Exploit the Rebound

Seize the moment to unlock working capital

PwC 2022 Middle East Working Capital Study

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 includes 386 publicly listed companies and covers five years of key working capital trends (2017 to 2021), using data sourced from Capital IQ and analysed by PwC.

Executive Summary

Listed businesses in the region have experienced a strong rebound since our last Middle East Working Capital Study. Revenues have risen above pre-pandemic levels, due to the strong response by the region's governments to COVID-19, combined with the regional boost provided by the increase in oil prices, the positive impact of EXPO 2020 (held in Dubai from October 2021 to March 2022) and the upcoming football World Cup hosted by Qatar.

However, Middle East businesses, like their counterparts around the world, have continued to experience disruption throughout 2021 and the first half of 2022 due to global macroeconomic and geopolitical events. For example, although inflation has been less severe in the Middle East than in other parts of the world, the region remains globally connected and companies are having to pay higher prices for many imported materials, finished goods and services. These higher costs are trickling through balance sheets, increasing the amount of working capital tied up in operations.

There have also been continued delays in receiving orders, resulting in products being out of stock and lost sales, or companies planning strategic buffer stocks to cover the gap, which also ties up working capital. Lastly, higher interest rates, which are likely to rise further in the short-term, are increasing the cost of working capital financing.

As a result, many businesses in the region are rethinking their overall strategy as well as their end-to-end supply chains in order to increase resilience. In this context, corporates need to align their working capital approach with their new strategic and operating model, and treat working capital as a strategic pillar that can strengthen their performance and resilience in turbulent market conditions.

Yet we do not so far see many Middle East companies considering this option, with the latest data only showing a small improvement in working capital efficiency across publicly listed companies. Furthermore, this improvement is driven entirely by extensions of the time it takes to pay suppliers. Many companies are committed to sustainable improvements in their Net Working Capital (NWC) days performance, but only 6% of the study sample have reduced their NWC days for the past three consecutive years (2019, 2020, 2021). Meanwhile, cash collections and inventory management deteriorated in 2021 compared with 2020.

In this study we outline the underlying regional trends impacting Middle East businesses and set out how companies can start addressing working capital efficiency.

Key Findings

$35.5bn
in excess working capital is currently trapped on Middle East corporate balance sheets

6%
compound annual growth (CAGR) in short-term debt since 2017

25%
average increase in revenues between 2020 and 2021

2%
average annual decline in EBITDA margins between 2017 and 2021

Middle East companies benefit from post-pandemic rebound but little progress on working capital efficiency

The annual revenues of listed companies in the region rose by 24.8% in 2021 compared with 2020, to a combined total of $345bn. This rebound was primarily due to the increase in oil prices, boosting government revenues which have cascaded down through all layers of regional economies. A significant increase in M&A and IPO activity across the region in 2021 also contributed to substantial revenue growth for the sample of companies included in our study, as an increasing number of companies moved into the publicly-traded domain.

Against this background, consumer confidence rose across the Middle East in 2021, as vaccines and less lethal COVID-19 variants offered hope of an end to the pandemic. For example, our Pulse 3 Middle East results for PwC's Global Consumer Insights Survey (GCIS), conducted in late 2021, found that 53% of the region's shoppers were optimistic about the economy, significantly more than the global survey average.

However, this significant top-line growth in 2021 across most sectors has not yet translated into similar levels of bottom-line growth, as costs are starting to rise. On the one hand, the rebound in revenues has helped some Middle East sectors achieve higher margins: namely petrochemicals, hospitality and leisure, metals and transport and logistics. On the other hand, profitability has decreased in healthcare, retail and consumer, construction, and pharma and life sciences (PLS), with retail and consumer companies' margins at their lowest average level for the past five years.

Across all companies, the average EBITDA margin increased from 17.6% in 2020 to 19.4% in 2021, in line with 2019 levels. Yet despite this short-term recovery, the region continues to experience a long-term deterioration in EBITDA margins, with a compound annual decline of 2% since 2017. This long-term deterioration combined with a continued increase in capital employed means that between 2017 and 2021, shareholders have received overall a reduced return on capital employed (ROCE).

The ROCE improved year-on-year between 2020 and 2021 from 8% to 9.3% due to the improvement in profitability last year. However, the five-year trend also shows a compound annual decline of 7% from 12.7% in 2017.

