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Working your capital
2016 Middle East Working Capital Study

2016

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A growing challenge

The cheapest source of capital

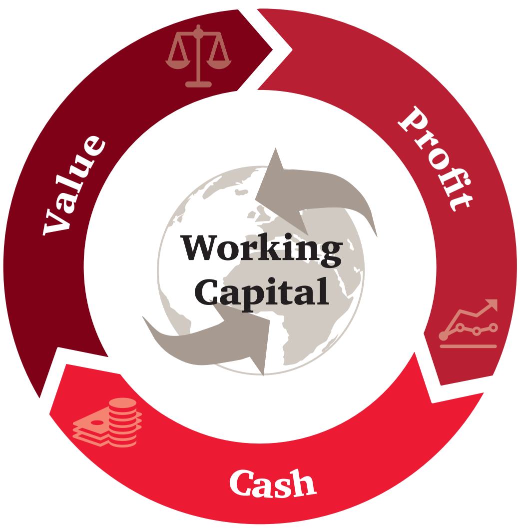
Difficult but worth the effort

Welcome to our Working Capital Study for the Middle East ('ME') region. We believe this is the first working capital study to focus on the ME, therefore we hope you find our local perspectives relevant and insightful.

In the years since the financial crisis struck the region (2008/09), companies in the ME experienced a strong period of growth. Since 2015 however, this growth has slowed, with many industries now forecasting continued pressure on growth going forward. The expectation of slower growth coupled with the continued impact of a lower oil price on oil dependent economies is the new reality facing the region. This new reality impacts all segments of the economy and cuts across industries.

Whilst there are many factors that affect a company's ability to grow, and ultimately survive, access to capital is essential. Although interest rates remain relatively low, liquidity is patchy and banks operating in the ME are becoming much more cautious in this new environment. We are seeing more companies today than ever before looking for alternative sources of capital. Unlocking cash from excess working capital is an option many are turning to, attracted by the amount of cash available (through improved focus and efficiency) and the fact that working capital presents the cheapest source of financing available.

Managing working capital efficiently can be complex and challenging. Our study shows however that companies that put the necessary focus on working capital are able to perform better not only from a cash and working capital perspective, but also across a range of other key metrics (revenue, profitability, return on capital and rate of capex investment), demonstrating that getting it right is very rewarding. Focusing on working capital management will not only help to ensure survival through this changing landscape but also help companies grow and strengthen their position for the future.



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Our analysis indicates that top ME working capital performers have a 2x higher return on capital employed compared with low performers

4.6 days

…deterioration in the 2015 cash cycle (average net working capital days)

AED 9.4 billion

…cash trapped due to deterioration in average working capital performance

8/16 industries

…where working capital performance has deteriorated since 2013

The time to act

ME companies have not reacted fast enough to the current economic environment. Average Net Working Capital (NWC) days in the ME have increased by 4.6 days (equivalent to a cash impact of AED 9.4b) between 2014 and 2015, driven by a decline in overall revenues.

The relative increase in working capital, coupled with tightening bank liquidity across the region has resulted in an overall cash on hand decline in 2015. Working capital is therefore becoming an increasing priority for boards and management teams, as a tool to ensure their organisations are best positioned for the future.

Size matters, but what can the others learn?

Overall, larger companies consistently outperform on working capital, relative to smaller companies. Our study shows that the performance gap between small companies and the very large companies in the ME is also widening. The largest companies in the ME have been able to use their negotiating power, and have invested in people and processes to improve their working capital performance to the detriment of small companies. Working capital performance of large and medium companies however has remained flat over the last three years, implying an opportunity for a significant number of companies in the ME to release cash from excess working capital, replicating some of the success their larger peers have demonstrated.

Top working capital performers lead on all key metrics

Our study shows that top working capital performers, also performed significantly better across all key performance indicators when compared with low working capital performers, in their peer group. Top working capital performers, on average, have been able to grow revenue twice as fast and achieve a 5p.p. better EBITDA margin, a higher return on capital employed and higher investment rate.

Whilst growth is typically a consumer of working capital, top performers have shown that it is possible to both grow revenue and manage working capital levels, compounding their successes against low working capital performers across all key performance metrics.

Room for improvement, irrespective of industry

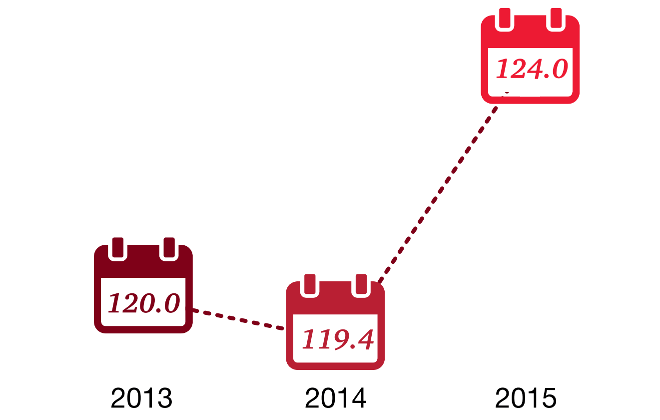
Working capital performance of companies within each industry varies significantly, implying there are opportunities to improve performance in every sector. Industrial Manufacturing, Healthcare and Engineering and Construction have the greatest performance variance between top and bottom working capital performers. These sectors also have some of the highest levels of invested working capital.

The performance of companies within the Communications and Hospitality and Leisure industries standout, with the lowest average NWC days, but also with the lowest variance between top and bottom performers.

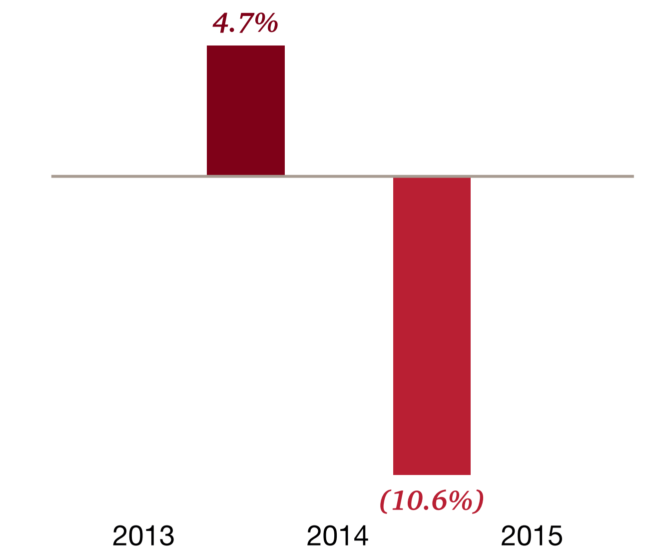
Our study looks at data across ***332*** listed companies, ***8*** countries and ***16*** sectors covering ***AED 132.5b*** of working capital.

