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CBRE Group, Inc. (CBRE)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to CBRE's Q4 2020 Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Kristyn Farahmand, Vice President of Investor Relations and Corporate Finance. Please go ahead.

Kristyn Farahmand

Vice President, Investor Relations and Corporate Finance, CBRE Group, Inc.

Good morning, everyone, and welcome to CBRE's fourth quarter 2020 earnings conference call. Earlier today, we issued a press release announcing our financial results, which is posted on the Investor Relations page of our website, cbre.com, along with a presentation slide deck that you can use to follow along with our prepared remarks as well as an Excel file that contains additional supplemental materials.

Our agenda for this morning's call will be as follows. First, I'll provide an overview of our financial results for the quarter. Next, Bob Sulentic, our President and CEO; and Leah Stearns, our CFO, will discuss our fourth quarter results and expectations for the future. After their comments, we'll open up the call for questions.

Before I begin, I'll remind you that this presentation contains forward-looking statements that involve a number of risks and uncertainties. Examples of these statements include our expectations regarding CBRE's future growth

prospects, including 2021 outlook and multi-year growth framework, operations, market share, capital deployment, financial performance, including profitability, margins, and the effects of both cost-savings initiatives in COVID-19, and the integration and performance of acquisitions, and any other statements regarding matters that are not historical fact.

We urge you to consider these factors and remind you that we undertake no obligation to update the information contained on this call to reflect subsequent events or circumstances. You should be aware that these statements should be considered estimates only and certain factors may affect us in the future and could cause actual results to differ materially from those expressed in these forward-looking statements.

For a full discussion of the risks and other factors that may impact these forward-looking statements, please refer to this morning's earnings release and our most recent annual and quarterly reports filed on Form 10-K and Form 10-Q, respectively. We have provided reconciliations of adjusted EPS, adjusted EBITDA, fee revenue, certain other non-GAAP financial measures included in our remarks to the most directly comparable GAAP measures, together with explanations of these measures in the appendix of the presentation slide deck.

Now please turn to slide 4, which highlights our fourth quarter 2020 and full-year financial results. During the fourth quarter, total revenue and fee revenue fell about 3% and 7%, respectively, driven by constrained transaction activity in Advisory Services. Lower revenue was more than offset by prudent cost management and the continued benefit of transformation initiatives that improve both our cost structure and operational agility.

Overall, adjusted EPS grew nearly 10% to \$1.45. GAAP EPS of \$0.93 includes around \$0.28 of transformation initiative costs. Importantly, GAAP EPS in the prior year fourth quarter included a \$0.67 tax benefit primarily from legal entity restructuring. Excluding these unusual items in both periods, GAAP EPS would have been up slightly compared with the fourth quarter of 2019.

Now, for insights on results and our longer term strategy please turn to slide 6 as I turn the call over to Bob.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Thanks, Kristyn, and good morning, everyone. As you've seen, we ended 2020 on a high note with adjusted EPS for the quarter reaching an all-time high and adjusted EBITDA growing 9%. This capped a year of significant challenges stemming from COVID, but also one that brought to the forefront CBRE's competitive advantages, our ability to capture often overlooked industry opportunities, and the resiliency we've built into the business over the past decade. This resilience has allowed us to offset the steep decline in sales and lease transactions, and the pandemic's unique effects on the office market.

Today, CBRE is more diversified than ever before across four key dimensions: property types, lines of business, geographic markets and clients. A few examples will bring definition to this. While office remains an important property type for us, its negative effects have been tempered by our large and growing presence in industrial, data centers and multifamily. Leasing is a key line of business for us that has been under pressure. However, other lines of business, such as GSE financing, investment management and facilities management have all continued to grow.

Geographically, New York, London and San Francisco are key markets for us. But our presence in Asia is robust and growing, and our significant activity in Europe and second-tier US markets has held up relatively well. We served many clients that have been negatively impacted by COVID, but do a huge amount of business with technology, life science and other clients that have thrived over the past year. Reflecting how large companies

increasingly rely on CBRE, nearly 90% of our 100 largest clients purchased 4 or more services in 2020, up from less than a quarter a decade ago.

