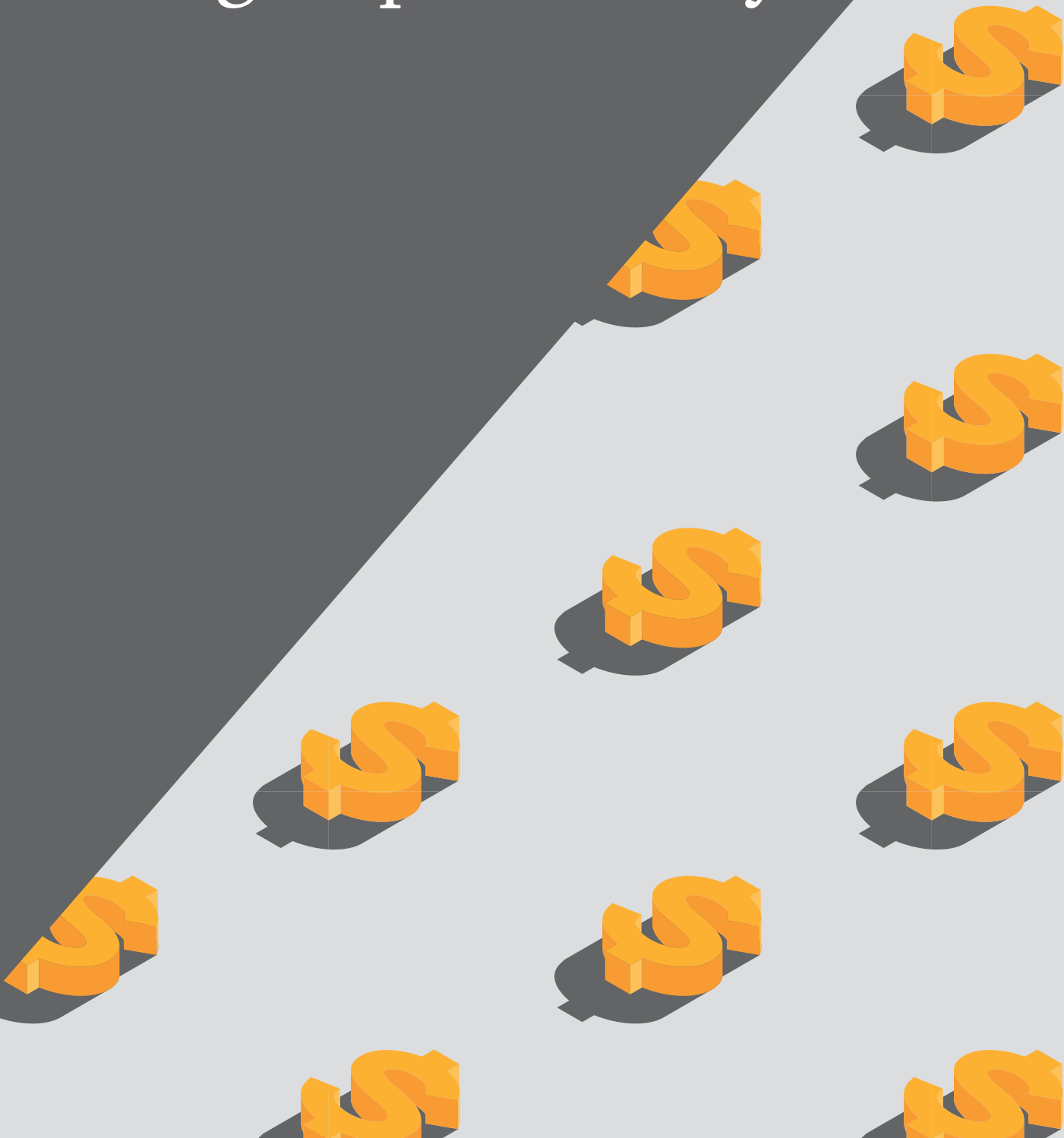


2020 Middle East Working Capital Study



Act Now To Recover

#ActNowToRecover
www.pwc.com/me/working-capital-2020





About the study

Every year we review the financial performance of publicly listed companies in the Middle East to assess their working capital performance and related key indicators. This year's review included 433 publicly listed companies and covered five-years key working capital metric trends (2015 - 2019). We have also looked at the data for the first and second quarters of 2020 to assess the impact of the dual shock of the COVID-19 pandemic and oil market disruptions on working capital and liquidity.





AED 134bn

excess working capital is trapped on the balance sheets of the Middle East companies in our survey

Executive Summary

The combined shock of the COVID-19 pandemic and the steep fall in oil prices have fundamentally changed the business environment this year in the Middle East. Companies have seen reduced cash flows, forcing working capital front-and-center in the mind of executives. The three main drivers impacting cash flow include:

- Reduced consumer demand, leading to a downturn in corporate revenues
- Slowing accounts receivable payments as customers delay payments due to their own falling revenues
- Increased expenses to respond to remote working requirements and supply chain disruptions

These cash flow issues have been further compounded in the Gulf by significantly lower oil prices causing a significant decline in government and state-owned enterprise revenues. This, in turn, has led to payment delays to private sector suppliers. Non-oil exporting countries in the region also witnessed a delay of remittances, further impacting consumer spending.

