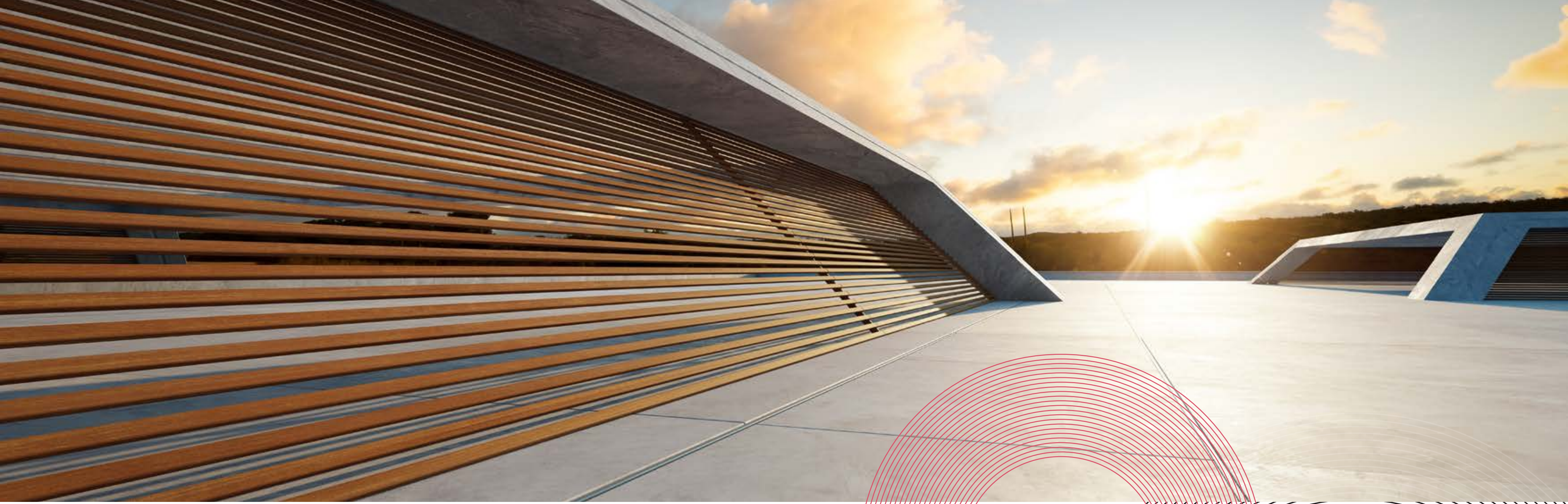

# 2023 Middle East Working Capital Study

## Act now or be left behind:

Middle East companies must ensure a strong working capital performance to scale and navigate a challenging market

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# 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 424 publicly-listed and private companies, covering key working capital trends for a five-year period from 2018 to 2022, using data sourced from Capital IQ and analysed by PwC.

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# Executive summary

Businesses in the Middle East continued their strong bounce back in the wake of the global pandemic, with a robust year-on-year rise of 21% in the top line, in part driven by high oil prices, which peaked at **US$116 per barrel** during 2022. This boosted regional economies, coupled with a resurgence of the non-oil economies spearheaded by the 2030 and 2031 national visions and diversification agendas of the KSA and UAE.

Between 2018 and 2022, we have observed a strong Merger and Acquisition (M&A) activity and an increased number of listings on local exchanges. In fact, by the end of 2022, a total of 632 M&A deals were recorded in the region; more than double the number of 2018. However, global macroeconomic uncertainty that persisted during the first half of 2023 has seen a 40% decrease in M&A activity compared to the same period in 2022, with 186 completed deals in the Middle East, as revealed in our 2023 Transact Middle East mid-year report. High interest rates, concerns about an imminent recession, and inflationary pressures have resulted in an uncertain environment, further heightened by the sharp downturn in oil prices in Q1-2023.

