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CBG - Q3 2017 CBRE Group Inc Earnings Call

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OVERVIEW:

Co. reported 3Q17 YoverY local-currency gross revenue growth of 10% and adjusted EPS of $0.64. Expects 2017 adjusted EPS to be $2.58-2.68.

CORPORATE PARTICIPANTS

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James R. Groch *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

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PRESENTATION

Operator

Greetings, and welcome to CBRE Third Quarter Conference Call. (Operator Instructions)

I would now like to turn the conference over to your host, Brad Burke.

Bradley Kenneth Burke - *CBRE Group, Inc. - Head of IR*

Thank you, and welcome to CBRE's Third Quarter 2017 Earnings Conference Call. Earlier today, we issued a press release announcing our financial results, and it is posted on the homepage of our website, cbre.com. On this page, you will find a presentation slide deck that you can use to follow along with our prepared remarks.

This presentation contains forward-looking statements. These include statements regarding CBRE's future growth momentum, operations, market share, business outlook and financial performance expectations. These statements should be considered estimates only, and actual results may ultimately differ from these estimates. For a full discussion of the risks and other factors that may impact these forward-looking statements, please refer to our third quarter 2017 earnings report furnished on Form 8-K and our most recent Annual Report on Form 10-K.

During our remarks, we may refer to certain non-GAAP financial measures, as defined by SEC regulations. Where required by these regulations, we have provided reconciliations to what we believe are the most directly comparable GAAP measures. These reconciliations, together with explanations of these measures, can be found within the appendix of this presentation. Additionally, all growth rate percentages cited in our remarks are in local currency unless otherwise stated. References to results before FX impacts also exclude the impact of FX hedging activity.

Our participants on the call this morning are Bob Sulentic, our President and Chief Executive Officer; and Jim Groch, our Chief Financial Officer and Head of Corporate Development.

Please turn to Slide 4 as Bob discusses our third quarter performance.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Thank you, Brad, and good morning, everyone.

As you've seen, CBRE produced another quarter of excellent results, with double-digit revenue growth and adjusted EPS up 28%. Our performance is the direct result of our focused strategy to produce exceptional outcomes for our clients and the commitment of our more than 75,000 professionals to executing our strategy.

The strength of our performance in the third quarter was broad based. Each of our 3 global regions produced solid growth, and trailing 12-month adjusted EBITDA is at an all-time high in each of the 3 global regions.

Leasing returned to double-digit growth in the third quarter and was exceptionally strong in the United States.

Revenue growth accelerated in our occupier outsourcing business as we continue to capitalize on our commanding position in this growing sector.

Global property sales saw healthy growth despite a generally tepid market for transaction activity, reflecting the strength of our brand and our ability to take market share.

Finally, we also had excellent performance in both of our real estate investment businesses: Global Investment Management and Development Services.

Longer term, our outlook is supported by 3 significant industry trends that play to CBRE's strength as the world's largest commercial real estate services and investment company. The first is the growing demand for outsourced commercial real estate solutions. The second is the increased allocation by institutional investors to commercial real estate. The third trend is consolidation. Clients are awarding their work to fewer, more capable global service providers, which drives consolidation within our industry. We continue to make investments in our people, service offering and operating platform, particularly digital technology capabilities, to capture the opportunities created by these industry trends.

With that, Jim will take you through our third quarter results in detail.

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

Thank you, Bob.

As Bob noted, CBRE continued to produce great results in Q3. Let me start with a few highlights on Slide 5.

First, adjusted EBITDA growth was broad based, up in all 5 business segments and up 17% in total versus last year.

Second, leasing revenue in the Americas increased 13%, led by the U.S., which was up 16%, as we continued to take market share.

Third, adjusted EBITDA margin on fee revenue in our regional businesses was up 20 basis points to 15.9% despite a year-over-year decline in gains from mortgage servicing rights related to GSE lending. Excluding this impact, the margin on fee revenue in our regional businesses increased by 70 basis points. Margin on fee revenue for our entire business increased by 120 basis points overall to 17.7%.

Fourth, we continued to deploy capital into attractive M&A opportunities. We have closed 9 acquisitions thus far this year and maintain an active pipeline. These investments enhance our core strategy and reflect our continued underwriting discipline.

Slide 6 summarizes our financial results. CBRE produced strong top line growth in Q3. Gross revenue and fee revenue increased by 10% and 9%, respectively, with virtually all growth being organic.