These extraordinarily challenging market conditions struck when companies already had less cash on hand due to declining

profitability trends since 2016 with an 11% drop year over-year for 2018 to 2019. PwC Middle East's Working Capital Study suggests that as much as \$36.5bn (AED 134bn)¹ of excess working capital is currently trapped on the balance sheets of the Middle East companies in our survey. This could be released through companies improving their working capital performance to the median level in their sector. The study also underscores the urgency of accessing this working capital to increase liquidity as companies emerge from lockdowns and restart operations.

The challenge for companies across the region in the coming months is how to strengthen working capital management from a weak starting position. At the end of 2019, the average time to turn cash was 127.6 days, the lowest performance in five years, with a further deterioration in the first half of 2020 as the pandemic measures were introduced. This slide occurred while the average days payable outstanding (DPO) for payments to creditors more than doubled between the year end 2019 and first half 2020, from 65 to 139 days.

The surveyed companies also reported an average 20% rise in net debt between 2018 and 2019, producing an average net debt-

1. converted at Nov 2 rate (rounded up) on Morningstar of 1 AED = \$0.27

to-EBITDA ratio of 2.6 for the region. This was the highest ratio in the past five years, increasing the pressure on net cash flows as the companies' ability to generate free cash flow from pre-tax earnings is decreasing.

As local economies emerge from the initial lockdown periods, the road to full recovery is unlikely to be a smooth one and corporates need to be in good shape to fare well on this journey. Economic conditions will most likely remain challenging for the immediate future, therefore the focus on liquidity, including the task of optimising working capital has never been more critical.

Key insights include:

62%

of total cash on hand at the end of 2019 was held by only 2% of the surveyed companies



23%

deterioration in the average working capital performance of surveyed companies was observed in the first half of 2020



8.5%

of the surveyed companies have sustained three consecutive years of improved working capital performance



40

is the average days of cash that is available for operational and interest expenses held by 423 of the 433 surveyed companies



4 p.p.

fall over a 5 year period in the average earnings before interest, tax, depreciation and amortisation (EBITDA) margins





Working capital trends

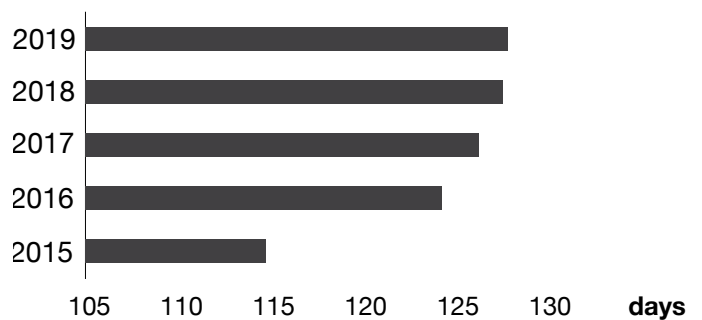
Average working capital efficiency in the Middle East deteriorated slightly between the end of 2018 and 2019 to 127.6 days, the lowest performance in the past five years. Net Working Capital (NWC) days deteriorated between 2015 and 2019 by a compounded rate of 2.7%, corresponding to around \$9.94bn (AED 36.5bn)² of additional cash tied up in operations by listed companies across the region.

In the first half of 2020 the average working capital performance deteriorated further during COVID-19 lockdowns to 156.7 days, as weaker credit policy controls slowed the rate of collections and shifting demand patterns coupled with rigid supply chain processes led to inventory build up. This increase in working capital days was a key early indication of reduced liquidity due to the pandemic, and delayed or cancelled payments by companies seeking to protect their balance sheet.

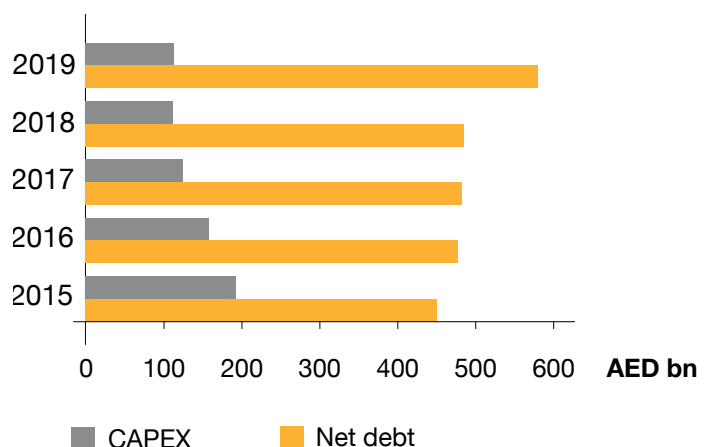
Net debt levels increased on average by 20% between 2018 and 2019, while capital expenditure (CAPEX) remained stable. However, CAPEX by listed Middle East companies has decreased by an average of 41% over the last 5 years, and dividend payouts stagnated last year, suggesting that debt has been widely used to fund other investments or to support inefficient operations. In May 2020, PwC's CFO Pulse Survey for the Middle East found that 67% of

respondents were planning to defer or cancel proposed investments in 2020, and that 91% of respondents identified CAPEX and facilities as the principal targets for budget cuts. This approach, however, risks starving the company of necessary investments, which have the potential to improve operational efficiency.

