change in Revenue (FY22 vs 21)	**4%**
Change in EBITDA (FY22 vs 21)	**(8%)**
Change in CCC (FY22 vs 21)	**10 days**
Change in CCC (FY22 vs 19)	**10 days**

Example working capital levers (non-exhaustive)

Receivables

Early payment discounts for shorter payment terms

Close monitoring of late payment to minimise cash flow risk (using stop supply if needed)

Inventory

Manage and continually assess safety stock levels

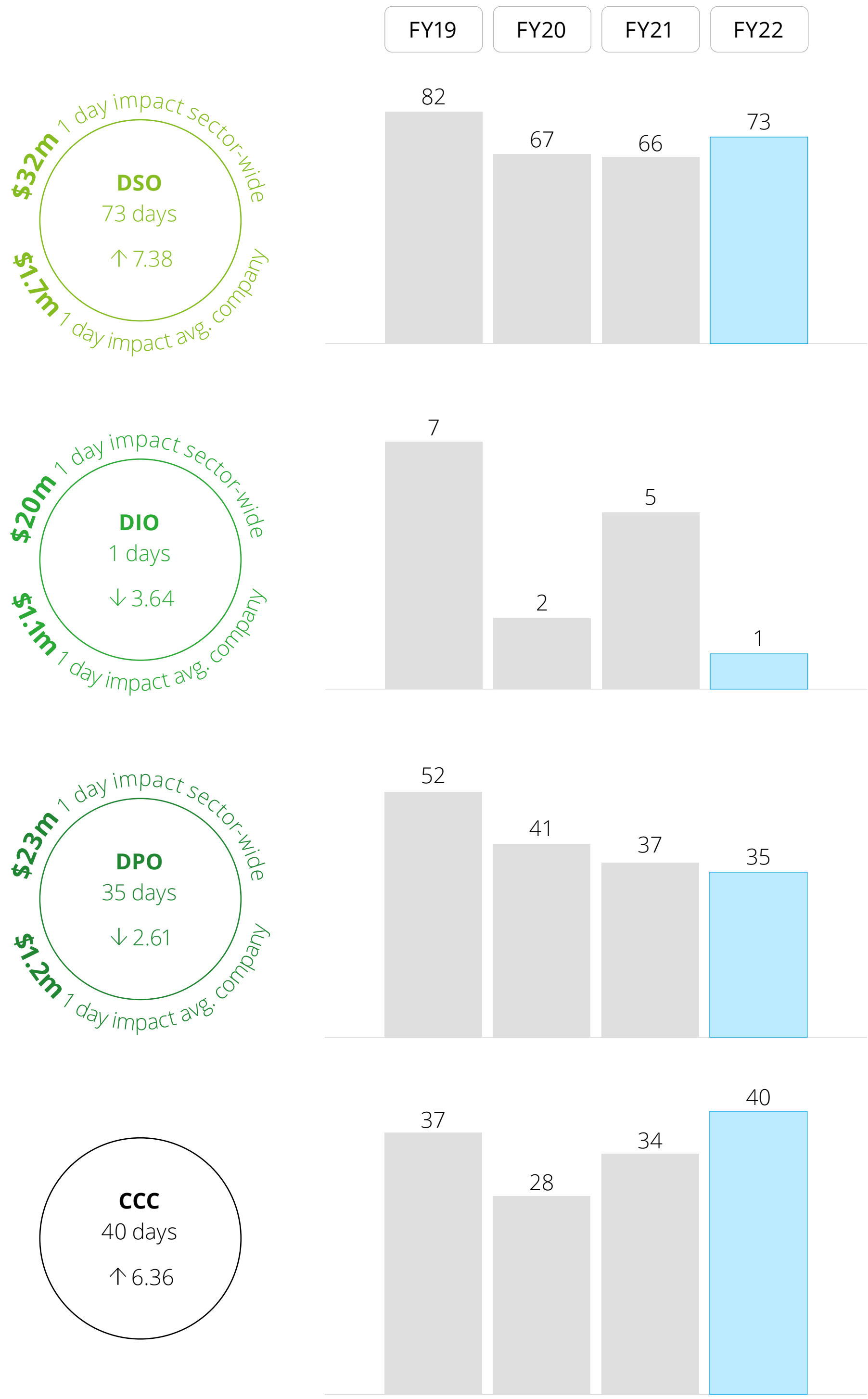
Payables

Manage and continually assess safety stock levels

Construction and Engineering

Despite construction and engineering businesses improving DSO and DIO relative to FY19, the sector has been paying suppliers faster, resulting in a c.$400m cash impact.

