Point of View

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November 2013

Working Capital Trends and Practices for the Major European Food Products, Beverage and Food and Staples Retailers Companies

The food product and beverage companies and food and staples retailing companies are all impacted by tightening margins, cost inflation and variability in consumer demand. The market is established and offers limited growth. These factors combined require the companies to have efficient business practices to remain competitive. For the top-performing companies this will include optimisation of working capital. The principle drivers to optimise working capital are: to relieve pressure on margins, release cash for acquisition to support growth and to service debt.

Working capital can be optimised by scrutinising the processes which tie up the company's working capital, namely the route from sales to customer payment, supplier management and the supply chain. This scrutiny has the advantage of optimising working capital and also taking out cost and improving on both supplier and customer relationships. Other options for working capital optimisation for these companies are within the distribution network and the use of supply chain financing.

The long-term historic trend for the food product and beverage companies is a significant reduction in overall working capital requirements. The top-performing companies in this industry have been able to achieve negative working capital in the last few years. For their retailers, the top-performing companies have actually increased their working capital requirement compared to a reduction in requirement for the rest of the retail group.

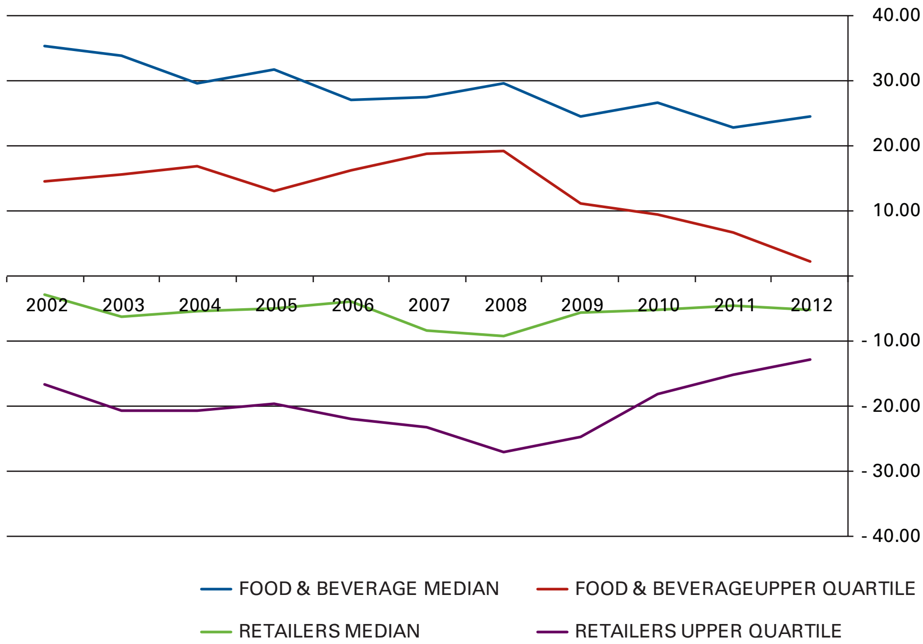
Over the last ten years, there has been a significant reduction in the median DWC for the food product and beverage companies. The reduction is 11 days, which translates into an average reduction in working capital of €219 million[1]. The change for the top-performing companies is an additional 1.3 days, providing an additional €26 million. Looking at the equivalent performance for retailers, the median DWC has reduced by 2.4 days, translating into an average €156 million reduction in working capital[2] with an actual decline of 3.8 days for the top performers or an increase in working capital requirement of €248 million.

Nevertheless, this performance still allows the bulk of the retailers to have negative working capital. This means that the payables balance, cash owed to suppliers, is greater than the receivables balance, customer sales not yet paid, added to the value of inventory. This is feasible in businesses with high turnover and customer cash payment, so in principle it is achievable for the food and staples retail industry.

Within the retailing industry the gap between the top performers and the median performance is closing. There is

1 Based on average revenue per day of €19.9 Million
2 Based on average revenue per day of €65.2 Million

10-year days working capital (DWC) trend



a slight gain in the median performance and a drop in performance for the top performers year on year. This is not true for the food and beverage companies; in fact year on year there has been an increase in the median DWC compared to a more significant decrease for the top performers. So the gap is increasing for the food product and beverage companies. This suggests that some of the companies within the sector are focussing on working capital while others are not. For the retailers the question is why the performance is merging and whether or not it's possible to regain past performance.