Meanwhile, the recent improved profitability and stretch of creditor days have allowed companies to report higher cash flows from operating activities. They have mostly used this extra cash to pay back dividends to their shareholders (up 19% on average from 2020) and improve their balance sheet position by topping up retained earnings (up 11% on average from 2020), and cash and cash equivalents (up 21% from 2020).

Surprisingly, 2021 was yet another year when capital expenditure was not a cash allocation priority for Middle East businesses in our study. Spending remained stable from 2020 to 2021, but CAPEX as a percentage of revenue dropped sharply on average from 12.4% to 10%, due to the increase in top line results.

Overall, there remains significant room for improvement in the working capital efficiency of the 386 Middle East businesses in our study. Our findings show that as much as $35.5bn of excess working capital is locked up on their balance sheets.

The combination of inflation costs, rising interest rates, significant supply chain disruptions that cause inventory buildups and increasing short term debts create an important opportunity for companies to shift their attention to their own operating models and internal processes and generate value through cash release.

Capturing value from trapped working capital will be critical for businesses as they seek to release cash for organic growth and to ensure resilience against global economic headwinds. These will continue to increase pressure on the operational working capital and bottom lines of businesses worldwide.

01 Latest working capital trends

Working capital efficiency in the Middle East, measured as average net working capital (NWC) days, slightly improved in 2021

Net working capital (NWC) days - the number of days required to convert cash paid out into cash collected – is a critical measure of a company's financial health. Between 2017 and 2021, NWC days increased on average by five days for listed Middle East companies. This increase corresponds to an additional $14.5bn tied up in working capital by the businesses in our study which they could not invest elsewhere, compared with 2017. In this context, it is worth noting that the 3% improvement in NWC days between 2020 and 2021 is solely due to the increase in the average amount of time companies take to pay their creditors.