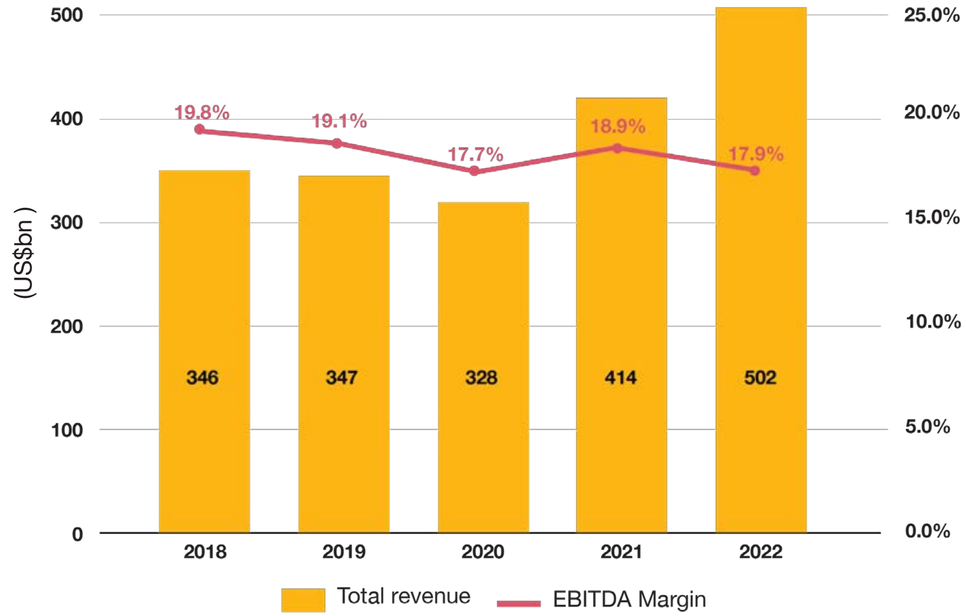


**Figure 1: Revenue and EBITDA trend, 2018-22**

With interest rates rising and profitability under pressure, a robust working capital strategy that places a company in the strongest possible position for transformation, is more important now than ever.

"With macroeconomic uncertainties, including turbulent market conditions, businesses should focus on efficient working capital management that can help them continue to invest towards future growth. Organisations must act now, treating working capital as a strategic pillar, thereby, strengthening their corporate resilience. We expect working capital optimisation to be a key focus area for companies in the next few years as it offers a cost-effective funding source and also supports investments in other strategic priorities like digitisation, and sustainability."

**Mo Farzadi**
Business Restructuring Services Leader

**Based on the latest results, our study highlights some key trends identified across the 424 regional companies analysed:**

## Declining profitability continues to impact businesses in the region

With eyes set on top-line growth and acquisitions, regional companies see yet another year of declining profitability. This continues the negative trend since 2018, deteriorating at a rate of 2.5% per annum, from 19.8% in 2018 to 17.9% in 2022. In 2021, businesses had experienced a post-COVID-19 recovery in profitability.

However, in 2022 the impact of global inflation, geopolitical tensions, continued supply chain disruptions and commodities price volatility have impacted, in particular, the cost of goods sold, which has led to a decline in profitability.

## Increasing interest rates add to working capital management woes

Interest rates have also continued to rise across the Middle East, increasing the cost of financing significantly as well as shining the spotlight, once again, on working capital inefficiencies. Many businesses have taken action, and our analysis shows that 52% of companies in this survey have improved their working capital performance between 2021 and 2022, with only 9% of companies being able to deliver sustainable improvement in Net Working Capital (NWC) days performance for the three consecutive years since 2020.

In 2022, regional companies showed a second year of improvement in NWC days, driven largely by improvement in cash collections, which was offset by a deterioration of inventory holding and a reduction in average days to pay creditors.

## Improvements are visible, but there's room for more

Despite an improvement in working capital performance across the region in the last two years, there remains a significant opportunity to improve the working capital efficiency of the 424 Middle East businesses in our study.

Our findings show that a staggering **US$44bn of excess working capital** is locked on their balance sheets, leading to cost inefficiencies, with the estimated cost of financing alone (at an average rate of 5%) adding up to **US$2.2bn** annually.

## Growing disparity between top and bottom performers

The opportunity stands now at the highest point in 5 years, and when looking at the performance of the companies in the study, it is clear that the gap between top performers (top quartile) and the median continues to widen every year, increasing from 68 days in 2018 to 107 days in 2022. Similarly, the worst performers continue to deteriorate, with their gap to median rising from 2018 to 2022 by 34 days.

Given the turbulent market conditions over the last few years, top-performing corporates are aligning their working capital practices with their refreshed strategy and operating model, treating working capital as a strategic pillar and strengthening their performance and corporate resilience.

If you haven't already started, 'now' is the time to act and revisit your working capital strategy, policies and procedures before the gap between top performers and the rest of the pack increases even further.

# Key findings

**US$44bn** excess working capital on corporate balance sheets

**5pp** decline in EBITDA to operating cash flows conversion in 2022 alone

**5%** improvement in working capital since 2020

**~9%** increase in gap between bottom and top quartile widening every year for the last 5 years

**~2.5%** yearly decline in EBITDA margin since 2018

**15%** CAGR for short-term debt since 2018

## Working capital trends

Based on our analysis of summarising data from 424 private and publicly-listed companies, we highlight key trends in working capital performance and liquidity.

We also deep-dive into the trends across working capital cycles, represented by Days Sales Outstanding (DSO), Days Inventory Outstanding (DIO) and Days Payable Outstanding (DPO), company sizes (small, medium, large, and very large), countries in our region (GCC, Egypt, and Jordan), and industry (including but not limited to healthcare, pharmaceutical and life sciences, industrial manufacturing, and retail and consumer).

## 01 Working capital performance trends

The working capital performance, measured as net working capital days, has improved since the COVID-19 pandemic from 118 days in 2020 to 112 days in 2022. However, regional businesses still have more to do before reaching the pre-pandemic performance of 108 days in 2018.

If companies close the gap to the 2018 performance, this would release approximately $5.6bn of liquidity, enabling them to fund their expansions or turnarounds, reduce the cost of financing, or provide further returns to shareholders.

The performance improvement from 2020 to 2021 has been largely driven by an extension of the average creditor days (DPO). As highlighted in our previous studies, extending creditor days is typically the easiest way for corporations to improve their working capital position, but it comes with operational risks and potential cost increases.

