20 Middle East
24 Working Capital Study

Transforming Middle East business resilience:
Unlocking value through strategic working capital management

About the study

Every year, we review the financial performance of companies in the Middle East to assess their working capital performance and related key indicators. This year's review includes 450 publicly-listed and private companies and covers five years of key working capital trends from 2019 to 2023, using data sourced from Capital IQ and analysed by PwC.

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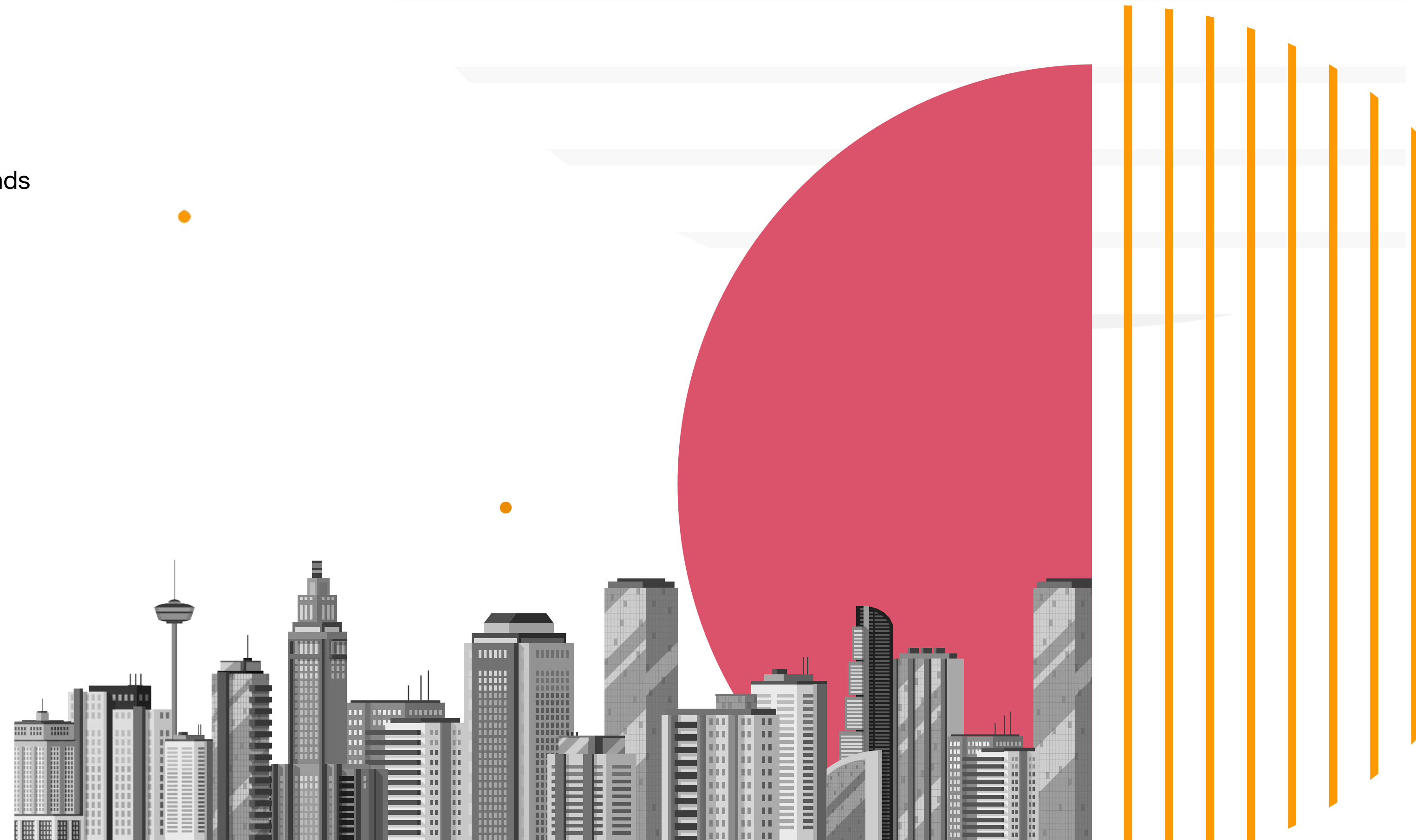


