Brookfield

INSIGHTS
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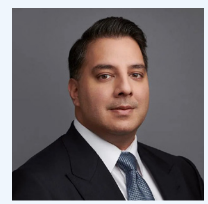
PRIVATE EQUITY

# Q&A: Technology and the Future of Real Assets

## Technology is influencing all aspects of the global economy, enabling growth, driving profitability and creating new markets and industry leaders.

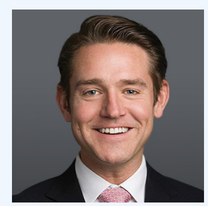
Meanwhile, several large traditional industries—such as real estate, transportation, energy and construction—remain in the relatively early stages of a digital transformation, and are increasingly seeking tools and solutions that enable automation.

Here, three senior leaders from Brookfield's Private Equity Group—**Anuj Ranjan**, **Josh Raffaelli** and **Doug Bayerd**—discuss how innovation is transforming the way these industries operate and generating opportunities to invest in the technology companies helping spur this transformation.

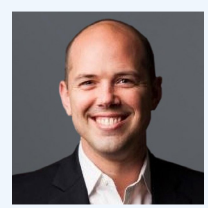
**Anuj Ranjan**

Managing Partner,
Head of Business Development



**Josh Raffaelli**

Managing Partner,
Private Equity



**Doug Bayerd**

Managing Director,
Private Equity

## Q: What is driving opportunities in technology investing?

## Anuj Ranjan:

Software has become the new infrastructure: It forms the backbone of the global economy, and it touches everything we do both personally and professionally. And now, a digital transformation is underway in traditional industries such as industrials, manufacturing, construction, real estate and infrastructure.

Companies in these industries—which are some of the largest and most critical in the world—are spending significantly on technology to drive automation, increase connectivity and enable users to harness the power of their data. We expect that investment in these historically under-digitized businesses will triple over the next 10 years (see Figure 1), and due to the types of margins we believe these companies will earn, we think that this spending will help generate over $12 trillion of equity value for shareholders and investors over the next decade.

FIGURE 1

### Technology Expenditures Are Rising in Traditional Industries


1. IDC
2. Brookfield estimate based on extrapolation from IDC data

**Q: With all the capital available in the world, have tech companies been overvalued?**

## Josh Raffaelli:

What's happened over the last 30 years is the evolution of an entirely new industry. There is $15 trillion worth of value in the market capitalization of the Fortune 1000 companies focusing on technology. All of which is to say: These companies are real, and they're here to stay.

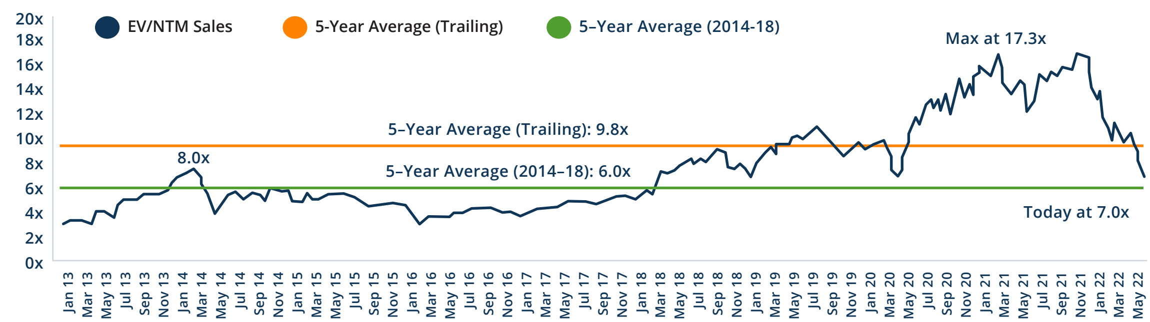
An important term related to software is net retention. Think about real estate: Imagine that a tenant paying $1 in rent today is going to be paying $1.50 next year without changing anything. That is the value of a 150% net retention for a company that sells software to a large business. That's powerful—it shows what software and technology can do, and why valuations have been high.