In 2022, we can see DPO reducing by one day, and a focus on cash collections drives the overall working capital performance improvement. Furthermore, the inventory performance of regional companies has deteriorated as a result of global supply chain disruptions and an attempt by companies to focus on the purchasing costs to combat rising inflation and price volatility by purchasing larger quantities to keep sourcing costs under control.

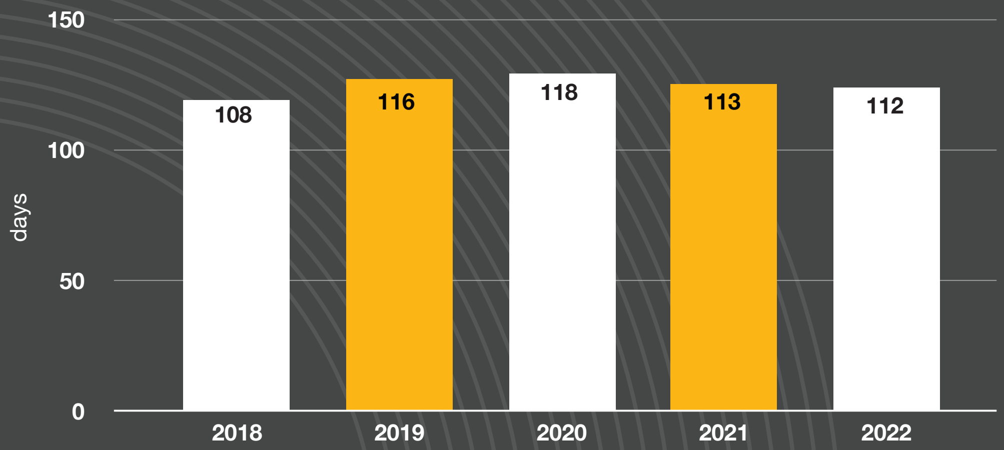


**Figure 2: NWC days trend, 2018-22**

Despite working capital performance improving over the last two years, Middle East businesses have seen short-term debt increasing by 15% over the same period - suggesting that companies are increasing their reliance on short-term working capital financing in spite of the increasing interest rates. If companies look at releasing working capital from operations through performance improvement, not only could the financing costs be eliminated for the cash released, but treasurers could use the cash to generate returns by investing it in fixed term deposits or other alternatives.

