

A close-up photograph of a sailboat's deck. In the foreground, a pair of dark sunglasses is perched on a coil of thick, white rope with red and blue flecks. The rope is coiled around a metal block. In the background, a white sail is visible against a bright blue sky with scattered white clouds. The overall scene is bright and sunny, suggesting a clear day on the water.

All tied up

**Working capital
management
report 2012**

**Central and Southern
Europe region**

Summary

All Tied Up Central and Southern Europe (CSE) region 2012 is the latest in a series of working capital (WC) management reports published by Ernst & Young. It focuses on the leading 150 companies in the CSE region and complements the previously released All Tied Up EMEA 2012 survey

Comparing 2011 with 2010 shows a significant deterioration in WC performance for the largest CSE companies. Cash-to-cash (C2C) increased by 12%, and by 3% excluding the oil and gas sector (which accounts for 40% of total sales). Results should be viewed in the context of extremely challenging economic and credit conditions among CSE countries, compounded by heightened volatility in currency and commodity prices.

These latest WC findings mean that, since 2005, the total reduction in C2C for CSE companies has been limited to 3%. Had the oil and gas sector been excluded from our calculations, C2C would have increased by 5%. By comparison, the US and Europe reported a reduction in C2C (excluding the oil and gas sector) of 5% and 4% respectively since 2005.

Although the analysis reveals similar levels of C2C between CSE, Europe and the US in 2011, these results mean that CSE companies have been significantly underperforming their US and European peers in the last six years, raising the question of whether CSE companies have been paying sufficient attention to WC management when planning and executing their responses to a more challenging environment.

For business leaders in this region, it is therefore important to continue implementing truly effective WC management strategies. These include identifying, adapting and improving best-practice solutions; working more closely and collaboratively with key customers and suppliers; building greater agility into their systems and processes; having robust risk management policies; giving consideration to fresh financing initiatives; and executing constantly against these requirements. Trust also needs to be built and competencies developed among supply chain partners. This also means taking an approach across all these areas that balances cash, cost and service levels.

Key working capital results

Change in WC metrics

A review of the WC performance of CSE companies reveals a significant deterioration in 2011 compared with 2010. C2C increased by 12% and by 3% excluding the oil and gas sector (which accounts for just over 40% of total sales).

These results were achieved in the context of highly challenging and sharply diverging economic and credit conditions among CSE countries. Volatility in currency and commodity prices also had a large impact.

Table 1: change in WC metrics, 2005–11

CSE	2011	Change 11/10	Change 11/05
DSO	46	2%	-2%
DIO	39	5%	13%
DPO	47	-3%	10%
C2C	38	12%	-3%

Table 2: change in WC metrics excluding the oil and gas sector, 2005–11

CSE	2011	Change 11/10	Change 11/05
DSO	57	3%	4%
DIO	37	4%	12%
DPO	53	4%	9%
C2C	41	3%	5%

Note: DSO (days sales outstanding), DIO (days inventory outstanding), DPO (days payable outstanding) and C2C (cash-to-cash), with metrics calculated on a sales-weighted basis

Source: Ernst & Young analysis, based on publicly available annual financial statements

The weaker WC performance (excluding the oil and gas sector) in 2011 was due to an increase in both DSO and DIO (up 3% and 4% respectively), which was partially offset by a rise in DPO (up 4%). Note that last year's deterioration in receivables performance partly reflects the impact of worsening economic and credit conditions in some CSE countries.

The oil and gas sector mostly consists of refiners, marketers and distributors of oil-related products.

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By comparison, the US and Europe reported a reduction in C2C (excluding the oil and gas sector) of 5% and 4% respectively since 2005. These results mean that CSE companies have been significantly underperforming their US and European peers in the last six years.

Sector performance review

Table 3: most significant WC changes among major sectors, 2005–11

Major sector	C2C change	
	2011/2010	2011/2005
Auto parts	19%	-21%
Building materials	15%	12%
Chemicals	18%	-20%
Electric utilities	107% *	-6%
Food producers	-9%	2%
Food and general retailers	-23%	-18%
Oil and gas	36%	-12%
Pharmaceuticals	-2%	5%
Steel	-2%	28%
Telecommunications	-4% **	-26% ***

Source: Ernst & Young analysis, based on publicly available annual financial statements

* 11 days vs. 6 days

** 6 days vs. 6 days

*** 6 days vs. 8 days

The biggest improvements in WC achieved since 2005 include the auto parts, chemicals, electric utilities, food and general retailers, oil and gas and telecommunications sectors. By contrast, building materials, food producers, pharmaceutical and steel companies scored poorly over the same period under review.

Regional performance review

In 2011, the number of countries showing a year-on-year improvement or deterioration in WC performance was evenly split, but with significant variations between them. Compared with 2005, there was an identical number of countries underperforming and outperforming.

However, the performance trends at country level need to be treated with a degree of caution. Firstly, the approach is based on consolidated numbers in the absence of further local details, with each company being allocated to the location of its headquarters. Secondly, factors such as year-end reporting, changes in the trade-offs between the profit and loss account and the balance sheet, and merger and acquisition (M&A) activity may each have had a significant effect on yearly comparisons. Thirdly, volatility in local currencies against other main currencies may have exacerbated WC changes. Finally, disconnect regulations in the utilities sector tend to vary jurisdiction by jurisdiction.