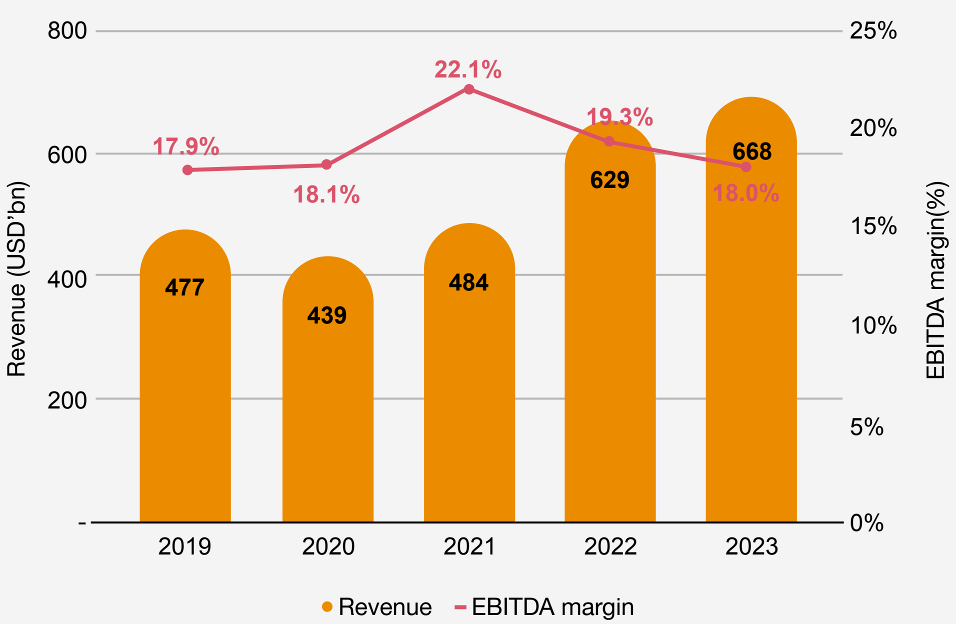
01 Executive **summary**

Executive summary

Middle East businesses demonstrated strong growth in 2023, with a combined revenue increase of **6.2% year-on-year** (see Figure 1). This robust performance was largely driven by the energy sector and continued strategic investment focused on the United Arab Emirates and the Kingdom of Saudi Arabia by private equity and sovereign wealth funds. Reflecting this positive market landscape, 73% of Middle East respondents in our latest 2024 CEO survey expect the region's growth to continue.

In fact the region's M&A market also recorded remarkable resilience, as seen in our 2024 TransAct Middle East report, leading to a relatively active deal market compared to other regions that have been more susceptible to higher interest rates and recessionary fears.

Figure 1: Revenue and EBITDA margin trend, 2019-23



> In the dynamic economic landscape of the Middle East, effective working capital management is crucial. Optimising working capital not only unlocks significant value and enhances liquidity but also strengthens resilience against market volatility. By focusing on sustainable working capital improvements, businesses can secure their financial stability, support growth initiatives, and pave the way for long-term success.

Mo Farzadi
Business Restructuring Services Leader

Middle East businesses continue to be affected by declining profitability

However, despite a significant average year-on-year increase in revenue, businesses have experienced an overall reduction in profitability across the region for the second successive year. This decline in profitability was driven by an increase in the cost of goods sold (COGS) across almost all sectors, influenced by various regional and global trends.

Firstly, falling **oil prices** in 2023 squeezed margins in the region's energy sector, tightening government budgets and intensifying price competition for public sector contracts. Secondly, input costs for companies rose due to the region's continuing dependence on imports for goods and services and exposure to global inflation. Lastly, international supply chain disruptions and geopolitical tensions increased logistics costs.

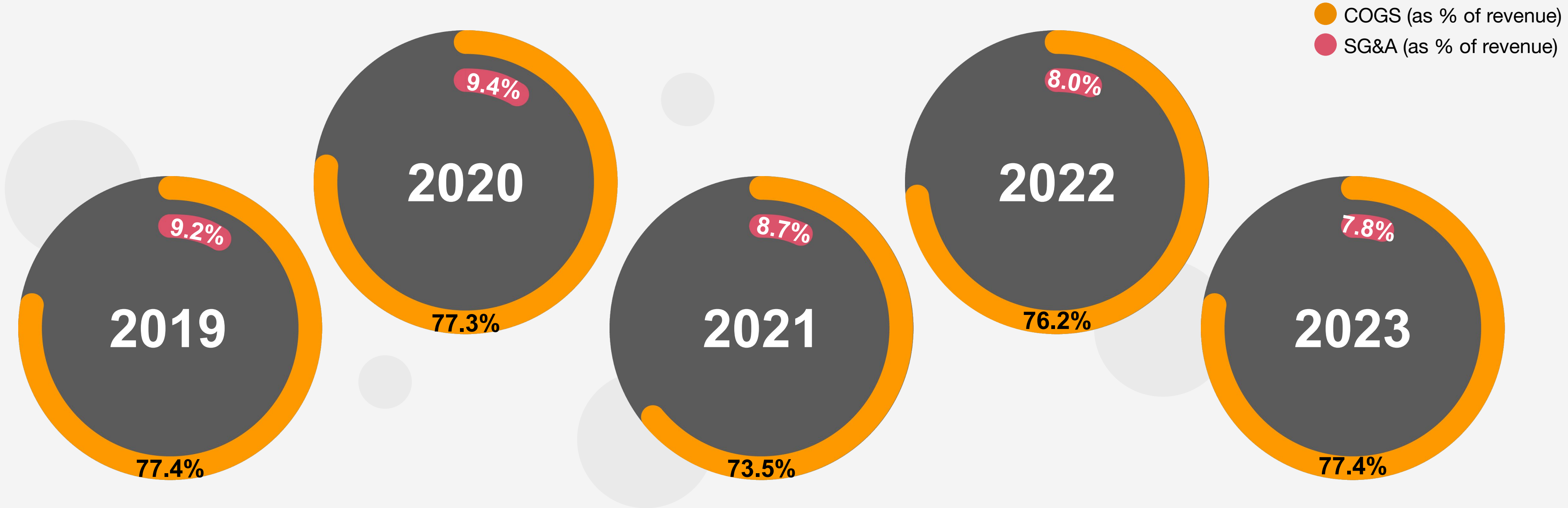
Focus on indirect cost reductions leaves limited room for further improvement

Against this background, businesses in this study have continued to focus on improving their cash flow from operations in 2023, primarily through indirect cost reductions and greater working capital efficiency.

Substantial reductions in indirect Selling, General & Administrative (SG&A) cost were achieved in the years following the COVID-19 pandemic, as much of the potential value was extracted from Middle East businesses. Between 2020 and 2023, SG&A costs as a percentage of revenue fell on average from 9.4% to 7.8% (see Figure 2).