Adjusted EBITDA for the quarter grew 18% in U.S. dollars to $412 million, reflecting positive operating leverage.

Adjusted earnings per share increased 28% in U.S. dollars to $0.64 for the quarter.

Our adjusted tax rate improved to 28.3% in Q3 '17 versus 33% in the prior year third quarter, and we continue to take steps to enhance our tax efficiency. The benefit of our lower tax rate in the quarter was mostly offset by increased depreciation and amortization when compared to prior year.

You'll notice that we enhanced our segment-level and income statement reconciliation disclosures. We are also including a detailed history of revenue and EBITDA by segment as a supplemental disclosure posted on our website. These enhanced disclosures should further improve the overall financial transparency of our business for our investors.

Slide 7 summarizes our 3 regional services businesses, which, as Bob mentioned, are all at record levels for adjusted EBITDA in the trailing 12 months. Adjusted EBITDA for the quarter was up 8% in the Americas, 12% in EMEA and 31% in Asia Pacific, excluding all currency effects.

The regions together produced fee revenue growth of 10%. Asia Pacific was a notable performer in the quarter, posting an 18% fee revenue increase, supported by outsized growth in Greater China, India, Japan and Singapore. In the Americas, fee revenue increased 9%, with double-digit growth in occupier outsourcing and leasing. Brazil, Canada and the United States all exhibited strong overall growth. Growth of 8% in adjusted EBITDA in the Americas would have been 18%, excluding the gains from mortgage servicing rights. EMEA fee revenue rose 8%, paced by strong gains in the United Kingdom.

Slide 8 reviews the performance of our major global lines of business in Q3. Revenue growth across these lines of business was almost entirely organic. As mentioned, leasing revenue rose 13% in the Americas and 16% in the U.S., paced by strong performance in New York City. Leasing increased by 4% in EMEA and 17% in Asia Pacific, where growth was especially strong in Australia, Greater China, India and Japan.

Property sales revenue rose 9%, reflecting market share gains in an environment where global market volumes were relatively flat year-over-year. Our performance in property sales was paced by robust growth in Asia Pacific, which increased 33%, led by Australia, Greater China and Japan.

Americas sales revenue improved 7% as robust gains in Brazil and Canada offset relatively flat revenue in the United States. CBRE extended its leading position in U.S. investment sales, with market share increasing by approximately 190 basis points versus last year's third quarter, according to Real Capital Analytics.

EMEA sales revenue declined 2%, reflecting fewer, large transactions in Continental Europe, although growth remained strong in the U.K.

Commercial mortgage origination revenue declined 12%, driven almost entirely by lower gains on mortgage servicing rights related to our GSE businesses, which more than doubled in Q3 of the prior year. Notably, our loan servicing business saw a 24% increase in recurring revenue from our portfolio, which now totals $165 billion. We have begun to separately disclose our loan servicing revenue, which has more than doubled over the last 3 years and now represents nearly 30% of our year-to-date revenue from commercial mortgage services. Our supplemental disclosure includes a 3-year quarterly history of our loan servicing revenue, providing an enhanced view of this recurring revenue stream for our investors.

Property management services produced solid fee revenue growth of 10% for the quarter. Revenue from our valuations business increased 4%.

Slide 9 summarizes results for our occupier outsourcing business, where we continue to see strong growth, with fee revenue up 13% for the quarter. To illustrate our value proposition, let's look at a contract expansion we signed this quarter.

Our client, CSC, was merging with a large division of Hewlett Packard Enterprises (sic) [Hewlett Packard Enterprise] to create DXC Technology. CBRE provided key support during the premerger period and subsequently expanded the relationship to include their entire 32-million-square-foot global portfolio for facilities management, transactions, project management and strategic consulting. In the most basic sense, for clients like DXC, we could be providing services that include managing the day-to-day operations of thousands of facilities and related capital improvement projects, advising on leasing new facilities and identifying and disposing of facilities that no longer meet the client's needs.

In summary, we dedicate an experienced leadership team to the client, supported by a global platform that includes market-leading technology, data analytics and the expertise of over 75,000 CBRE employees on the ground in over 100 countries. This is what we mean when we talk about our competitive advantages of scale, service scope and sector expertise.