Lower levels of cash on hand and increased cash tied up in working capital illustrates the need for an increased focus on working capital for boards and management teams

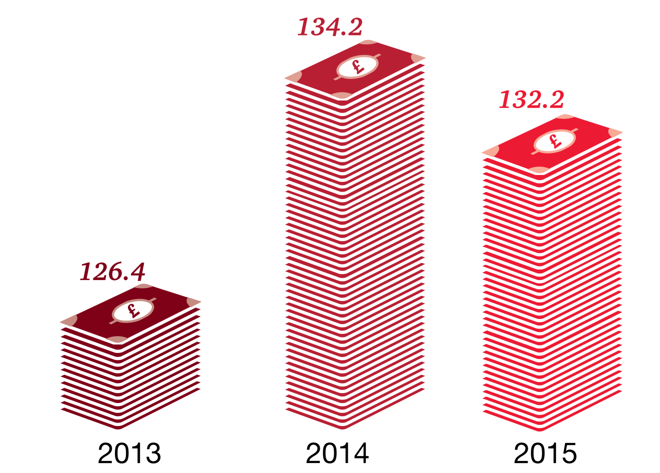
Net Working Capital Days



Change in annual revenue



Cash on hand (AED b)



A time to act

Tightening working capital ratios coupled with lowering levels of cash on hand are two key indicators that companies need to start being more proactive about releasing cash from their balance sheets.

Global CEOs who answered somewhat or extremely concerned regarding access to affordable capital, even in this low interest rate environment.

Source: PwC's Annual Global CEO Survey (2016)

There is *AED 132.5b* of cash tied up in working capital across the 332 companies in our study.

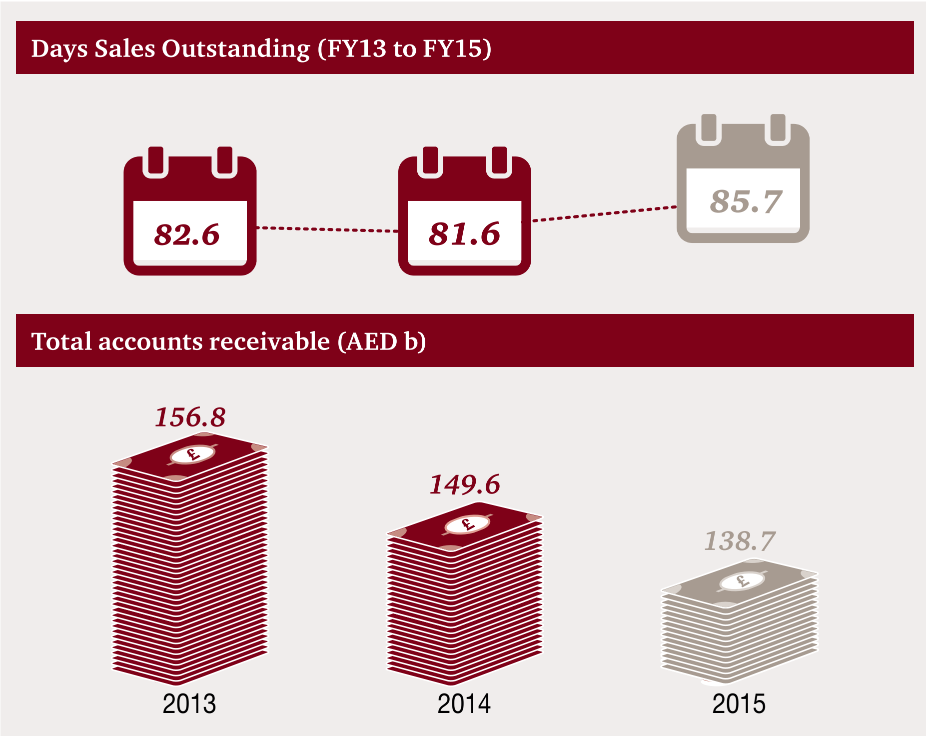
Average working capital efficiency across the companies in our study has deteriorated in 2015. Whilst the deterioration in average NWC days is a modest 4.6 days, this in cash terms equates to AED 9.4b of additional cash tied up in working capital, cash that could have otherwise been deployed elsewhere, for example to fund growth, return to shareholders or repay debt.

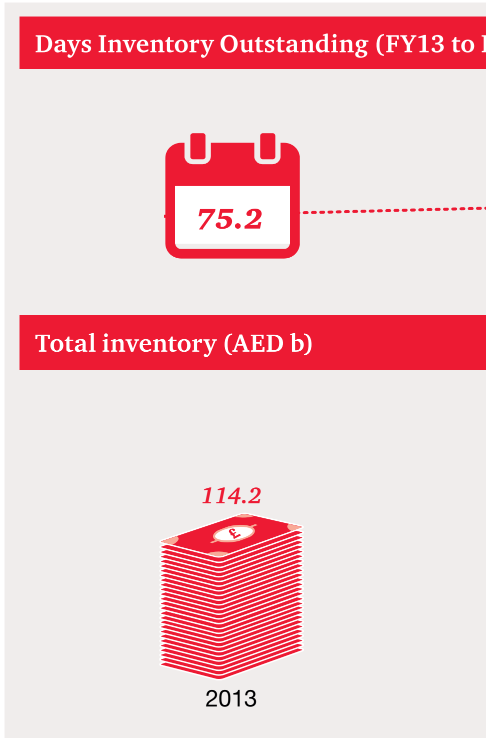
Cash on hand in 2015 has also fallen, compared with a significant increase the year before (2013 to 2014).

Strategic benefits of Working Capital

- ***Invest in new projects***
- ***Improved service levels***
- ***Pay dividends***
- ***Leaner organisation*** *able to deliver higher margins with less working capital*
- ***Make strategic acquisitions***
- ***More responsive*** *organisation to changes in demand and new product/services*
- ***Pay down debt/ refinance***
- ***Reduced borrowing costs***

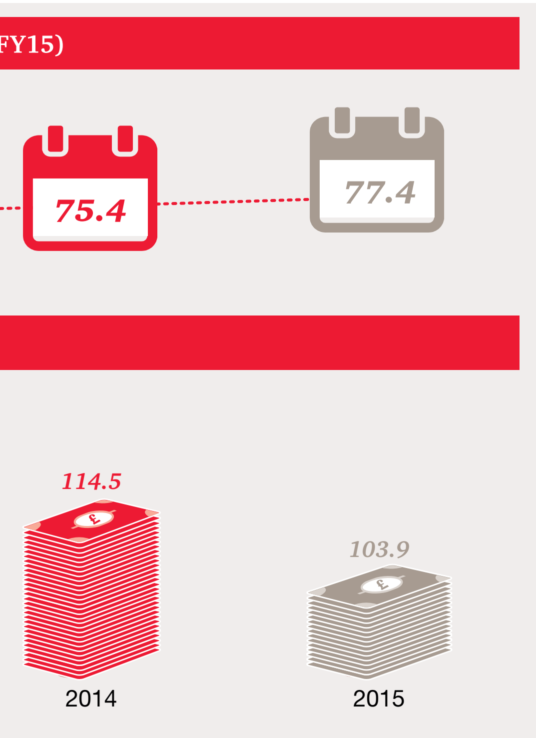
Falling revenues have led to a reduction in ME companies' absolute investment in net working capital...

