Consumer products industry and working capital management

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Ernst & Young
Quality In Everything We Do

Contents

Section		Page
1	Background	1
2	Study methodology	2
3	Summary of key findings	3
4	Working capital performance since 2002	4
5	Level of cash opportunity	7
6	Receivables performance	8
7	Inventory performance	12
8	Payables performance	17
9	Collaborative working capital	19
10	Opportunities for improvement	20

Appendices

1	EBITDA versus TWC trade-offs	22
2	Working capital performance metrics of retailers	23
3	Glossary	24

1 Background

For the consumer products industry, the active management of working capital needs to continue to be a key element of transformation

For the purpose of this study, we have chosen to focus on three principal segments of the global consumer products industry:

- brewery
- food and beverages
- household and personal care

While each of these segments has its own characteristics and drivers, they also share some common features and business issues:

- Sales growth relies on the continued development of market share in markets where brands are currently sold, the expansion of existing brands into new markets and the creation of new products.
- Acquisitions are a notable feature of the industry and are used to enhance growth, strengthen the portfolio of brands, increase geographic coverage, drive efficiencies and leverage relationships with retailers.
- The markets and industry segments in which consumer products are offered are subject to intense competition, compounded by the development of private labels.
- The customer base has been undergoing consolidation and truly global retailers have emerged. At the same time, manufacturing and supply chains are becoming increasingly global.
- The level of demand is increasingly volatile and unpredictable because of more frequent introduction of new products and the shortening of product lifecycles. Some products are also subject to large seasonal variations.

Against this backdrop, the global consumer products industry has been taking vigorous actions aimed at accelerating its growth and expanding its margins. These steps have primarily involved focusing on and investing in leading brands, while also reshaping the brand portfolio through acquisitions and divestitures, expanding into new markets and driving out costs, organizational complexities and assets.

This study considers a critical element of this transformation — the active management of working capital. We have compiled this report to examine the actions taken and the absolute and relative types of improvements achieved, and to evaluate in depth the current performance of the world's largest consumer products companies.

Our study shows there are currently wide disparities in working capital performance across the global consumer products industry and within its segments. These may partly reflect differences in areas such as commercial strategies (impacting cash discounts and payment terms); customer base (mass merchandisers, wholesalers, grocery stores, drug stores, bottlers and foodservice distributors); country sales and local payment terms practices; supply; distribution and production infrastructure; and local regulations.

Our conclusion is that most of the consumer products companies still have significant opportunities to release more cash from working capital.

- According to our analysis, the prize for improving the management of working capital is significant – between US$15b and US$29b, equivalent to up to 16% of the industry's net debt.
- In fact, companies may identify further opportunities for improvement by examining the practices of best-in-class performers within and across industry's segments.
- In summary, our message is clear; those who put this at the top of their agenda have the chance to access free capital, be rated above the competition and be best placed to take advantage of opportunities that will occur in the near future while liquidity in the capital markets is at an all-time low.

2 Study methodology

The report is based on a review of the working capital performance of the largest US and European consumer products companies

The report sets out the findings of a detailed review of the effectiveness of working capital management by the 23 largest US and European branded consumer products companies (by sales), operating in the segments of brewery, food and beverages and household and personal care.

To ensure consistent and meaningful results, the segments and companies were selected on the basis of common features and business issues, such as fast-moving products, brands, global reach and scale.

As well as evaluating companies' performance, the report identifies some of the key working capital trends, challenges and opportunities affecting this industry in general and the specific segments listed above.

The review on which the report is based is both segment- and company-specific and applies metrics to give a clear picture of overall working capital management and identify levels of cash opportunity.

The working capital cash and cost performance metrics are calculated from publicly available annual financial statements issued by the companies listed on the right. In order to make the figure as comparable and consistent as possible, adjustments (see glossary in appendices) have been made to the data to reflect the impact of acquisitions, disposals and off-balance sheet arrangements.

The performance of each individual consumer products company is anonymized.

Brewery	▶ Anheuser-Busch ▶ Carlsberg ▶ Heineken ▶ InBev ▶ SABMiller
Food and beverages	▶ Cadbury ▶ Campbell ▶ Coca-Cola ▶ Danone ▶ General Mills ▶ Heinz ▶ Kellogg's ▶ Kraft Foods ▶ Nestlé ▶ PepsiCo
Household and personal care	▶ Beiersdorf ▶ Clorox ▶ Colgate ▶ Kimberly-Clark ▶ L'Oréal ▶ Procter & Gamble ▶ Reckitt Benckiser ▶ Unilever

3 Summary of key findings

The industry's working capital performance has been uneven across its various segments

In the last few years, the consumer products industry's focus on working capital has intensified. This shift has reflected companies' efforts to leverage relationships with customers and suppliers, drive ever greater efficiency out of the supply chain and cope with increased complexity and risk in managing global manufacturing and supply chains, against a backdrop of ever changing customer needs and market conditions.

Our analysis of the industry's performance reveals that both brewery and food and beverages have made progress in reducing levels of working capital since 2002, while in contrast, the performance of household and personal care has deteriorated slightly. The headline analysis shows diverging trends in receivables performance, a deterioration in inventory performance and a significant increase in payables across the industry's segments. However, it is worth pointing out that the industry's trade working capital performance should not be considered in isolation, but in relation to the associated costs and service levels.

Several factors have contributed to the reported performance of each working capital component, some of them conflicting with each other:

- Consolidation in the retailing industry has produced a larger, more sophisticated customer base with greater buying power, able to demand higher discounts and rebates, together with enhanced payment terms and service.
- Prices for agricultural commodities, packaging and energy have been soaring, affecting the working capital cash and cost performance of the industry, especially in the food and beverages and brewery segments. The extent of this impact was determined by the degree and speed with which each segment and company were able to pass on these price increases to their customers.
- Significant inefficiencies have been removed from the industry's operations, especially in manufacturing, logistics and supply chain.
- Collaborative initiatives between manufacturers and retailers have been spreading steadily, gaining support from powerful sponsors.
- Year-on-year performance comparisons have been affected by currency conversion effects and by changes in the degree of consolidation due to M&A activity, driven in turn by the ongoing consolidation in the retailing industry.

In the short term, slowing consumer demand in developed countries and tightened credit conditions, compounded by commodity price and currency volatility will severely affect the industry's cash flow and its working capital in particular. In the light of this, there is also the question of whether companies will use working capital as a lever, for example, trading off payment terms, costs and service levels to win business.

In the longer term, we foresee the emergence of a blend of complementary and sometimes contradictory trends, including advancing globalization, rising concentration of demand and supply, volatility and unpredictability in demand, growing numbers of products, a wider variety of buying channels, greater complexity and risks in managing businesses and new regulations. These trends will increasingly shape the way consumer products companies have to manage their businesses – and hence their working capital. Their combined effect will be to increase the pressure on companies to achieve higher levels of excellence across the entire working capital value chain, notably through continuous transformation, collaboration with key customers and suppliers and standardization of processes and systems, while maintaining an appropriate balance between costs and service levels.