NWC days over a 5 year period



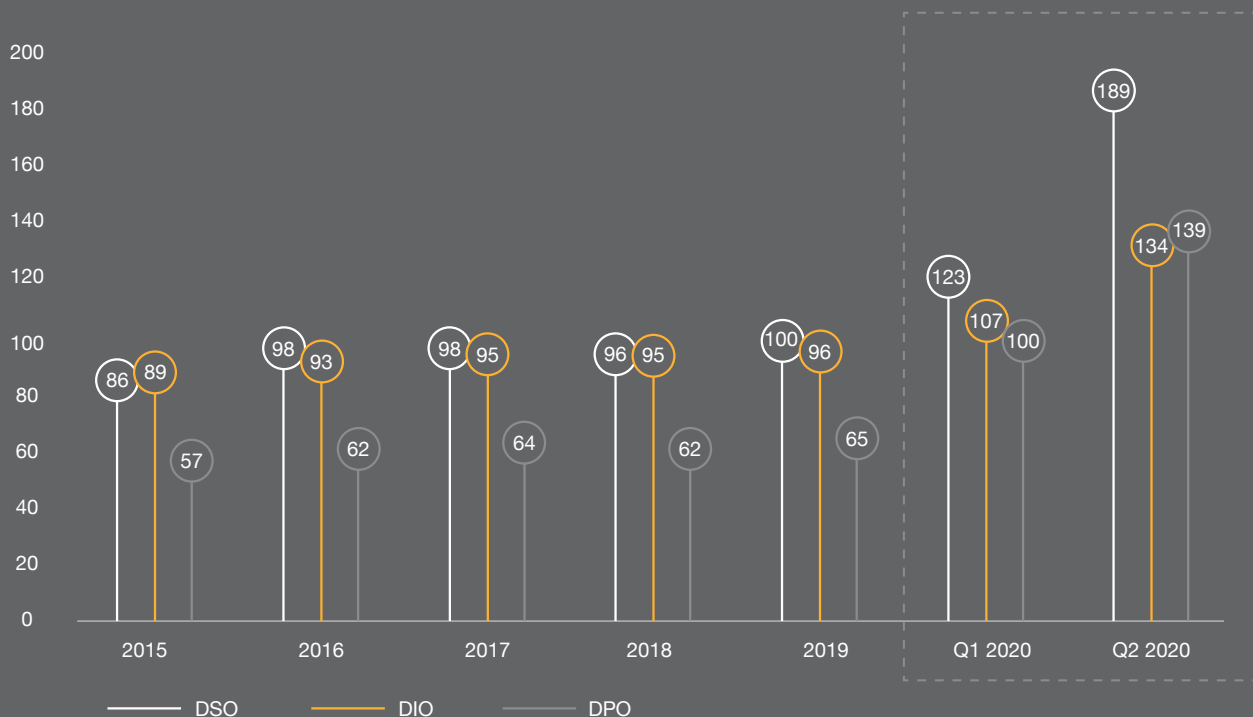
CAPEX and Net Debt over a 5 year period



2. converted at Nov 2 rate (rounded up) on Morningstar of 1 AED = \$0.27

Working capital trends by cycle

Figure 1: DSO, DIO and DPO trends



Customer collections performance deteriorated again in 2019, rising 3.8% to an average 100 Days Sales Outstanding (DSO) (See Figure 1), as companies struggled to enforce their credit policies. Too often, companies in the region associate improvement in collections with having to chase customers for money, instead of addressing the root causes for late payments and adopting a more targeted approach.

DSO performance deteriorated further in the first three months of 2020 to 123 days, as COVID-19 reached the Middle East and companies began to slow down and stop payments in order to conserve cash. By the end of June 2020, the sharp reduction in economic activity caused by national lockdowns had pushed the average DSO up to 189 days.

Meanwhile, the average time that Middle East companies took to pay bills and invoices rose sharply from 65 Days Payable Outstanding (DPO) at the end of 2019 to 100 by the end of March 2020, following four years when the average DPO was stable.