Median working capital days



- Total median cash conversion increased in FY22 and is slightly elevated against FY19, driven primarily by faster external payments.
- Median receivables days increased in FY22, meaning cash collection was slower, yet this is still an improvement from FY19.
- Minimal inventory is held by businesses in the construction and engineering sector. The median business held less than $2.0m of inventory across the last three years.

Highlights

Companies within sector	**19**
Change in Revenue (FY22 vs 21)	**25%**
Change in EBITDA (FY22 vs 21)	**(14%)**
Change in CCC (FY22 vs 21)	**6 days**
Change in CCC (FY22 vs 19)	**3 days**

Example working capital levers (non-exhaustive)

Receivables

Early payment discounts for shorter payment terms

Review 'time to invoice' processes and remedy bottlenecks

Payables

Ensure terms are in line with the businesses' policy and industry standards

Implement a robust payment run policy to avoid early payments

Transport

Whilst total median receivables collection times worsened by 6 days (c.$380m) relative to FY21, median DPO also increased by 8 days, resulting in an overall improvement in cash conversion across the transport sector on a median basis.

Median working capital days

- The main driver of working capital for retailers is inventory, with payables to a lesser extent. Sales are generally collected immediately.
- Total median cash conversion decreased by one day in FY22, although remained elevated against FY19, driven by faster external payments and longer inventory turnover.
- Median inventory days grew in FY21 and stayed at these levels by the end of FY22 as companies maintained higher stock levels due to long supply chain lead times.

Highlights

Companies within sector	**18**
Change in Revenue (FY22 vs 21)	**12%**
Change in EBITDA (FY22 vs 21)	**(2%)**
Change in CCC (FY22 vs 21)	**(8 days)**
Change in CCC (FY22 vs 19)	**(8 days)**

Example working capital levers (non-exhaustive)

Inventory

Enable visibility of slow moving stock—better use of data analytics insights.

Prioritise inventory reduction activities—e.g. discounted prices or alternative sale channels

Explore opportunities in consignment stock

Payables

Renegotiation of terms based on changes in order patterns, frequencies or suppliers

Working Capital Health Check

Key Questions to ask yourself...

- How does my business compare against industry peers?
- How much cash could we unlock with the right working capital management strategy?
- How much visibility do we have over the working capital cycle?
- How are we monitoring working capital in our business?
- How should we deploy our cash for better use?

Calculate your company's working capital metrics using the formula below and compare the performance with the benchmarks for your industry on the previous pages. If you would like further analysis, our team would be happy to assist with any benchmarking or working capital management advice.

Working Capital Formula	Your Company Calculate your Company's working capital days	Industry Benchmark Insert industry benchmark from previous pages	Notes
Days Sales Outstanding (DSO) $DSO = \frac{\text{Accounts Receivable}}{\text{Revenue}} \times 365$	[calculate from your company's financials]	[insert benchmark from previous pages]	1
Days Inventory Outstanding (DIO) $DIO = \frac{\text{Inventory}}{\text{COGS}} \times 365$	[calculate from your company's financials]	[insert benchmark from previous pages]	2
Days Payables Outstanding (DPO) $DPO = \frac{\text{Accounts Payable}}{\text{COGS}} \times 365$	[calculate from your company's financials]	[insert benchmark from previous pages]	3

[1] Your accounts receivable management is more efficient if your Company DSO is lower than the Industry Benchmark.
[2] Your accounts Inventory management is more efficient if your Company DIO is lower than the Industry Benchmark.
[3] Your Accounts Payable Management is less efficient if your Company DPO is lower than the Industry Benchmark.

Example

Taking DSO as an example, assume:

- your Accounts Receivable total is $50m; and
- your Days Sales Outstanding is 60 days (i.e. it take two months to collect your debtors).

The Opportunity

- Accelerating collections by 15 days (25% reduction in collection time) would unlock c.$12.5m in cash for the business.

The Cost

- Assuming the business has a cost of capital of 7%, the 15 days additional lock-up in receivables is costing c.$875k p.a.