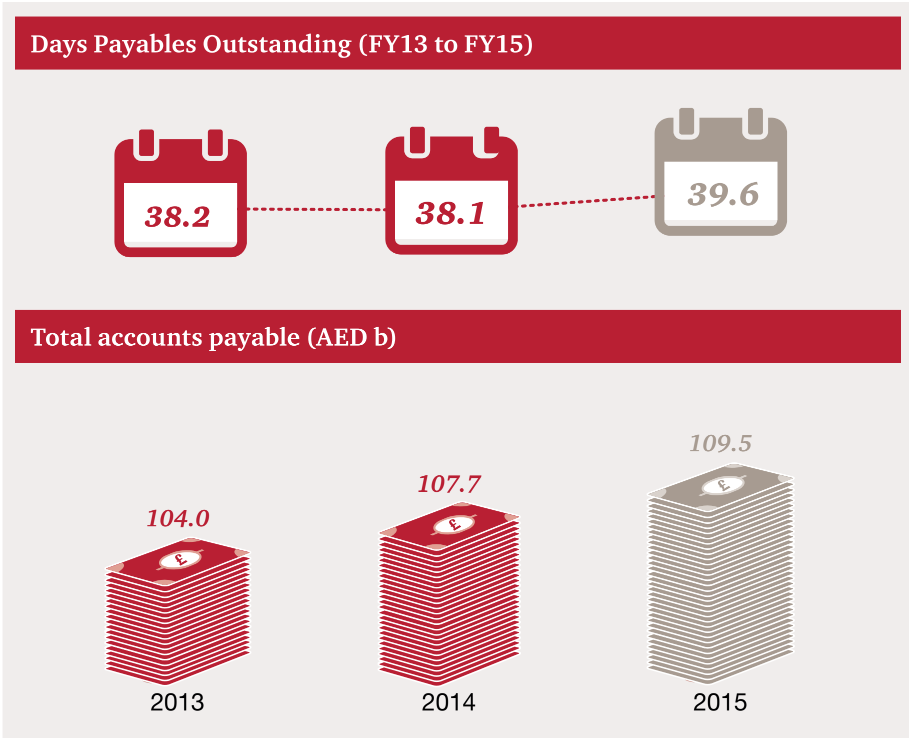


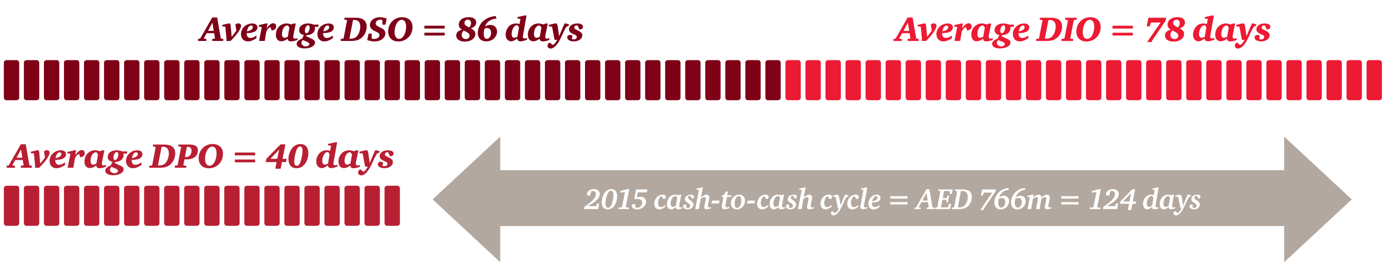


In 2015, it took ***124 days*** for the average ME company in our study to recoup the cash it had invested in working capital, compared to 119 days in 2014.

...however, ME companies have not reacted fast enough, resulting in average net working capital days increasing in 2015







Overall, deterioration in both days sales outstanding ('DSO') and days inventory outstanding ('DIO') has been partially offset by an improvement in days payables outstanding ('DPO').

Companies in our study, on average, are paying their suppliers 1.5 days slower than in 2014. For some companies this may be the result of tightening liquidity, but for others, who have focused on 'smarter' payment terms, may demonstrate a focused strategy to maximise the value from creditors.

The average time to collect cash from customers in the ME has slowed in 2015, with DSO deteriorating by 4.1 days. However, we note that ME companies within the upper quartile have an average collection rate of 43 days, compared to 152 days for companies in the lower quartile. Whilst there are number of factors that impact DSO performance, the significant range between average performance across our study, suggests there is room for improvement for many businesses.

Larger ME companies consistently outperform their smaller counterparts through better management and stronger negotiating power

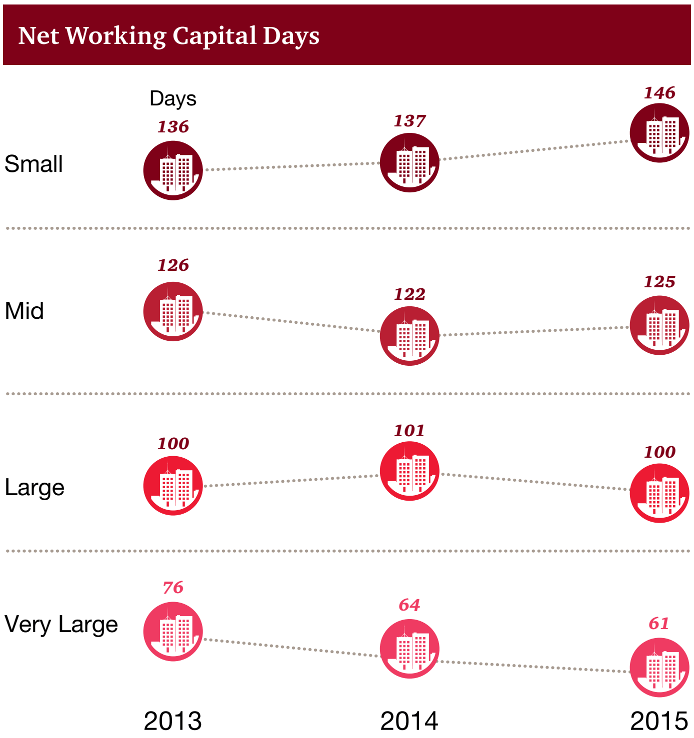
Our study shows that larger ME companies have better working capital performance than smaller companies. This trend has been consistent over the last three years.

Our study also suggests that very large companies in the ME have been able to significantly improve their net working capital performance year on year over the last three years. This improvement has been driven by their ability to collect cash from customers quicker and by extending creditor payments.

Very large companies are leading the way… **very large companies have been able to use their negotiating power, but also focus on cash, infrastructure and invest in processes and systems to improve working capital.**

Interestingly however, the performance gap between Very Large and Small companies has increased in each year since 2013, whilst Mid and Large companies have maintained their average performance. This seems to suggest that whilst there has been an improvement in the working capital performance of Very Large companies, this has been to the detriment of Small companies.

Given the relative flat performance of Mid-sized and Large companies (defined as those companies with revenue between AED 500m and AED 5b), we believe there are significant opportunities for companies within this segment to improve their working capital performance and learn from their larger counterparts by investing in working capital processes and systems.