At the end of the second quarter, the average DPO had reached 139 days, demonstrating

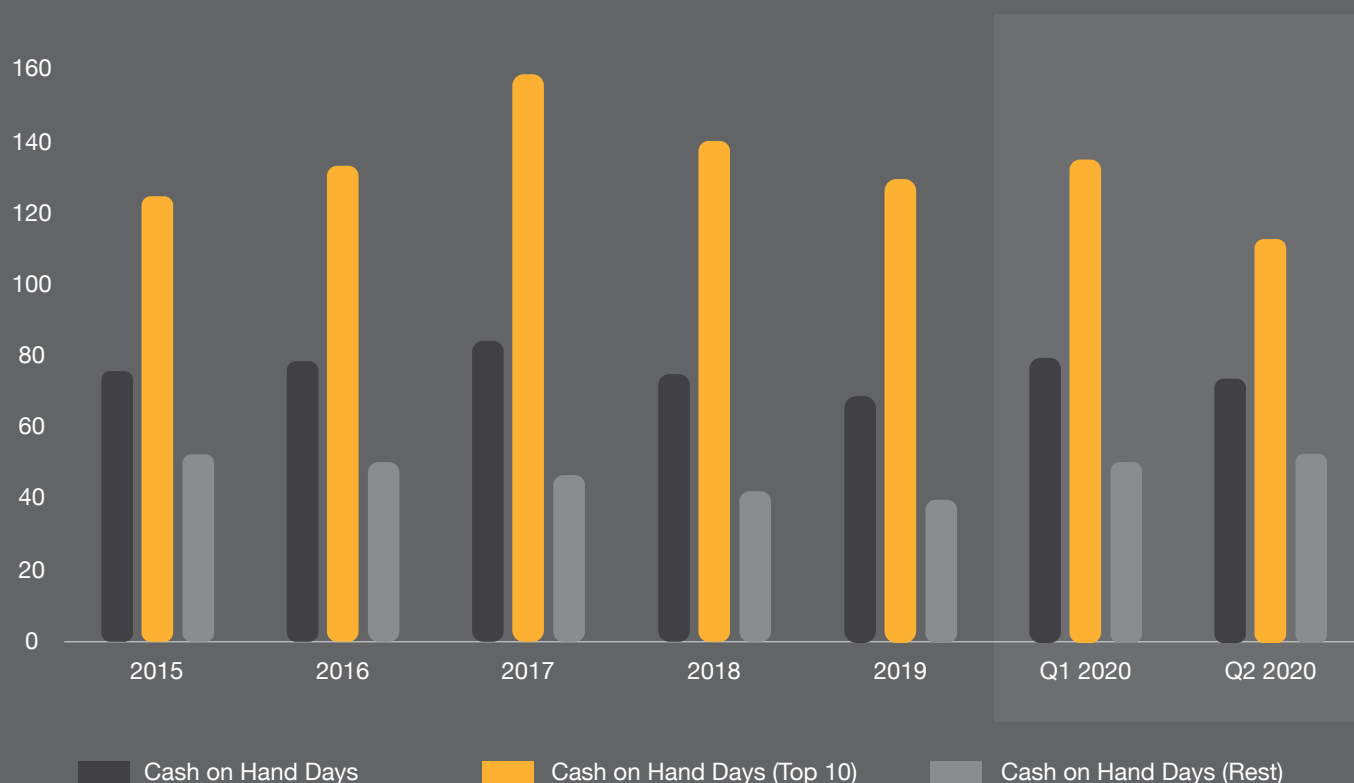
that stopping or deferring payments was again used by companies as the easiest way to preserve liquidity during the COVID-19 crisis, in the absence of more robust processes to manage working capital.

The average time that companies held goods remained unchanged at around 95 Days Inventory Outstanding (DIO) between 2016 and 2019, indicating that better supply chain management remains an untapped opportunity for Middle East businesses. The challenge is complex, because operational processes, changing demand patterns and extended supply chains must be addressed at the same time. COVID-19 severely impacted all three areas, with average DIO rising to 107 days by the end of March 2020, and 134 days by the end of June 2020.

Metals, Industrial Manufacturing and Retail & Consumer were the main sectors driving this deterioration. Revealingly, the inventory coverage ratio (the financial coverage for goods in stock) for the Retail & Consumer sector increased 24% during the first half of 2020, driven by products such as fashion and electronics where the increase was significantly higher as consumers curbed their discretionary spending.

Liquidity coverage

Figure 2: Cash On Hand Days trends



At the start of 2020, most companies around the world had no contingency plans that could possibly have predicted the impact of the pandemic on their operations. For Middle East companies, the COVID-19 crisis was compounded by the steep fall in oil prices between January and May 2020. Nevertheless, companies in the region with relatively strong balance sheets and good liquidity positions fared better than their peers during these turbulent months.

We have calculated the liquidity coverage on balance sheets as the cash on hand (COH) days, meaning cash and cash equivalents coverage based on total operating and interest expenses. Average COH fell from 76 to 70 days between 2018 and 2019 (See Figure 2).

While around two months' coverage might be a relatively safe level for most corporates, this figure needs to be set in context. It is

clear from our survey that liquidity is unevenly distributed across the region, with only 10 companies holding 62% of total COH. Once these companies are eliminated, average COH days drop to 40 days at the end of 2019 for the remaining 423 companies in our study.

