



Podcast transcript

Looking ahead: The COVID-19 impacts on the Asset Management industry

Podcast with Andrew Weir, Global Head, Asset Management, KPMG International and Regional Senior Partner and Vice Chairman, KPMG China; and David Neuenhaus, Global Head, Asset Management Tax, KPMG International, and Partner, KPMG in the US*

Musical intro

Announcer:

Hello and welcome to the KPMG podcast series for tax, legal and mobility leaders. This podcast mini-series focuses on the ongoing global impacts of COVID-19, by looking at the tax, legal and mobility considerations and top-of-mind business issues that have resulted from this global situation.

In today's episode, we spoke with leading KPMG professionals, Andrew Weir, Global Head, Asset Management, KPMG International and Regional Senior Partner and Vice Chairman, KPMG China; and David Neuenhaus, Global Head, Asset Management Tax, KPMG International, and Partner, KPMG in the US. We asked Andrew and David to share their insights on the impact that COVID-19 is having on the Asset Management industry, at the investor, fund, and portfolio company level. And we also discussed the impact COVID-19 is having on current investment trends, financial opportunities and hurdles, business and strategy impacts, and what to anticipate moving forward.

Andrew and David, thank you for joining me on the phone today.

Andrew and David: Hey how are you doing? Hi how are you?

Andrew, I'd like to start with you. Could you give us an overview of where we are, and where we're heading in the world of Asset Management?

Andrew:

I think we're at a very interesting stage in asset management. I think, even before the crisis, asset management was approaching a bit of a crossroads. Particularly, of course, in the context of a relatively low yield environment.

I think what coronavirus has done – like in every sector – it will reinforce those forces of change and will act as a catalyst for change in the sectors. I think, probably, some of the key things one needs to think about, is really the role of technology.

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Everything, from how one uses technology as an asset manager and an investment manager through to how one runs ones operations, how one data mines, through to actually the impact of technology and digitalization on the underlying investee companies. So, I think it's a very interesting time. I think it would take time for the dust to settle as to where the asset management industry will end up. But I think it's fair to say it's at a very interesting inflection point. And the situation is very dynamic.

Announcer:

And David, what are the challenges and concerns the industry is managing through at the moment and are businesses seeing any potential opportunities in the future.

David:

The first challenge was just business continuity, and the ability for funds to stay in contact internally, the health and welfare of their workforce, the ability to meet the required deadlines for the different stakeholders. Then it moved on from that towards considerations of liquidity and solvency. I think that's where we are from a sort of an initial reaction to where are we today. And what we expect to see coming next is sort of what are the opportunities in the market that on the back of the health challenge are going to be some financial challenges and financial opportunities, and what do we expect that to look like.

We're seeing that being first category of the first, let's just all be safe, we saw lots of continuity across our clients in that regard, but we start to see a little bit of separation by the investors in terms of what their long-term view and perspective is as we start to go down and focus on those economic challenges and now into what comes next kind of viewpoints.

Announcer:

Andrew, you're based in Hong Kong – could you tell us how business is currently progressing in both Hong Kong, as well as in mainland China?

Andrew:

It's very interesting being based in Hong Kong and being part of a greater China organization. Of course, after Chinese New Year, what was first a local issue in Wuhan then became a national issue in China. Then, first stop after that was Hong Kong. So Hong Kong in the mainland China really were the epicenter, and for this to have morphed from being a local and regional matter into a global matter has been, obviously, absolutely terrible, but also a fascinating development.

Maybe I could just reflect that in China the vast majority of the country is back at work. It is different province by province, but overall, the economy is recovering on the back of domestic demand and domestic spending.

And there has not yet been a very, very large fiscal stimulus from the government and as, yet, of course, the international MNC activity, be it directly in China itself or through the global supply chains. That really has been quite significantly disrupted. And the full effect of that coming through hasn't yet been seen. So I would caution if one reads in the newspapers and believes that there is a full recovery in place in this part of the world.

Regarding Hong Kong, it's very, very difficult. There's a recognition of Hong Kong as an IFC, an international finance centre, is much more subject to the very heavy winds of global trade, any changes in pattern of trade and also, of course, a global recession. So it's still very, very early days. Certain countries are still in resilience mode as opposed to recovery mode and there's recognition that the recovery will be a longer and more restricted recovery than initially thought.

