

Will COVID-19 turbo-charge M&A and transformation?

C-suites reframe corporate strategies and plan to invest their way out of the crisis.



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A note from Brett M. Johnson, Principal, Strategy and Transactions, Ernst & Young LLP

Real estate and construction executives see recovery ahead; uptick in cross border and sector transactions

After nearly two years of substantial market disruption and change, real estate and construction (REC) executives feel the sector is on the verge of recovery, with many eyeing cross-border and cross-sector transactions in the year ahead.

Nearly three-quarters (78%) of REC executives in the 23rd EY *Global Capital Confidence Barometer* survey are optimistic of revenue recovery in 2021 and 2022, with many expecting profitability to rebound in 2022. Recovery may be based, in part, on companies moving beyond their borders and looking for cross-border and cross-sector synergies. Fifty-nine percent of those surveyed say they are interested in acquiring assets internationally, and 62% expect an increase in cross-sector M&A (further diversifying portfolios where risk is too concentrated in certain asset classes).

The pandemic hit the REC sector particularly hard. The real estate and construction sector intersects with nearly all aspects of the economy, including housing, offices and retailers. Prior to the pandemic, the industry was experiencing record-high valuations. When the pandemic began, deals nearly ground to a halt.

Transaction data supports the survey results. According to Real Capital Analytics, the number of US transactions plummeted from a record high of more than 10,000 property sales in the fourth quarter of 2019 to an eight-year low of just 3,800 in the second quarter of 2020.

Geopolitical considerations also hindered REC sector mergers and acquisitions (M&A). In the survey, 59% of REC executives say they failed to complete a planned acquisition because of geopolitical challenges and 72% altered their strategic plans in response to these same uncertainties.

Like many companies, most REC companies say they conducted a comprehensive strategy and portfolio review during the pandemic. Eighty percent of executives say they conducted a review, largely accelerated by the pandemic. The broad consensus among REC executives is that competition for investments will increase during the next 12 months, with 74% expecting increased competition in the year ahead, largely driven by private capital.

What REC companies can do now to ensure future success

Looking forward, companies with built-up capital will have a significant advantage over competitors to capitalize on opportunistic assets in the marketplace. Further, strong companies may find opportunities during this time and act on previously shelved deals and business transformation.

The following actions can help REC companies be ready to seize the moment.

- If not undertaken yet, **revisit portfolios and conduct bold reviews** with a focus on new market dynamics, talent expansion, digital transformation and access to capital. Investors will need to analyze the long-term impact that COVID-19 will have on differing asset types. One example is the future of corporate office utilization as remote work becomes increasingly prevalent.

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- ▶ **Identify underperforming assets and act quickly to divest.** As noted above, companies that have accrued additional capital by divesting underperforming properties and laggard-growth sectors will be better poised to move when opportunistic assets become available during the early recovery stages of the post-pandemic era. Companies that have previously concentrated on domestic assets may diversify by adding international properties to their portfolio, and vice versa. Likewise, investors that focused solely on one asset type may explore alternative property classes to have a more balanced portfolio and mitigate risk.
 - ▶ Leaders should **continue to invest in talent and digital transformation** regardless of financial circumstance. Perhaps more than ever, future acquisitions will require proper due diligence and the effective integration of assets. Post-pandemic, the process will be more complicated. The right talent and data will help companies to successfully capitalize on future opportunities and enable growth.
 - ▶ Accelerating and **infusing the use of emerging technologies into the deal process** not only adds speed, it also supports better outcomes. Executives need to understand the positive impact of emerging technologies on their deal strategies.

Conclusion: how creative M&A can pave a path to stability, future growth

Real estate is simple economics. Deals are made when the price point for an asset reaches equilibrium on supply and demand curves. The barrier that the REC sector may experience in the near term is establishing market valuations or pricing when there is a lack of confidence in underwriting assumptions. Acquisition teams will be challenged with incorporating the short- and long-term impacts of the pandemic into their financial modeling. Investing in technology and talent now may help address uncertainty and lack of confidence in forecasts. Like firms that capitalized on opportunistic acquisitions following the 2007-09 Great Recession, companies that continue to raise capital and invest in M&A during this period of uncertainty will have a huge advantage over their competition.

Key highlights

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About the survey

The *Global Capital Confidence Barometer* gauges corporate confidence in the economic outlook, and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY framework for strategically managing capital. It is a regular survey of senior executives from large companies around the world, conducted by Thought Leadership Consulting, a Euromoney Institutional Investor company.

The panel comprises select EY clients across the globe and contacts and regular Thought Leadership Consulting contributors.

- From November 2020 until January 2021, Thought Leadership Consulting surveyed on behalf of the global EY network a panel of more than 2,400 executives in 52 countries; 82% were CEOs, CFOs and other C-suite-level executives.
- Respondents represented the following sectors: financial services, telecoms, consumer products and retail, technology, media and entertainment, life sciences, hospital and health care providers, automotive and transportation, oil and gas, power and utilities, mining and metals, advanced manufacturing, and real estate, hospitality and construction.

- Surveyed companies' annual global revenues were as follows: less than US\$500m (25%), US\$500m-US\$999.9m (26%), US\$1b-US\$4.9b (25%) and greater than US\$5b (24%).
- Global company ownership was as follows: publicly listed (60%), privately held (40%).

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