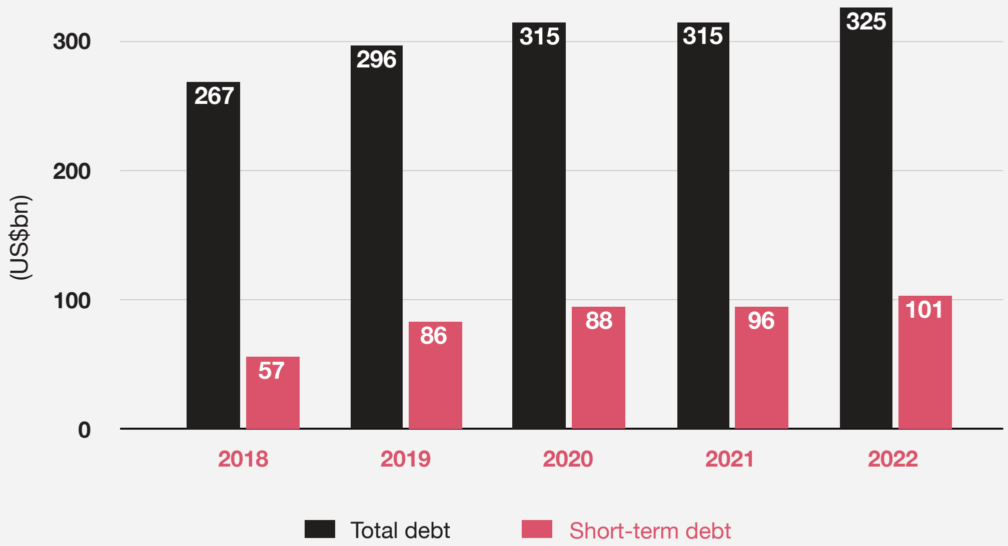


**Figure 3: Short & long-term debt trend, 2018-22**

# 02
# Liquidity trends

## 02 Liquidity trends

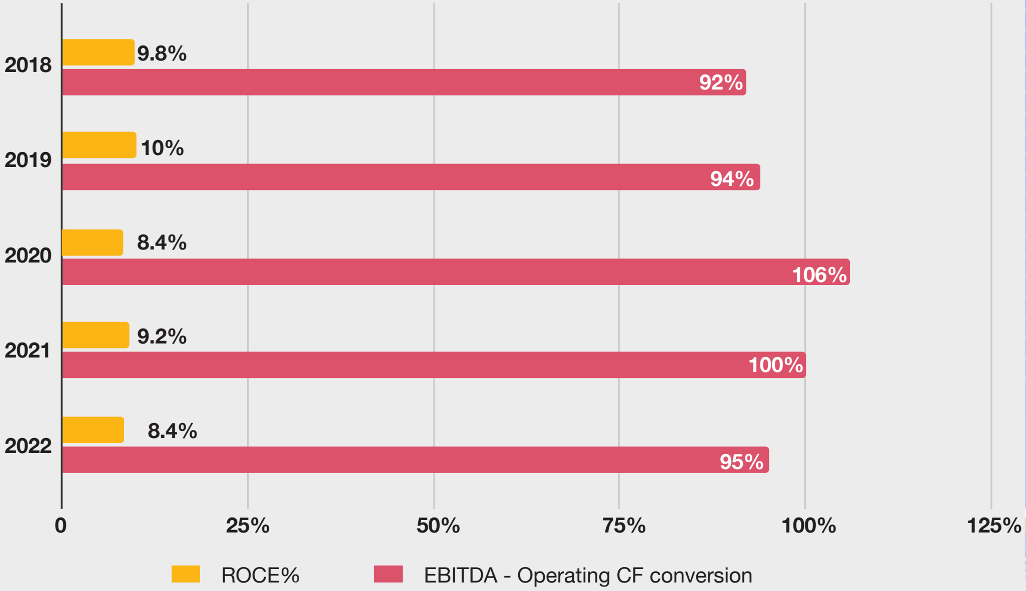


**Figure 4: ROCE and EBITDA - Operating CF conversion, 2018-22**

With eyes set on top-line growth, companies in the region witnessed yet another year of decline in EBITDA margins, reaching 17.9% in 2022 from 18.9% in 2021. Consequently, the region continues to experience a long-term deterioration in EBITDA margins, with a compound annual decline of 2.5% since 2018.

This deterioration, combined with an increase in the capital employed, means that shareholders have continued to receive a lower return on capital employed (ROCE), which in 2022, was on average 8.4%. The ROCE experienced a compound annual decline rate of 4% since 2018, despite an isolated rebound in 2021, primarily driven by the recovery of profitability post the COVID pandemic.

Liquidity generated from operations has also reduced as the long-term declining EBITDA trend is further impacted by a declining conversion of EBITDA to operating cash flow, which has dropped from 105.9% in 2020 to 94.8% in 2022. The reduction in operating cash flows over the last year, coupled with a 3% increase in the total debt between 2021 and 2022, suggests that companies are looking for alternative sources of cash to fund their needs and plans.

# 03

# Working capital trends by cycle

## 03 Working capital trends by cycle

The working capital performance improvement of companies in our study has been driven by a reduction in DSO, a measure of how long companies take to collect cash from customers. The DIO and DPO, which represent the average inventory time and average time to pay creditors respectively, have deteriorated in 2022.

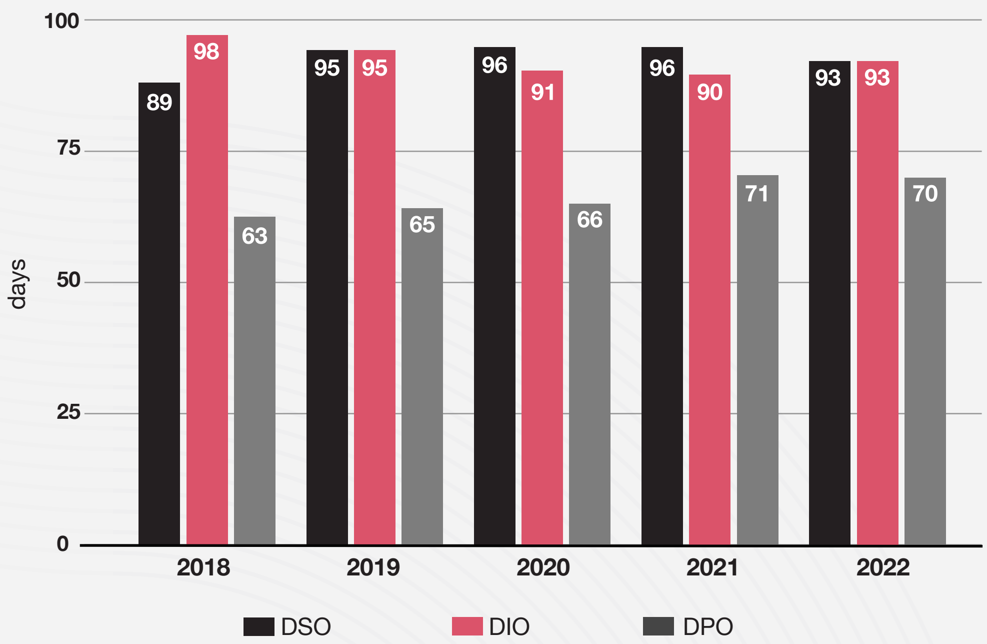


**Figure 5: Working capital performance indicators trends, 2018-22**

One of the key drivers for the improvement in DSO during 2022 is the increased focus from corporates on tactical cash collections management, which albeit a short-term solution, usually yields results. The focus on collections has also been from a regional Government perspective, looking for ways to improve the business ecosystem and expedite payments, a good example being the Etimad portal in KSA.