Table 4: change in C2C by CSE country, excluding the oil and gas sector, 2005–11

CSE	C2C	
	Change 11/10	Change 11/05
Bulgaria	-6%	98%
Croatia	-16%	-8%
Czech Republic	4 days vs. -2 days	4 days vs. 5 days
Hungary	-6%	-8%
Poland	1%	4%
Romania	27%	-5%
Slovenia	-3%	11%
Turkey	5%	3%
Total	3%	5%

Source: Ernst & Young analysis, based on publicly available annual financial statements

Note: Variance for the Czech Republic is expressed in days to avoid being misled by applying percentage variance (+300%)

Converging WC performance between CSE countries

A certain degree of convergence in WC performance between CSE countries can be expected given the increased impact of intra-regional trade. Intra-regional M&A activity is also growing steadily, driven by consolidation activity, market deregulation and the need to diversify internationally and gain access to new markets. That said, WC performance in many CSE countries is likely to remain heavily influenced by local payment practices and industry characteristics.

WC comparisons with the US and Europe

WC comparisons

Comparing the WC performance of leading CSE companies with those in Europe and the US shows significant variations overall and for each metric. It is worth noting, however, that regional comparisons should be approached with a particular nuance in mind. Since some of the business carried out by top country-headquartered companies takes place outside their home regions, their WC results to some degree reflect global market conditions, as well as those at home.

Table 5: WC metrics by region excluding the oil and gas sector, 2011

	CSE	Europe	US
DSO	57	54	39
DIO	37	36	32
DPO	53	47	30
C2C	41	42	41
DSO - DPO	4	7	9

Source: Ernst & Young analysis, based on publicly available annual financial statements

Analysis shows similar levels of C2C between CSE, Europe and the US in 2011, but with significant variations among metrics.

CSE and Europe score poorly in receivables and inventory compared with the US, fully offset, however, by a much stronger performance in payables. For the US, the high differential between receivables and payables cycles (DSO vs. DPO) is compensated at the C2C level by a strong showing in inventory.

The DSO and DPO performance gap across regions can be explained to some extent by variations in local payment practices (payment terms and behaviors, payment usage, legal frameworks and cash collection effectiveness). Payment terms, for instance, are generally longer in the CSE region than in the US. Significant disparities in the levels of payment delays and defaults (and subsequently in provisioning and write-off policies) can also be observed between regions. While payment usage plays a role, these differences can also be explained by local behaviors, as well as by variations in the degree of effectiveness of credit management policies and legal enforcement procedures.

Marked differences in the degree of management focus on cash and process efficiency can also be observed among these regions. These partly reflect variations in the commercial and industrial strategies deployed, as well as differences in the degree of process maturity among companies, as they seek to respond in different ways to distinct economic and financial conditions and opportunities.

WC comparisons among sectors across regions

An analysis of WC performance by sector across regions reveals substantial variance, exacerbated by the impact of factors that are specific to each local sector.

Compared with Europe and the US, electric utilities in the CSE region boast a superior performance in C2C, helped by much higher levels of payables.

In the case of telecommunications services, the performance by region is largely influenced by the mix of fixed-line vs. mobile and prepay vs. post pay mix, local payment practices, payment methods and levels of capital expenditure.

For the oil and gas sector, comparisons have been made with independent refiners and marketers in the US. The discrepancy in performance between the two regions partly reflects variations in business models and in levels of minimum national stockholding requirements.

Food producers in the CSE region exhibit much weaker WC performance. As well as lacking the benefits of size, many deal with a dispersed customer base and operate comparatively inefficient supply chains.

In the pharmaceutical sector, the poor WC performance reported by CSE companies relates to receivables, due to longer local payment terms, exacerbated in 2011 by an increase in the levels and collection periods of receivables in the public sector of certain CSE countries.

Table 6: WC metrics by sector across regions, 2011

C2C	CSE	Europe	US
Auto parts	71	60	34
Chemicals	45	70	60
Building materials	100	53	56
Electric utilities	11	37	35
Food producers	72	37	46
Oil and Gas	34	nm	27*
Pharmaceuticals	93	86	
Steel	125	86	62
Telecommunications	6	-2	14

*Refining and marketing

Source: Ernst & Young analysis, based on publicly available annual financial statements

Methodology

- ▶ The report contains the findings of a review of the WC performance of the largest 150 companies (by sales) headquartered in the CSE region (comprising Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovenia and Turkey).
- ▶ The analysis draws on companies' latest fiscal 2011 reports. Performance comparisons have been made with 2010 and with the prior six years.
- ▶ The review on which the report is based is segmented by region, country and sector, with numbers calculated on a sales-weighted basis. It uses metrics to provide a clear picture of overall WC management.
- ▶ Because of differences in industry weightings and in the level of international activity within each economy, an analysis of the WC performance gap across CSE countries would not have been useful or meaningful.
- ▶ The WC performance metrics are calculated from the latest publicly available company annual financial statements. In order to make the figures as comparable and consistent as possible, adjustments (see glossary) have been made to the data to reflect the impact of acquisitions and disposals and off-balance sheet arrangements when this information is available.

Glossary

- ▶ DSO (days sales outstanding): year-end trade receivables net of provisions, including VAT and adding back securitized receivables, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ DIO (days inventory outstanding): year-end inventories net of provisions, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ DPO (days payable outstanding): year-end trade payables, including VAT and adding back trade-accrued expenses, divided by full-year pro forma sales and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise)
- ▶ C2C (cash-to-cash): equals DSO, plus DIO, minus DPO (expressed as a number of days of sales, unless stated otherwise)
- ▶ Pro forma sales: reported sales net of VAT and adjusted for acquisitions and disposals when this information is available

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