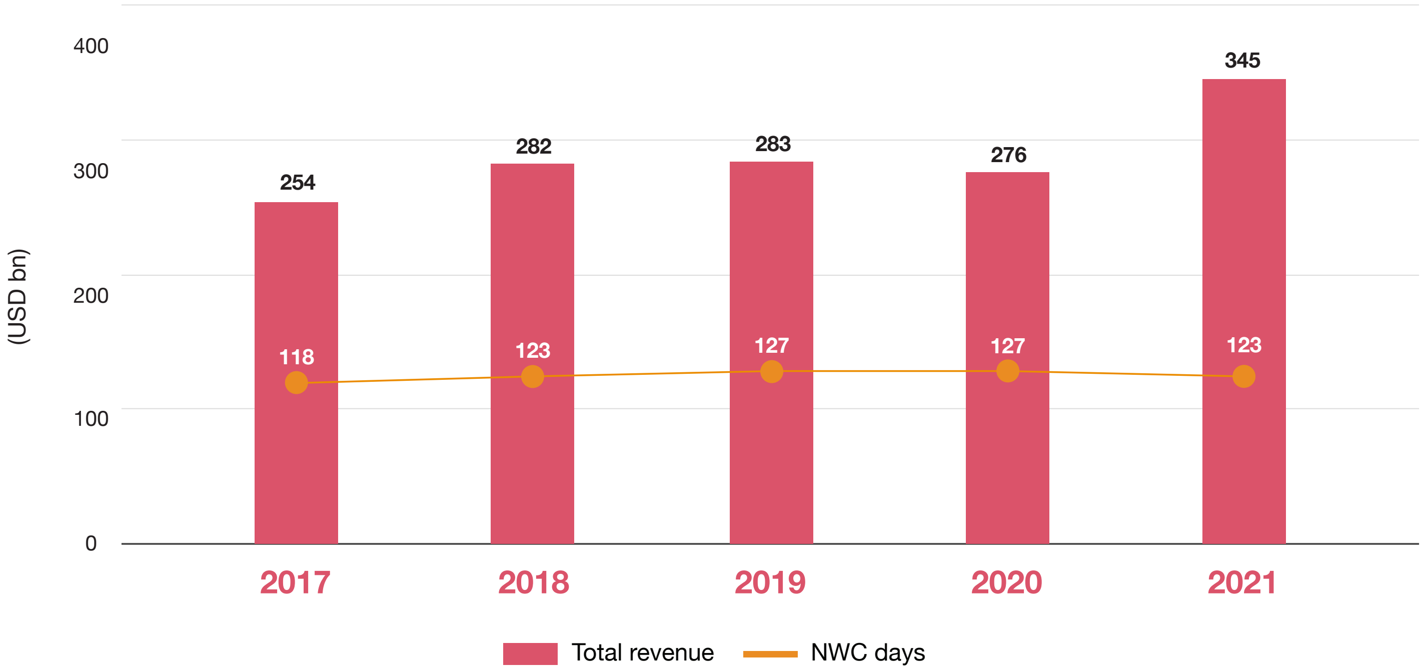


Figure 1: Net working capital (NWC) days trend, 2017-21

Alongside their deteriorating working capital performance, Middle East businesses have seen short-term debt steadily increasing since 2017 at an average annual rate of 6%, with the rate rising steeply by 