Anheuser-Busch Inbev gets awarded the prize for best performance in the ten-year time period, with an overall reduction in days working capital of 79 days. The next best performer, Carlsberg, has managed a 51-day reduction. The AB Inbev reduction has largely been achieved by shortening days sales outstanding (DSO) (38 days) and extending days payable outstanding (DPO) (41 days). The inventory measure, days inventory on-hand (DIO), is the same as it was 10 years ago. There has been some variance, with a marked increase in 2007 and 2008, but more or less flat performance for the last 4 years. The story is similar for Carlsberg with a reduction of 20 days in DSO and an extension of 26 days for DPO. They are the two best performing companies in the 10-year period and also have the best overall performance in the beverage sector.

Dairy Crest and Unilever are the best-performing food product companies, with a reduction of 34 days and 31 days in DWC respectively over a 10-year period. For Unilever it's a similar story to the beverage companies, with the change being driven by DSO and DPO. For Dairy Crest, in contrast, there has been a marked improvement in DIO of 22 days, a 9-day improvement in DSO and an increase in DPO of 4 days. However, Dairy Crest's overall performance for DWC FY2012 is higher than the median and it is not a top performer. Unilever is ranked 5th for DWC performance FY2012.

Greencore and Campofrio Food are the food product companies showing the best actual DWC performance for FY2012. Greencore has made gains in the 10-year period through across-the- board activity. DSO has reduced 6 days, DIO has reduced by 16 days and DPO has increased by 6 days, suggesting a concerted effort across the board to improve working capital. In contrast, Campofrio Foods has been able to achieve a positive result for DWC through a 39-day increase in DPO. The DSO has increased over the 10-year period (9 days) and DIO has risen to a peak in 2008, reducing back down to a similar level achieved at the start of the period (1 day change). The DSO is still within upper quartile range, so opportunity here may be limited. The DIO is higher than the average DIO, so there should be potential here.

So as a food or beverage company, to take the lead set by the top performers, look at all aspects of your working capital. The first question to answer is whether or not there is opportunity to reduce inventory. This can be established by understanding your levels of inventory versus your peers and understanding what activity your company has undertaken to optimise inventory. If the DIO is above median and your company has had limited activity to optimise inventory, then there will be opportunity here. If the performance is closer to the upper quartile and active inventory optimisation projects have been conducted, then it is likely that there is little room for improvement on inventory given the existing business model. In this situation, the emphasis must be on how to sustain these results. A change in the business model may provide further gains.

The next step is to look at DSO and DPO performance. The decision here is more straightforward. The top performers have demonstrated that there is room for improvement, and any company with a figure higher than the upper quartile performance for DSO or lower than the upper quartile performance for DPO should have the opportunity to make gains in these areas. Upper quartile is 32 days for DSO and 58 days for DPO.

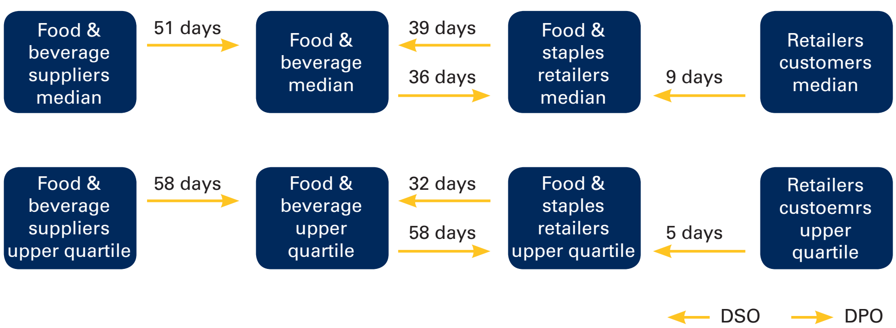
Looking at the top performers amongst the food and staples retailers, Metro and Ahold stand out over the 10-year period, with a reduction in DWC of -10 days and -15 days respectively. Metro holds the number 2 position for overall DWC performance for the latest financial year and Ahold is mid-table. For Metro the gain mostly comes from increasing DPO with some additional improvement from DIO. For Ahold the gain comes from inventory reduction with some improvement also on DSO and DPO. Jernonimo Martins is the top performer for the industry and has consistently good performance for the last ten years, with some improvement achieved in receivables and inventory and little movement on DPO.