Slide 10 summarizes our Global Investment Management segment, where adjusted EBITDA increased 21% in Q3 and is up 10% year-to-date. Our Investment Management business continues to attract significant equity capital. Total commitments reached $9.4 billion over the past 12 months. AUM rose in the third quarter to $98.3 billion, up USD 10.4 billion from a year ago or $2.6 billion, excluding the Caledon Capital acquisition, which was completed in August 2017. Positive FX movements added $2.2 billion to total AUM versus the prior year.

Please turn to Slide 11 summarizing our Development Services segment. This business continues to produce outstanding results. Adjusted EBITDA contributions increased to $35.9 million from $15.7 million in Q3 2016. Year-to-date, adjusted EBITDA is up 29% versus the prior year.

I'll remind you that the timing of realizing incentive income can vary quarter-to-quarter. Our in-process and pipeline portfolios remain healthy, and we expect to realize meaningful income in the fourth quarter, though less than last year's fourth quarter.

Our development pipeline stands at $5.4 billion, with fee-only and build-to-suit projects representing more than half of our pipeline.

Please turn to Slide 12.

This quarter represents the 2-year anniversary of our closing on the Global Workplace Solutions acquisition and is a good time to reflect on our performance since then.

Over this period, growth in employment and GDP has been slow and steady but not great, and property sales volumes have declined. Against this backdrop, I'd like to highlight 2 metrics. First, our trailing 12-month adjusted EPS has increased by 38% over the last 2 years compared to 5% growth in EPS for the S&P 500 over this period.

Second, our leverage over this period has declined even after making a $1.5 billion acquisition. As of Q3, our leverage ratio is only 1x net debt-to-adjusted EBITDA versus the 1.2x level we had immediately prior to our acquisition of Global Workplace Solutions. This reflects our strong cash flow and earnings growth over the past 2 years. We believe this performance highlights the strength of our company and our strategy.

One housekeeping item before I turn the call back to Bob.

We are moving our Annual Investor Day to early March of 2018. This will give us the benefit of having full year 2017 results when providing our outlook for 2018. We look forward to speaking with you again in early 2018.

With that, please turn to Slide 13 as I turn the call over to Bob.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Thank you, Jim.

2017 is proving to be another outstanding year for CBRE. Last quarter, we updated our full year earnings guidance, and our results are generally trending above the midpoint of those expectations. We want to remind you that results in our regional services businesses in the fourth quarter of last year were exceptionally strong, with adjusted EBITDA up 30% from the prior year. Additionally, we continue to expect adjusted EBITDA in our combined Investment Management and Development Services businesses to decline year-over-year in the fourth quarter while still realizing an increase for the full year. To be clear, we continue to see healthy momentum across most of our businesses and regions, and we are increasing our full year 2017 guidance for adjusted EPS to a range of $2.58 to $2.68.

We are very pleased with the strong performance we have delivered for our shareholders. The strength of our business, the quality of our people and the perception of our brand continue to improve. As a global market leader in commercial real estate services and investment, we are benefiting disproportionately from long-term trends that should support continued growth for our sector.

Please turn to Slide 14.

Before we conclude, I want to take a moment to comment on CBRE's role in helping our clients respond to natural disasters. These capabilities were certainly put to the test this quarter with multiple events in the U.S., the Caribbean and Mexico City. Our disaster relief response teams mobilized quickly to keep our clients' facilities safe and operational. Our people often put their client responsibilities ahead of their own personal needs, and I can tell you that this extraordinary effort in a time of great need has not gone unnoticed by our customers. I want to thank everyone at CBRE who balanced their work commitments with their family and community obligations during the recent natural disasters.

With that, operator, we will open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is from Josh Lamers with William Blair.

Joshua Kapler Lamers - *William Blair & Company L.L.C., Research Division - Associate*

Oh, great. How about kind of a broader-picture question? Over the last handful of years or more, the real estate industry has gone through a pretty wild period of technology innovation, whether it's in the form of new products and whatever it may be. So I guess I'm just curious to get your thoughts on the level of adoption of that technology internally, because I get the sense that either in the market or CBRE, that the productivity gains are not necessarily keeping pace with the unveiling of new technologies.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Josh, we've introduced a good number of enablement technologies for our people across our business in the last few years. We track adoption closely, and adoption has gone up considerably over the last couple years in particular as we've doubled down on our focus in that regard. I would tell you that we are getting productivity gains from technology, and I think that's part of what's showing up in our results. As you see, we have continued to have better and better operating leverage in our business, and so I think we are benefiting from that. However, I think there's an awful long way to go, both in our sector and our company, as it relates to using enablement technology to support our people and serve our clients.