During the first quarter of 2020, average COH for the total survey sample rose to 80 days, amid the global disruption triggered by the pandemic. In the second quarter, as lockdowns came into force, there was a significant drive by Middle East companies across all sectors to reduce operating expenses and cut costs. In addition, many businesses chose not to spend their cash reserves, resorting instead to external financing from existing or new lines. Overall, average COH fell slightly to 74 days in the second quarter, mainly driven by the top 10 companies holding around two-thirds of total cash.

NWC development by company size

Figure 3: Cash On Hand Days trends



The average number of Net Working Capital (NWC) days outstanding for very large companies in the survey more than doubled from 22 days to 49 days between 2015 and 2019, with the sharpest rise between 2018 and 2019 (See Figure 3). This declining performance was mostly due to a 5.5% annual compounded fall between 2015 and 2019 in the average Days Payable Outstanding (DPO) as payment patterns normalised for very large companies to aid local economies.

Small, medium and large companies have also experienced a deterioration in NWC days since 2015, driven mainly by their ability to convert revenues into cash as well as by inventory build-ups. Indeed, very large corporates are still able to turn over cash two to three times more rapidly than their smaller peers, despite the operational levers available to all companies, regardless of their size, to improve performance, and the increasing use of working capital financing products in the Middle East.

These financial instruments can benefit both the buyer and the seller by enabling smaller companies to access their cash more rapidly, using the larger buyer's credit rating to secure more attractive financing rates; meanwhile, the buyer can extend payment terms to pay towards the lender.

It is true that a company's size can increase its negotiating power when seeking to reduce NWC days. Yet very large companies also have a markedly better inventory holding record than the rest of the survey, indicating that operational improvements account for a significant part of their superior performance. Surprisingly, the increase in the use of working capital financing products, especially in the last 12 to 24 months, has not yet led to any noticeable impact on the DSO performance; we have only seen a 5% year-on-year improvement in the DSO performance of large companies.

NWC performance in the first half of 2020, when COVID-19 triggered national lockdowns, was clearly linked to the size of the company. Very large corporates immediately stopped or slowed down payments in order to compensate for delays in debt collections caused by the pandemic. They were also the only category that recorded a slight improvement (2%) in DIO performance. Large corporates used the same approach and on average stretched payables to more than 140 days to cover both inventory build-ups and slower debt collection. Similar attempts to delay payments to suppliers were made by many small and medium-size companies, but their average working capital performance still deteriorated by 39% and 18% respectively in the first half of 2020.



NWC development by country of origin

Figure 4: NWC days by country of origin





Last year, Saudi Arabia's working capital performance improved significantly for the first time since 2015, falling from 171 NWC days in 2018 to 161 at the end of last year (See Figure 4). Nonetheless, Saudi Arabia remained the lowest performer amongst its Middle East neighbours, with the shortest DPO cycle and the highest DIO performance. More importantly, Saudi Arabia's improved NWC track record in 2019 came from small improvements across inventory, receivables and payables, indicating greater emphasis by corporates on good working capital management and more policy focus on these issues by local government.

In the UAE and Qatar, NWC days have been deteriorating since 2015, with a compound annual rise of 12% and 17% respectively. Listed Qatari companies have suffered in particular from deteriorating figures for inventory and receivables, recording compound annual deterioration since 2015 of 7% and 5% respectively. As a result, Qatar's average NWC days have almost doubled from 58 days in 2015 to 110 days in 2019 – the equivalent of around \$3.65bn (AED 13.4bn)³ of additional cash tied up in operational working capital over the past five years.

In the UAE, many companies masked a continuous deterioration in receivables

and inventory performance by successfully extending their payables cycle. Payables were stretched by companies across many Middle East countries even during the first quarter of 2020, in anticipation of the potential COVID-19 liquidity crunch to follow. In the second quarter, the impact of reduced collections and increased inventories became visible in every country, with deteriorations ranging from 1% to 72% for inventory and 17% to 107% for receivables during the first half of 2020.

These significant variations were masked in the NWC days performance figures for some countries by the sharp increase in the average length of stretches in payables during the first half of 2020. Overall, the average DPO for all Middle East countries increased by up to 172% between the end of 2019 and the end of the first half of 2020. This explains why some Middle East countries such as the UAE and Egypt showed an improved net working capital performance in the second quarter, compared with the end of 2019.

However, the cost to restart operations will be far greater in countries where the suppliers have been stretched so far, given that the outstanding balances will have to be normalised in order for the supply chain to operate and return to its planned capacity.

3. converted at Nov 2 rate (rounded up) on Morningstar of 1 AED = \$0.27



NWC development by industry

Overall, 51.5% of companies in this year's study ended 2019 with a year-on-year improvement in working capital performance measured by NWC days (See Figure 5). In total, twelve sectors had a broadly balanced year in terms of working capital improvement or deterioration, with the split ranging from around 50:50 for "Improvement" and "No Improvement" to around 60:40. Encouragingly, sectors including Engineering & Construction, Retail & Consumer and Healthcare have

improved performance in the last year becoming more balanced where in previous years have been struggling.