## Ranjan:

The recent correction in the technology sector has clearly been significant—according to Morgan Stanley, the valuation multiples for software providers are currently trading below the trailing five-year average (see Figure 2). But given that many of these are great businesses that provide infrastructure-like technology services, we are excited that we now have opportunities to invest in them at attractive prices.

FIGURE 2

### Overall Software Coverage Group Below the Trailing 5-Year Average




Source: Morgan Stanley Research, Refinitiv, Company Data

At the same time, not all tech is created equal. You have higher-growth/lesser-profitability companies and lower-growth/higher-profitability companies, and the high-growth/low-profit companies generally trade at much higher multiples—almost double their lower-growth/high-profit peers. Most enterprise solutions that we are looking at fit into the higher-profit bucket, so we are quite thankful that the markets don't appreciate them in the same way as they do high-growth.

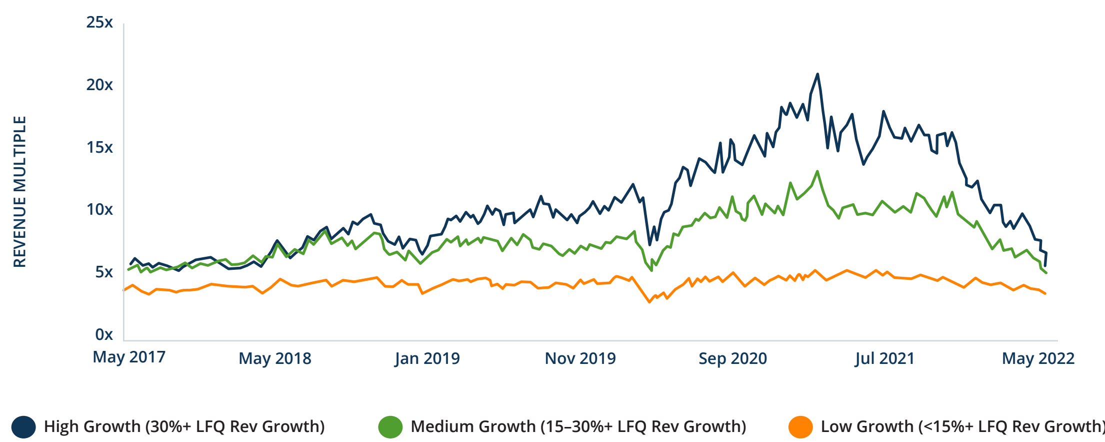
## Doug Bayerd:

Not only that, but the recent correction in tech stocks had a massive impact on the multiples for high-growth companies, while low-growth stocks saw little change (see Figure 3). In my mind, this divergence in prices reflects a shift in investor focus from growth to profitability. Of course, the selloff in growth has also created opportunities to look at some companies that were previously quite expensive. The key in all markets is to focus on investing in high-quality businesses that provide essential services.

FIGURE 3

## Low-Growth Stocks Have Been Relatively Unaffected by the Recent Market Correction

### EV/NTM Revenue Multiples Over Time




Source: Capital IQ, Bloomberg, Factset and IBES. Data as of May 13, 2022

## Q: Finance 101 says that the value of a business is the net present value of future cash flows. Do these revenues eventually translate to cash flows? Does that rule still exist or have we rewritten the rules entirely?

## Bayerd:

That rule absolutely still exists. Technology companies are held to the same investment standards as every other industry sector within Brookfield. The investments we make in technology businesses support the delivery of mission-critical products to enterprise customers and are part of the daily workflow of the end-user. Because these businesses have contractually recurring revenues, we have a high degree of confidence in their ability to generate free cash flows. This confidence stems from the fact that customers are reluctant to rip out product that has been entrenched in their workforce. Retraining your entire staff to learn a new process or procedure will likely lead to a loss of productivity in the short term and may not provide significant savings in the medium to longer term.