Key:

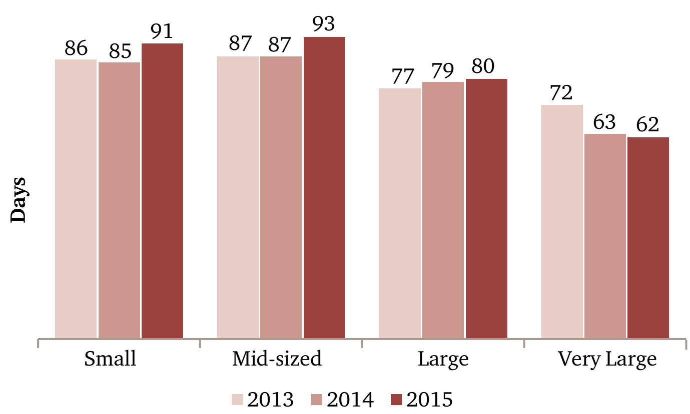
- *Small: Revenue < AED 0.5b*
- *Mid: Revenue ≥ AED 0.5b < 1b*
- *Large: Revenue ≥ AED 1b < 5b*
- *Very Large: Revenue ≥ AED 5b*

If Large companies in the ME were able to reduce their net working capital days at the same rate as Very Large companies between 2013 and 2015, they would have released *AED 6.7b* in cash.

There are significant opportunities for large and medium sized businesses across all three areas of working capital to improve performance relative to their larger competitors

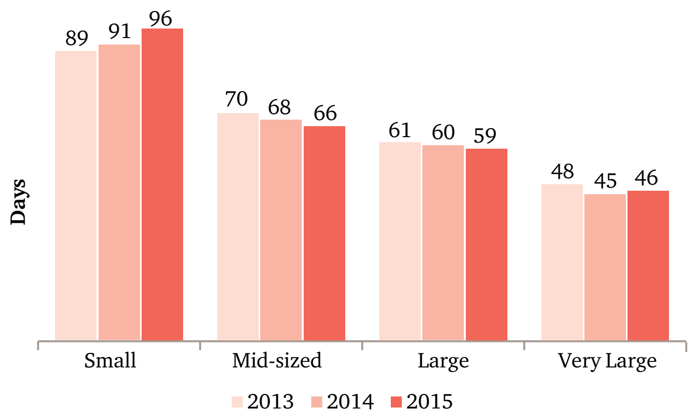
The working capital landscape for SMEs has gradually deteriorated since 2013, but the pressure has increased significantly in 2015.

Days Sales Outstanding (DSO)

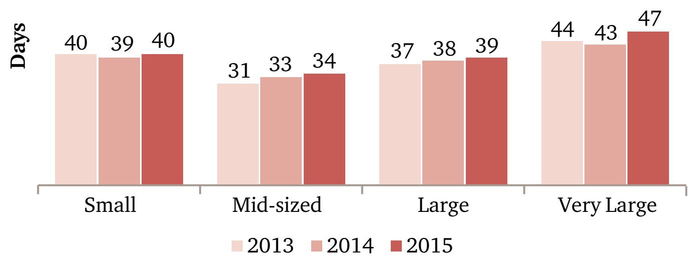


With larger companies typically having access to more and alternative sources of capital, resources for smaller players are at a premium. Small and Mid-sized businesses are bearing the double impact of reducing bank liquidity and the pressure from larger companies on trading terms.

Days Inventory Outstanding (DIO)



Days Payables Outstanding (DPO)



There has been an overall increase in DPO across all companies (except small companies). That is, companies on average are paying their suppliers at an increasingly slower rate. This indicates that larger companies are pushing or adopting 'smarter' strategies to maximise cash flow, reflective of tighter liquidity in the ME in 2015. Small businesses are losing out.

According to our study, Small companies have been the least efficient at actively managing their inventory levels in light of falling revenues, with DIO lengthening by 5 days in 2015 compared to 2014.

Large and Very Large companies on the other hand have broadly managed to maintain stable DIO over the last three years, which again reiterates their ability to focus and adapt to their operating environment more quickly and effectively.

Companies that are able to achieve top quartile working capital performance, outperform their peers across all key metrics...

On average, top working capital performers have...

5 p.p. ...higher EBITDA margin, on average

x2 ...the return on capital

100% ...more revenue growth

...compared with bottom quartile

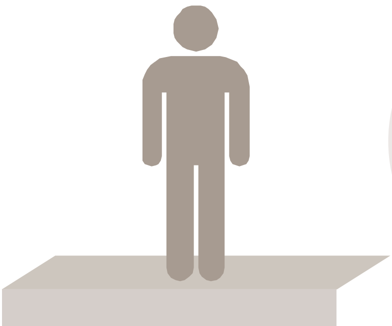
Top performers
(Average performance of the top quartile in each industry)

Bottom performers
(Average performance of the bottom quartile in each industry)

	Avg. growth in revenue (FY13-FY15)	ROCE %	CAPEX/Revenue	EBITDA Margin
Top performers	4.5%	5.5%	28%	18.2%
Bottom performers	2.2%	2.2%	12%	13.2%

...demonstrating the importance of working capital efficiency and the impact well beyond cash

On average, bottom working capital performers have...



50% ...less investment in capex (relative to revenue)

18% ...more cash consumption in working capital since 2013

x9 ...longer cash conversion cycle

...compared with top quartile

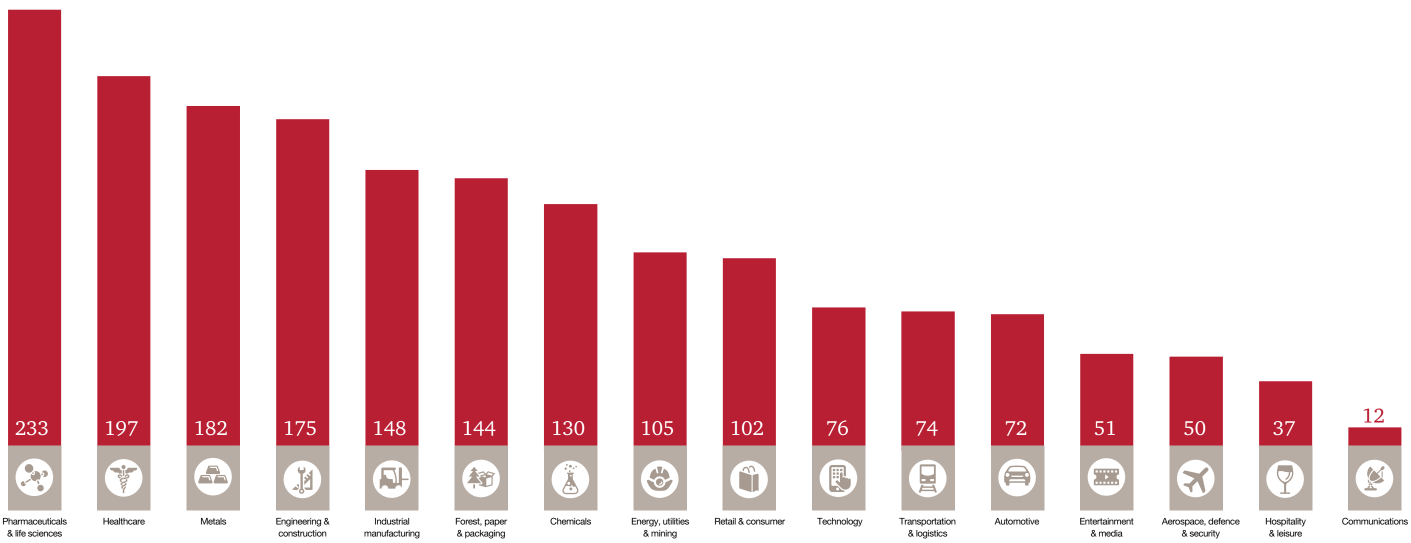
43	40	54	(25%)
DSO	DIO	DPO	Change in NWC days, % (FY13-FY15)
152	154	41	+11%

Working capital requirements vary significantly by industry, as each has its own unique operating characteristics

The main factors behind different working capital profiles between industries include customer and supplier mix, business model, strategy, supply chain, geographies supplied, seasonality and industry norms.