The industry data shows that regardless of size and sector, working capital improvements are within a company's grasp. Despite external competitive and economic challenges, companies with the right focus and drive at the top can use operational levers to improve working capital management.

Industries 2018 and 2019 NWC days

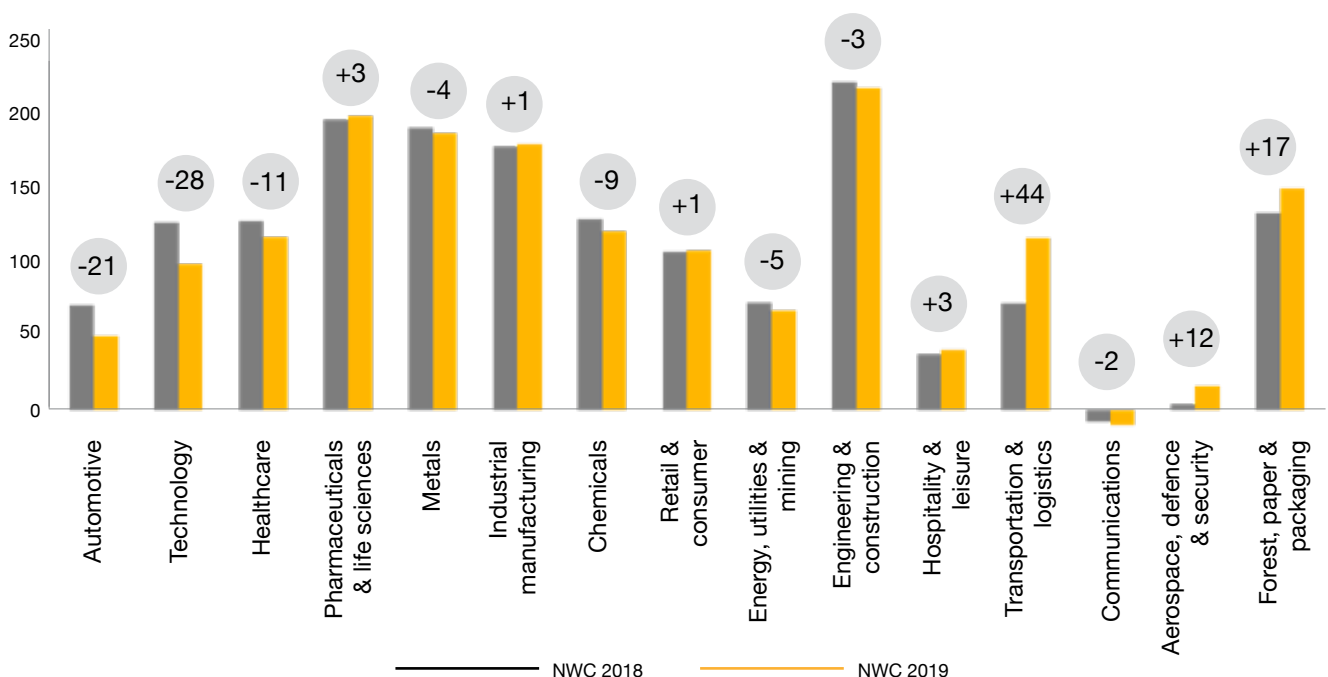
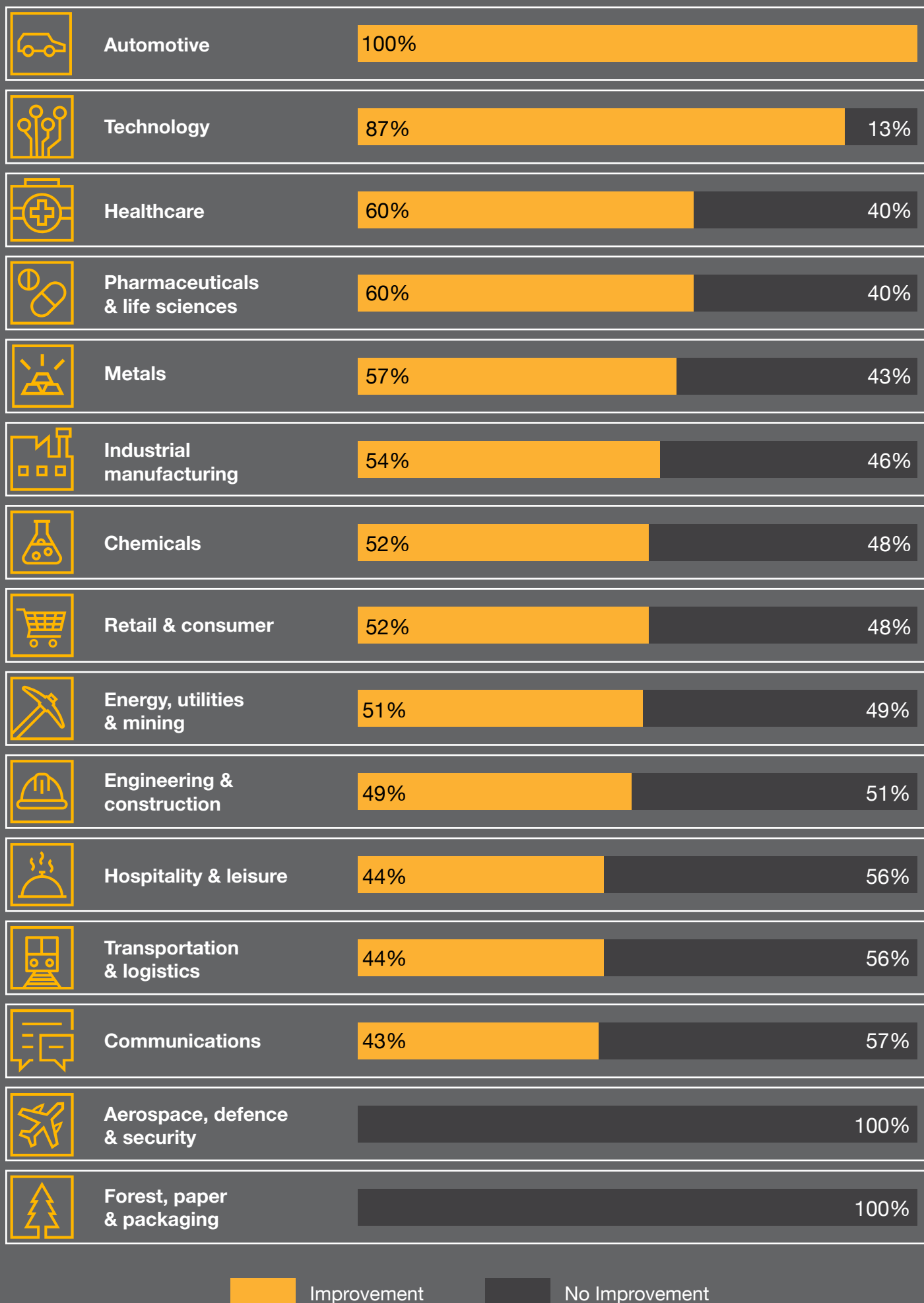