Finally, the financing part of receivables has increased in popularity, with receivables portfolio sales and factoring arrangements being pursued by more mature companies to lower their working capital requirements. This is supported by the fact that large companies (over US$2bn revenue) had the largest improvement in year-on-year collections compared to small companies (below US$100m revenue) that showed a significant deterioration in their average collections performance.

During 2022, inventory performance has deteriorated by three days to 93 days at the end of 2022. Several disruptive events during 2022 have impacted global supply chains, starting with geopolitical tensions, logistics disruptions, production delays, commodities' price volatility, and global inflation.

We have seen from interactions with our clients across the region that the deterioration has been mainly driven by increased safety stocks to protect top line, bulk purchases aimed at lowering purchase costs and attempting to hedge against price volatility in the sectors where commodities are involved.

However, we are now seeing signs that companies across the Middle East are increasingly focused on strengthening their supply chain resilience and investing in technology to help manage inventories, forecast demand and manage their stock mix. The average days to pay creditors (DPO) was reduced by one day in 2022, from 71 to 70 days, which remains relatively high. The silver lining, however, is a reversing trend for the first time in the last five years.

This reduction is driven by both large and very large businesses (with annual revenue over US$500m), while at the other end, medium and small companies (with annual revenue under US$500m) have stretched their creditor days for another year.

The gap in DPO between small and very large companies has narrowed to only two days in 2022. Nevertheless, practices differ entirely with very large companies using dynamic discounting to improve profitability or supply chain finance programmes to extend credit days as well as well defined payment run strategies. On the other hand, smaller companies are often forced to stretch their creditors past the agreed terms in order to manage their day to day liquidity.

# 04
# Working capital trends by company size

## 04 Working capital trends by company size

The results of this year's study show a similar trend to previous years, where very large companies have a working capital cycle that turns cash over two times faster compared to their small and medium peers.

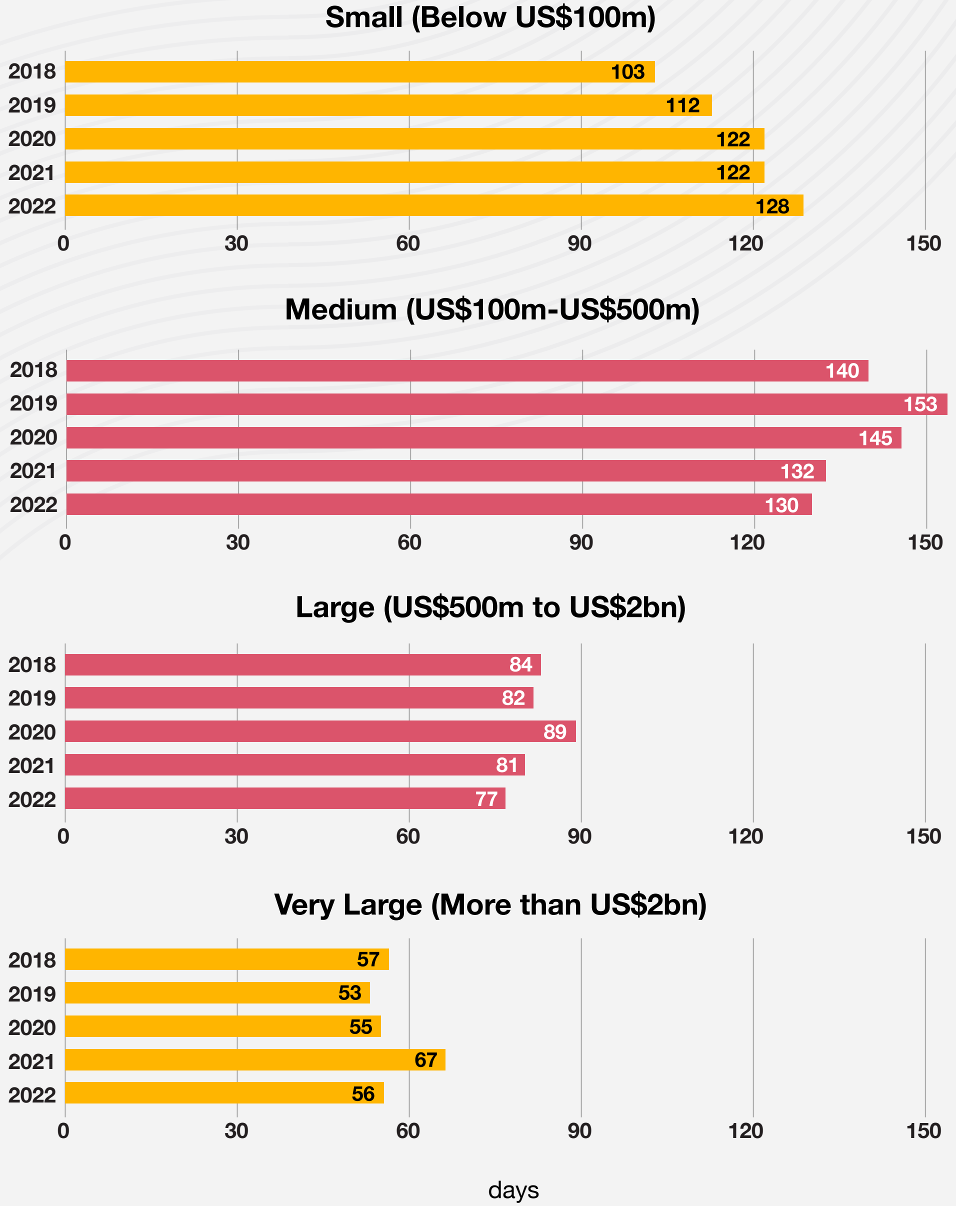


**Figure 6: NWC days by company size, 2018-22**

Smaller companies have been the only ones to experience a deteriorating working capital performance in 2022 despite a substantial increase in their DPO. These companies struggle to collect cash from customers, with their performance significantly deteriorating by 9% in 2022 alone. Inventory management remains challenging with a 5% deterioration from last year, bringing the position to the worst in five years.