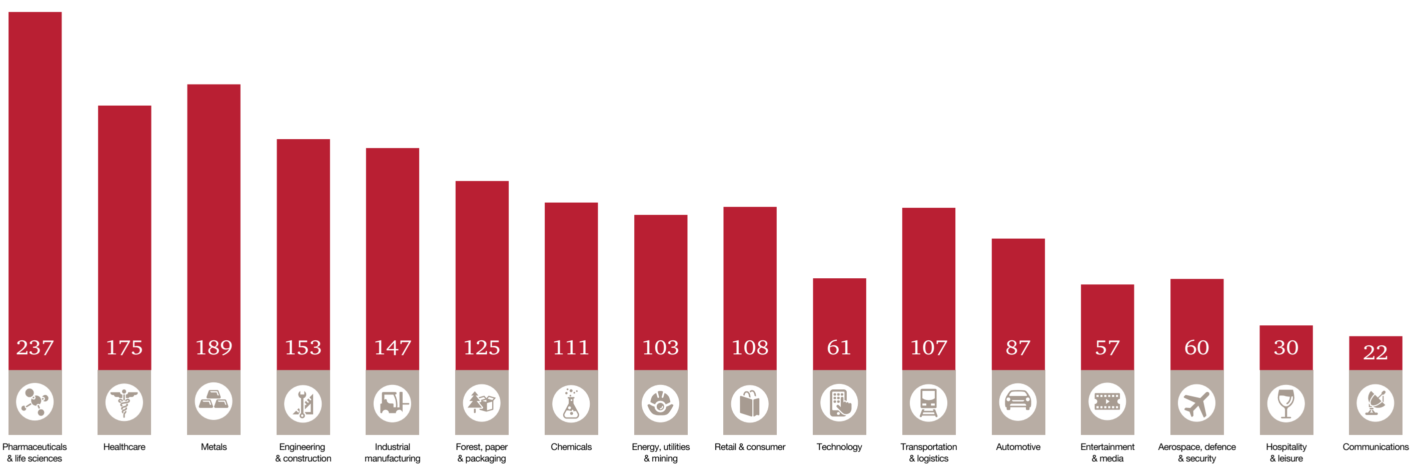
These are also contributing factors to the difference in working capital metrics between companies within the same industry.