Announcer:

David, how has the COVID-19 situation affecting market valuations and what are you hearing from asset management clients?

David:

The immediate impact on COVID in terms of just volatility was that valuations plummeted, and people weren't really sure how far down they would go. So there was a lot of concern in relation to our clients in terms of pipeline deals of what the appropriate valuation ought to be and how they could support that for immediate transactions and what things would look like into the future.

So only time will tell in terms of what the future holds. But as we're recording the podcast now, things seem to have at least settled down a bit, not to say that tomorrow won't be different, every day seems to have its own surprises. But the valuation issues have settled. The question is now if they will sort of climb back to where they were.

But in all of this, there's a silver lining in that we've seen a number of our asset management clients sort of hesitate, they had dry powder, but they thought valuations have gotten a bit frothy, it certainly has come down. So we do expect that to provide some opportunity for some of the investors but it really gets back to the earlier point in terms of what the viewpoint is of each organization in terms of long term. Is this a good time to move in or will, will tomorrow hold some bad news and valuations will move back down? But it's helped overall in terms of the frothiness of valuations, but still a bit of hesitation in the market to act on that.

Announcer:

Andrew, what does this all mean from a business perspective? What conversations are you having with clients right now?

Andrew:

The conversations we've had with our global clients and clients locally has been obviously first about business continuity planning, and how practical and pragmatic that needs to be. And the importance of stakeholder management, communication, marshalling of resources et cetera, et cetera. And this again has given rise to this advancement of technology and digitalization.

The second item of discussion has been liquidity. And I think it's worth noting that, particularly out in Asia, there's not really that high gearing compared to the global financial crisis 10 years ago. However, liquidity is a challenge in terms of cash flow analysis, looking at loan facilities, pulling down on existing loan facilities and looking for new loan facilities. And this has been a very important modeling exercise we've been doing for many of our clients. Really the scenario planning on steroids is how I've described it. What may be interesting to people listening in is, back in February or March, assumptions on the duration and severity of the virus turned out to be very optimistic.

And this agility in how one looks at business modeling and different scenarios and sensitivity is super, super important. With that has become a lot more analysis of what truly is core business. What's non-core business?

And all of this, of course, is in a backdrop that there isn't a never-ending supply of capital. Yes, there's a lot of dry powder out there and although banks are broadly under influence not to call in loans and to provide liquidity, there are restrictions. And I think one's getting quite close to the stage now, where the ability of banks to carry on lending is very questionable.

Announcer:

And what does this mean in the area of investments, especially in terms of rate of returns, interest rates and discount rates?

Andrew:

I think what's very, very clear is the intervention of governments in nearly all economies will have a supportive effect in the short-term, but probably more of a disruptive effect in the medium-term.

So what does that mean really for investment? It is very, very hard to call at the moment. And the question mark I still have, and I'm afraid I won't give too much answers today, is let's monitor hugely carefully what this means for discount rates. And for example, in the real estate world, cap rates and what it means when doing business valuations. When you've got negative interest rates and recently you saw in Europe negative interest rates on bonds being issued by government, what does this mean for the risk-free rate of return, which is the basis of all capital market judgments? So, I think, we're still waiting to see how the financial system will digest all of this change. But the areas to particularly lookout for are patterns of demand that will be truly reflecting the reality of demand as opposed to supported. And secondly, what really is the right discount rate or cap rate to use when doing business decisions? I think the reality of this is basically looking at ranges, not rushing and taking a very measured view and making sure investment committees operate properly and considerable eventualities is absolutely key.

Announcer:

Thanks Andrew. David, Andrew mentioned the challenge around liquidity, and there have been a number of tax measures put in place to help organizations manage liquidity. What are your thoughts on this?

David:

Yes, so the tax measures are allowing the organizations to keep more of their cash to service more of their immediate obligations. So whether they're obligations on loans, whether they're obligations from an employee sort of payment perspective, so it allowed companies to make delay the payments for instance, it allows companies to potentially accelerate the ability to offset their income with certain tax depreciation, tax yield and to accelerate the utilization of losses are sort of the baskets that we're seeing with different stimulus packages around the world.

