

Cytec Industries reduces working capital by nearly **40%**

Cytec Industries Inc. is a global specialty chemicals and materials company focused on developing, manufacturing and selling value-added products. Its products serve a diverse range of end markets including aerospace, adhesive, automotive and industrial coatings, chemical intermediates, inks, mining and plastics. Headquartered in New Jersey, Cytec has operations in more than 35 countries.

Funding future growth

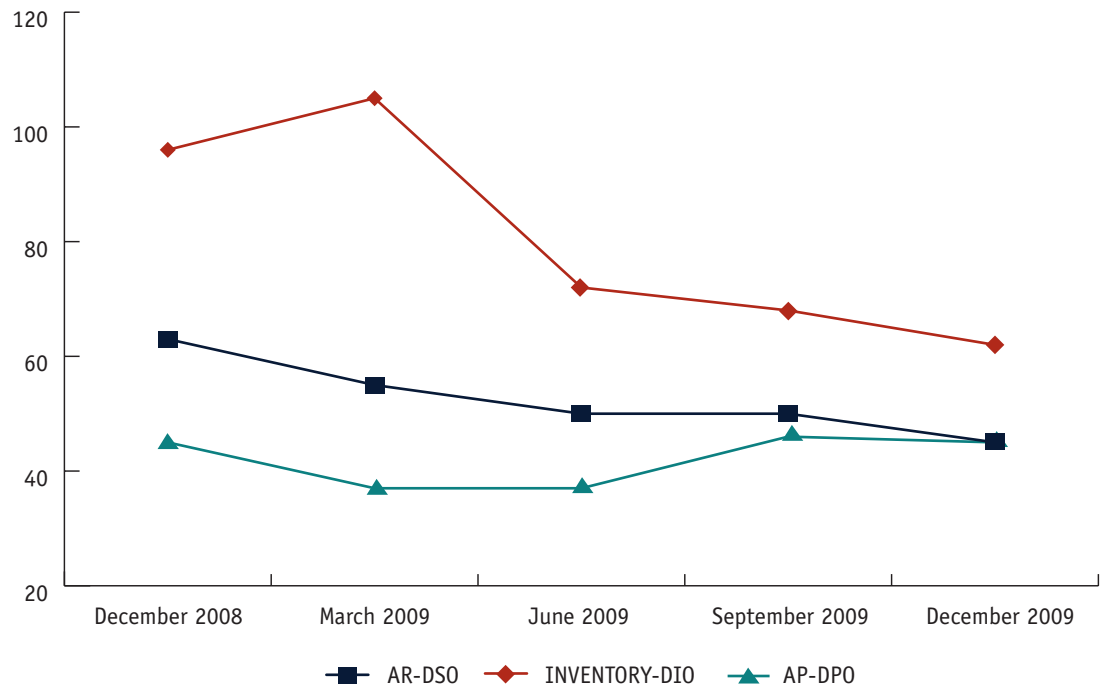
In the second half of 2008, Cytec foresaw a strong downward trend in the economy and its business activity. Cytec's businesses tend to be cyclical, although not all fit in the same part of the economic cycle. Senior management knew that focusing on cash would be critical to riding out the coming downturn and positioning the company for an eventual recovery. The market having reduced its share price; Cytec needed to amend its bank facility covenants and wanted to take the proactive step of refinancing senior debt due in 2010 by the end of the third quarter of 2009. So the pressure was on to demonstrate to the capital markets that Cytec could continue to generate cash through the downturn in the business cycle.

Cytec's working capital levels had been increasing year-over-year as a result of growth and acquisitions. The company

compared poorly to the industry peer group. Cytec's own analysis showed excess working capital of more than \$200 million. When markets were strong, the focus had been on earnings rather than the balance sheet. Understanding the downward trend in the business cycle, the company's management team realised that better working capital management would be the most effective lever to boost cash generation.

"We recognised the opportunity to tap excess working capital to invest in the businesses that will shape our future," says David Drillock, Cytec's vice president and Chief Financial Officer. "When the economy began to deteriorate in 2008, we decided to accelerate this effort."

Furthermore, to sustain the changes, Cytec would need better metrics and reporting capabilities. Importantly, it would need to change its culture, effectively embedding

Working Capital Metrics: YTD December 2009


a focus on working capital into decision-making throughout the organisation. “We want our people to understand how their day-to-day activities affect working capital,” says Scott Hain, Vice President, Global Supply Chain, Cytec Specialty Chemicals. “Anytime an individual makes a decision, he or she should ask, ‘What impact will this have on working capital?’”

Charting the course for improvement

To help the company formulate a plan for accelerating working capital improvements without negatively affecting customer service, Cytec sought assistance from REL. “Just about anyone can take steps to address working capital, but we wanted to make sure our results were sustainable,” notes Drillock. “We wanted a partner who understands this and working capital is REL’s business.”