10% between 2020 and 2021. This shows that companies have taken on more debt to support their daily operations, rather than looking at sustainable ways to reduce the baseline of working capital required to run the business.

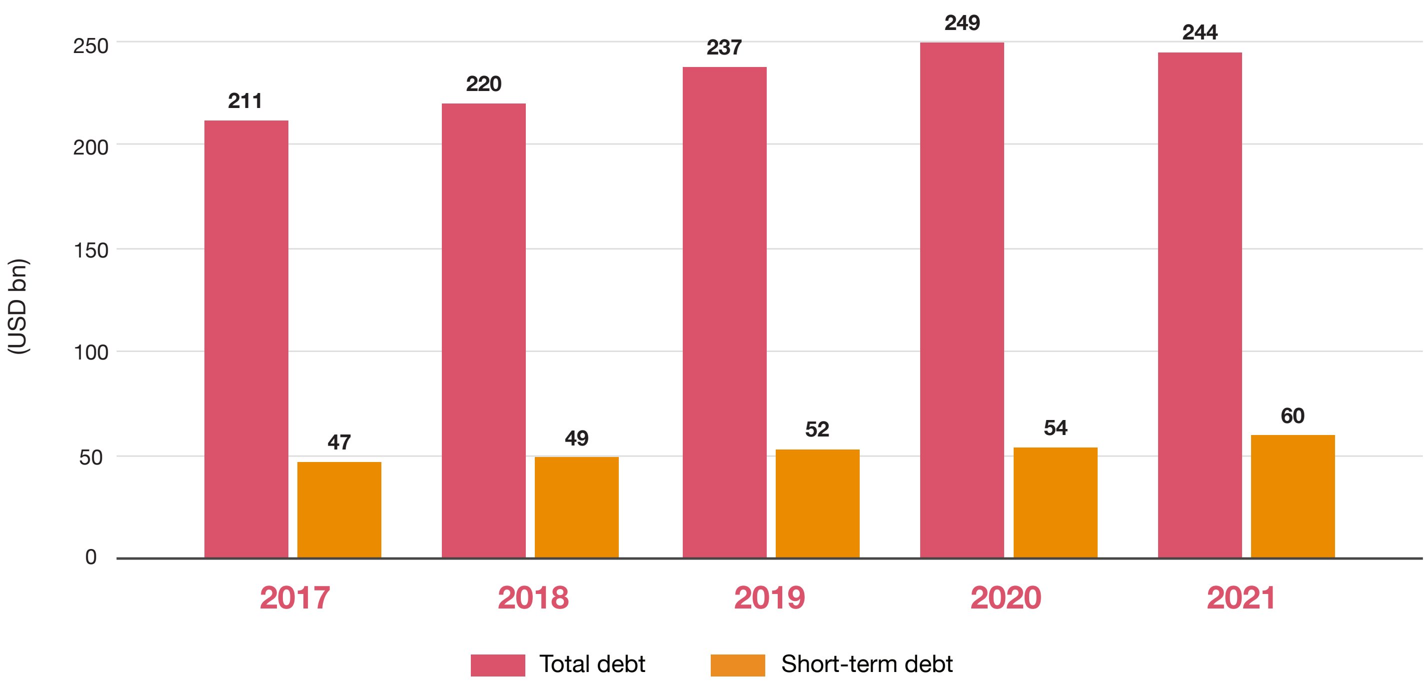
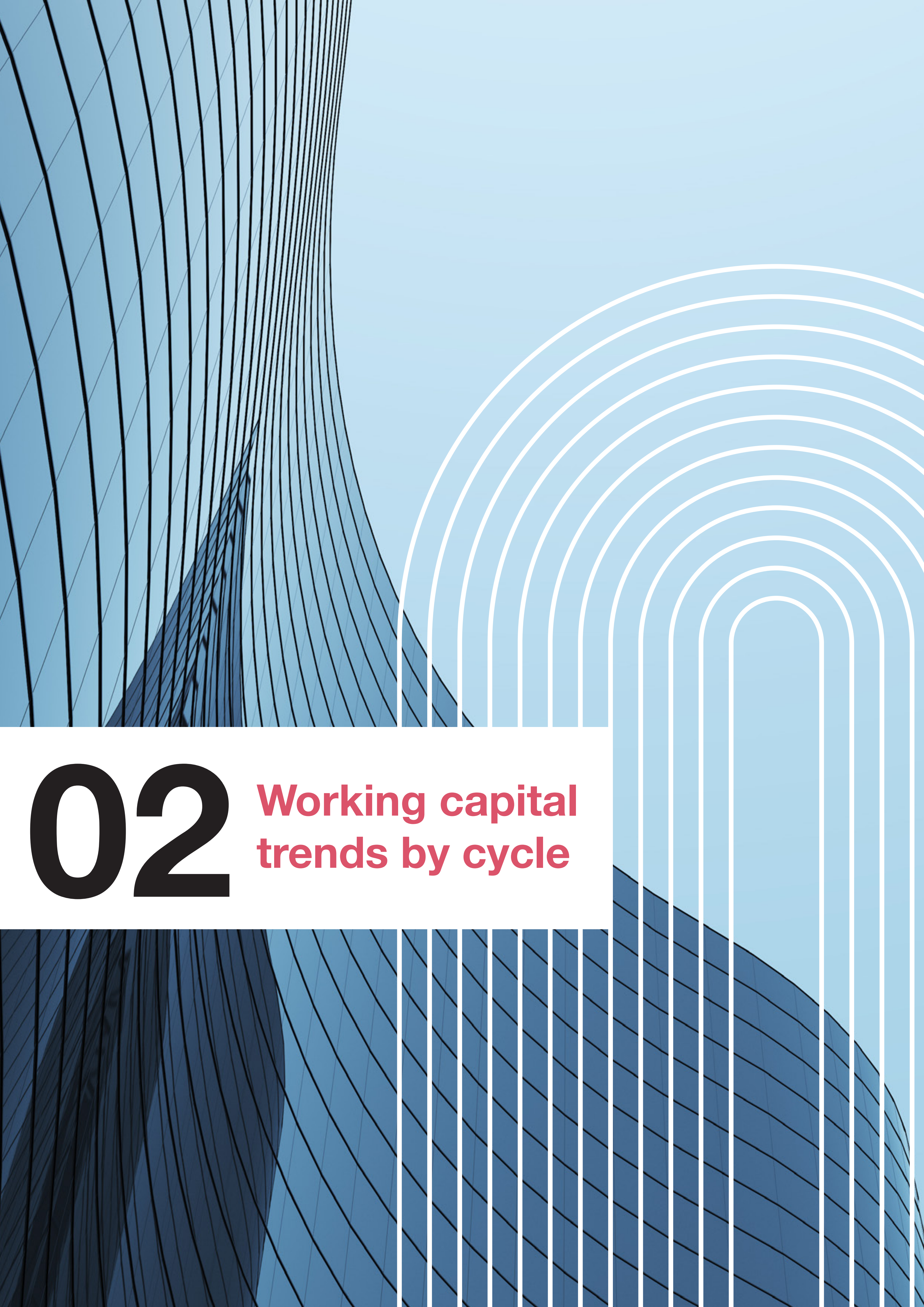