Basis of Preparation

Source Data:

Data contained in this publication was sourced through the S&P Capital IQ database, updated on 26 September 2022. Whilst we believe the data to be reliable and complete, we cannot guarantee the accuracy of all information. We have excluded companies with FY22 Revenue under $10.0m.

Key Terminology:

- Days Sales Outstanding (DSO)—expressed in 'days', this calculation measures the rate at which a company collects payments from debtors following the sale of goods and/or services. The lower the DSO, the faster cash is collected. Refer to the formulas on pg. 10.
- Days Inventory Outstanding (DIO)—expressed in 'days', this calculation measures how long a company holds inventory before selling it on to a customer. The lower the DIO, the less time inventory is owned by the company. Excess inventory ties up cash and makes the company vulnerable to market price volatility. Refer to the formulas on pg. 10.
- Days Payables Outstanding (DPO)—expressed in 'days', this calculation measures the rate at which a company pays its suppliers for goods and/or services provided. The higher the DPO, the longer cash is held in the business. Refer to the formulas on pg. 10.
- Cash Conversion Cycle (CCC)—expressed in 'days', this calculation represented the cumulative view of DSO, DIO and DPO. It attempts to measure the rate at which cash is tied up in the operations of a company. To calculate CCC, add DSO to DIO and subtract DPO (i.e. DSO + DIO—DPO = CCC).

Calculations:

- Change in DSO FY22 vs FY19 ($) = (DSO (FY22)—DSO (FY19)) * Sum(Accounts Receivable (FY22)/DSO (FY22) * 365)
- Change in DIO FY22 vs FY19 ($) = (DIO (FY22)—DIO (FY19)) * Sum(Inventory (FY22)/DIO (FY22) * 365)
- Change in DPO FY22 vs FY19 ($) = (DPO (FY22)—DPO (FY19)) * Sum(Accounts Payable (FY22)/DPO (FY22) * 365)

Detailed Data

Sectors and subsectors have been slightly adjusted from the Capital IQ classifications, with some subsectors combined.

		FY22—Median						
Sector	**Subsector**	**Companies**	**DSO**	**DIO**	**DPO**	**CCC**	**CCC—Upper Quartile**	**CCC—Lower Quartile**
Construction and Engineering	Construction and Engineering	19	73	1	35	40	(5)	85
	Total	**19**	**73**	**1**	**35**	**40**	**(5)**	**85**
Consumer Products	Brewers, Distillers and Vintners	5	61	375	100	336	189	471
	Electronics and Household Appliances	4	60	175	114	120	61	180
	Foods and Drinks	23	28	85	50	63	(4)	196
	Personal Products	4	47	121	70	98	66	152
	Specialized Consumer Services	4	158	18	54	122	50	361
	Total	**40**	**44**	**131**	**63**	**112**	**(17)**	**254**
Homebuilding and Materials	Building Products	3	60	155	50	165	113	180
	Construction Materials	5	53	89	74	69	38	101
	Homebuilding and Furnishings	4	67	68	45	90	25	171
	Total	**12**	**57**	**98**	**49**	**106**	**32**	**181**
Retail	Apparel Retail	9	4	142	41	105	35	154
	Department Stores	3	2	100	63	39	26	80
	Electronics and White Goods	7	17	86	51	53	24	92
	Food Retail	5	3	31	46	(12)	(24)	26
	Home Improvement Retail	6	1	134	43	92	16	113
	Specialty Stores	11	1	65	51	15	(49)	118
	Total	**41**	**2**	**94**	**49**	**47**	**(14)**	**121**
Transportation	Air Freight and Logistics	5	48	0	24	24	4	41
	Airlines	4	44	15	35	23	(21)	85
	Airport Services	1	26	0	33	(6)	(6)	(6)
	Highways and Railtracks	3	53	169	82	141	26	162
	Railroads	1	39	42	58	24	24	24
	Trucking	4	102	19	118	3	(235)	156
	Total	**18**	**48**	**12**	**59**	**1**	**(43)**	**75**

Contact Us

Our team has experience across a range of sectors, working with Management, private equity and lenders to improve cash and enhance profits for our clients.

Our experienced Cash & Working Capital team leverage Global best practice methodologies to optimise cash and tightly monitor cash flows, bringing a combination of data-driven insights and operational and practical implementation best practices to sustainable improvement.

To further compare your company's working capital performance relative to ASX-listed or private market peers, and to explore ways to better track, monitor and implement sustainable working capital change in your business, contact us for a discussion.

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