Further reductions in SG&A costs will likely require more structural changes to the operating models, as most of the quick wins have already been addressed. While SG&A improvements can largely be managed internally, enhancing the COGS efficiency requires longer term strategic and operating model changes. Improvements in this area will be highly susceptible to external disruptions, expected to continue for the rest of 2024 and possibly into 2025. Nonetheless, addressing these structural changes to ensure the efficiency of direct costs will be critical for regional companies to realise further value.

Figure 2: COGS and SG&A trends, 2019-23



Improved working capital management is the key to unlocking shareholder value

In recent years, due to the increased cost of finance, regional corporations have increased their focus on working capital optimisation. Some have addressed internal inefficiencies to achieve sustainable change whilst others continue to have a more tactical approach to realise short-term cash gains.

Since the pandemic, there has been a greater focus by businesses on both indirect cost and working capital optimisation, a trend expected to continue in 2024. Findings of this study reflect this encouraging trend. Net Working Capital (NWC) days have improved on average from 121 days in 2020 to 108 days in 2023, with the average working capital cycle stabilising in the past two years (See Figure 3).

Notably, the average Days Payable Outstanding (DPO) of 65 days has returned back to the 2019 levels, whilst the Days Inventory Outstanding (DIO) remained relatively stable at 93 days and Days Sales Outstanding (DSO) have come down by 0.7 day to 85 days.

Despite this improved working capital cycle, there are still opportunities across the region for substantial cash release. We estimate that as much as US$50bn is currently trapped on the balance sheets of listed companies, costing shareholders up to US$5bn in total to finance, assuming a weighted average cost of capital of 10%.

In this context, it is worth highlighting that whilst 54% of companies reported a year-on-year improvement in their working capital performance, only 9% of the companies in the study have maintained a positive trend for three consecutive years. This indicated that only 9% have demonstrated to investors and shareholders that their results are sustainable changes and not short-term tactical measures.

Improving working capital management will remain a priority for Middle East business leaders, especially as the cost of capital across the region is likely to remain high. Average interest expenses for corporates rose 37% year-on-year to reach a record high in 2023 whilst the total debt increased only 4% year-on-year, with the cost of debt up by 120 bp (basis points) between 2022 and 2023. Looking ahead, there is no immediate prospect of a significant fall in lending rates for Middle Eastern companies. In July 2024, Bloomberg forecast that the Emirates Interbank Offered Rate (EIBOR) would remain above 4% for the next five years, whilst the Saudi Arabian Interbank Offered Rate (SAIBOR) would only fall below 4% in Q4 of 2027.

The gap continues to widen between the best and worst working capital performers

In these challenging financing conditions, it is striking that the disparity in average working capital performance between the most efficient and least efficient companies continues to widen. The gap between the bottom quartile containing the worst performers and the upper quartile containing the best performers increased by 30% year-on-year between 2022 and 2023. If lagging businesses do not prioritise better working capital management, they will fall even further behind.

Throughout 2023 and into 2024, an increasing number of companies across key regional markets are experiencing different degrees of financial distress, largely due to deterioration in their ability to generate free cash flow. Based on the situations in which we have been involved over the last 12 to 18 months, the primary driver behind this decline is the working capital cycle. Cash is often tied up in either receivables due to relaxed credit risk policies and reactive collection processes or inventories due to poor forecasting capabilities and rigid supply chains with long lead times. This makes it difficult for companies to quickly react to changing market conditions.

Key Findings

$50bn
trapped on corporate balance sheets

4%
increase in total debt in 2023

130 bps
bps decline in profitability in 2023

$5bn
financing cost to shareholders

0.5 days
deterioration in NWC days in 2023

37%
increase in interest expenses costs in 2023

02 Working **capital trends**

Working capital trends

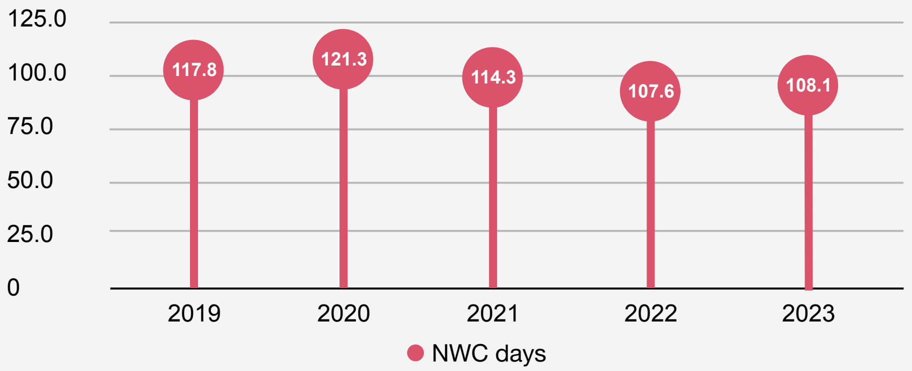
After analysing data from **450 private and publicly-listed companies**, we highlight and deep-dive into key trends around working capital performance and liquidity

- Days Sales Outstanding (DSO), which measures how long companies take to collect cash from customers
- Days Inventory Outstanding (DIO), which measures how long companies hold stock before sales
- Days Payable Outstanding (DPO), which measures how long companies take to pay suppliers, vendors and creditors
- Company sizes based on their revenue size (very large, large, medium, small)
- Countries including GCC plus Egypt and Jordan
- Major industries, including healthcare, pharmaceutical and life sciences, industrial manufacturing, and retail and consumer