Therefore, we find that customers tend to leave this type of software in place. This inertia is important, as the businesses we invest in also tend to have high gross margins, relatively stable operating expenses and limited capital expenditures. In other words, if we can diligence and underwrite the revenue stream with a high degree of confidence, we can also determine with a high degree of confidence when to expect high-margin free cash flows. A good example would be Microsoft Excel—it would be really difficult to rip that software out of our computers, given the way we have trained our staff to work and manage our businesses today on that software.

## Q: Construction seems to be one of the least digitized industries in the world, which can lead to massive inefficiency. Is this an investment opportunity?

## Raffaelli:

This is a core area of focus for Brookfield. To illustrate the extent of the opportunity, in 1994, the productivity per worker in the manufacturing and construction industries was the same, at $64,000 per employee. Twenty years later, that number had almost doubled to $106,000 for manufacturing, while it remained completely flat for the construction industry. One of our first growth investments was in a company that helps simplify the processes involved in construction projects. Consider a general contractor who needs to hire various subcontractors. How do they make that process more efficient? Unless they have a technology solution, they'll be dealing with stacks of paper, making it difficult to compare and contrast their options for plumbers, electricians, builders, etc. Our portfolio company essentially digitized a workflow to make this more efficient.

Another one of our portfolio companies is helping to change the way dollars flow between a developer like Brookfield and a bank. The company's software automates manual workflows and centralizes loan information so banks can make faster, more informed lending decisions. We are very interested in this area—it has taken a very long time to digitize—and see substantial opportunity for growth and expansion.

## Bayerd:

We are seeing an explosion of activity in real estate and construction at the growth stage of investing. Software is digitizing what used to be manual processes and automating them. Real estate is no different from every other sector that has gone through that progression. As software continues to penetrate the sector, we are hopeful that this will result in larger businesses that we can invest in at scale.

## Ranjan:

And there are many other examples where technology is helping transform more traditional sectors that revolve around real assets. In the real estate space, we invested in a smart-lock manufacturer and were able to immediately roll its products out to 40,000 of our multifamily units in the U.S. Because of our experience as an owner and operator of real assets, we had very clear insight into what this technology could do if used in properties like ours. In health care, we invested in a telemedicine provider. During the pandemic, when the company needed 87 locations virtually overnight, we were able to provide those locations across our retail and office footprint in the U.S.

Being able to identify these types of synergies allows us to decide specifically and in a very disciplined fashion where we want to invest.

## Q: What are some other areas where you see technology having a significant impact?

### Ranjan:

In renewables, there are companies that are adopting technology at an increasingly rapid pace to meet ESG mandates. For example: Net-zero enablement enterprise software is needed to measure and track net-zero initiatives. In infrastructure, there is the digitization of the supply chain—such as automated ports, or autonomous trucks. In real estate, where and how people are working is evolving, and technology is playing a big role in enhancing connectivity and increasing productivity. In credit, some innovative software packages are helping creditors provide loans in a better and faster way. In insurance, enterprise software is playing a big role in the digital transformation to drive additional returns in a low-interest-rate environment. We're also spending a lot of time evaluating cybersecurity businesses—this is an area we believe can generate stable, infrastructure-like cash flows. If you have the right software in a particular industry, it's something that people are going to pay for forever.

### Bayerd:

The goal is to partner with management teams as a differentiated investor through differentiated information. This is done by serving as the voice of the customer—since Brookfield *is* the customer in many circumstances. We can also provide insights for companies looking to expand into new markets or geographies, given Brookfield's footprint around the world. In many cases, we have had a front-row seat to witness the growth of software within these industries, and a view on how technology is being adopted to solve workplace problems.

Across everything that we do, we are seeing technology play a key role in changing the underlying businesses.

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