4 Working capital performance since 2002

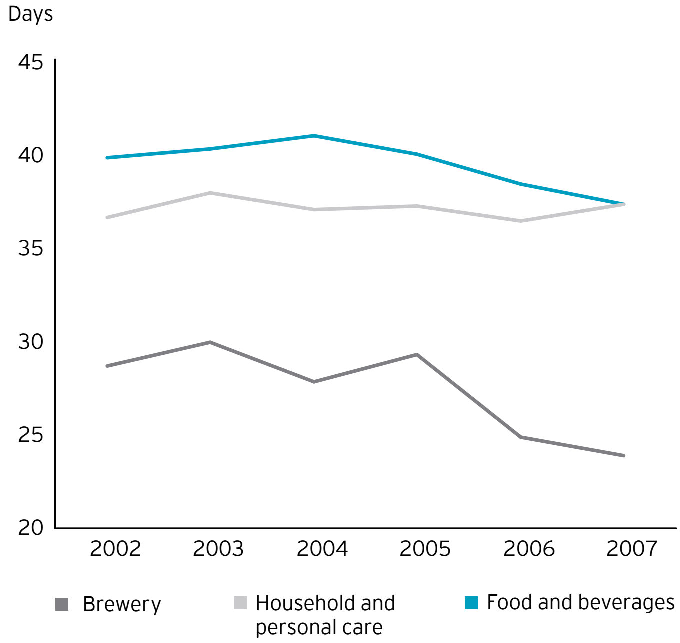
Brewery and food and beverages have made progress in reducing their levels of working capital since 2002, but the performance of household and personal care has deteriorated slightly

Within the consumer products industry, both brewery and food and beverages have managed to reduce their levels of working capital since 2002, with a cash-to-cash (C2C) reduction of 17% and 6%, respectively. In contrast, the C2C performance of household and personal care deteriorated by 2% moving within a narrow range over the same period.

Looking more specifically at 2007 compared with 2006, brewery and food and beverages reported a reduction in C2C of 4% and 3%, respectively, while the C2C performance of household and personal care deteriorated by 2%.

A general note of caution on the analysis of working capital performance is required, as year-on-year comparisons may have been affected by currency movements (with the relative weakness of the US dollar against the Euro and the GB pound at the year-end conversion of the balance sheet, compared to its average during the year for the P&L) and changes in the degree of consolidation due to M&A activity.

C2C[1]



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

1 C2C metric is sales-weighted

Current C2C performance

C2C performance varies widely both across the industry's segments and within each segment

The overall average level of C2C ranges between 24 days for brewery and 37 days for both food and beverages, and household and personal care.

For brewery, analysis shows a wide variation in C2C performance, ranging between 1 day and 38 days, due in part to differences in distribution (organized around owned, independent wholesalers or directly with retailers) and production models (with or without bottling operations). C2C fell significantly from 29 days in 2002 to 24 days in 2007, with 4 out of 5 brewers showing an improvement.

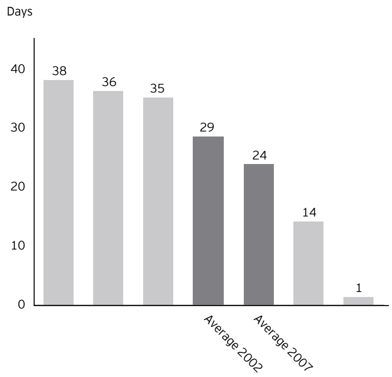
For food and beverages, analysis shows a wide variation in C2C performance, ranging between 3 days and 52 days, in part due to differences in country and product lines sales mix. C2C fell from 40 days in 2002 to 37 days in 2007, with only half of the companies showing an improvement.

For household and personal care, analysis shows a wide variation in C2C performance, ranging between 21 days and 65 days, due in part to differences in country and product lines sales mix. C2C rose marginally between 2002 and 2007 to 37 days, with half of the companies showing an improvement.

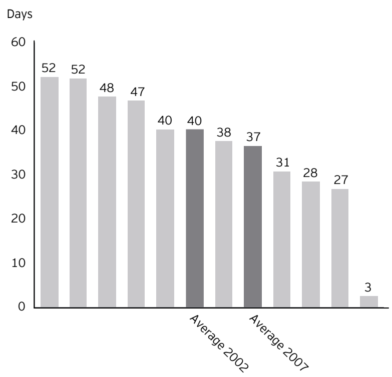
However, there is a need for a degree of caution when reviewing individual C2C performance due to differences in trade accruals accounting and disclosure (with the latter potentially leading to some C2C being overstated).

C2C (based on sales)[1]

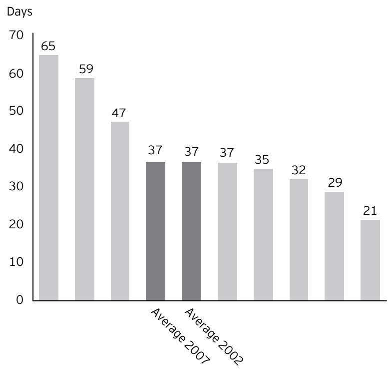
Brewery



Food and beverages



Household and personal care



Source: annual accounts 2007

1 Averages are sales-weighted

Impact of soaring input costs

Soaring prices for commodities and packaging weighed on the working capital cash and cost performance of the industry

Soaring prices for agricultural commodities, packaging and energy in the last few years have had a material impact on the working capital cash and cost performance of the consumer products industry, especially in the food and beverages and brewery segments.

Since year-end 2002, the weighted average commodity price index (including packaging) has almost doubled in US dollar terms, with an acceleration in 2006 and 2007.

At the inventory level, this cost impact has been compounded by the time-lagged effect of rising prices (smoothed in some cases by the use of hedging policies) and temporary build-up ahead of further price increases. This effect has been partially countered by higher spend costs and additional purchases in relation to inventory build-up, benefiting trade payables.

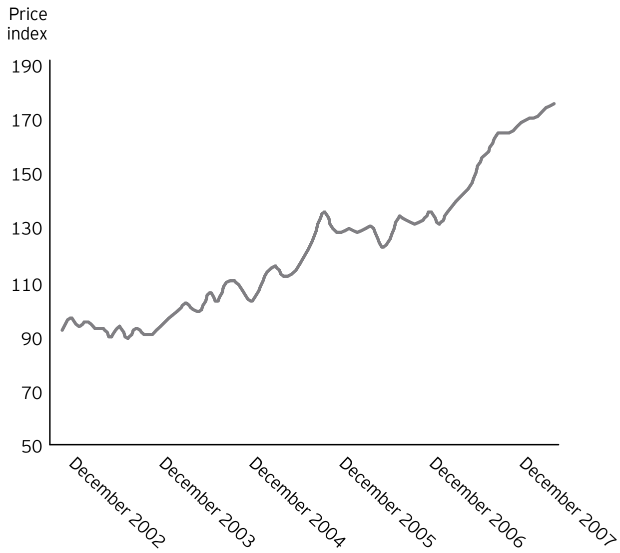
Higher energy prices have also weighed heavily on the cost performance in logistics and supply chain. Companies have responded by intensifying their efforts to drive out costs across the entire supply chain, including optimizing purchasing and sourcing, reducing product size and cutting back on packaging. In the long term, an environment of high energy prices may force companies to rethink and redesign their logistics and supply chain, most of which were developed and implemented in the 1980s and 1990s. This may involve changes such as shifting manufacturing sites closer to consumers and creating a more evenly distributed sourcing network.