01 Overall working capital performance trends

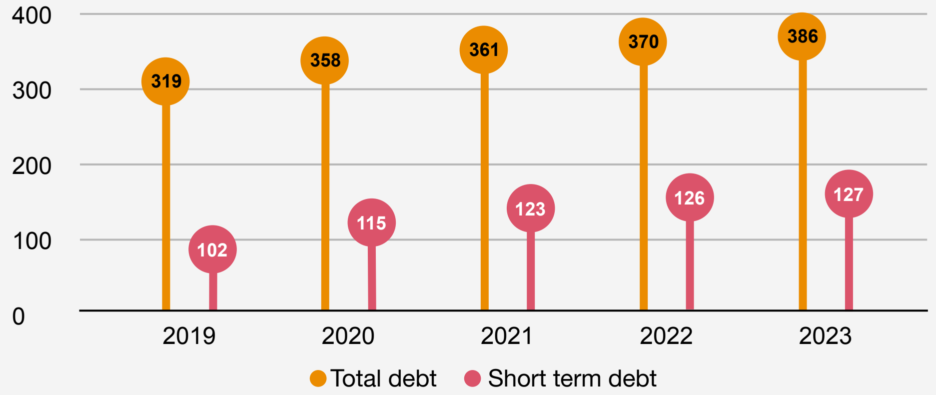
Average working capital performance, measured as Net Working Capital (NWC) days, improved from 121 days in 2020 to 108 days in 2022 (see Figure 3), as companies increased efficiency across all working capital cycles.
However, this trend was slightly undermined in 2023, with an average year-on-year slight deterioration in NWC days across the survey of 0.5 days. Small positive and negative movements were observed across the main cycles.
The improvement in NWC days since 2020 is primarily due to a reduction in the average DSO (See Figure 6). In 2023, DSO improved again by 0.7 days year-on-year, but this was offset by a reduction of 1 day in the DPO. The average inventory performance or DIO remained largely unchanged in 2023.

Figure 3: Net Working Capital (NWC) days trend, 2019-23



The overall improvement in NWC days is driven by both a normalisation of the spike in the working capital cycle during the pandemic as well as a mix of sustainable changes in the way companies operate (c. 9% of companies) and one off tactical pushes across a larger part of the companies in the study (c.54% of companies).
Our analysis shows that since 2020, DSO and DIO have improved by 12 days and 7 days respectively whilst the DPO has deteriorated by 4 days, reflecting a correction in the pandemic-era payment practices where companies had slowed or even stopped payments in an effort to conserve liquidity.
We note in the markets, especially UAE and KSA, an increased focus from corporates on either targeted working capital improvement projects or larger scale turnarounds, often with a specific workstream for working capital or balance sheet optimisation. Despite these efforts, significant opportunities remain, with as much as US$50bn trapped on corporate balance sheets that could be potentially released through the lagging business (bottom quartiles) targeting working capital improvements in a sustainable way.
Across the survey, the short-term debt burden for businesses increased incrementally to US$127bn in 2023, up from US$102 bn in 2019. However, the average proportion of short-term debt as a percentage of total debt decreased year-on-year for the first time since 2019.
Post pandemic, the regional restructuring market has seen an uptick in debt restructuring and reprofiling as businesses have struggled with short and long-term debt repayment profiles, increasing cost of financing and misaligned cash flow generation projections and debt repayments. These restructurings have converted short-term obligations into longer term debt in order to align their debt profile with their projected future cash flows, hence this is also masking the true increase in short-term debt across the region.
Despite this trend, the average short-term to long-term debt ratio across the study is still above pre-pandemic levels. The key to reducing the short-term debt burden is to improve the overall efficiency of the working capital cycle to reduce the dependency on external financing. Cash released as well as the associated debt financing costs eliminated, could be used in turn to provide returns to shareholders or to reinvest in the company.

Figure 4: Short and long-term debt trends, 2017-22

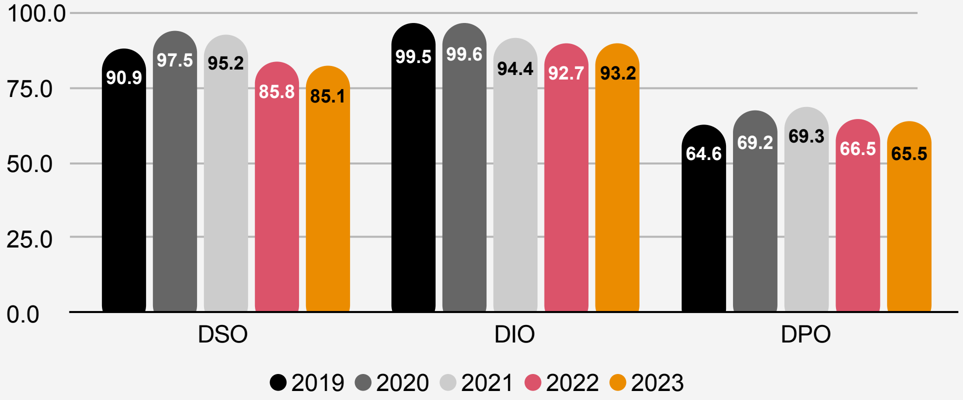


02 Working capital trends by cycle

The average overall working capital performance of companies deteriorated slightly by **0.5 days** in 2023. Meanwhile, the underlying movements in the three working capital cycles were as follows (See Figure 5):

DSO improved by 0.7 days | **DPO increased by 1 day** | **DIO rose by 0.5 days**

Figure 5: Working capital performance indicator trends, 2019-23



In recent years, a key focus for most corporations has been their DSO performance, as they have looked to accelerate collections and reduce the risk of bad debts. Based on our interactions in the market, businesses have resorted to both short-term tactics and internal transformations of processes, focused on credit risk and cash collection and have leveraged technologies to enable efficiencies across various processes such as billing, collections and dispute management. More mature businesses have also utilised financing products for their private receivables, though primarily on an as-needed basis.