Figure 5: Percentage improvement and deterioration by sector





Top and bottom working capital performers

Analysis of the top and bottom working capital performers in each industry (the top and bottom quartiles respectively) suggests that the operational improvements required to release capital trapped on the balance sheet are yielding benefits beyond access to liquidity (See Figure 6).

On average, the profitability (EBITDA margin) of the top performers was 15% in 2019 compared with 12% for the bottom-ranked companies. In addition, return on capital employed (ROCE) was far greater for the top performers, which also had a much better track record for dividend payments.

Those companies with the best working capital record also had a noticeably superior net debt to EBITDA ratio. In 2019, the top performers reduced net debt by an average of 15%, while the bottom group saw an average increase of 9%. Lastly, the top performers on average collect cash almost three times faster than the bottom group, and convert inventory into sales four times faster, regardless of their size or country.



Figure 6: Top and bottom working capital performers

| ↑ Top performers | | Bottom performers ↓ |
|------------------------|--------------------------------|---------------------------|
| 15% | EBITDA % 2019 | 12% |
| 11% | ROCE % 2019 | 3% |
| 9% | CAPEX % Revenue 2019 | 7% |
| 52% | Change in dividends 2018-19 | -1% |
| 56 | DSO 2019 | 159 |
| 46 | DIO 2019 | 187 |
| 99 | DPO 2019 | 50 |
| 5% | NWC % Revenue 2019 | 71% |
| 5.3 | Net debt to EBITDA 2019 | 7.1 |
| -15% | Change in net debt 2018-19 | 9% |





Conclusion

Key measures to improve working capital management during and beyond the COVID-19 crisis

In these uncertain times, with no immediate end in sight to the pandemic, companies can access cash from working capital and speed up the restart of their operations by following some simple operational guidelines:

- Pursue targeted collections by analysing customers' payment profiles and exploiting specific negotiating points before resupplying or contract extensions
- Strictly enforce credit policies and only adjust terms temporarily until collections are normalised
- Clear inventory using a cost vs. cash trade-off approach to release cash needed to speed recovery
- Ensure that cash outflows are controlled and released only if they deliver an immediate return on investment or serve a clearly-defined strategic purpose

As well as these operational and tactical measures to improve working capital management, companies should take advantage of other means to increase liquidity and reduce short-term cash pressures created by the unprecedented COVID-19 crisis. They include:

- Tax relief measures to improve cash flow
- Adjusting transfer pricing policies to reflect current market conditions
- Accelerating cash reliefs by changes to the indirect tax profile in areas such as VAT and customs and excise tax
- Reviewing legal agreements and restructuring, terminating or cancelling contracts on the basis of Force Majeure

Above all, Middle East companies will need to assess their liquidity position and short term outlook swiftly to ensure that as the region recovers from the COVID-19 downturn, they can seize opportunities rather than lose precious market share or competitiveness because they lack sufficient cash.