For each individual company, the effect of this input price inflation on the working capital performance was partially determined by the degree and speed with which the company was able to deliver increased cost efficiencies across the supply chain and pass on these price increases to its customers. In this context, large branded companies appear to have enjoyed reasonable success during the past two years in passing on at least some of these higher input costs to customers. In some cases, however, these pricing actions have translated into lower demand and some customers "trading down" to cheaper lines and private label products.

In the last few months, commodity prices have fallen back sharply. This situation, in combination with the prospect of a severe slowdown in consumer demand, may prompt some consumer products companies to revisit certain aspects of their commercial and operating strategies.

Nestlé Weighted Average Commodity Price Index*

Raw materials, packaging and energy in $ (Jan 1998 = 100)
Dec 02 to Dec 07



*Converted in US$

5 Level of cash opportunity

The focus on working capital creates an opportunity to release billions of dollars of cash

In our survey, we found that significant levels of cash were tied up in working capital across the three selected segments of the consumer products industry:

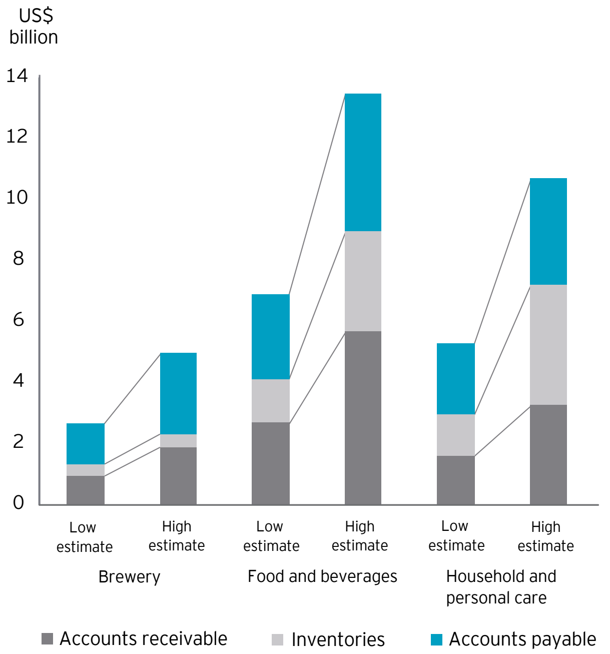
- Between US$2.6b and US$5.0b in brewery, between US$6.9b and US$13.5b in food and beverages and between US$5.3b and US$10.7b in household and personal care.
- The range of opportunity has been defined as the sum of the working capital cash opportunity for each company when comparing the performances of each of its working capital components with those of the average (low estimate) and the upper quartile (high estimate) of its industry segment peer group.

The "cash potential" analysis also reveals that the opportunity is distributed across the various components of working capital.

The figures for cash surplus need to be treated with some caution: firstly, because they are based on an external view of each company's working capital performance and have not been adjusted to reflect each company's operational strategy, geographical reach or product mix; and secondly, because of differences in the accounting and disclosure of trade accruals.

In addition, while significant operating cost benefits may arise from process optimization, additional capital expenditure may be needed to realize them.

Cash opportunity



Cash Opportunity	Brewery		Food and beverages		Household and personal care	
	From	To	From	To	From	To
% sales	3%	6%	2%	5%	2%	5%
% gross working capital[1]	12%	23%	9%	17%	8%	16%
% net debt	8%	16%	8%	16%	9%	18%
% enterprise value[2]	1.7%	3.3%	1.1%	2.2%	1.0%	2.1%

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

1 Sum of trade receivables, inventories and trade payables

2 Sum of market capitalization and debt

6 Receivables performance

Since 2002, there have been diverging trends in receivables performance across the various segments of the industry

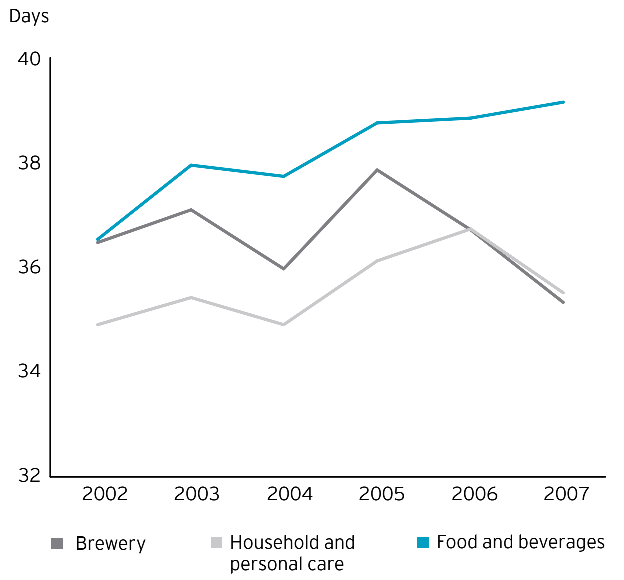
In food and beverages, there has been a significant deterioration in receivables performance (DSO up 7%) between 2002 and 2007, with year-on-year increases occurring in four out of the five years.

As for household and personal care, the deterioration in days sales outstanding (DSO) performance has been moderate, with an increase of 2%. However, in 2007 compared with 2006, household and personal care posted a reduction of 3%.

In contrast, brewery has made some progress in cutting DSO by 3%, but this entire gain was only achieved in the last two years.

Caution is also required in the analysis of receivables performance, as year-on-year trends may have been affected by currency movements and M&A activity.

DSO[1]



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

1 DSO metric is sales-weighted

Current receivables performance

Receivables performance varies widely in each segment of the consumer products industry

The overall average level of receivables ranges between 35 days for brewery, 36 days for household and personal care and 39 days for food and beverages.

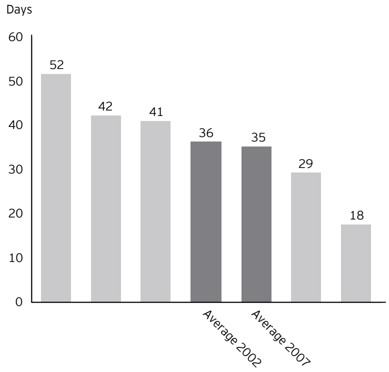
For brewery, analysis shows a wide variation in DSO performance, ranging between 18 days and 52 days, due in part to differences in distribution models (organized around owned and/or independent wholesalers and/or directly with retailers). DSO fell slightly from 36 days in 2002 to 35 days in 2007, with 3 out of 5 brewers showing an improvement.

For food and beverages, analysis shows a wide variation in DSO performance, ranging between 25 days and 47 days, in part due to differences in country and product lines sales mix. DSO rose from 37 days in 2002 to 39 days in 2007, with 6 out of 10 companies showing a deterioration.