In 2023 the average DIO remained stable, amid continuing supply chain disruptions which prompted some corporates to mitigate risks and protect their topline by building up buffer stocks. Given the increase in lead times and buffer stocks due to disruptions and the reliance on imports throughout the region for a number of key sectors, the stable inventory performance actually indicates an improvement of underlying inventory management whilst some of the external factors mentioned earlier are driving an increase in buffer stocks.

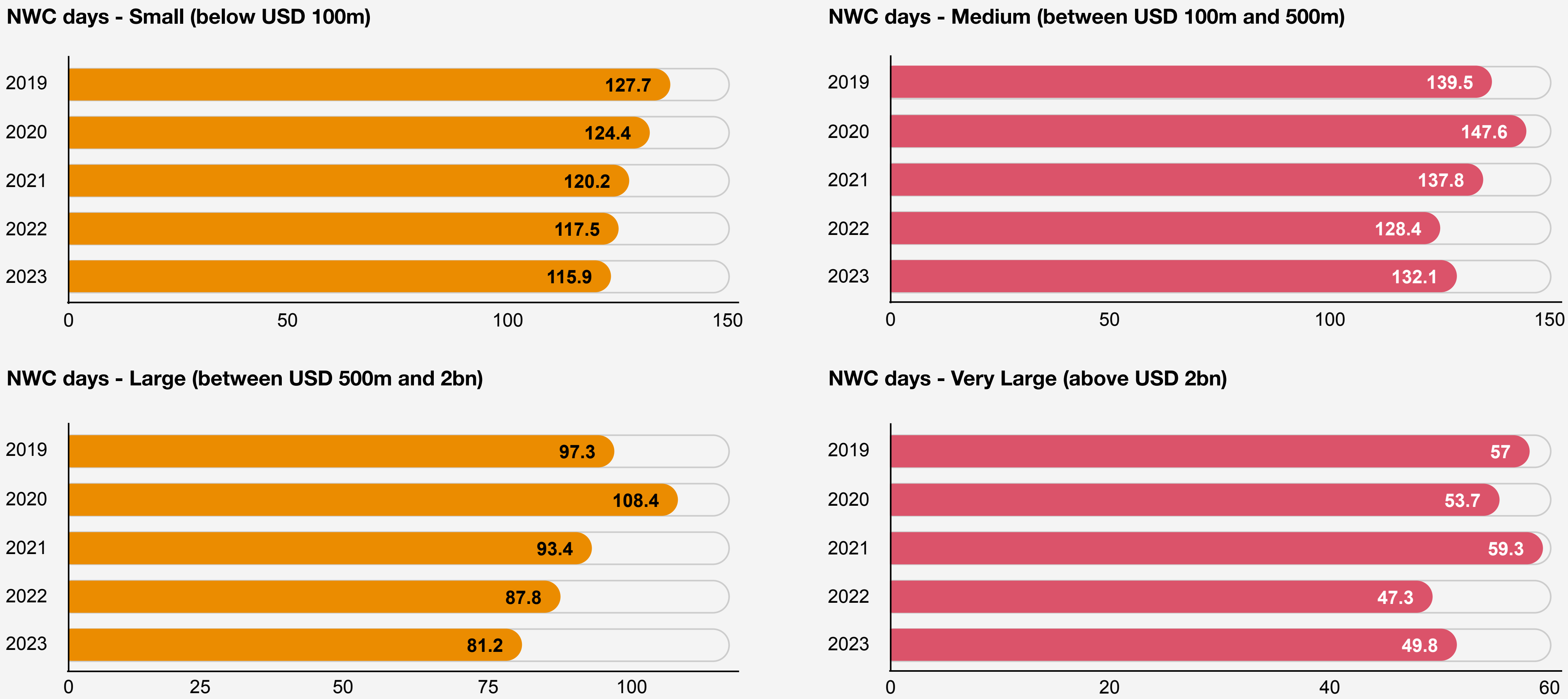
At the same time, there were notable differences in inventory management which are worth noting. Smaller companies in particular, with less than **US$100mn** in annual revenue, increased their inventories in an effort to ensure they were protected against disruptions and price volatility. Meanwhile, medium and large companies, with between **US$100mn** and **US$2bn** in annual revenue, have maintained the improvement in their average DIO performance since the pandemic by correcting their inventory levels and driving efficiencies across their demand planning and replenishment processes.

The average DPO performance of companies in the study has normalised across the region over the past three years and has now returned to the 2019 level of **65 days**. During the pandemic, companies typically stretched their suppliers or in some cases stopped most payments in efforts to conserve liquidity. The downward DPO trend since 2021 suggests that as business conditions gradually have returned to normal, many businesses have realised the negative impact on their own operations of a lengthy DPO cycle which could lead to price increases or supply fluctuations

03 Working capital trends by company size

This year's study continues the trend of previous years, with **very large companies** on average turning over cash in their working capital cycle more than twice as fast as their **small** and **medium** peers (see Figure 6).

Figure 6: NWC days by company size (annual revenue), 2019-23



03 Working capital trends by company size

Between 2019 and 2023, very large companies improved their overall working capital performance, reducing NWC days by seven days on average. Despite this improvement, their performance deteriorated year-on-year in 2023, with an increase of three NWC days compared to 2022, primarily due to a rise in DIO.

Many **very large companies** built up stocks to ensure they can meet demand and mitigate supply chain disruptions, as well as take advantage of improving market conditions. Their overall better performance in working capital management allowed for liquidity to be deployed effectively, ensuring risk mitigation and enhancing their position vis-a-vis competition when opportunities arise in the market.

