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Real Estate, Hospitality & Construction
Global Capital Confidence Barometer

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A note from Brett Johnson, Real Estate Valuation Solutions Leader, Transaction Advisory Services Ernst & Young, LLP

M&A appetite wanes as good deals become harder to find

The global economy has just passed 10 years of economic expansion. We continue to enjoy an extraordinary stock market, historically low interest rates and high consumer confidence. But, to use a baseball metaphor, we're now well into extra innings in the real estate, hospitality and construction (RHC) life cycle. It's getting harder to find good deals – a perspective that's supported by the latest edition of the EY *Capital Confidence Barometer*.

For the first time in three years, expectations around dealmaking intentions have fallen below the historic 10-year *Capital Confidence Barometer* average. Thirty-eight percent of RHC executives say they plan on pursuing M&A in the upcoming year, down from 53% six months ago. There is a clear indication in these numbers that RHC companies are being more deliberate and taking more time in pursuing and closing strategic transactions. Almost two-thirds of RHC executives are bracing themselves for an increase in hostile and competitive bidding in the 12 months ahead. Seven out of 10 expect private equity to be a major acquirer of assets. Meanwhile, nearly two-thirds expect an increase in cross-sector M&A driven by technology and digitalization.

RHC executives are still using digital technology to protect the business they have rather than innovating for the business they need to be

In an environment where it is getting harder to find value, RHC companies are looking to technology – and specifically data and analytics – to help them gain a competitive advantage. As the margins get tighter on traditional core real estate assets, companies are taking more chances on secondary markets and opportunistic real estate, including inserting nontraditional assets classes into portfolios, from infrastructure to fiber optics to billboards. Data and analytics tools are helping RHC companies find deals in areas others may not be looking into.

More than half (54%) of RHC executives say they are investing in digital assets through external corporate venture capital (CVC) funds, joint ventures, alliances and M&A, while 44% intend to develop the tools they need in-house or through internal CVC funds.

With 75% saying that their company has a clear vision for digital technology's transformational impact on its business strategy and an equal percentage saying that their organization has a strong innovation culture focused on using technology for operational, financial and commercial success, we would expect to see more investment in innovation that drives the customer experience. And indeed, when asked in which areas RHC companies have made or are planning to make significant technology investments, 38% say they have devoted past investment in improving the customer experience and creating new products and services; 36% say these will be a part of their future investment strategy.

More telling, however, 46% say they channeled past technology investment into improving internal efficiencies, improving financial automation and reducing risks, while 47% say they will continue to do so in the future. While it's too early to say which digital technologies will help RHC companies gain a clear competitive advantage, what is clear is that they need to be making bolder decisions to find out.

As long as the sector economy continues to grow, RHC executives still have time to make the bold moves that will position them to thrive

Fortunately, 63% believe that the sector economy continues to grow and their confidence remains high across key market fundamentals (credit earnings, short-term market stability, credit availability and equity valuations). This, combined with three-quarters expecting improvements in revenue and two-thirds anticipating increases in profit margins over the next 12 months, gives RHC executives a few more innings to boost their investment in digital transformation. Such investments will allow them to make the bold moves that will generate value and better position them to thrive in an increasingly dynamic and disruptive environment.

Top five investment destinations

1. US
2. Australia
3. UK
4. China
5. Canada

Executives remain cautiously optimistic despite slowdown talk

Despite a slowdown in certain global capital markets indicators, RHC executives remain optimistic about global and sector outlook. A slight majority do not expect an economic slowdown in the near to mid term.

86% have a constant or improved outlook for the global market compared with six months ago.

67% expect sector profit to increase over the next year.

52% do not expect an economic slowdown in the near to mid term.

Digital transformation is here

Digital and technology transformation has finally caught on in the sector. A vast majority of executives now have a clear vision of its impact, and 60% are beginning to invest in the transformation. Executives are split on whether to invest externally or develop internally.

75% have a clear vision for digital technology's transformational impact on business strategy.

60% are now devoting 25% or more of their investment dollars to digital and technology assets.

54% are investing in digital assets via joint ventures, acquisitions and external venture funds.

Core M&A will continue to be a challenge

RHC executives expect core pricing competition to continue over the next 12 months, primarily from private equity sources. Only 38% of executives plan to actively pursue M&A this year, the lowest level in our survey since October 2014.

64% expect an increase in hostile and competitive bidding in the next 12 months.

38% are planning to actively pursue M&A in the next 12 months.

57% expect planned M&A to be bolt-on acquisitions (to complement the current business model).

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