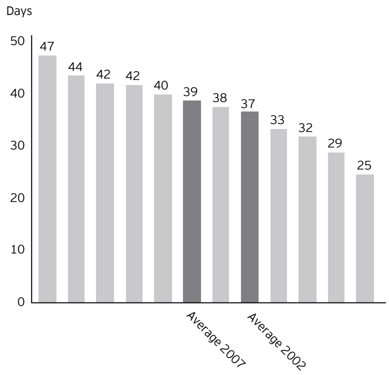
For household and personal care, analysis shows a wide variation in DSO performance, ranging between 27 days and 56 days, due in part to differences in country and product lines sales mix. DSO rose slightly to 36 days between 2002 and 2007, with half of the companies showing a deterioration.

DSO (based on sales)[1]

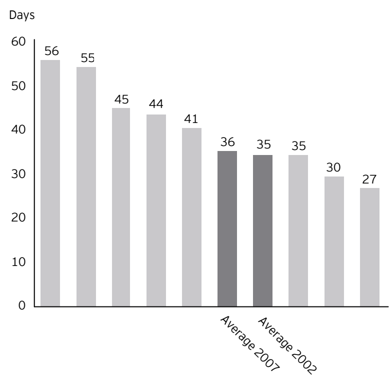
Brewery



Food and beverages



Household and personal care



Source: annual accounts 2007

1 Averages are sales-weighted

Retailing industry

Consolidation in the retailing industry has created a large, sophisticated customer base with increased buying power

The consumer products industry's key customers include mass merchandisers, grocery stores, drug stores, bottlers, independent wholesalers and foodservice distributors. In many countries in the world, this customer base has been undergoing consolidation, which has resulted in the emergence of truly global retailers. More generally, this consolidation has created a large, sophisticated customer base with increased buying power, capable of operating with a reduced level of inventories. These customers are also large enough to resist price inflation while demanding higher discounts and rebates, together with enhanced payment terms and service, as well as developing their own private label products.

For a retail customer, the factors that determine its buyer power include its size (both absolute and relative to its supplier) and the availability of alternative sources of supply, such as products from competing suppliers and its own label products. However, some other factors may mitigate a retail customer's buying power, such as major brands that are difficult to replace and the costs of switching supplier.

In the last five years, the aggregate global market share of the six largest retailers (by sales) has increased from 15% to almost 20% both through a combination of organic growth and expansion by acquisition. Wal-Mart remains the dominant player, with a market share up from 6.7% to 8.6%. For the global top 15, the combined market share rose from 25% to 31% over the same period. In both the US and Western Europe, the level of market concentration is much higher and its pace has also accelerated, with the top three retailers now commanding a market share in excess of 40% (and the top five over 60%).

In addition to building their market share, the world's largest retailers have continued to invest in their own labels. In the US and Western Europe, especially the UK, Germany and Spain, private label products now account for over 30% of total retail sales. Tesco and Sainsbury's, for example, attribute half of their current sales to private labels. For Wal-Mart, the figure is over 35%, while Carrefour has a target of 30% for this year. In terms of product categories, the penetration of private labels varies greatly between grocery and non-grocery products and across each sub-category, creating variations in retailers' buying power. For the branded consumer products industry, this trend also raises the question of whether it should participate in the growing market for private label products. Choosing to do this means a company risks undermining its image and pricing strategy, while choosing not to do so raises the risk of losing market share to private label manufacturers.

The consolidation in the retailing industry has also driven further consolidation in the consumer products industry. Concentration is now especially high in the brewery, soft drinks, household care and beauty segments, with the top 5 suppliers controlling over half of the world market. In contrast, the market is much more fragmented in some food and household and personal care sub-segments, with a large number of global, regional, local and private label manufacturers supplying a wide range of product lines.

In the food and beverages and household and personal care segments, the customer base is highly concentrated, with the five largest ones accounting for between 25% and 30% of total revenues. Wal-Mart is by far the largest customer, with a share that has grown in the past few years to reach an average of 15% of the total revenues of each supplier (in contrast, the largest supplier to Wal-Mart accounts for less than 4% of its sales). In the brewery market, the customer base — ranging from wholesalers and distributors to smaller retailers — is more dispersed. The effect of retail consolidation and concentration on this segment is less direct, but still significant through wholesalers.

Trade terms, costs and service levels

Trade terms in the industry should not be considered in isolation, but in relation to the associated costs and service levels

Manufacturers of consumer products typically negotiate and agree the terms of a commercial agreement with each customer based on five key elements — placing a different emphasis on each one depending on the industry segment, the company's objectives and nature of the relationship. These elements are: purchasing conditions (price and volume, price adjustment conditions and rebates, discounts and other incentives); trade terms (credit terms and cash discount); stock policy (stock location, vendor-managed inventory policies and product return); service levels (delivery to distribution centers, direct-store-delivery, delivery frequency and stock availability, order fill rates, customized products and services and logistics costs) and duration (generally one year).

The level of sales incentives is one of the largest cost variables for the industry, amounting to between 10% and 20% of total gross sales. Sales incentives are offered through various programs to customers and consumers. They include incentives paid to customers for performing merchandising activities, such as payments for in-store displays, payments to gain distribution of new products, payments for shelf space and discounts to enable products to be retailed at lower prices. The resulting costs are recognized as a reduction in revenue. A number of sales incentives, such as customer volume rebates, are based on annual targets and accruals are established during the year for the expected payout. These accruals are based on contract terms and historical experience. Most of these incentives have terms of no more than one year. Anecdotal evidence in the industry has not revealed any material change in the level of sales incentives in relation to sales in the last five years.

Trade terms with customers vary greatly across the consumer products industry:

- Local and market practices constitute the main driver of trade terms. Analysis of the payables performance of the largest global retailers (by sales) across regions for 2007 indicates average terms (defined as weighted average DPO based on Cost of Sales) of 34 days in the UK, 38 days in the US and 90 days in continental Europe (France, Germany and Spain). Even within a region or a country, the terms offered by a customer may vary between its different suppliers. For example, the DSO of a major US food supplier for 2007 was 22 days with Wal-Mart, while the overall DPO of Wal-Mart (based on COS) was 39 days for the same year. It is also worth noting that in some continental European countries, such as Spain (from 2005) and France (from 2009), the regulator has set caps for the payment terms between retailers and suppliers, having judged them excessive, but with clauses attached allowing some scope for exceptions.
- Analysis of the trends in retailers' payables performance also reveals some interesting insights. In the last five years, the average DPO has risen significantly across every region (by 14% in the US, 12% in continental Europe and 5% in the UK between 2002 and 2007), suggesting that retailers have become more successful in the most recent years in extracting improved cash terms from their suppliers.
- There is no apparent correlation between the size of the supplier in sales value and the level of trade terms. In other words, larger suppliers do not appear to get better cash terms. However, the caveat is that the buyer power can also be exercised by acting on purchasing and supply chain cost and service.
- Trade terms in general should not be considered in isolation, but in relation to the company's commercial, operational and financial objectives and performance. For example, a company may choose to offer or take payment discounts, or to pursue extended payment terms, favoring either the profit and loss account (P&L), the balance sheet, or the commercial activity.