Joshua Kapler Lamers - *William Blair & Company L.L.C., Research Division - Associate*

Helpful. Last one for me would be really curious to get your thoughts on the shared space business, especially in light of the WeWorks (sic) [WeWork] purchase in New York.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Okay. Well, first of all, we -- we're around that dynamic in a lot of ways and specifically with regard to WeWork. WeWork is a client of ours. WeWork is a place where we send a good number of our clients. And in some places, they compete with us. We think they're a very good company. They're here to stay. The concept is here to say. And I think we're really well positioned to compete in an environment where that's part of the environment. We have a number of capabilities that serve us well to address that circumstance, and we're investing significantly in ways that'll help us address it more in the future.

Operator

Our next question is from Nick Yulico with UBS.

Greg Michael McGinniss - *UBS Investment Bank, Research Division - Associate Analyst*

This is Greg McGinniss on for Nick. You know the growing demand for the outsourcing CRE services. And with the acceleration into the back half of the year proceeding as expected, can we assume this double-digit revenue growth in the occupier outsourcing business is going to continue into 2018?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

We expect that growth rate to continue indefinitely, the double-digit growth rate. We've said that for years, and we continue to believe that'll be the case.

Greg Michael McGinniss - *UBS Investment Bank, Research Division - Associate Analyst*

And how -- and I know you said that mostly, it was entirely organic growth. But, I mean, how much of that double-digit growth is based on acquisitions?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

It's organic. That double-digit growth is almost entirely organic, not through acquisitions in the quarter.

Greg Michael McGinniss - *UBS Investment Bank, Research Division - Associate Analyst*

Okay. And just one more for me. On (technical difficulty) transactions -- to (inaudible) on transaction, markets or cap rates have been relatively stable, but these declining transactions volumes suggest a bid/ask spread is just a bit too wide for most investors. Do you think prices need to come down to jolt transaction volumes? I'm just trying to get a sense for how much money might be waiting on the sidelines in the U.S. transaction market.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

There's a lot of money on the sidelines for transactions in the U.S., particularly in the areas of industrial and multifamily. We have big multifamily business, big industrial business, and we're having trouble keeping the buyers that we work with satisfied with the amount of product we're delivering. Transactions have, in fact, slowed down a little. The time to get a transaction closed has slowed down by 5% or so. But the fact of the matter is there's plenty of capital out there, and the product that's coming to market is well leased with good tenants, and we see that at market -- while transactions have certainly slowed down from their peak in 2015. It's still a healthy market out there, and we've had nice growth in our investment sales business around the world.

Greg Michael McGinniss - *UBS Investment Bank, Research Division - Associate Analyst*

Is there any issue with folks just not wanting to sell decent assets at this point then?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Sure, there is. I mean, people that are investing in commercial real estate and believe in it, and that -- and the institutional capital in commercial real estate is growing, aren't going to exit assets unless they feel like they have an opportunity to get into another asset in certain cases because they're building portfolios. So that's a situation that we definitely see in some cases.

Operator

(Operator Instructions)

Our next question is from Jade Rahmani with KBW.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Based on your conversations with your brokerage force and with institutional investors for the market overall, would you expect a similar level of activity in 2018 as in 2017 in terms of property sales?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

Jade, this is Jim. I don't think we're going to give any forecast at this point. But we'll come back to that at year-end.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

As a follow-up to the prior question, could you provide any insights into property sale pipelines with respect to number of property listings, number of bidders? You commented on time lines to deal close, but just anything that could give sort of a sense of color in the market.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Well, we've -- what we've said, (Jay) [Jade], is that we expect a low single-digit growth this year in investment sales volumes, and nothing about that projection has changed. There's a lot of buyers in the marketplace. There's a decent amount of product. As I said a couple of minutes ago, it's not what it was in 2015, but it's still a very healthy market with some really good circumstances: little overbuilding, growing rental rates, growing occupancies and a lot of institutional capital around the world is interested in commercial real estate.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Within that commercial mortgage services segment, can you say how much of the debt placement revenue is from the GSE multifamily business and how much from other sources?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

We haven't broken down that detail. But our...