Figure 2: Short & Long term debt trend, 2017-21



02 Working capital trends by cycle

The working capital performance of the companies in our study has again been impacted by another increase in the days payable outstanding (DPO), a measure of how long companies take to pay creditors. The days sales outstanding (DSO) and days inventory outstanding (DIO), which represent respectively the average time to collect cash and average inventory holding time, have remained stable or deteriorated slightly.

Overall, the increase in DPO more than offsets the deterioration in the other cycles, leading to an overall improvement in working capital performance.

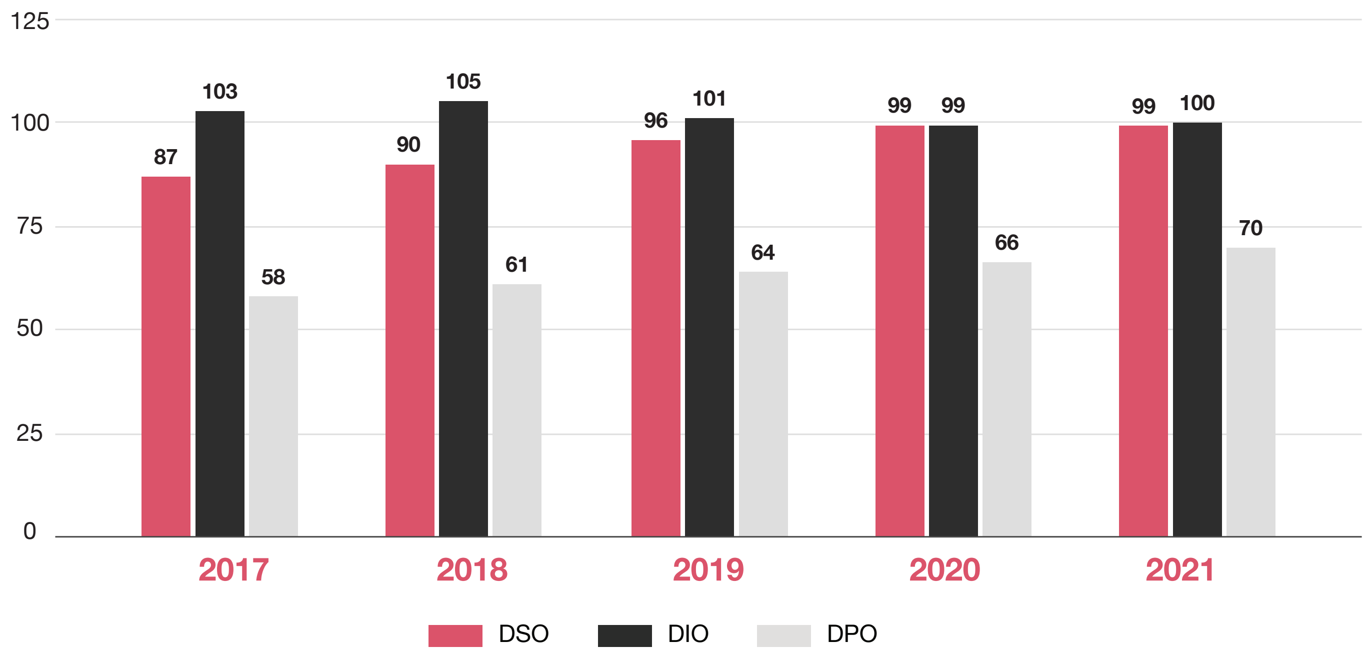


Figure 3: Working Capital performance indicator trends, 2017-21

The average annual speed of collections across the companies in our study has steadily slowed over the last five years, with DSO rising on average by 3% per year from 87 days in 2017 to 99 days in 2021. During 2020, collections were generally slower due to companies holding on to their cash because of the uncertainty generated by the global pandemic. Whilst the region saw a significant growth in revenues in 2021, the average speed of collections remained the same, equating to a like-for-like increase in total debtor balances of $18.9bn. Corporates are struggling to reduce this debt burden through improved operational performance and we see increased interest for trade finance assistance from banks or other financial institutions.

The average inventory holding time was relatively stable between 2020 and 2021 at around 100 days. However, the impact on supply chains of the COVID-19 pandemic and global geopolitical events are causing significant stock imbalances. Some companies are building buffer stocks to minimise risks, while others are experiencing stock shortages due to extended lead times and product unavailability. In both cases, these businesses still require time to follow the example of top performing peers which are actively working to embed agility in their supply chains and strategies in order to react quickly to shifting trends and prevent operational disruption.

Taking longer to pay suppliers continues to be the “go-to” approach for Middle East companies to mitigate the impact of their deteriorating collections and inventory performance. This is driven by necessity, with companies either unable to make payments without extending the cycle in this way, or seeking to protect their cash position. Between 2017 and 2021, the time to pay suppliers rose on average 5% per year to reach a five-year high of 70 days in 2021. Until 2020 the deterioration in DPO came on the back of declining operating cash flows. By contrast, in 2021 operating cash flow was generally strong across the companies in our study, however the payables cycle still rose by four days compared with 2020.

We see many companies in the region which are turning to financing solutions to avoid these payment delays, with an increased interest in trade finance products such as receivables factoring or supply chain finance. Payment delays can further increase costs as suppliers look to recover their cost of capital for an extended collections cycle into their pricing. Nonetheless, in many cases trade financing solutions are considered by corporates before any other internal improvements, such as unlocking working capital from operations which comes free of cost.