NWC days by industry in 2015

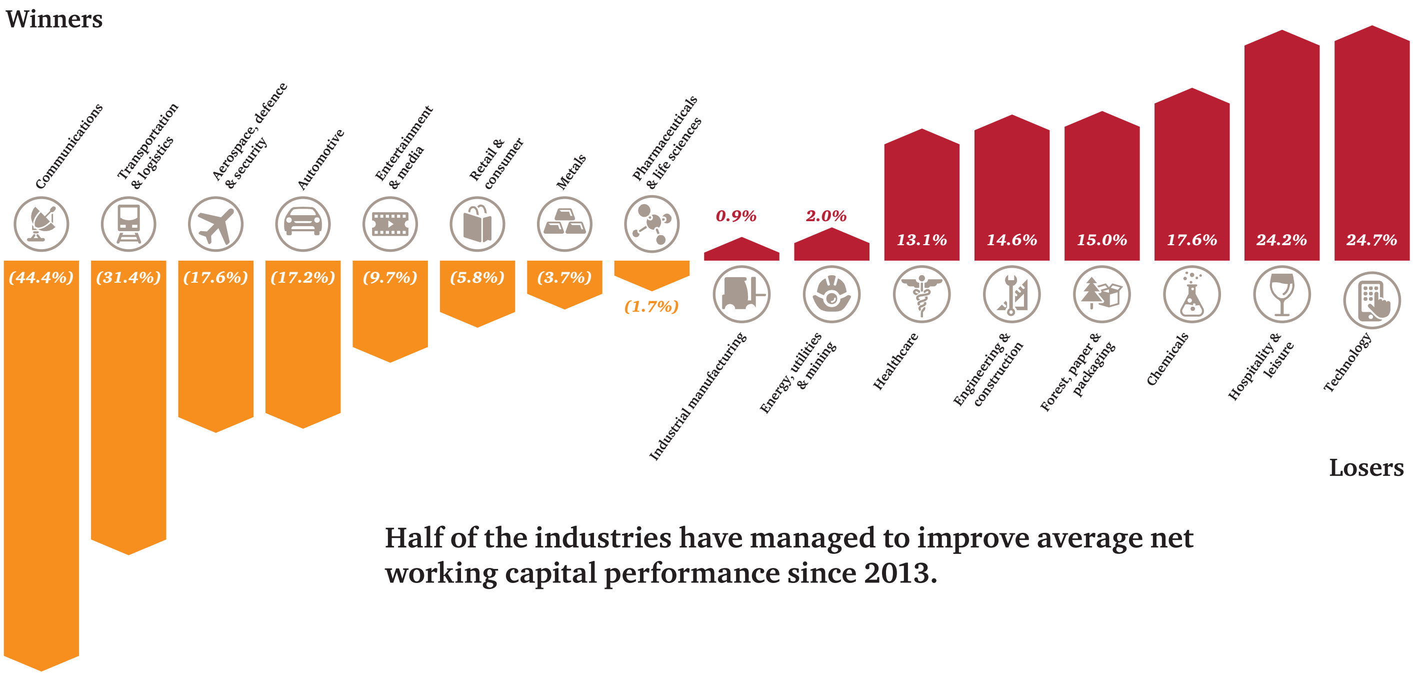


NWC days movement between 2013 and 2015

NWC days by industry in 2013



NWC days percentage change between 2013 and 2015

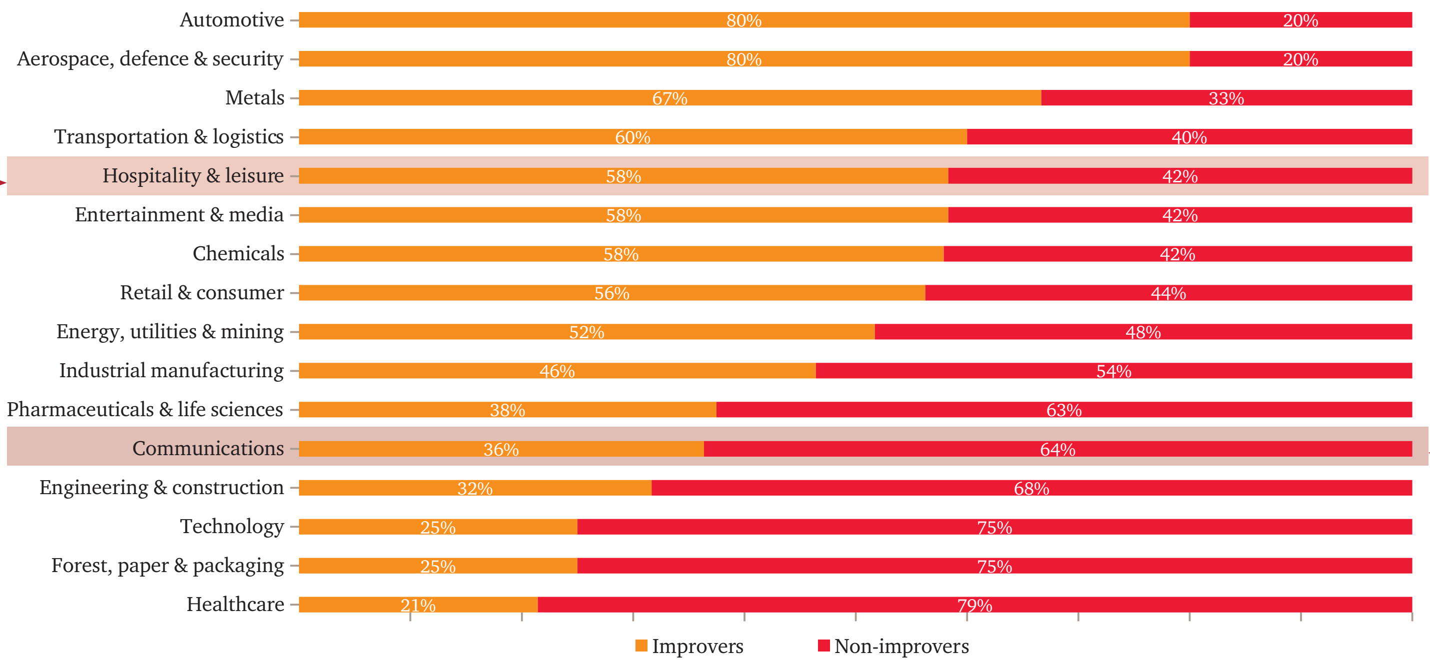


Half of the industries have managed to improve average net working capital performance since 2013.

Irrespective of an industry's overall trend, companies in each and every industry have demonstrated they are able to improve working capital performance

The majority of companies within 9 of 16 industries have managed to improve their working capital performance since 2013. However 51% of all companies in our study, across all industries, have not been able to improve their working capital performance.

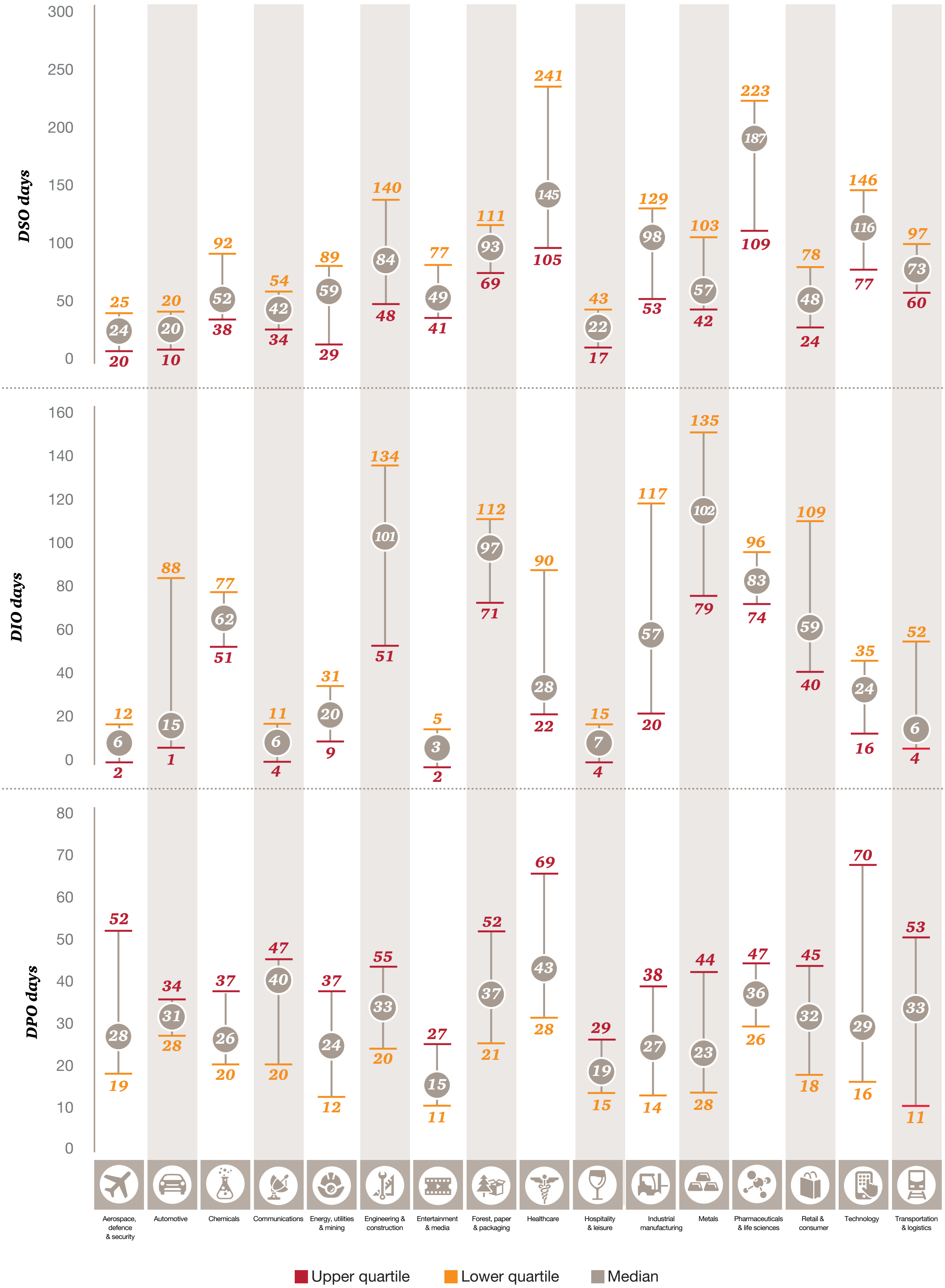
Improvers versus non-improvers by industry between 2013 and 2015