The year-on-year deterioration in the NWC performance of very large companies in 2023 was only partially offset by an increase in their DPO, which was still 10 days less than the equivalent figure in 2019 of 86 days. Between 2019 and 2023 many very large companies released payments faster to their suppliers to support the ecosystem and the wider economy. This reduction in DPO was made possible by an improvement of 17 days in DSO between 2019 and 2023, due to concentrated efforts to implement best practices and systems to support billing processes and cash collection as well as reduce credit risk.

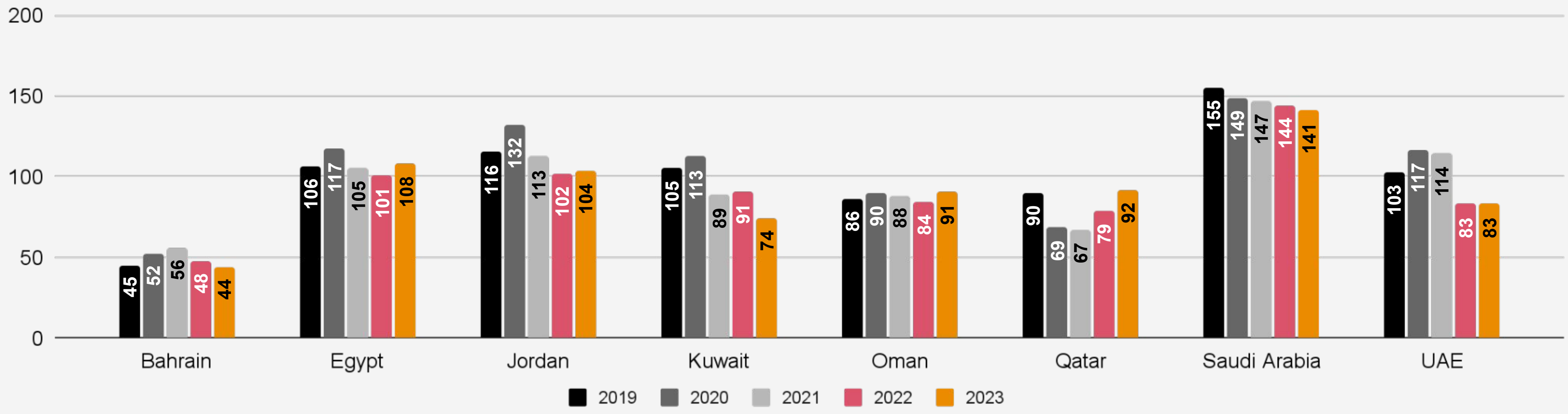
Large companies recorded the best overall improvement in average NWC days in 2023, due to a year-on-year decrease of three days in both DSO and DIO, and a year-on-year increase of two days in DPO. This improvement continues a five-year trend beginning in 2019, with large companies placing a greater focus on efficient working capital management as a way to improve their balance sheet in a challenging debt market.

Medium companies saw a year-on-year increase of 4 days in NWC days, largely driven by a longer average DIO cycle, due to supply chain disruptions prompting the accumulation of buffer stock as well as a less efficient supply chain with the second longest DIO cycle. This segment continues to lag behind, with the slowest DSO cycle and the fastest DPO cycle. There remains significant room for improvement across the medium companies with a lot of quick wins to be taken from their regional peers especially around aligning the DSO and DPO cycles to the market averages and placing more focus on inventory planning and management.

By contrast, **smaller companies** managed a slight one-day year-on-year improvement in their working capital efficiency, continuing a positive five-year trend since 2019. Their performance demonstrates that despite their size, smaller companies can achieve sustainable working capital efficiency by focusing on internal controls and optimising systems and processes. The small companies in our study have the second best collection cycle after the very large companies which goes to show that focused efforts can yield significant results.

04 Working capital trends by country

Figure 7: NWC days by country, 2019-23



Saudi Arabia continues to have the longest working capital cycle in the region, despite its slowly improving NWC trend since 2019. In 2023, Saudi companies on average achieved a two-day year-on-year improvement in their DSO, largely due to continued efforts by the government to accelerate cash release and to corporates improving their internal practices.

Between 2022 and 2023, the average DPO of Saudi companies improved by six days, returning to previous levels. However, their average DIO deteriorated year-on-year by six days, representing the longest DIO cycle in the region. Whilst the DPO stretch occurred across a number of key sectors across the Kingdom, primarily in communications, healthcare and retail and consumer, the deterioration in DIO was primarily driven by the engineering and construction sector and more precisely in the building materials sub sector where delays in construction projects and poor planning led to a significant inventory increase year-on-year.

The **UAE** maintained its working capital performance in 2023, following an abrupt correction in 2022 to reverse the general deterioration in companies' working capital management during the pandemic. In 2023, marginal improvements and deterioration across the DSO, DPO and DIO cycles balanced each other, with the average number of NWC days remaining at 83 days, the same figure as in 2022.

We note an increased focus in the UAE market from investors and shareholders (primarily sovereign wealth funds, private equities and family conglomerates) on working capital management and realising value from their balance sheets. These have translated into large scale internal transformations including a large focus on working capital or in working capital financing exercises to reduce the working capital on the balance sheet. Similarly, working capital has become an increasingly important topic across the deals closed recently as a value creation lever for shareholders.

