# Active global M&A in the hospitality industry

For several years, confidence in the economy and in deal markets has improved, and the recent surge of mergers and acquisitions (M&A) activity appears reminiscent of 2007. Within hospitality, deals have gained traction, with flush capital and portfolio optimization remaining key drivers. Sentiment in the sector remains positive: a recent EY survey of more than 75 hospitality and leisure executives found that 99% of the respondents expect the global M&A market to continue to improve or stay the same in the next 12 months.[19]

M&A activity overall and in the RHC sector is driven by a desire for incremental growth, the strategic merit of transactions and the availability of debt and equity on favorable terms. The presence of these elements has fueled M&A in recent years. The higher volume of global capital chasing real estate opportunities has also contributed. In the US, for example, foreign investors made approximately 11% of the US$355 billion in real property deals last year, with prominent investment groups from China, Japan and Singapore fueling transaction volume within hospitality specifically.[20, 21]

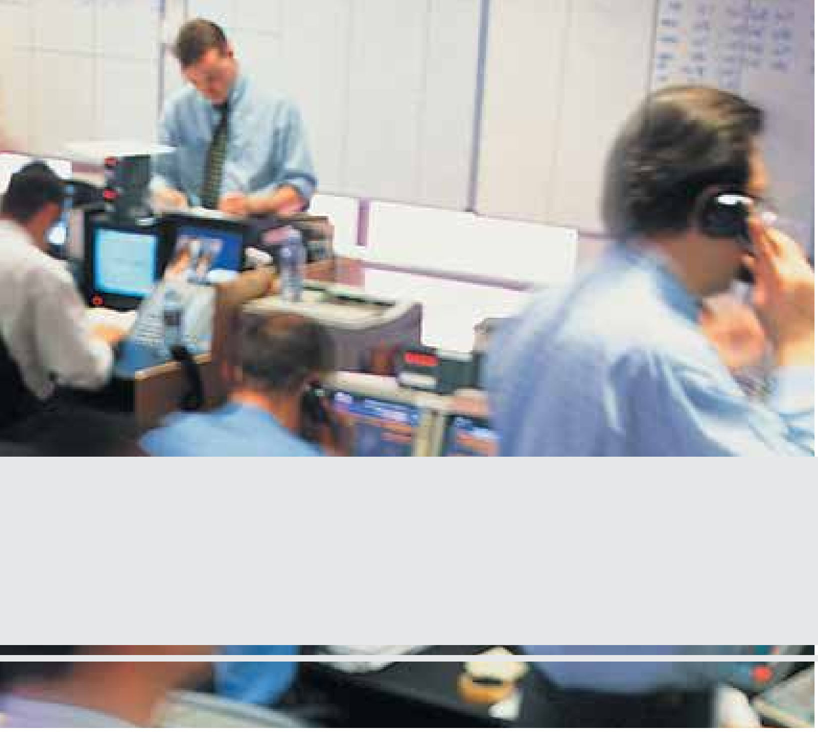
The influx of capital has caused fund managers to look for new ways to expand their real estate portfolios in a hypercompetitive environment, with favorable market conditions encouraging higher confidence and the risk appetite to place capital. However, investors out to make deals should be aware of additional risks and complexity in the markets.

Across the world, real estate investors have become more confident about acquiring real estate operating platforms with the objective of owning the underlying real estate, and not necessarily for operating the platform as a business. However, the challenge lies in vetting this type of deal, particularly under an increasingly high-speed diligence period. Real estate investors may be familiar with underwriting individual hotels, assessing value and modeling cash flows, but these kinds of transactions cannot be solely dissected as real estate portfolio acquisitions. There are additional, value-impacting factors to weigh when buying an entire platform, including the appropriate level of overhead required to operate the properties, as well as potential commitments and off-balance-sheet liabilities of the business. Additionally, the parties may encounter discrepancies in pricing expectations — for example, if a seller prices itself as a stand-alone business while a prospective buyer prices the deal as the acquisition of individual properties.

19. "Global Capital Confidence Barometer," EY, October 2014.

20. *"Cross-border capital tracker for United States,"* Real Capital Analytics, 3 March 2014.

21. *"2013 Year in review,"* Real Capital Analytics, January 2014.



For company acquisitions, the real estate portfolio valuation is a critical part of the due diligence process when the real estate is key to the strategic rationale of the transaction. Yet a top-down business assessment is also crucial to ensure the property valuation is not misguided.

Within hospitality, a recent trend of acquiring hotel management platforms has emerged, in which the real estate is often not a significant component of the transaction. The strategic rationale of investors in this space is to acquire a management platform and enlarge it by adding management contracts with minimal capital investment and operating costs, resulting in future earnings growth. However, an operating platform must be carefully evaluated to determine whether the business can sustain earnings growth.

New players are also emerging. In recent years, certain financial institutions and other alternative investors, which have been indirect real estate investors, are now looking to expand to new platforms, taking advantage of their base-level knowledge of real estate from their lending or other investment activities. These new players are not only diversifying the M&A landscape but are also making it more competitive. Within hospitality, new players are mainly competing for trophy assets in select gateway markets. However, seasoned industry players with a track record of success are still driving most activity in the hotel space.

While it is uncertain whether M&A activity in 2015 will outpace the peak observed in 2007, investors appear to be chasing opportunity and expansion with a newfound discipline. Capital marked for the real estate markets may once again be abundant, but the way it is channeled continues to reflect the lessons learned since the financial crisis.