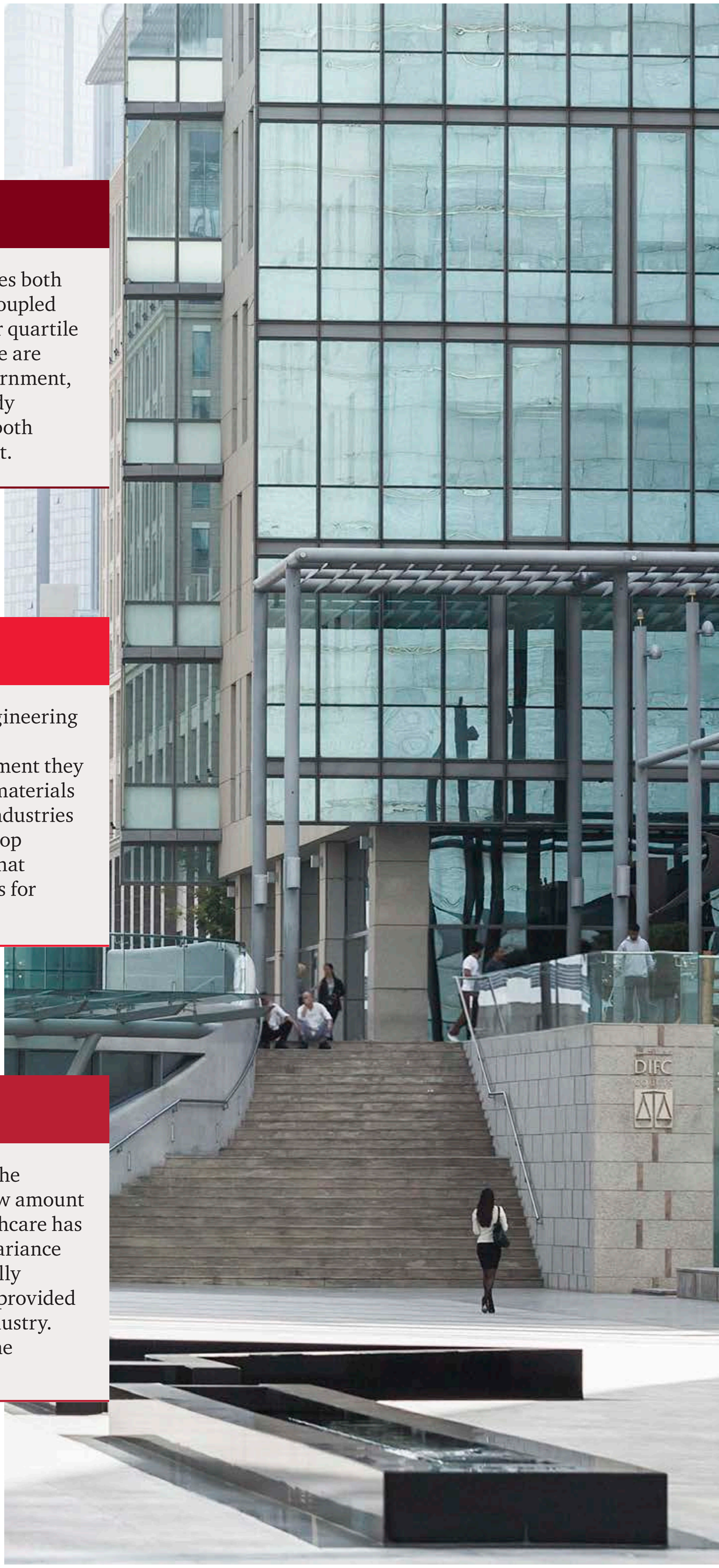


Whilst the overall Hospitality and Leisure industry saw a deterioration in average NWC days, 14 of 24 of companies (58%) improved their performance between 2013 and 2015, bucking the industry trend.

In the Communications industry, 7 out of 11 (64%) companies had a deterioration in average NWC days between 2013 and 2015. However, overall the average NWC days for the industry saw 44% improvement.

All industries exhibit a variance in working capital performance between top and bottom performers during 2015, demonstrating that a significant proportion of ME companies have room for improvement, regardless of sector





DSO

The Pharmaceutical and Healthcare industries both have exceptionally high median DSO days, coupled with a large performance gap between upper quartile and lower quartile performance. Whilst there are challenges in both these sectors (role of government, complex value chain to name a few), our study suggests a significant value opportunity for both industries and individual companies within it.

DIO

Metals, Forest, Paper and Packaging and Engineering and Construction have the highest DIO days, reflecting the complex supply chain environment they operate in (long conversion times from raw materials to sold finished goods). Nevertheless these industries also have a large performance gap between top quartile and lower quartile, demonstrating that despite the sector complexities, opportunities for working capital improvement exist.

DPO

The Entertainment and Media industry has the shortest median DPO primarily due to the low amount of purchases compared to sales, whilst Healthcare has the highest. Automotive has the narrowest variance between upper and lower quartiles, potentially reflecting the consistency of payment terms provided by the global suppliers who dominate the industry. Conversely, the greatest variance is within the Healthcare industry.

Key statistics by country

Country	Companies included in the study	Average NWC days in 2015	Total NWC (AEDm) in 2015
Saudi Arabia	88	133.0	76,579
United Arab Emirates	31	121.3	21,243
Qatar	14	118.1	8,093
Egypt	45	123.1	7,852
Oman	56	93.8	6,627
Kuwait	44	95.5	5,208
Jordan	45	186.5	4,511
Bahrain	9	74.1	2,435
Total	**332**	**124.0**	**132,548**

Study methodology

Basis of calculations and limitations

In this study we have undertaken working capital analysis from the reported financial results of 332 publicly listed companies across the ME. Companies operating in the financial services, real estate and insurance industries are not included in the study.

The countries covered include: Bahrain, Egypt, Jordan, Kingdom of Saudi Arabia, Kuwait, Oman, Qatar and United Arab Emirates.

Metric	Overview	Basis of calculation
Days Sales Outstanding ('DSO')	DSO is a measure of the average number of days that a company takes to collect cash after the sale of goods or services have been delivered.	(Accounts Receivable/Revenue) x 365
Days Inventory Outstanding ('DIO')	DIO gives an idea of how long it takes for a company to convert its inventory into sales.	(Inventory/Revenue) x 365
Days Payables Outstanding ('DPO')	DPO is an indicator of how long a company takes to pay its trade creditors.	(Accounts Payable/Revenue) x 365
Net Working Capital ('NWC') days	NWC days indicates the length of time it takes a company to convert resource inputs into cash. This is commonly referred to as the Cash Conversion Cycle ('CCC').	DSO + DIO – DPO
NWC percentage	NWC % measures working capital requirements relative to the size of a company's revenue.	(Accounts Receivable + Inventories – Accounts Payable)/Revenue
Return on Capital Employed ('ROCE')	ROCE is an indicator of profits as a proportion of a company's capital employed.	EBIT x (1 – Tax Rate)/Average Total Capital Employed
EBITDA margin	EBITDA margin is an indicator of a company's profitability level as a proportion of its revenue.	EBITDA/Revenue

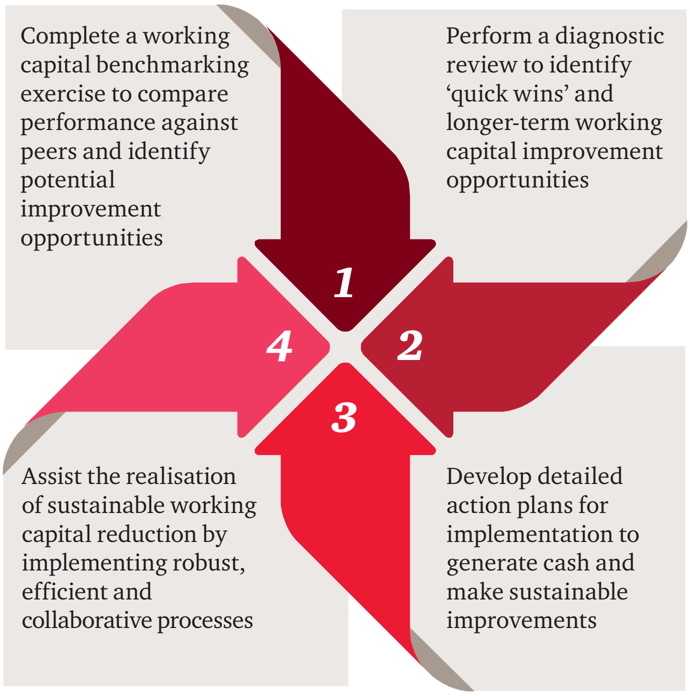
Note: DIO and DPO are usually calculated with Cost of Goods Sold as a denominator, however due to the data availability and reliability, we have used revenue as a denominator throughout this study.