05 Working capital trends by industry

In 2023, 54% of companies across all sectors improved their year-on-year working capital performance. This was only a slightly higher proportion than in 2022 (52%) and previous years, illustrating a key message to emerge from the current study. Many companies in the Middle East are still too focused on one-off tactical working capital improvements such as chasing customers, selling off inventories and delaying payments. Not enough are implementing lasting changes to internal processes which in the longer term will deliver su`stainable efficiencies. It is nonetheless encouraging that the share of companies that record year-on-year working capital improvements is rising incrementally, although too slowly. This modest positive trend suggests that more Middle East companies are beginning to realise that short-term and tactical measures take a lot of effort from employees to increase focus temporarily and also the results disappear very fast when the efforts are stopped or slowed. There is a balance across the sectors when it comes to year-on-year working capital performance changes with seven of the sectors improving performance and the other seven showing a deterioration or stagnation.

It is not surprising to see the **engineering and construction sector** not only having the longest working capital cycle but also the largest year-on-year deterioration. The sector continues to experience a significant level of financial distress due to operational delays and cash shortages exacerbating the said delays. We note that the deterioration is largely driven by a 15% increase in DIO showing the accumulation of stock due to project delays across the value chain with both contractors and building material suppliers. There is also an year-on-year deterioration in DSO of 2% returning to 2021 performance after an improvement in 2022.

The **healthcare sector** continues its year-on-year improvement trend for another year with a notable reduction in the overall working capital cycle. There are improvements across all three cycles, however the most significant is in DPO with a 20% jump year-on-year to 87 days in 2023 (the highest DPO in the last 5 years). This is a significant stretch which could have further ramifications on the suppliers to the regional healthcare sector.

Although we have seen improvements on both DIO and DSO, the DSO still stands at 151 days (second largest across all sectors) and there could be more done here to release cash if the DSO is improved even to the best performance in the last 5 years (143 days), which would in turn allow for the working capital cycle to remain at the 2023 level without such a stretch on its suppliers.

↑ Improvement
↓ Decline
– Stable

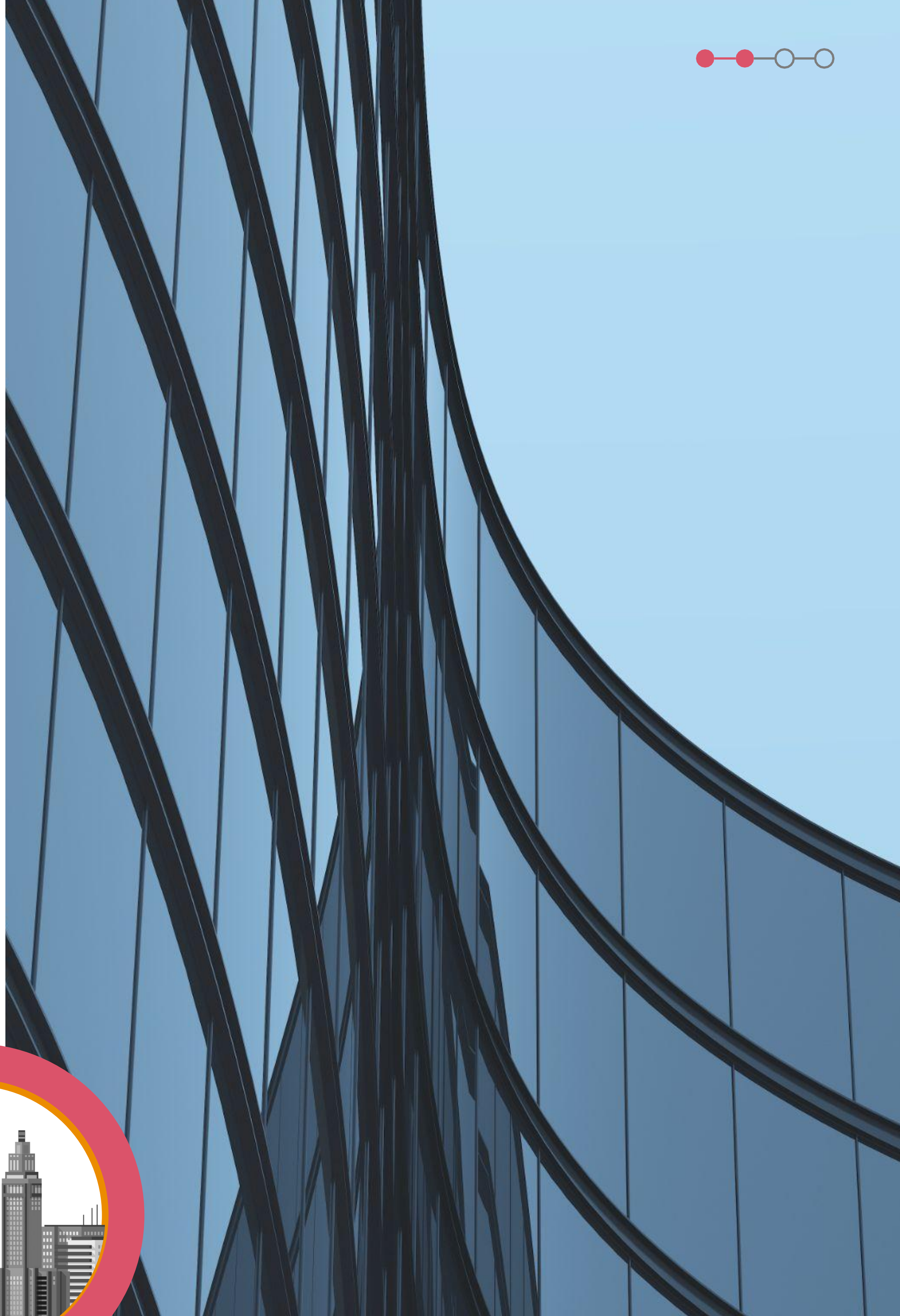
Figure 8: NWC by industry/sector, 2022-23

