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Private Equity outperforms listed companies on working capital management

Strong focus of PE on working capital optimisation pays off

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1. PE outperforms listed companies on working capital management

PwC research reveals that PE owned portfolio companies have significant less cash 'locked' in their operational processes (approximately 30%) than listed companies operating in the same industry. The research covered ~ 750 companies located in Western Europe in the Healthcare (e.g. pharmaceuticals and biotechnology), Industries (e.g. construction, engineering, transport and logistics), Materials (e.g. producers of machines and construction materials) and Consumer goods industry (e.g. retail and apparel producers).

Healthcare	DSO	+	DIO	-	DPO	=	CCC
PE	54		88		72		**69**
Listed companies	64		100		64		**100**

Materials	DSO	DIO	DPO	CCC
PE	64	85	86	**63**
Listed companies	56	102	66	**92**

Consumer goods	DSO	DIO	DPO	CCC
PE	45	98	67	**76**
Listed companies	42	118	66	**94**

Industries	DSO	DIO	DPO	CCC
PE	60	32	65	**27**
Listed companies	61	32	54	**39**

Definitions:
DSO ('Days Sales Outstanding') = The average number of days it takes companies to collect revenue after a sale has been made
DIO ('Days Inventory on Hand') = The average number of days it takes companies to sell the entire inventory
DPO ('Days Payables Outstanding') = The average number of days companies take to pay their suppliers
CCC ('Cash Conversion Cycle') = The average number of days it takes companies to convert resource inputs into cash

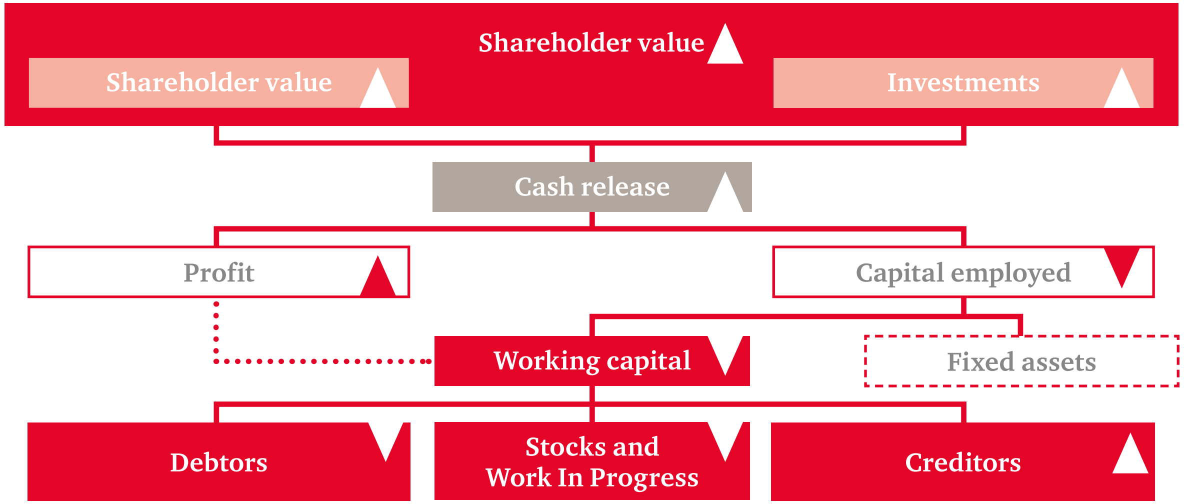
Differences in length of the CCC ('Cash Conversion Cycle') cannot merely explained by a higher DPO due to stretching of credit terms or deliberately paying late suppliers. For most of the sectors the lower CCC also coincides with improved operational processes, resulting often in significantly lower inventories.

2. Why leading PE-investors focus on WCM

Working capital performance is often a barometer of how well a company is managed. It is an indicator of good management, can provide a real competitive advantage, and is the life blood of every company.