Limitations

Companies have been assigned to countries based on the location of their headquarters. Although a significant part of their sales and purchases might be realised in that country, it does not necessarily reflect typical payment terms or behaviour in that country. As the research is based on publicly available information, all figures are financial year-end figures. Due to the disproportionate efforts to improve working capital performance towards year-end the real underlying working capital requirement within reporting periods might be higher. Also, off-balance-sheet financing or the effect of asset securitisation have not been taken into account.

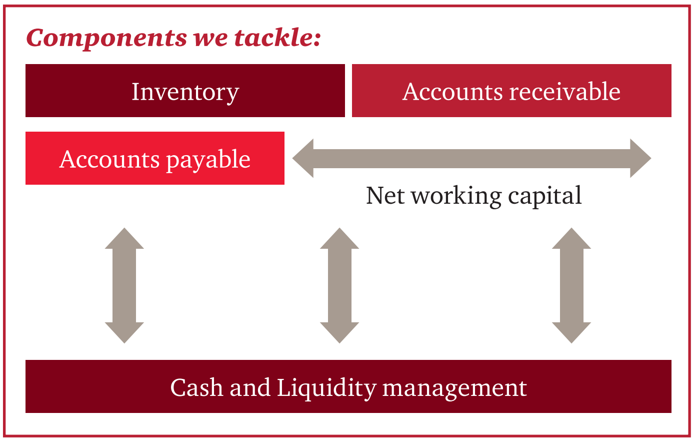
How we can support you

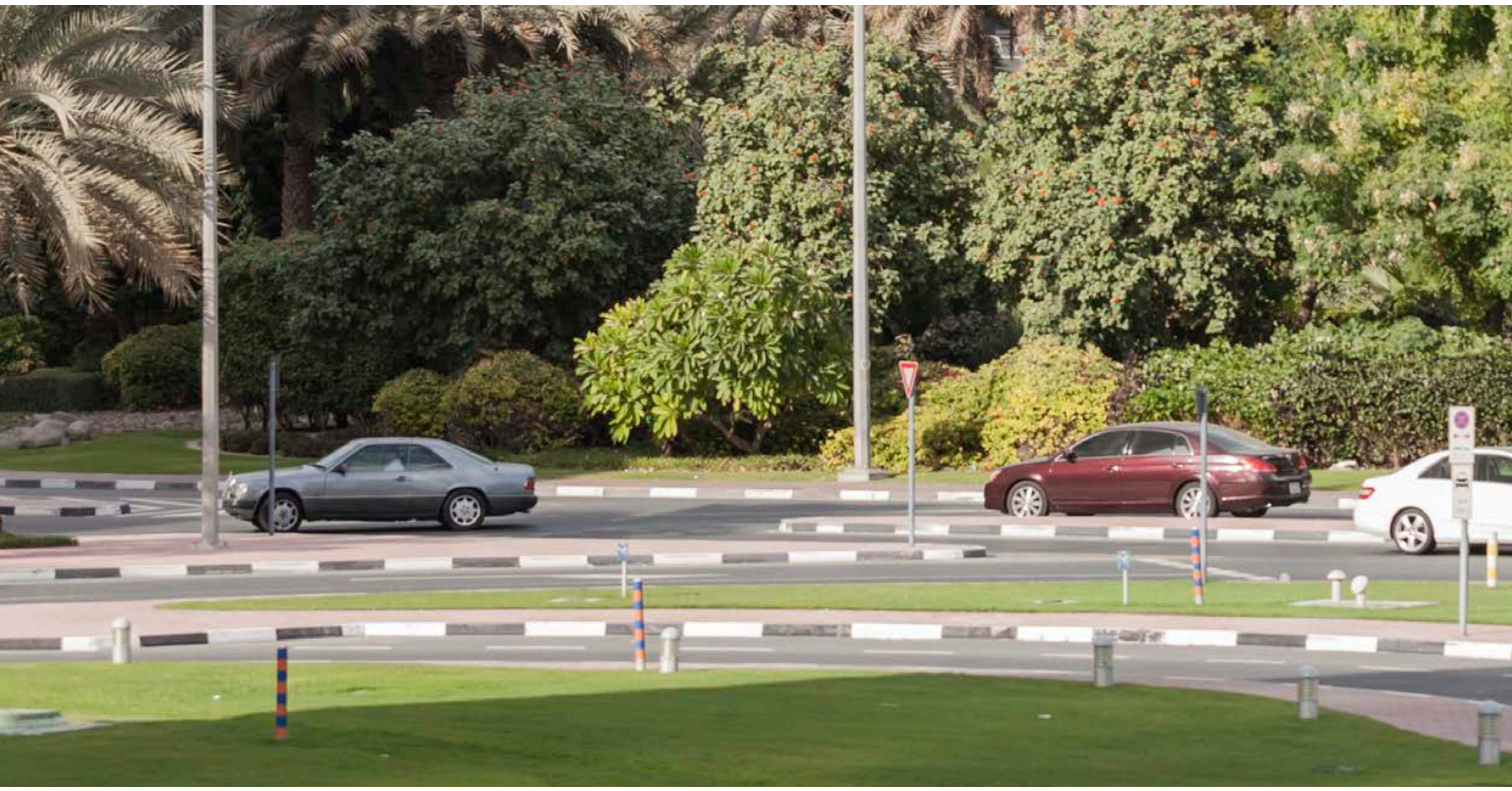
Phases in the journey



Addressing the key levers:

- Identification, harmonisation and improvement of commercial terms
- Process optimisation throughout the end-to-end working capital cycles
- Process compliance and monitoring
- Creating and embedding a 'cash culture' within the organisation, optimising the trade-offs between cash, cost and service





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Mihir leads our Operational Restructuring and Working Capital Management team in the Middle East. He has been advising companies for over 12 years and is a specialist in cash and working capital management, restructuring and performance turnaround. Mihir's experience draws from his diverse experience across M&A, transaction due diligence, distressed situations and change management roles, across the Middle East, Europe and Australia.

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Lakhvir has over ten years of experience including over five years in the Middle East. Lakhvir has focused on diagnosing, advising and implementing commercial solutions across restructuring and turnaround situations. His specialisms include reviews of stressed companies (to find value), assisting corporates on capital re-engineering projects and short term cash flow forecast reviews.

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Matti has over eight years of deep working capital experience within consulting and industry across Europe, US and Middle East. His areas of expertise cover identifying and implementing operational efficiencies, working capital optimisation and change management. Matti has led numerous working capital and cash flow assessment initiatives and has been involved in multiple turnaround planning and facilitation projects.

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In addition to our dedicated Middle East Working Capital team, PwC has over *70* dedicated Working Capital Management specialists operating globally.

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