A company's size does impact the strength of commercial negotiations around terms and other contractual obligations. That said, irrespective of their size, companies have sufficient levers at their disposal to improve internal efficiencies, tighten controls, as well as look at technology solutions that can be tailored to companies of all sizes, providing affordable platforms to digitise processes as well as offering good data availability for enhanced decision making.

Small and medium companies have also seen their inventory management performance deteriorate with the average number of inventory days going up 5% and 7%, respectively, in 2022 alone. Inventory management remains the most complex element of working capital performance, and coupled with the increasing complexities and uncertainties that globally connected supply chains bring as well as the lower maturity of supply chains for smaller companies in the region, not only results in larger amounts of cash tied up in inventory but comes with significant stock imbalances leading to impacts on the top-line through lost sales. Our study has revealed that small companies had a 2% compounded annual growth in revenue over the last five years versus 11% for very large ones.

# 05

## Working capital trends by country

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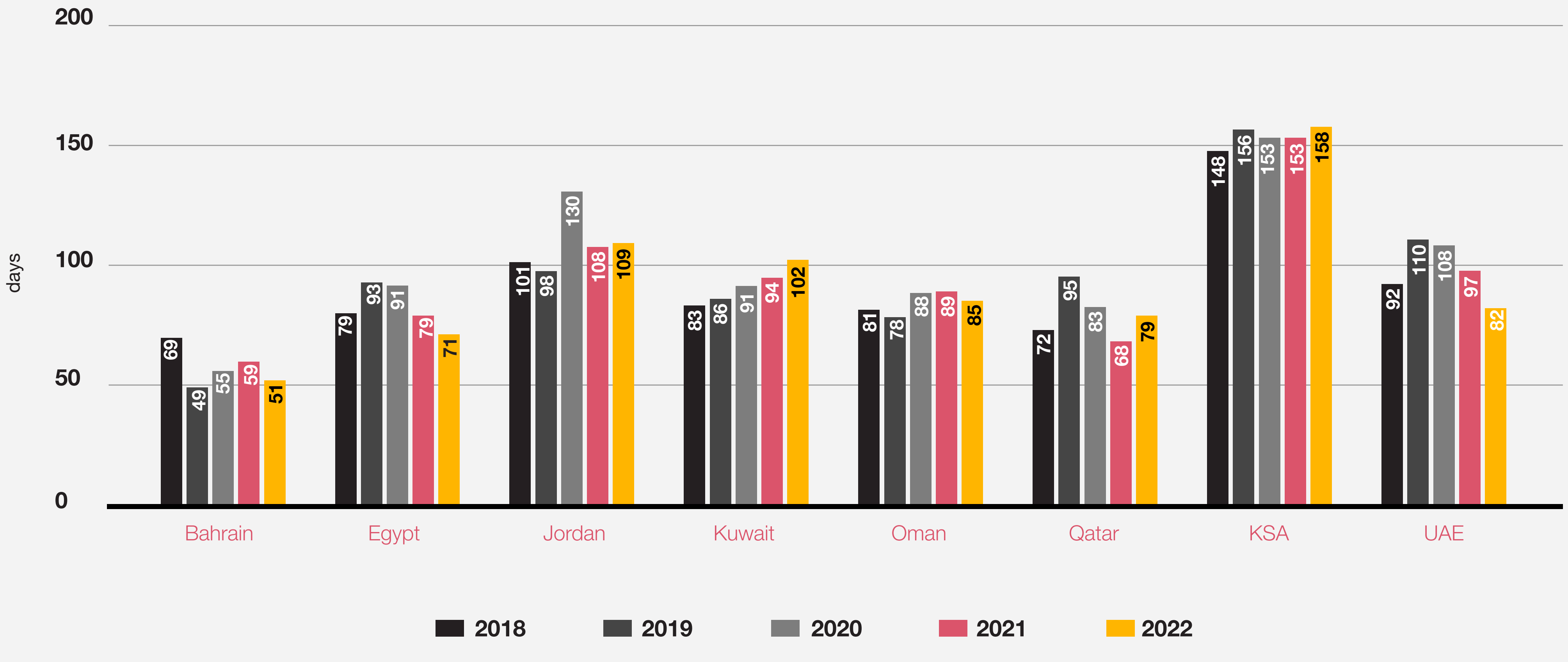