The long-term impact is going to be some of the structures to utilize some of these tax rules are longer term. So they are in fact, the restructuring of different holding company structures, different assets that are held. So it's accelerating the use of losses, which means in the future, there will be less access to that. But on the net, it's typically beneficial to utilize losses early on from a – just the amount of time, value of money perspective.

So, and the other point is that a lot of the provisions are temporary. So it's not clear if these temporary provisions get extended as sometimes happens, or if they really are just a window for a year or two. And so as organizations try to take advantage of some of these provisions, they need to keep in mind that the window may be limited. And after that two-year period ends, if these provisions go away, they'll be back to, some new rules and it's never exactly clear, exactly what they look like.

So, any kind of restructuring has taken account the uncertainty that's going to follow the relief provisions that we have now to help with liquidity challenges.

Announcer:

Thanks David. Andrew, we're hearing leading scientists expect a second wave of the virus in September 2020 and potentially similar outbreaks to happen in the near future. So with that in mind, what should organizations be considering?

Andrew:

I think the question of second or third waves or recurring waves is a very important one. I think the key on this then is building in to all of one's business operations basically mitigation of the risk. Be it a supply chain, where I think we can honestly say global and regional supply chains previously had very little buffer in them. I think, moving forward, there clearly would need to be buffer when doing our budgets, when looking at growth. Surely we'd have to revisit now this never-ending uptake in growth all of our budgets and investment propositions are considering and maybe reflect on right – it's a period of consolidation. It's a period of cash and profit preservation.

I think what will also be very important to this, as the relationship between shareholders, management, staff and regulators is going to be very, very important. And increasingly the pressure is going to be on organizations to demonstrate, as an employer, what are they doing to look after their staff and retain employment.

So I think there's a lot to think about on this, but the key is agility. And I think, you know, in the investment management world, asset management real estate, ... are the right people involved in these discussions? Are we thinking the unthinkable? When doing scenario planning, are we really thinking of all aspects? And I would just encourage everybody to have a very, very broad, holistic look at this. Because I think the situation would take a long time to resolve itself and will require considerable agility.

Announcer:

Thanks Andrew. I'd like to now move the conversation around to the future, and trends in business. So David, how are you seeing asset managers tackle decisions when thinking about portfolio value creation?

David:

We're seeing deal teams spend more time in organizations, spend more time on improving the value of their existing portfolio companies rather than looking to the next investment. And with the new stimulus packages that are coming out around the world, there is a lot of opportunity for companies that focus on their portfolio companies, their challenges and the stimulus packages and even beyond longer term to bring more value to that portfolio company since deal flow has really slowed down. So there are opportunities, and the most sophisticated organizations certainly are spending a lot of time on the portfolio value activities, during this period.

Announcer:

Andrew, in a previous episode of this podcast series, Lewis Lu, Head of Tax, at KPMG China, mentioned

pipelines and revenue projects are starting to come back. Would you agree? What green shoots are you seeing from an economic and business standpoint?

Andrew:

I think there are definitely good signs of recovery in China. Definitely. The pipeline is still reasonable in Hong Kong, but I think it's fair to say China, mainland China, is further along the line. What type of things are we seeing? Interestingly, IPOs, capital market transactions. Not deals so much as one would expect. Not yet, but capital market transactions, rationalization of businesses. Interestingly privatizations have become quite attractive and there's a lot of actual work with regard to government subsidies, tax planning and – but the most important area for us has been digital transformation. Organizations are saying let's accelerate our transformation of our organization and take advantage of this.

I think there's another couple of interesting things coming out. China really has a remarkable track record on developing technology. And one's seeing a real take-up in interesting technology and data-driven products in real estate. So I'm starting to see things come through. Two things I'd just caution again. It's largely on the back of domestic demand. There's a high savings rate in China. There is a high wealth effect. One of the biggest driving forces in China, Asia and the world is the mainland Chinese middle-class. They are spending again and, as I said, they have financial capacity. Banks are lending. So the fair question would be, how far can a largely domestic driven recovery go? And this knock on effect of what's happening globally and what's happening in global supply chain, and how multinational companies are behaving given all the pressures back in their home offices, I think is going to be quite a significant challenge as we move forward.

Announcer:

David, the Asset Management industry is accustomed to bringing investors and investments together cross-border. Looking ahead, will the asset management industry be as global as it once was?