7 Inventory performance

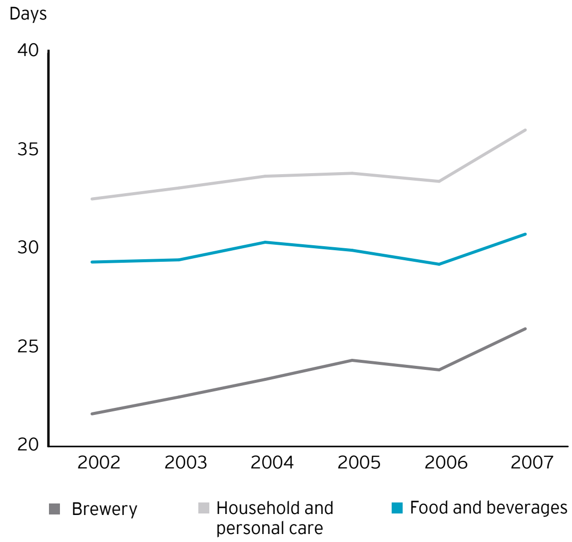
Each segment of the consumer products industry has suffered a deterioration in inventory performance since 2002

Measuring inventory performance using either sales or cost of sales (COS) reveals a significant deterioration for each segment of the consumer products industry between 2002 and 2007.

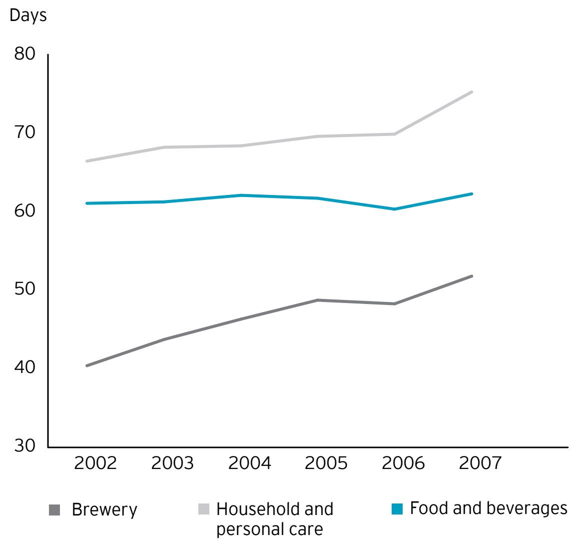
Using sales as a factor, the days inventory outstanding (DIO) has risen by 20% for brewery and 11% for household and personal care (and by 28% and 13% on a COS basis, respectively). For food and beverages, the deterioration in inventory performance has been more moderate, with DIO rising by 5% (and by 2% on a COS basis).

For each segment, 2007 shows a larger deterioration in DIO, with performance severely affected by soaring prices of food, metal and energy. The extent of this impact was partially determined by the degree and speed with which each segment and company were able to pass on these price increases to their customers.

DIO on sales[1]



DIO on COS[1]



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

1 DIO metrics are COS and sales-weighted

Current inventory performance

Inventory performance varies widely both across the industry's segments and within each segment

The overall average level of inventory ranges between 26 days for brewery, 31 days for food and beverages and 36 days for household and personal care.

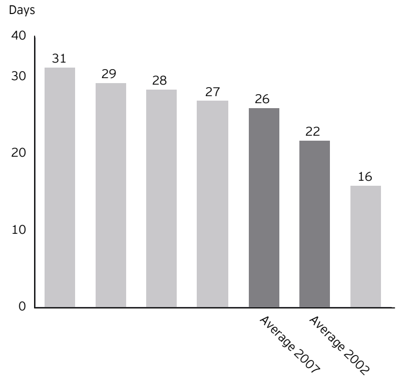
For brewery, analysis shows a wide variation in DIO performance, ranging between 16 days and 31 days, due in part to differences in distribution models (organized around owned, independent wholesalers or directly with retailers). DIO rose significantly from 22 days in 2002 to 26 days in 2007, with 4 out of 5 brewers showing a deterioration.

For food and beverages, analysis shows a wide variation in DIO performance, ranging between 21 days and 50 days. DIO rose from 29 days in 2002 to 31 days in 2007, with 7 out of 10 companies showing a deterioration.

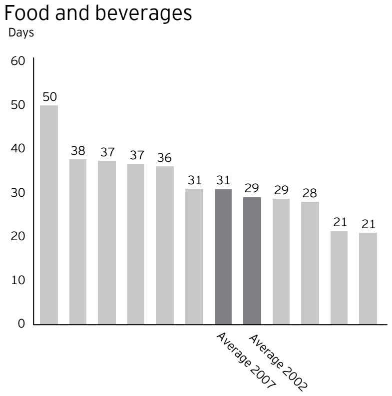
For household and personal care, analysis shows a wide variation in DIO performance, ranging between 26 days and 49 days. DIO rose from 33 days in 2002 to 36 days in 2007, with each company but one showing a deterioration.

DIO (based on sales)[1]

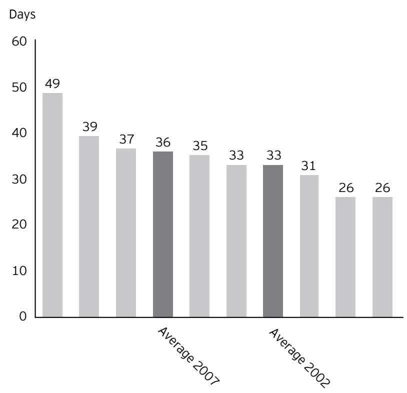
Brewery



Food and beverages



Household and personal care



Source: annual accounts 2007

1 Averages are sales-weighted

Focus on supply chain management

Supply chain management has been a major focus, providing the industry with opportunities to remove waste from operation

For the last decade, logistics and supply chain management has been a major focus for the consumer products industry, providing the industry with opportunities to optimize cash, cost, asset utilization, risk, quality and delivery. Companies have pursued these opportunities against a backdrop of intense competition, selling price and input costs pressure, customer consolidation and globalization.

As exemplified by Nestlé, Procter & Gamble and Unilever, significant inefficiencies have been removed from the industry's operations. More specifically, these changes have included restructuring of manufacturing operations and redesign of distribution networks (for instance, through fewer, more focused and centralized production and distribution facilities), globalization of procurement, outsourcing, business process rescaling and information technology implementation. In addition, manufacturers and retailers have been collaborating more effectively, driving greater efficiency out of their respective supply chains.

By its nature, logistics and supply chain management cuts across many different business processes and functions, with impacts across cash, cost and service. This makes it difficult to identify and assess progress and performance. In addition, any analysis needs to consider the types of trade-offs commonly associated with this area:

- Logistics and distribution is one of the largest cost elements of the consumer products industry, accounting for between 5% and 10% of total revenue, with a wide diversity of cost resulting from differences in business models and corporate strategies between companies and segments. Another element to consider is the relative level of inventory in relation to sales and capital employed, which are 7% and 6%, respectively for brewery, 8% and 9%, respectively for food and beverages and 10% and 11%, respectively for household and personal care.
- According to the industry, significant costs have been taken out of these functions in recent years, with additional benefits arising from acquisitions that provided the opportunity to leverage cost structures. To a large extent, these savings have been passed on to customers to drive sales growth and respond to demands for higher-quality service, such as increasing product configuration and delivery flexibility. The trend towards globalization may have also resulted in longer and more variable lead times, while in the past two years, soaring energy costs have weighed on transportation costs (which represent up to half of total logistics and distribution costs). Analysis of distribution costs in relation to sales disclosed by a sample of companies (with a definition and a scope which vary significantly among them) indicates a flat to slightly rising trend over the 2002-07 period.
- Analysis of the inventory performance of the consumer products industry in relation to the retailing industry indicates a deteriorating trend over the 2002-07 period, varying by segment to a degree. This highlights the difficulties facing the consumer products industry in dealing with increasingly complex supply chains, input costs inflation and more aggressive inventory management by retailers, on the back of trends such as more frequent deliveries and greater use of consignment stocks. Over the period, the DIO rose by 20% for brewery, 5% for food and beverages and 11% for household and personal care, while the inventory performance of retailers remained unchanged (with a fall of 4% in the US and an increase of 3% in Europe). Measuring inventory performance using only finished goods shows a more moderate deterioration for brewery and for food and beverages (up 7% and 3% respectively) but a larger deterioration for household and personal care (up 14%).