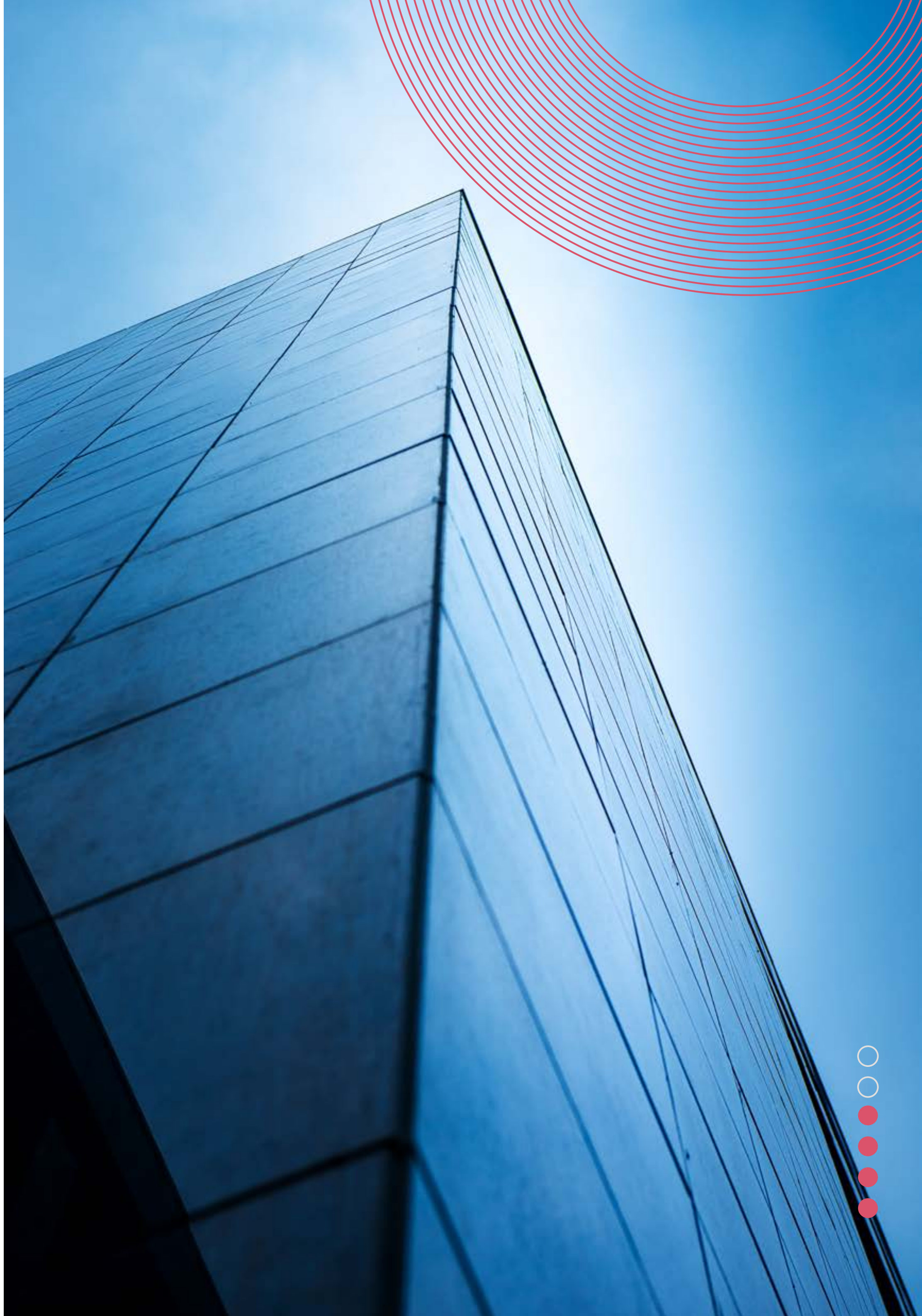

**Figure 7: NWC days by country, 2018-22**

Only three countries across the Middle East, namely KSA, Kuwait and Qatar, have experienced a deterioration in working capital performance during 2022. The performance at country-level across the Middle East continues to show a significant variation from companies in KSA, operating with an average cycle of 158 days in 2022, to companies in Bahrain where the working capital cycle averages 51 days only.

KSA retains its position of having the largest working cycle capital cycle across the region despite recording  a 3% deterioration in 2022, its lowest performance in the last five years. While the collection cycle has remained stable with a DSO of 100 days, the average time companies hold inventory across the Kingdom has deteriorated, and the time to pay suppliers has contracted by one day. Businesses in KSA have the longest inventory cycle across the region with an average of 122 days in 2022, which leaves significant room for improvement across the supply chain.

Companies in the UAE continue their improvement trend, which started in 2019, reducing net working capital days by approximately 9% each year until 2022. A large part of this improvement is driven by extension of the creditor days, which in 2022 are the second largest in the region with an average of 86 days (only two days behind Egypt). Considering that UAE imports are significant and are typically undertaken on guarantees, advance terms or cash against documents, this only suggests a larger average creditor cycle for the rest of the trade creditors and, in turn, stretches their cash flows.