10-30%

is the average opportunity that companies can identify during a working capital diagnostics

How we can help

We are the largest dedicated Middle East Working Capital Management team consisting of industry practitioners and functional experts in logistics, supply chain management, finance, engineering, sales and marketing with significant experience across sectors e.g. energy, healthcare, retail and distribution construction.

We assist both government and private entities in cash and liquidity management, active working capital management and unlocking trapped cash.

We help our clients to:

- Identify and realise cash and cost benefits across the end-to-end value chain
- Improve operational processes that underpin the working capital cycle
- Implement digital working capital solutions and data analytics
- Achieve cash conservation in crisis situations
- Create a 'cash culture' and upskill the organisation through our working capital academy
- Roll out trade and supply chain financing solutions
- Create short term cash flow forecasting and related action plans
- Stand up surge teams and resolve backlogs

Our working capital improvement approach:

Quick scan



Diagnostic



Design



Implementation



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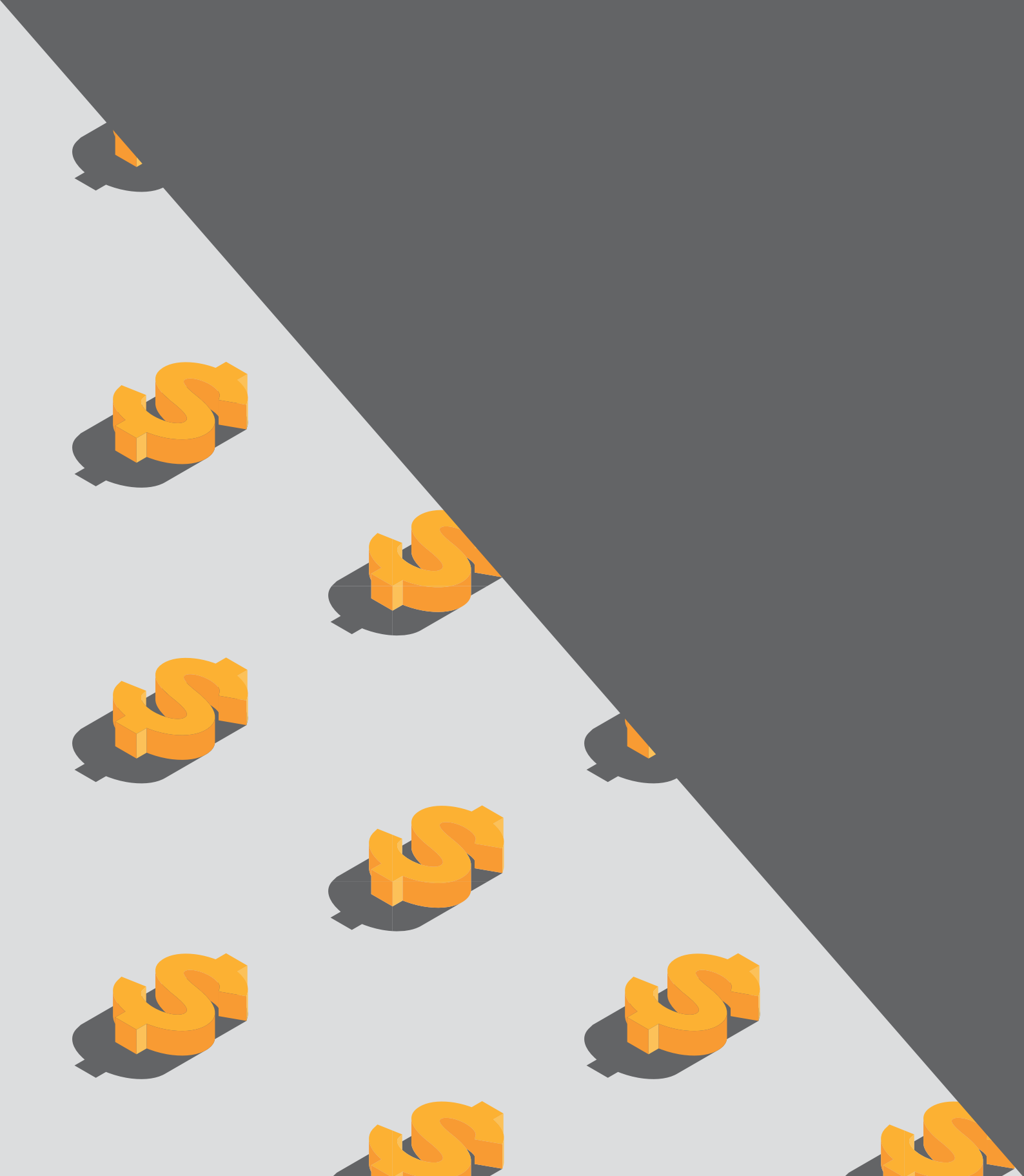
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Established in the Middle East for 40 years, PwC has 22 offices across 12 countries in the region with around 5,600 people. (www.pwc.com/me).

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