Supply chain issues and challenges

While more attention has been paid to the supply chain, there are still many issues and challenges associated with this area

While the consumer products industry has been paying much more attention to the supply chain in recent years, evidence suggests that there are still many issues and challenges associated with it:

- Supply chains are in constant need of change and adaptation to keep pace with ongoing rapid evolution in economic, regulatory and market conditions.
- It is getting harder to balance operational excellence with flexibility and responsiveness — how best to combine "lean" practices with an "agile" response?
- Global supply chains are becoming increasingly complicated.
- Most supply chains are still suffering from poor visibility and control of inventory, supply and demand information.
- Several factors — shorter order cycle times and increased product availability, more frequent introductions of new products compounded by growing combinations of packaging materials and sizes, shortening product lifecycles and greater variety of buying channels — are resulting in increased volatility and unpredictability in demand. This in turn is making demand forecasting, production planning and inventory management more difficult.
- Higher energy costs have turned the original economics of existing logistics and supply chains upside down, with most designs having been developed and implemented in the 1980s and 1990s.
- The lack of standardization in business processes and information systems, together with the proliferation of legacy systems compounded by acquisitions activity presents a major hindrance to communication and efficiency across the extended working capital value chain. Adding to the confusion is the emergence of many new (and in some cases overhyped) competing technologies, not all of which offer clear benefits.
- The interests of the functional groups and multiple partners in the extended working capital value chain are often misaligned and sometimes in conflict with each other.
- There is generally little coordination or integration between the sales, the manufacturing and the extended supply chain processes towards achieving common objectives.

Inventory breakdown

There is a wide range of inventory breakdown by category across the industry's segments and companies

The wide range of inventory breakdown by category across the industry's segments and companies reflects different business models and strategies across inventory acquisition.

Packaging is a major area of differentiation across the industry. Some companies have substantial in-house bottling and packaging capabilities that are increasingly leveraged through collaborative deals, while others have turned to contract packaging.

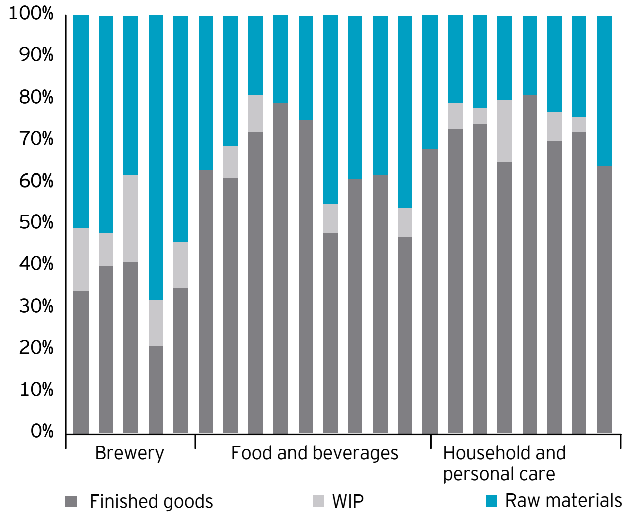
Among the industry's segments, household and personal care has the highest level of finished goods and the lowest level of raw materials in relation to total inventory. In contrast, brewery has the highest level of raw materials and the lowest level of finished goods in relation to total inventory.

For brewery at year-end 2007, finished goods accounted for 34% of total inventories (with a range of between 21% and 42%), WIP for 13% (with a range of between 8% and 21%) and raw materials for 53% (with a range of between 38% and 68%). By way of comparison, the corresponding figures at year-end 2002 were 39%, 15% and 46%.

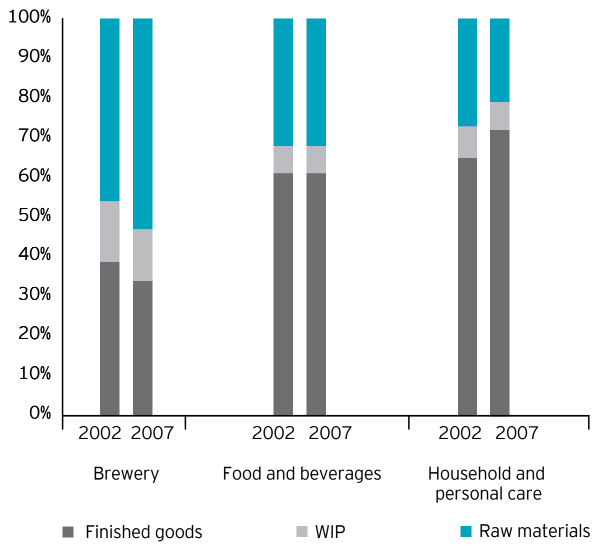
For food and beverages at year-end 2007, finished goods accounted for 61% of total inventories (with a range of between 47% and 79%), WIP for 7% (with a range of between 6% and 8%) and raw materials for 32% (with a range of between 19% and 46%). By way of comparison, the inventory distribution per category at year-end 2002 was almost the same.

For household and personal care at year-end 2007, finished goods accounted for 72% of total inventories (with a range of between 64% and 74%), WIP for 7% (with a range of between 4% and 15%) and raw materials for 21% (with a range of between 20% and 36%). By way of comparison, the corresponding figures at year-end 2002 were 65%, 8% and 27%.

Inventory breakdown per company, 2007 (ranked by DIO)



Inventory breakdown per segment, 2002 and 2007[1]



Source: annual accounts 2002 and 2007

1 Averages are sales-weighted

8 Payables performance

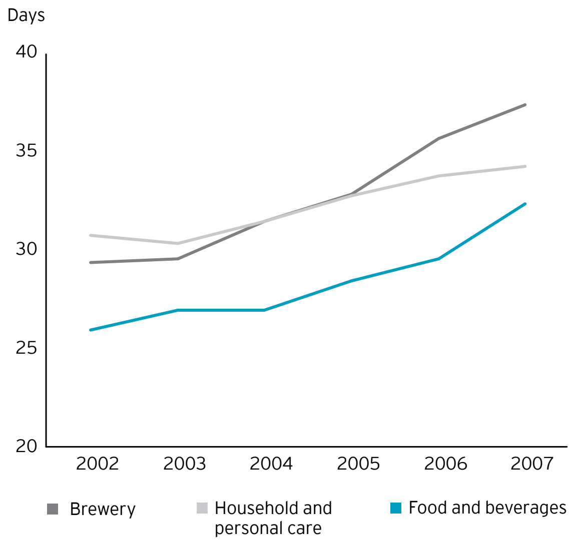
Each consumer products segment has achieved significant progress in payables performance since 2002

Measuring payables performance using either sales or COS reveals a large improvement for each segment of the consumer products industry between 2002 and 2007.