03 Working capital by company size

Our results show that the largest companies are able to operate with a much shorter cash cycle than their smaller peers. Very large companies, with more than $2bn in annual revenues, take on average 64 days to convert cash paid out into cash collected, while small and medium-size companies, with annual revenues of less than $500m, take more than twice as long with 139 days.

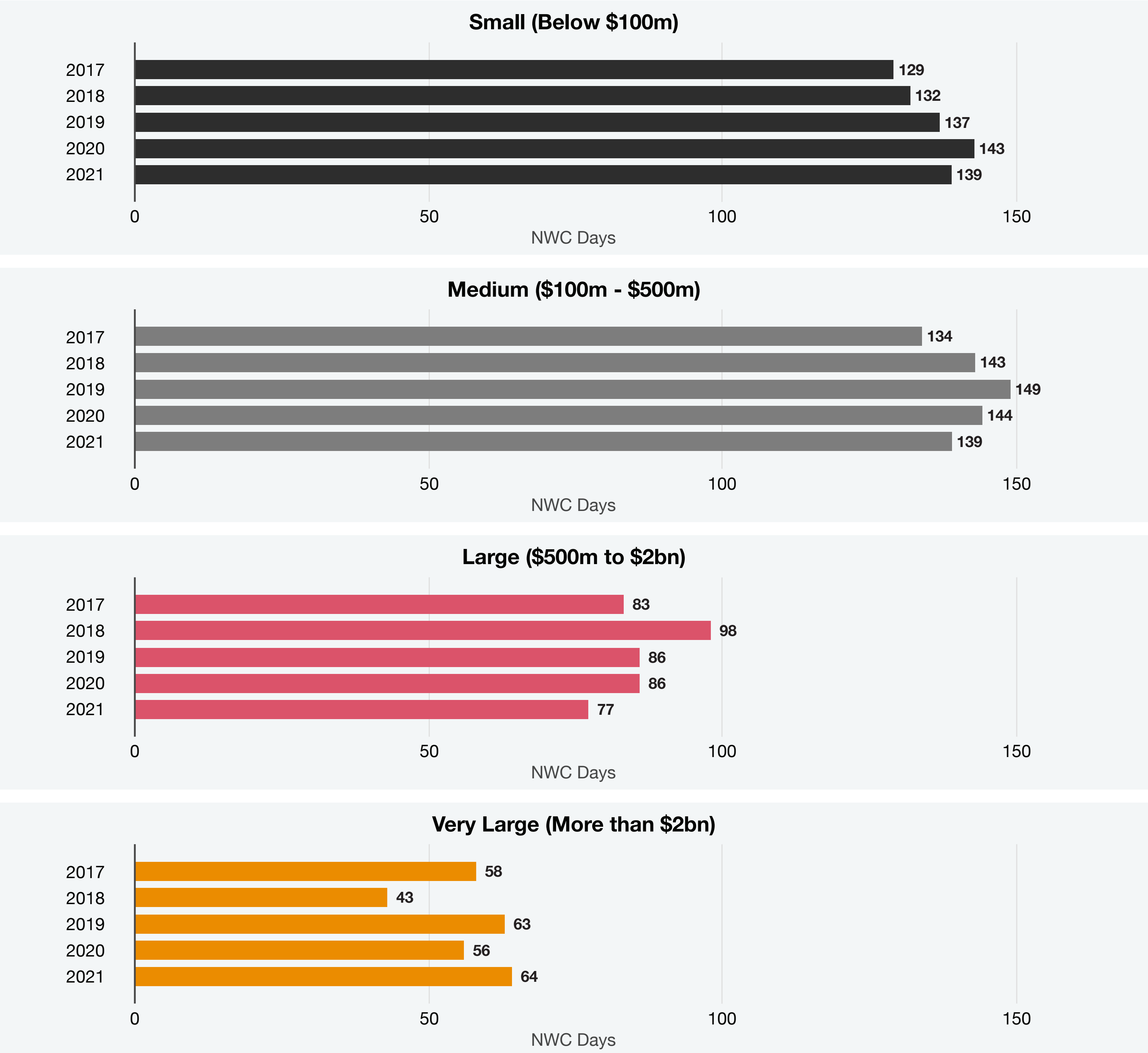


Figure 4: NWC days by company size (annual revenue)

Large and very large corporates also outperformed smaller companies in 2021 when it came to cash collections from customers. Nonetheless, over the past five years the cash collections performance has deteriorated across all company sizes. The underlying reality for many larger companies is that while they possess more negotiating power with debtors, they are still insufficiently focused on this critical aspect of their operations which impacts the cash tied up but could also lead to increased risks of bad debt if the policies and processes are not robust enough.