Overall for the industry, there has been pressure on DPO to come down for the top performers within retail, but there has been room for small gains in the 30- day range. There has been some squeeze on inventory with a reduction of a day here and there. For DSO, the top performers have improved marginally but the mid-table have lost a bit of ground here.

For a food and staples retailer company in the top performing bracket, it would seem that there is little room for improvement in DPO and if anything further squeezing of terms is likely. Therefore these companies need to look at their customer payment and inventory for further gains or to sustain existing performance. For companies which are in the mid-table there should still be room for improvement on DPO, but they should also look to inventory and receivables for continued improvement.

The geographical location may constrain the potential for DPO improvement. For the retailers based in the Nordics, United Kingdom, Belgium and The Netherlands, the median DPO compared to the other countries is 30 days versus 63 days for the others. The same does not apply for the food product and beverage companies. Taking an overview of the payments between suppliers and the customers in the industry, it's clear to see how the top performers have an advantage over the others in their industry. The DSO is nearly half for the retailers, and there is a 22-day gap in DPO. The DPO of 58 days is passed on from the retailers to the suppliers of the food and beverage companies. There is also nearly a month between the DSO payment to the upper-quartile suppliers compared to the DPO achieved by the

Days sales outstanding (DSO) and days payable outstanding (DPO) Comparison



The Grocer TWC Data Survey

Terms Defined (in order of appearance)	What It Means	How to Interpret the Numbers
DWC	'Cash on Hand' Days Working Capital: (AR + inventory - AP)/ (total revenue/365): Year-end net working capital (trade receivables plus inventory, minus trade payables) divided by one day of average revenue.	The lower the number of days the better. The percentage change is marked N/M (not meaningful) if DWC moved from a positive to a negative number or vice versa.
DSO	'Company Receivables' Days Sales Outstanding: AR/ (total revenue/365): Year-end trade receivables net of allowance for doubtful accounts, plus financial receivables, divided by one day of average revenue.	A decrease in DSO represents an improvement, while an increase is a sign of deterioration. In the accompanying charts, companies marked with an asterisk have securitized receivables, which improve DSO through financing alternatives without improving the underlying customer-to-cash processes such as credit-risk assessment, billing, collections, and dispute management. The scorecard eliminates this distortion by adding securitized receivables back on the balance sheet before calculating DSO.
DIO	'Inventories' Days Inventory Outstanding: Inventory/ (total revenue/365): Year-end inventory plus LIFO Reserve, divided by one day of average revenue.	A decrease in DSO represents an improvement, while an increase is a sign of deterioration.
DPO	'Payables/Outgoings' Days Payables Outstanding: AP/ (total revenue/365): Year-end trade payables divided by one day of average revenue.	An increase in DPO is an improvement, while a decrease signals deterioration. For purposes of the survey, payables exclude accrued expenses.

For the purpose of this analysis, the industries for food products and beverages have been combined. Then the top 20 performers by days working capital (DWC) performance for FY2012 have been selected for inclusion.
For the food and staples retailing industry 18 companies have been included.

Source: 2013 Europe Working Capital Survey

top-performing retailers. This suggests that the balance of power typically held by the retailers may be shifting, especially for those food product and beverage suppliers in the upper quartile of performance.

Working capital is definitely being challenged in this industry. All the retailers are under pressure to sustain their working capital performance. The food product and beverage companies need to take the lead set by the top-performer beverage companies and look to see where they can drive down their working capital requirement. How far can the rest of this industry go to achieve negative working capital? While DPO may be past its peak, for some there is plenty of opportunity. There's a potential €49 billion tied up in working capital amongst the top 20 food product and beverage and food and staples retailing companies which could be released. It is across all areas – with €11.7 billion in receivables, €17.6 billion in inventory and €20 billion in payables.

— Anne Morgan-Smith
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