



# Trading asset turnover

#PositiveImpact

The two big drivers of corporate returns over the last decade have been upended in 2022. Specifically, corporates can no longer rely on higher debt or fatter profit margins as they have done post-financial crisis. Instead, a key source of returns will be generating more sales from existing assets – in other words, boosting asset turnover.

Asset turnover has fallen because managers have slowly but steadily lost their focus on driving sales from assets. In fact, 20 years ago companies generated \$1 in revenue for every \$1 they held in assets. Now they generate revenue of just 65c. This decline has been pronounced even after adjusting for cash and goodwill. Managers have not necessarily been slack. Incentivised companies to borrow money, boost their balance sheet with M&A, and outsource operations to boost profits.

Yet, recent events have shown that companies can no longer rely on those tailwinds to boost returns. Meanwhile, a host of issues are exerting significant downwards pressure on profit margins. Just a few include: rising wage demands and input costs, the inability to pass on price increases to customers, the worsening perception of business by the general public, and governments putting more emphasis on boosting competition.

When we screen for stocks that have strong and improving asset turnover, we can see that these tend to outperform the market over time. The following chart shows this effect and also that those stocks that rank poorly on asset turnover metrics tend to underperform (*stock screens and methodology is available upon request*).

Total return index for US stocks rank (equal weight)



Source: Bloomberg Finance L.P., Deutsche Bank

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Company-controlled sources of returns are now critical given the macro environment has swung against the traditional ones. The headwinds of inflation, wage demands, and others appear likely to persist into the medium term. For investors, this is even more pertinent given that stocks have sold off heavily this year.

Asset turnover will be critical if the unusual state of the labour market persists – namely if wages continue to rise while productivity continues to fall. Of course, many have predicted a post-covid burst in technology adoption, but so far this has not provided a widespread and sustainable boost to corporates.

The winners in this environment will likely include companies that can generate more sales from existing assets. The key here is management quality. Thus, we expect investors to put more emphasis on the qualitative aspects of their investment process and more closely scrutinise key managers.

Improving asset turnover sounds like a pipe dream to some. The opportunity comes from the fact that so many companies have balance sheets bloated from years of overinvestment, borrowing, or overpaying for asset acquisitions. Now, if companies have the managerial capabilities, it is time to use those assets more efficiently.

The final effect of covid on productivity may turn out to be positive. However, it will likely take some years for the fallout from the new working environment to fully work its way through the economy and find an equilibrium. In the meantime, investors may focus on how a company optimises its existing asset base.

Deutsche Bank Research clients can access the full report [here](#).