The increase in the number of days taken by very large companies to convert cash paid out into cash collected between 2018 and 2021 is due to a corresponding decrease in the average time to pay suppliers (DPO) from 97 days to 86 days. Although this substantial reduction in DPO has helped release some much needed liquidity back into the local economies, very large corporates still take by far the largest average time to pay suppliers compared with the rest of the sample. The main reasons include the negotiating power they hold over their suppliers, stricter adherence to payment runs and more favorable costs for trade finance products such as supply chain finance which allows them to further extend payment terms.

04 Working capital by country

Companies in most Middle East countries, apart from **Oman** and **Bahrain**, managed on average to improve their working capital performance during 2021. While the deterioration in Bahrain was marginal, the performance of listed companies in Oman worsened on average by 12% last year, predominantly because of an increase in inventory holding times.

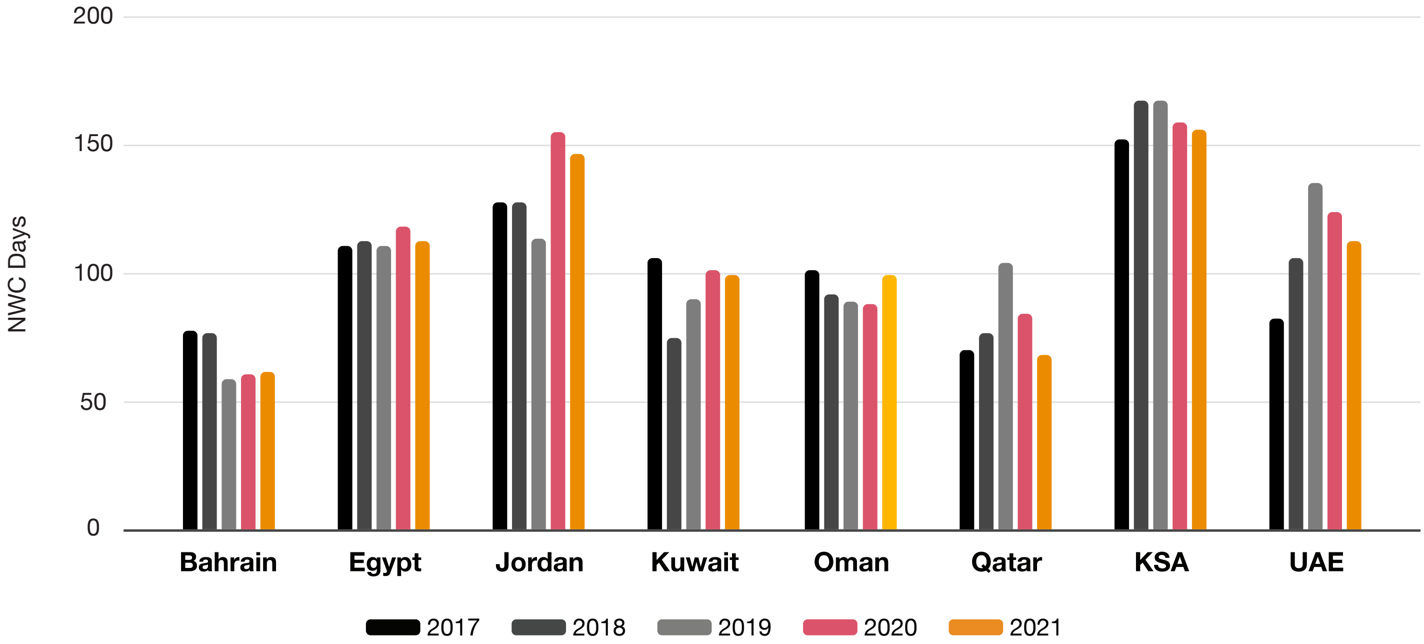


Figure 5: NWC days by country, 2017-21

Despite continued improvements by companies in **Saudi Arabia**, the kingdom continues to have the longest cash conversion cycle (NWC days) across the region, with 156 days in 2021. Saudi companies also have the longest inventory holding period in the Middle East, with an average of 125 days last year. These challenges stem to a large extent from historic public sector payment times, which Saudi Arabia's government is continuously improving as part of the country's wider transformation. In addition, Saudi corporates have historically been focused on top line growth and as they mature, they are starting to shift their focus towards value creation and internal improvements.