NWC days	2023	2022	Variance	
Aerospace, defence & security	12.8	9.9	2.9	↓
Chemicals	95.7	93.1	2.6	↓
Communications	-44.1	-21.6	-22.5	↑
Energy, utilities & mining	61.0	56.6	4.4	↓
Engineering & construction	222.3	197.9	24.5	↓
Forest, paper & packaging	110.5	133.4	-22.9	↑
Healthcare	113.0	130.4	-17.4	↑
Hospitality & leisure	11.6	17.2	-5.6	↑
Industrial manufacturing	152.6	158.3	-5.6	↑
Metals	162.0	176.6	-14.5	↑
Pharmaceuticals & life sciences	192.3	190.5	1.7	↓
Retail & consumer	94.3	96.8	-2.5	↑
Technology	115.0	115.1	-0.1	–
Transportation & logistics	39.5	35.9	3.6	↓

The case for implementing sustainable working capital improvements

Many Middle East companies are continuing to improve their working capital efficiency after a general deterioration in their performance during the pandemic. However, there is still too much dependence on short-term actions such as stretching suppliers, targeted collection efforts or liquidating inventories. These measures often do not deliver lasting working capital efficiencies as they do not address the internal process inefficiencies or system limitations that are driving the underlying working capital performance.

The task is increasingly urgent, given the high interest rate environment which is expected to continue for the next three to five years. The high cost of borrowing will ensure that working capital efficiency will remain a priority for shareholders and investors, given that inefficiencies absorb cash that could otherwise be used to fund M&A activity, growth plans, other investments to improve the efficiency of the business or to simply provide returns to shareholders. Effective deployment of capital by Middle East investors and shareholders will be critical to ensure sustainable returns in the coming years.



03

Recommendations **and actions**

Recommendations and actions

In the next 12 months, we recommend that companies need to:

Strengthen working capital analytics

There is an abundance of information available for companies across their end to end value chain and from external sources as well as digital tools to easily analyse and present concise findings to stakeholders. Companies need to increase their analytics and digital capability across the working capital cycles in order to ensure data is leverage for informed and agile decision making across customer behaviours and collections, inventory planning and replenishment as well as payment terms and benchmarks.

Enhance billing and collection processes

Ensure that invoices are raised on time and with a high degree of accuracy is the fundamental step in ensuring that collections are not unnecessarily delayed and reduces efforts on managing disputes. Automated billing and targeted collection approaches based on customer segment and payment behaviour are key to reduce the working capital tied up.

Optimise credit risk management

Although the region is still lagging behind Europe or North America, when it comes to available credit information on customers, this is not an excuse to not focus on credit risk management which not only protects against bad debts but ensures a smoother collection process. Clear policies and systems should be in place to set the credit ratings of customers as well as clear processes and triggers for customers to be reviewed and adjusted accordingly to protect the interest of the company.

Focus on inventory planning and replenishment

Implement a cross functional processes to generate and review demand plans regularly and ensure the replenishment is based on differentiated stock parameters that will tailor for specific demand patterns as well as being based on a mix of historical data and forward looking forecast.

Have a working capital governance structure in place

Last but definitely not least having a governance structure in place which ensure that policies and procedures are documented, roles and responsibilities are clear, KPIs are in place to measure performance and staff are incentivised on working capital performance is paramount to ensure that working capital improvements are sustainable.

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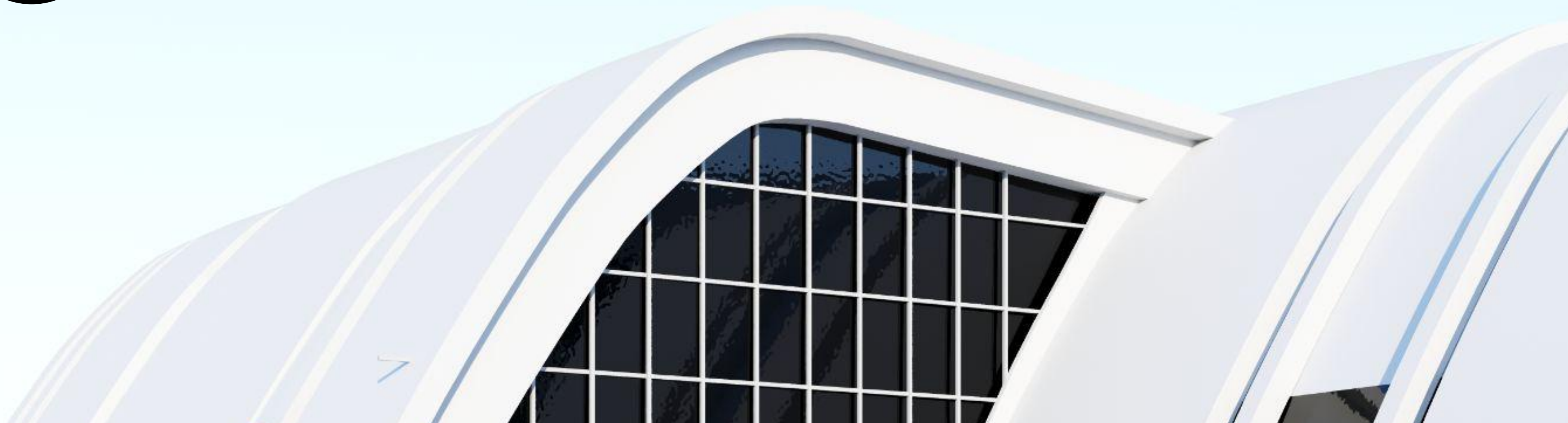

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