INSIDE CONSTRUCTION

New research points to more cash tied up in working capital and suppliers being squeezed, but construction and engineering bucks the trend.

By Simon Gould, Monday 12 November 2018

McGrathNicol Advisory Partner, Jason Ireland

McGrathNicol Advisory launched its 2018 Working Capital Report and revealed that working capital metrics worsened, on average, across a sample of 146 ASX-listed businesses, in nine sectors. But, for the construction and engineering sector, a shortening of debtor and inventory cycles have driven a stronger working capital performance.

The report revealed working capital cycles increased by an average of 0.5 days to 48.7 days in 2018, tying up an additional $691 million in working capital within the sampled companies. The net result of 0.5 days was driven by companies holding higher average inventory balances, but attempting to offset that cash impact by taking slightly more time to pay suppliers where possible.

Whilst there was an overall increase in cash tied up in working capital, four of the nine sectors achieved an improvement in average metrics. The construction and engineering and telecommunications sectors performed the best, each achieving more than a four day reduction in working capital cycles, on average.

For construction and engineering, a shortening of debtor and inventory cycles drove a stronger working capital performance. The sector generally operates in an environment where suppliers are paid much faster than payments are received from customers, under what are sometimes complex contracts. Closing this structural funding gap is going to become more challenging under proposed changes to the Security of Payments Act, meaning businesses in the sector need to focus on improving their contracting billing and collections processes. The results show that on average, the gap closed by 0.4 days. Downer EDI was one of the biggest improvers, managing to materially reduce the average time to collect cash - closing the funding gap by 15 days.

The improvement in the telecommunications sector was driven by a mix of faster customer collections, lower inventory and longer supplier payment cycles. Telstra and Amaysim were the best performers in telecommunications, with their working capital improvements representing a net cash benefit of $919.6 million and $14.6 million respectively.

"The Construction & Engineering sector benefited from stronger market conditions with 81% of companies in the sample growing both revenue and EBITDA," said Jason Ireland, McGrathNicol Advisory Partner.

"The majority of companies in the sample were also able to improve their working capital management, unlocking more than $670 million in cash.

"However, the solid performance in construction and engineering went against the grain, with the majority of other sectors seeing an increase in cash tied up in working capital. That's cash Australian businesses could be using to fund their growth and deliver more value to shareholders.

"The figures show that even a relatively small deterioration in metrics can represent a significant lost opportunity."

The food and beverage sector had the longest working capital cycle of any of the industries covered, mainly due to its large inventory holdings. Two thirds of companies in the food and beverage sector sample held onto inventory longer driving a 2.6 day increase in days working capital across the sector.

"Some companies are performing exceptionally well in determining their optimal working capital holdings then setting a course to achieve them," Ireland said.

"The findings confirm that management teams need to keep a balanced and concerted focus on all three working capital levers, inventory, debtors and creditors, in order to maximise their cash flow.

"The competitive advantage to be gained is clear when you consider the length of working capital cycles can vary by more than 100 days between best and worst performers within a sector."