Amid the current global supply chain disruption, Saudi businesses are also likely, in the short term, to need to invest more of their cash in working capital. This could become a strain, given their starting position, especially when Saudi companies will also be tackling inflationary costs and other risks.

UAE companies delivered a significant year-on-year improvement in their average working capital performance in 2021. However, this was purely driven by a stretch in creditors' terms which masked a general deterioration last year in other working capital cycles. For example, UAE companies have the slowest average collection performance across the Middle East, and one of the longest cycles to pay their suppliers after last year's increase. In general, UAE companies have very reactive processes for cash collection, with reporting and automation not optimised in many instances, which in turn slows down gathering the right information for decision-making.

By contrast, companies in **Qatar** performed better year-on-year in 2021 across all working capital cycles. The material difference in Qatar came from a reduction of around 26% in the average inventory holding time (DIO) to 46 days. However, this sharp decline in DIO probably shows that some companies in Qatar are starting to feel the effect of global supply chain disruptions, with inventory dropping below optimal levels.

05 Working capital by industry

A total of 51% of the companies in our study improved their working capital performance in 2021. Regardless of their industry, these improvements were achieved by focusing on factors within their control, such as making their operating model and internal processes more efficient.

Nonetheless, our analysis of working capital performance by industry between 2020 and 2021 reveals significant variations between sectors. For example, retail and consumer and transportation and logistics showed a strong overall improvement, while the average performance of technology companies declined sharply.

	2020	2021	Variance
Aerospace, defense & security	15	3	-11
Automotive	41	34	-8
Chemicals	110	105	-5
Communications	-12	-12	0
Energy, utilities & mining	64	60	-4
Engineering & construction	221	221	0
Forest, paper & packaging	126	114	-12
Healthcare	166	168	2
Hospitality & leisure	37	29	-8
Industrial manufacturing	177	177	0
Metals	163	169	6
Pharmaceuticals & life sciences	214	210	-3
Retail & consumer	102	92	-10
Technology	137	168	31
Transportation & logistics	93	76	-17

The stronger working capital performance by the transportation and logistics industry is not surprising, given that the pandemic and other global disruptions have reduced capacity and increased the negotiating power of companies in this sector across the value chain. In 2021 they used this leverage to shorten the average time it took to collect payments from customers, while extending the average time to pay their suppliers.

By contrast, the technology sector's substantially worse working capital performance during 2021 was driven by a 22% increase in the average time companies took to collect customer payments to almost six months. It seems likely that the doubling on average of annual revenues at Middle East technology companies has been achieved by providing customers with more generous contractual terms and more relaxed collection deadlines.

Two industries which every year have some of the longest cash-to-cash cycles are engineering and construction and pharmaceuticals and life sciences (PLS). Engineering and construction have been under significant stress regionally, due to the perennial problem of poor budgeting and delivery challenges which lead to disputes, legal claims and lengthy collection cycles. These challenges have been evidenced by the number of players who have collapsed recently or have been going through financial restructurings. Yet the sector still managed to perform as well on average from a working capital perspective as in 2020.

In contrast, PLS companies continued to operate in 2021 with a cash-to-cash cycle of around seven months, despite a marginal improvement in their working capital performance. This extended cycle is largely due to the sector's regional distribution model, with suppliers importing from major global companies and selling to an increasingly consolidated private sector and government buyers. As a result, the sector's working capital performance is undermined from two directions. Government collections are subject to continuously changing processes and requirements which delay cash inflows. Meanwhile, large global manufacturers have considerable power when negotiating contract terms with Middle East suppliers and are much stricter regarding payment deadlines.

Key steps to improve working capital performance

The findings in our 2022 Working Capital Study confirm that while many Middle East companies are taking positive action to improve their performance, there is still far too much “hidden treasure” locked up on balance sheets which could be released to drive growth and build resilience in the face of continuous global disruption. We recommend that companies should take the following actions to ensure they manage their working capital as productively as possible:

01	**Revisit**	Your working capital operating model in light of changing market conditions and the latest corporate strategy
02	**Embed**	A cash culture across all layers of the organisation to ensure a clear understanding of how each decision can impact cash flows
03	**Define**	Clear rules for trade-offs between cash and costs
04	**Review**	Policies and procedures to ensure the business transformation has the right guidelines
05	**Leverage**	data analytics and internal information to improve the decision-making process
06	**Optimise**	Internal processes to ensure companies can efficiently deliver on their defined working capital operating model

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