Effective and efficient management of working capital constitutes a key lever for increasing shareholder value. Leading PE houses acknowledge this and therefore adapt their day-to-day business and corporate strategy. They want to increase shareholder value through realizing operational improvements and not by merely refinance their portfolio companies with additional debt. PE houses and their portfolio companies have therefore increased their focus on optimizing working capital through all stages of the deal cycle:

- **Pre-deal:** As potential upside (but also red flags) for investment thesis. During DD ('Due Diligence') they investigate whether operational improvements can be realized that will optimise the working capital position in the short and long run.
- **Portfolio optimization:** Further optimise the working capital positon of all their PE portfolio companies to unlock cash for new investments. Working capital reduction through e.g. embedding a real 'cash-culture' within the organization and implement operational or tactical WCM measures.
- **Pre-exit:** Enlarge deal value from reduced working capital.



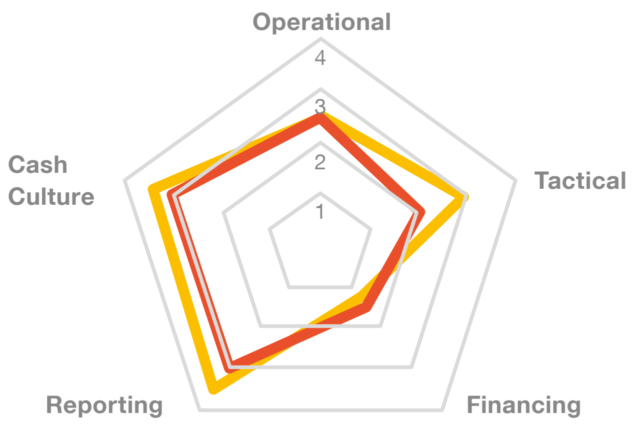
3. What can we learn from PE?

A qualitative survey, completed under CFOs and Finance Directors of various Dutch portfolio companies, confirmed that the type of ownership drives the focus on WC. The large majority of the respondents replied that the change of ownership to a PE owned company, has led to an increased focus on WC. The companies' relatively large debt position is an important contributor for this.
The result of the study shows that PE portfolio companies who actually achieved a significant WC improvement did both:

1) highly focusing on working capital management ('WCM');
2) deploying a significant number of WC initiatives.

The level of WC initiatives has been scored on five WCM 'Levers for Improvement': Operational, Tactical, Reporting, Financing and Cash Culture. Results show that PE portfolio companies with relatively a high score on the Cash Culture, Reporting and Tactical lever, show a significant WC improvement. The largest difference in score is measured on the Tactical lever. However, there is still room for improvement for both low and high performers on the Operational and Financing lever.

Figure 1 Levers for improvement



Hover with your mouse over one of the five levers to read an explanation.

Legenda
1 = Low level of implementation of WC initiatives
4 = High level of implementation of WC initiatives

Reasonable WC improvement
Significant WC improvement

4. *What are the key lessons for both corporates and PE?*

Still, even for companies that are highly focused on WCM it seems to be difficult to sustainably improve their WC position. Approximately 50% of highly focused PE portfolio companies did only consider a medium improvement in their WC position. An explanation may be that PE portfolio companies do not yet deploy in full the improvement measures of all the working capital levers, as research also shows. This applies in particular to the operational and financing measures.

1. A high focus on WCM pays off, in particularly through the implementation of tactical measures and inventory levels (e.g. optimise credit terms and inventories)

2. Other measures that distinguish companies with a relatively low working capital position are:
   - Establish a 'Cash Culture' creating cash awareness throughout the organization
   - Measure and monitor actively the WCM performance in the standard reporting cycle

3. For both good and bad performers on WCM there is additional potential to improve the WCM position. This e.g. through the introduction of end-to-end solutions in all operational cycles, and the use of working capital financing tools such as SCF ('Supply Chain Financing') and factoring

5. *How can PwC support you?*

PwC can help you to increase the return on your investments by reducing cash tied up in operations. Our team has worked with 400+ business including many PE-houses and their portfolio companies. We are dedicated practitioners with hands-on experience, which builds trust, generates buy-in and drives sustainable results.

Please visit our website for more information:
[*http://www.pwc.nl/workingcapital*](http://www.pwc.nl/workingcapital)

Complete a working capital benchmarking exercise to compare performance against peers & identify improvement opportunities

1 *Benchmarking*

Perform a diagnostic review to identify 'quick wins' and longer term improvement initiatives

2 *Diagnostic review*

Develop detailed action plans for implementation to generate cash and make sustainable improvements

3 *Action planning*

Assist the realisation of sustainable working capital reduction by implementing processes & controls

4 *Reporting & control*

Contacts

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