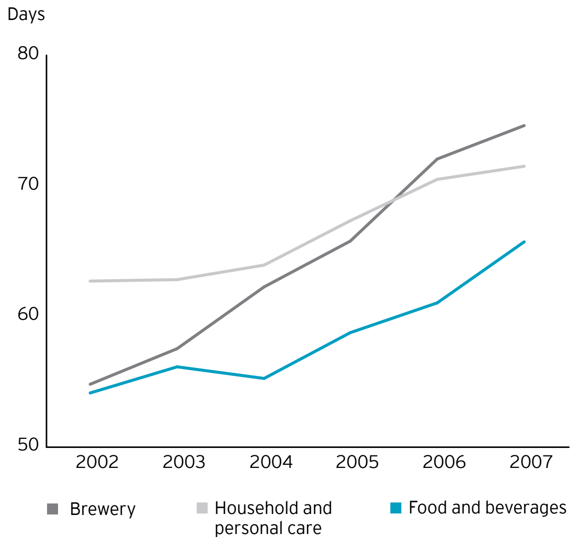
Using sales as a factor, the days payable outstanding (DPO) has risen by 27% for brewery, 25% for food and beverages and 11% for household and personal care since 2002. On a COS basis, the numbers were 36%, 21% and 14%, respectively.

To an extent, the payables performance has been boosted in the past two years by the impact of soaring prices of food, metal and energy on spend costs, compounded by additional spend ahead of expected price increases.

DPO on sales[1]



DPO on COS[1]



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

1 DPO metrics are COS and sales-weighted

Current payables performance

Payables performance varies widely both across the industry's segments and within each segment

The overall average level of payables ranges between 32 days for food and beverages, 34 days for household and personal care and 37 days for brewery.

For brewery, analysis shows a wide variation in DPO performance, ranging between 19 days and 55 days. DPO rose significantly from 29 days in 2002 to 37 days in 2007, with every brewer except one showing an increase.

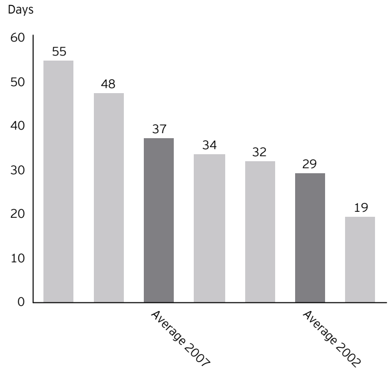
For food and beverages, analysis shows a wide variation in DPO performance, ranging between 17 days and 56 days. DPO rose from 26 days in 2002 to 32 days in 2007, with 8 out of 10 companies showing an improvement.

For household and personal care, analysis shows a wide variation in DPO performance, ranging between 28 days and 54 days. DPO rose from 31 days in 2002 to 34 days in 2007, with each company but one showing an improvement.

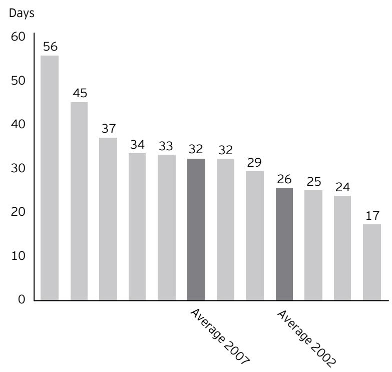
However, there is a need for a degree of caution when reviewing individual DPO performance due to differences in trade accruals accounting and disclosure (with the latter potentially leading to some DPO being understated).

DPO (based on sales)[1]

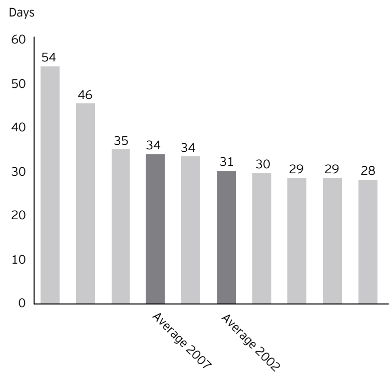
Brewery



Food and beverages



Household and personal care



Source: annual accounts 2007

1 Averages are sales-weighted

9 Collaborative working capital

Collaborative initiatives between manufacturers and retailers have been spreading, but there is still opportunity for improvement

Achieving true collaboration between manufacturers and retailers would represent a further major step forward in streamlining the business processes in the value chain.

Effective collaboration calls for organizations within the supply chain to work together towards mutual objectives through the sharing of data, information, business practices, experience, risks and rewards.

Most large manufacturers and retailers are now engaged in some form of collaboration, such as customer and supplier relationship management, supply chain management (via cross-docking, vendor-management inventory management and continuous replenishment), efficient consumer response and its further developed form, collaborative planning, forecasting and replenishment.

Some of these collaborative practices have been spreading steadily across the marketplace, gaining support from powerful sponsors, while others are still in their infancy, suffering from complexity, high implementation costs and lack of industry standards. There are also major differences in the levels of adoption and momentum between the US and Europe, with each market having its own characteristics and constraints (for instance, in terms of market homogeneity and promotions activity, the planning of which stands out in the relationship between manufacturers and retailers).

Effective collaboration offers many benefits to each partner in the extended enterprise. For the manufacturer, the benefits include increased sales, lower purchasing and supply chain costs, higher asset efficiency and improved service levels, all achieved through quicker, more efficient and responsive systems and processes, lower levels of inventory and reduced out-of-stocks, optimized production planning and use of capacity, improved forecasting accuracy and better supply chain delivery reliability.

However, there are many challenges associated with collaboration. These can arise from the misalignment of business processes and information systems, the cost of implementation, the lack of trust, the absence of management's full commitment and the need to develop new competencies within the organization and across the different supply chain partners.

Also because collaboration can be many things and may involve many different partners, a company will have to decide on the type of collaboration with each partner. This means balancing leverage and the use of collaborative efforts, building the corresponding business processes (including the appropriate information systems) and executing constantly.

10 Opportunities for improvement

Several areas of working capital offer significant opportunities for improvement

Realizing the full benefits of a comprehensive approach to working capital management requires:

- Implementation of best practices across the main trade working capital areas (with the associated challenge of identifying, adapting and improving best practice solutions)
- Management's full commitment, including balanced financial incentives
- Changing behaviors and developing competencies within the organization at all levels

An effective working capital management strategy will focus on the following actions that offer the best opportunities for improvement:

1. Incentivizing cash performance
2. Effective management of payment terms for customers and suppliers, including renegotiation of terms
3. Improving credit, billing and cash collections and dealing with disputes effectively, which means resolving them in a timely manner, while also eradicating the root cause of issues that give customers a genuine reason not to pay
4. Monitoring rebates, discounts and other sales incentives
5. Adapting the supply chain in response to changed market conditions, including developing global, responsive and resilient supply chains with standardized processes and metrics
6. Establishing best-in-class demand forecasting processes
7. Building greater linkage and closer coordination across the entire supply chain, enabling enhanced demand and supply visibility, elimination of waste, cost reduction and improved service levels
8. Achieving true collaboration with major retailers, building trust and adopting new technologies to enable sharing of information
9. Developing new procurement initiatives, such as working with suppliers to achieve shorter and more reliable lead times, reducing the supplier base to get more leverage in negotiations, developing e-sourcing and building effective relationships with third-party logistics providers

Typically, we would expect the full cash and cost benefits to be realized within 12 to 24 months from the launch of a working capital program.