Furthermore, UAE companies have significantly improved their collection cycle over the last three years. We have seen an increased focus on both credit risk management and targeted programmes to improve collections, as well as an increase in the receivables factoring in the years preceding the COVID-19 pandemic.



# 06 Working capital trends by industry

## 06 Working capital trends by industry

Following the same trend from previous studies, this year a total of 52% of the companies in our sample have improved their working capital performance. This highlights that regardless of size or sector, a clear focus on internal processes, policies, systems and people can yield significant benefits.

| | 2021 | 2022 | Variance | |
|---|---|---|---|---|
| Aerospace, defence & security | 55.5 | 43.1 | 12.5- | ↓ |
| Automotive | 35.5 | 28.0 | 7.6- | ↓ |
| Chemicals | 92.3 | 86.6 | 5.7- | ↓ |
| Communications | 5.2 | 3.0- | 5.4- | ↓ |
| Energy, utilities & mining | 51.6 | 45.4 | 6.2- | ↓ |
| Engineering & construction | 218.7 | 209.5 | 9.2- | ↓ |
| Forest, paper & packaging | 114.3 | 133.4 | 19.1 | ↑ |
| Healthcare | 136.9 | 129.9 | 7.0- | ↓ |
| Hospitality & leisure | 23.3 | 27.4 | 4.1 | ↑ |
| Industrial manufacturing | 171.8 | 180.9 | 9.1 | ↑ |
| Metals | 167.5 | 199.4 | 31.9 | ↑ |
| Pharmaceuticals & life sciences | 201.4 | 198.1 | 3.2- | ↓ |
| Retail & consumer | 86.3 | 86.0 | 0.3- | — |
| Technology | 173.3 | 161.8 | 12.0- | ↓ |
| Transporation & logistics | 64.9 | 59.7 | 5.2- | ↓ |

* ↓ Improvement

* ↑ Deterioration

* — Consistent

Most sectors across the Middle East have shown signs of improvement in working capital performance with a selected group of top-performing companies in each sector leading the charge.

**The pharmaceutical and life sciences** sector improved their working capital performance in 2022, driven by accelerated cash collection. This has been seen mainly in KSA, which benefits from the Etimad platform, faster invoice approval and collection from government institutions, and a focus on tactical collections from many players in the sector driven by a need to reduce the funding cost.

The inventory holding time has also improved across the region. However, there is much more to be done, as the inventory holding time is the second largest after construction and engineering.

On the other hand, **the industrial manufacturing sector** has seen a deterioration in working capital performance in 2022, driven solely by a nearly 10% increase in average inventory holding time.

Given the extended supply chains for manufacturing businesses and the disruptions experienced, the increase does not come as a surprise. However, the extent of deterioration suggests that many companies in the sector did not act to implement measures in order to reduce or control the impact.

**The retail and consumer sector** has also seen a deterioration in average inventory holding days, primarily driven by changing demand patterns (i.e. customer buying behaviours), coupled with the rigid planning and forecasting processes in place with many companies. Despite this, we see a significant shift from companies in this sector in 2023 as they strive to improve their inventory management and demand planning capabilities.

## Act now

Ongoing geopolitical events and the steady rise in the cost of financing across the region have shown a bright spotlight on how costly working capital inefficiencies are becoming for shareholders.

Our study highlights that although companies in the Middle East have been improving their working capital performance over the last two years, it is primarily driven by the top-performing corporates that are increasing their gap to the medium and bottom quartiles.

The top-performing corporates have embedded a cash culture across their organisations and have working capital as a key strategic pillar, meaning that working capital practices are aligned to the strategy and operating model, increasing the business resilience by optimising the amount of cash required to run day to day operations and increasing their agility.

During 2023, the interest rates continued their growth to combat inflation and although we see an increasing number of companies attempting to improve working capital, there is far more that can be done to ease the burden for shareholders and accelerate cash generation.

**The time to act is now, and in our experience working with all types of businesses across the region, the top four areas of focus for the coming 12 months should be:**

**01 Working capital metrics and reporting** is a key aspect of working capital management which many regional corporates do not have. This is imperative for understanding their current position as well as tracking improvement over time.

**02 Inventory management and demand planning** are crucial to optimising the cash tied up in stocks and ensuring supply chain resilience. Companies should focus on segmenting their supply chain, applying differentiated strategies and parameters and making use of the available technology to support demand planning, statistical parameters and process automation.

**03 Cash collections and dispute management** are key areas to improve payment delinquency. Clearly understanding the root cause of disputes and targeting to eliminate them, along with a proactive and differentiated approach based on the payment behaviour profile, will allow companies to unlock cash from their debtor days.

**04 Payment term standardisation** for both customers and suppliers is an exercise that should reduce the complexity in the system, lower the risk of errors and allow businesses to move their extended supply chain towards preferred terms as much as possible. Companies must benchmark themselves and seek to optimise their position during the standardisation exercise.

## Contact us

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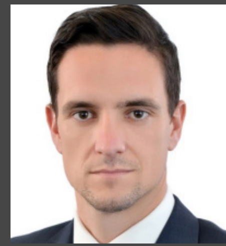

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Established in the Middle East for 40 years, PwC has 24 offices across 12 countries in the region with around 8,000 people. (www.pwc.com/me).