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Is the majority GSE multifamily?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

Yes, our origination business is heavily weighted to multifamily. Not all GSE but definitely heavily weighted to multifamily.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

And I guess in the MSR gains, somewhat confusing because I think you said that GSE multifamily volumes doubled year-over-year, but the MSR gains were a headwind. Can you just explain that?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

I don't think we said that volumes doubled. But volumes are up, so the -- but you do get -- depending on the mix of the type of origination, where it's coming from, factors relating to that, fees can be quite different from one origination to another. So revenues don't always follow level of origination.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

What was the year-over-year growth in the GSE volumes?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

So the -- we have hit a -- if you look at the overall impact, if you try and assess the overall impact on our numbers from GSE, it was a $21 million negative impact to pretax earnings. And the way you can -- the details of that are, we had $35 million of gains in Q3, we had $26 million of amortization. But if you're comparing, the gains are down by $13 million, the amortization is up by $8 million. The net impact is negative $21 million.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

And what about overall GSE production volumes year-over-year?

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

Volumes are up. Like I said, they're up. So you -- but you can have times where volumes and revenue just are different just by the nature of the size of the deals, the types of deals, fee structures in different deals.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

Turning to the M&A -- recent M&A transactions. Are there complementary service business lines? I noticed in the Heery acquisition that the company has an aviation segment, which caught my attention. Are you looking at broadening the service offering? And is that a meaningful opportunity?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Well, Heery does address some markets that we weren't in before in terms of project management. So they do some stuff in the aviation area. They do some stuff in public education and other public sector-type things. That deal or that business comes with not only broadened scope but some seriously talented professionals that are very additive to a number of our local markets. So we're quite excited about that deal and what it adds to our business.

Jade Joseph Rahmani - *Keefe, Bruyette, & Woods, Inc., Research Division - Director*

And just lastly, I wanted to see if you could offer any comments on the House's Tax Reform Bill, whether you view it as positive for commercial real estate and what, if any, implications there are to CBRE's tax rate.

James R. Groch - *CBRE Group, Inc. - CFO and Global Director of Corporate Development*

Yes, we have taken a look at the bill that came out yesterday. Our initial take is positive. Obviously, we're going to be cautious and waiting. There could be a lot of twists and turns between now and when legislation is finalized. But net-net, we see it as positive for the industry.

Operator

Our next question is from David Ridley-Lane with Bank of America Merrill Lynch.

David Emerson Ridley-Lane - *BofA Merrill Lynch, Research Division - VP*

So congratulations, I guess, on the 2-year anniversary of the GWS acquisition. I did want to check in about the progress you're making in cross-selling those clients, particularly around outsourcing-led leasing transactions.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

David, we're making really good progress with the clients that came over through GWS, the GWS acquisition. Certainly, some in the area of cross-selling but just broad-based better results with the individual clients we brought over. Client satisfaction has gone way up, which positions us well to sell new services to them and do more of what we were already doing for them. But in the vein of the question you're asking, I think it's worth noting that we have a lot of cross-sell opportunities all over our business when we do work with those big clients. And so the trend is very positive in that regard, and we're happy with the way that specific acquisition has gone and the way those clients are evolving as clients of ours now.

David Emerson Ridley-Lane - *BofA Merrill Lynch, Research Division - VP*

And then it sounds like the M&A activity is -- or, excuse me, environment is getting incrementally better for you. I did want to ask, though, on Asian recruiting and retention. Is it a attractive market in terms of looking to add talent? And then on the other -- flip side of that, are you having any difficulty in retaining your talent?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

We continue to have good success in attracting talent. This will be the fourth or fifth year in a row where we've recruited, net of departure, several hundred producers around the world. Much like when we do infill acquisitions, we have an advantage in terms of the cost that we pay to recruit or the cost that we pay to retain because brokers that come to our platform or stay on our platform can produce more revenues for themselves and their company here than they do elsewhere. That's a well-proven dynamic. And so recruiting and retention are going well. I think the pressures are actually a little less this year than they were last year. Things have settled out in the industry. And as Jim said, that's been the case for infill acquisitions as well. So we're seeing good opportunities, and we're executing well against those opportunities.

David Emerson Ridley-Lane - *BofA Merrill Lynch, Research Division - VP*

And heard you in saying there were hundreds of additions. Any -- would you go so far as to give a sort of rough growth rate?

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

We just don't -- we don't give that number.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. I would like to turn the call back over to Bob Sulentic for closing remarks.

Robert E. Sulentic - *CBRE Group, Inc. - CEO, President and Director*

Well, thank you, everyone, and we'll talk to you in about 3 months with our year-end results. Take care.

Operator

This concludes today's conference. You may disconnect your lines at this time, and thank you for your participation.