Appendices

Appendix 1	EBITDA versus TWC trade-offs	22
Appendix 2	Working capital performance metrics of retailers	23
Appendix 3	Glossary	24

Appendix 1 EBITDA versus TWC trade-offs

Since 2002, there has been a divergence in working capital and EBITDA margin performance across the industry's segments

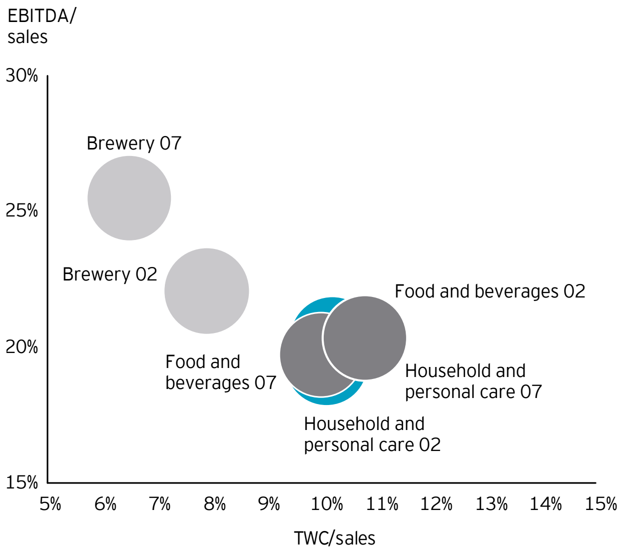
Brewery's 2007 working capital performance and EBITDA margin have improved compared with 2002, from 7.9% to 6.5% of sales and from 22.2% to 25.5% of sales, respectively.

Food and beverages' 2007 working capital performance has improved compared with 2002, from 10.9% to 10.2% of sales, but its EBITDA margin has fallen from 20.4% to 18.6% of sales.

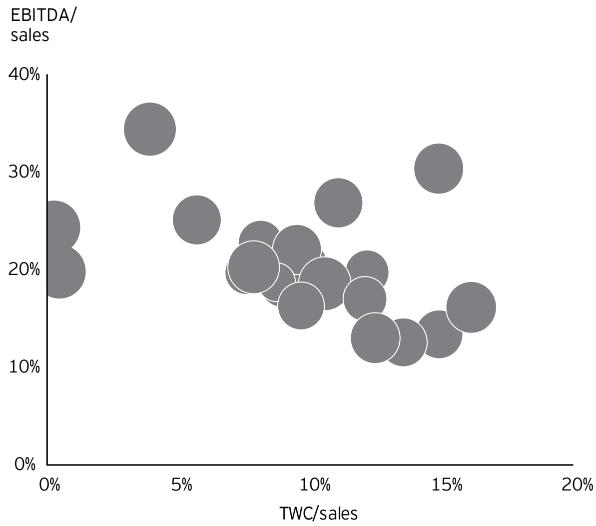
Household and personal care's 2007 working capital performance has deteriorated compared with 2002, from 10.1% to 10.2% of sales, but its EBITDA margin has risen from 19.3% to 20.4% of sales.

Brewery generally enjoys significantly lower level of working capital requirements and higher EBITDA margins than both food and beverages and household and personal care.

EBITDA margin and TWC[1]/sales per segment, 2002 and 2007[2]



EBITDA margin and TWC[1]/sales per company, 2007

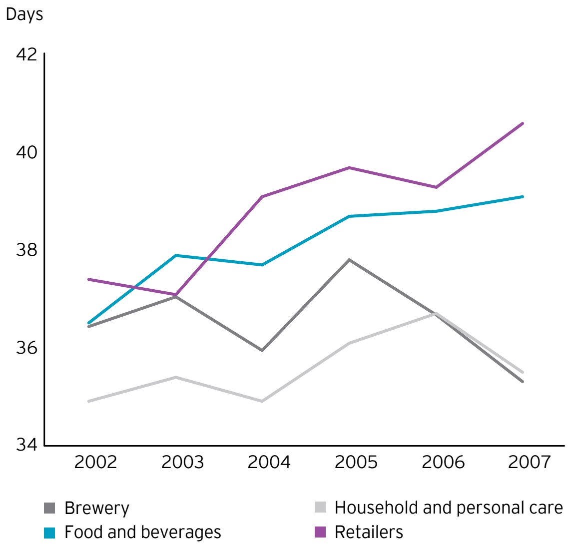


Source: annual accounts 2002 and 2007

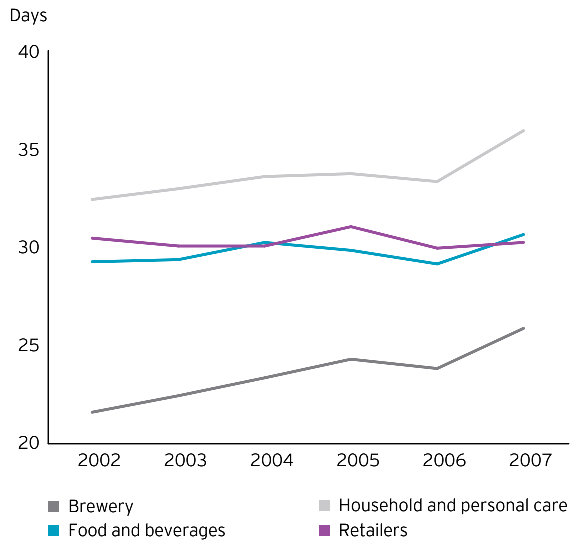
1 Total Working Capital (TWC) = accounts receivable + inventories – accounts payable
2 Segment peer group averages are sales-weighted

Appendix 2 Working capital performance metrics of retailers

DPO retailers[1] versus DSO consumer products industry



DIO consumer products industry versus DIO retailers[1]



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

1 Auchan, Carrefour, Casino, Metro, Morrisons, Sainsbury's and Tesco in Europe, Costco, Kroger, Safeway, Supervalu and Wal-Mart in the US

Appendix 3 Glossary

DSO (days sales outstanding)	Year-end trade receivables net of provisions, including VAT, added-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)
DPO (days payable outstanding)	Year-end trade payables, including VAT and added-back trade-accrued expenses, divided by full-year pro forma sales (or by COS) and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise, or COS)
DIO (days inventory outstanding)	Year-end inventories net of provisions, divided by full-year pro forma sales (or by COS) and multiplied by 365 (expressed as a number of days of sales, unless stated otherwise, or COS)
C2C	DSO plus DIO minus DPO (expressed as a number of days of sales)
COS	Cost of sales (including depreciation and amortization)
Pro forma sales	Reported sales adjusted for acquisitions and disposals when this information is available

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