Partnering with the Cytec team, REL outlined a clear, detailed, practical path for analysing and addressing several key functional areas that affect working capital, with project teams assigned to each area. Over a six-week period, team members examined a sample of Cytec’s operating locations on two continents, conducted in-depth interviews with front-line personnel and analysed transaction-level activities to identify potential drivers of increased working capital. A key component of REL’s analysis involved a nine-box segmentation model, used to differentiate products, suppliers and customers according to key attributes. “The nine-box segmentation model was crucial to the success of this project,” says Cytec Specialty Chemicals Controller Duncan Taylor. “It’s a simple model, but it really changed the focus for us by providing the quantitative basis for segmentation.”

Based on its analysis, REL estimated that Cytec could exceed its working capital improvement goal by:

- Standardising collections processes across geographies and units, developing differentiated credit and collection policies based on customer characteristics and implementing an escalation process to avoid overdue receivables.
- Updating inventory parameters and creating a tool for making intelligent trade-offs between cost and service levels for different categories of products.
- Negotiating improved payment terms with key suppliers and implementing a payment clock to ensure bills were not paid before they were due.

Before the analysis, Cytec's management expected that the main working capital benefits would come from inventory reduction. In fact, the analysis showed that there were greater near-term improvements available in payables and receivables. These quick wins improved the overall cash flow of the project and help fund the longer-term inventory work stream. "We knew that we were on the right track," says Hain, "but the analysis provided the evidence and specificity that enabled us to refocus priorities across functions and gain support for moving forward." Together, REL and Cytec used the findings to create a comprehensive business case for process changes that helped obtain buy-in from senior leaders as well as operational teams.

Building a cash culture

Just a few months into the implementation process, Cytec executives observed their own people "talking" the new concepts and applying them with discipline in their day-to-day activities. "We were able to generate some quick wins, particularly in the payables and receivables area," says Hain. "Once

people saw the successes, everyone wanted to be involved." Taylor credits the project with helping the company's culture evolve. "This project, for example, brought new exposure to the credit group and emphasised the importance of its role in facilitating collections rather than just managing credit risk," he comments.

Guided by REL's project management approach, which included frequent status reviews and strong coordination between multinational teams, Cytec initiated a five-month effort to implement the recommended process changes in its Specialty Chemicals business unit. Implementation in its Engineered Materials unit began several months later. Cytec teams participated actively in the process and in REL-led workshops, in effect becoming subject matter experts who now apply the tools and best practices to accelerate and sustain the benefits. "We were impressed with how REL explained the various concepts involved, with its emphasis on knowledge transfer, and with its collaborative, team-oriented approach," says Taylor. "REL involved Cytec in every aspect of the effort, rather than doing everything with Cytec personnel watching."

REL also helped Cytec define the operational metrics and key performance indicators that it is using to measure these processes going forward, using Cytec's data warehouse to produce reports that provide greater performance insight for the three key process areas addressed. "If you change the way you look at things, then those things will change," Drilllock notes. "We had all of this information before, but we weren't able to get to it efficiently and present it in the right way."

Strong sponsorship and visible leadership support were instrumental in helping Cytec move quickly to address its goal. Leaders communicated its progress and successes widely and reorganised regular departmental

DAYS SALES OUTSTANDING (DSO)

Month-end trade receivables net of allowance for doubtful accounts, divided by one day of average revenue

A decrease in DSO represents an improvement, an increase a deterioration

DAYS INVENTORY OUTSTANDING (DIO)

Inventory/(Total Revenue/365) Month-end inventory divided by one day of average revenue

A decrease in DIO represents an improvement, an increase a deterioration

DAYS PAYABLES OUTSTANDING (DPO)

AP/(Total Revenue/365) Month-end trade accounts payable divided by one day of average revenue

An increase in DPO represents an improvement, a decrease a deterioration

and management meetings to focus on the metrics that drive working capital. In addition, the company adapted its incentive compensation structure at all levels to reward individuals for achieving company-wide working capital goals.

Surpassed expectations, sustainable processes

Less than a year after it began incorporating REL's recommendations, Cytec surpassed its own working capital reduction goals through a combination of changes to its receivables, inventory management and payables processes. This has occurred even as the company continues to roll out the changes to other regions of the world. Within each process area, Cytec made significant progress against its key metrics.

For example, it realised reductions in days inventory on hand, days sales outstanding, and days to pay. Most importantly, by turning working capital into cash, Cytec remained focused on its future vision for growth and was able to continue investing in the businesses that are critical to that vision, even through a challenging economic environment. Simply put, the new management processes give the company a competitive edge.



David Drillock

Vice President and Chief Financial Officer Cytec Industries

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