David:

We deal with funds that are based around the world that have asset portfolios around the world, and we talk to our clients about these very challenges. And I'll say universally, there is no pulling up stakes and saying we don't want to have exposure to a particular market, or we want to become, more myopic or more domestic in the focus.

The business community in general and asset managers who are usually fairly flexible are still have a very much a global perspective and are still looking to invest around the world. So we have not seen a slowdown in that.

Announcer:

Andrew, looking forward, what do you see in terms of evolving government policy? What will this mean for the asset management sector?

Andrew:

I think the two big things regarding government policy will be the tax situation – how does this eventually get paid? Point number two, in this trade-off between governments, businesses, people, property owners, asset owners, I think it's fair to say it's the asset owners and the property owners who aren't getting any help. Now, a ramification of that is valuation and a ramification of that is the knock on effect to the real economy if there's a very significant drop in valuations. So, I think, before too long where we'll need to be government policies, which do not give rise or protect a collapse in asset values.

The second aspect of government policy, I think, will be the obligation to look after employees and the role of business. And I think one has to read the mood music. Those organizations who are able to come up with a very proactive front foot narrative about the value of the investment – the value of investment manager and what it does for society, what employment it provides, ways in which it can basically aid the recovery. Those organizations will be in very good stead.

I think the last points on government policy is disruptive effect on patterns of demand. If you're running an asset which relies on a particular stream of demand, is that demand changing? If it is, to what extent is it supported or influenced by government policy. And, if there is an effect, to what extent is it temporary versus permanent? And then we're back to this point I keep raising of what is that rate of return in this world where there's been so much liquidity pumped into the economy by government?

I'd also say, more broadly, geopolitical analysis is very, very important. A fresh look at markets once in. A fresh look for direction of travel and things like patterns of trade, global tensions and whether certain policies taken in certain countries during the virus mean they are going to be much more inward looking moving forward and much more nationalistic.

Announcer:

David, what are your insights around how the asset management space can start to rebuild for a new reality?

David:

I think as we look out to where things are going and the new reality, each organization again has to come to its own strategic perspective. There's no perfect market timing in terms of valuations. But we are starting to see points of view evolve from our various clients, for sure. So that's from an investment perspective.

I'd say, just from an operational perspective, I think some things that are with us for the long term are just some improvements around the operating models they have and the ability to stay connected virtually, the use of technology and so we're seeing a quick adoption of technology to make the organizations more efficient with the challenges we have. And I'll say when the challenges around COVID go away, I suspect clients to continue to leverage what they've learned during this period and become much more efficient in that use, so I think we will continue to see that into the new reality.

Announcer:

Thanks David. And finally, Andrew, where do you anticipate seeing shifts and changes for the asset management industry as we move into the new reality?

Andrew:

I think the biggest shift in the asset management industry has got to be a massive push on sustainability and environmental matters and social responsibility. You can see really there's a massive driving force of a regulator on sustainability and responsible investment.

But there's another very big driving force and that is what investors want. Basically the millennials of other generations look to see their money being deployed in a responsible way whilst getting a return. They can feel they're making a difference. And I think this is going to be a massive change.

I think the second big change that will come through is this balance between shareholders, employees, investors and also the owner managers.

And that distinction between dividends and return to shareholders, wages as return to staff, bonuses as return for management – that whole equation I think is going to come under quite considerable debate. And I think increasingly one's going to get into a much more holistic view of what is profit, what is return? Much more integrated reporting and much more demonstration of different ways in which an organization brings value to the investors of society. And I think a number of the very, very large funds and investment management groups are very, very cognizant of it.

Finally, I would say, geographically – I still believe that the demographics and the structural growth story in Asia with the rising middle class. These economies with their spending power are still going to be drivers and originators of capital, but also markets in which major global organizations are going to invest. So I think those three things are going to be very, very important.

Announcer:

Andrew, David, on behalf of our listeners, thanks again for your time today, and for breaking down the business and financial impacts, and investment trends you are seeing across the Asset Management industry, and how best to navigate through this environment.

For more information and resources on COVID-19, visit home.kpmg/covid19taxandlegal

Join us again next time and please email us with any questions you have about today's episode at tax@kpmg.com and we'd also love to hear from you with any suggestions you have for future episodes.