Our broad diversification across these four key dimensions has served us well compared with prior downturns. Adjusted EPS fell 12% in 2020. We expect earnings to rise to near peak profitability this year, the second year of the downturn, and continue up from there. By comparison, during the great financial crisis, we suffered a more than 80% peak-to-trough decline, and adjusted earnings per share did not return to the prior peak for 8 years. We're exiting the worst of the COVID crisis in great shape. Our strengths include a leaner operating structure, significant financial capacity, and a strategy squarely aimed at the many opportunities unfolding in our industry, including those with secular tailwinds.

We built our long-term plan on the assumption that office demand remains under pressure due to a lasting increase in remote working and occupiers' need for greater flexibility and space obligations. This is reflected in our base case forecast which nevertheless expects us to achieve a minimum of low-double-digit average annual adjusted EPS growth through at least 2025 absent a recession.

This forecast is driven by organic growth and deploying capital notably in M&A and real estate investments with meaningful upside potential from additional capital deployment. We expect to achieve this strong growth while continuing to evolve our business as we reduce contributions from lower secular growth business lines and increase our focus on areas that have higher secular growth profiles.

One growth area we are particularly high on is flexible office space. We identified this sector as an opportunity three years ago and have been building our Hana business expressly to meet rapidly rising demand from occupiers and investors. Our investment in Industrious now aligns us with an exceptional operator and outstanding leadership team that is executing a great strategy. With more than 100 units in 50 markets, Industrious enables us to participate in the flex space opportunity at scale and contribute meaningfully to Industrious' expansion.

Now, Leah will discuss the quarter and our outlook for 2021.

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

Thanks, Bob. Turning to slide 8, our Advisory Services segment fee revenue and adjusted EBITDA declined about 13% and nearly 8% respectively. These declines are mostly attributable to continued weakness in high margin sales and leasing businesses. This was partially offset by disciplined cost management and strong performance by the rest of our Advisory businesses, which in combination grew revenue nearly 11%. Overall, our Advisory adjusted EBITDA margin expanded about 120 basis points compared to a year ago. This margin benefited from cost optimization efforts and 210 basis points from substantially higher OMSR gains than in last year's fourth quarter.

Global leasing revenue declined about 28% as occupiers around the world continued to defer leasing decisions due to the pandemic. For the US, Continental Europe and the UK, which together comprise about 78% of global leasing, revenue decreased 36%, 18% and 6%, respectively. The UK again benefited from particularly strong industrial activity in the quarter, which helped to offset subdued demand for office space. The continued growth of e-commerce drove industrial leasing revenue increases of 20% globally and 24% in the Americas. We're also seeing greater resilience among US leasing transactions generating less than \$1 million of revenue, which were down just 25% versus a decline of over 60% for those over \$1 million.

Advisory sales improved notably from Q3, but remained 15% below Q4 2019 levels. The Americas and APAC regions saw sequential improvements paced by the US where Advisory sales revenue fell just 5% in Q4 compared with nearly 39% in Q3. Strength in the Americas reflected both US market share gains of 90 basis points to nearly 19%, and relatively strong industrial and multifamily transactional activity.

Looking more closely at our activity with office assets underscores the benefits of our geographic diversification. In the Americas, office sales and leasing revenue fell over 50% compared to declines of around 30% for each in EMEA, and 17% for sales and 20% for leasing in APAC.

Commercial mortgage origination revenue rose 49% in the quarter, reflecting a surge in GSE lending particularly targeted at affordable housing. This activity also reflects the benefit of continued strong refinancing and loan sales activity. As a result of the strong pace of loan originations, our loan servicing portfolio grew 17% to \$269 billion, while servicing revenue grew nearly 25%.

Valuation revenue grew about 4%, reflecting increased assignments for investor clients particularly in Continental Europe, North Asia and Pacific. Finally, advisory property and project management together declined about 4%. Property management fee revenue grew just over 1%, while advisory project management declined 12% as demand from US public sector and industrial clients partially offset a steep decline in office. Notably, we completed 18% fewer projects than in the last year's fourth quarter, while the margin on these projects improved. We expect project management to benefit from pent-up demand as economies reopen and business activity normalizes.

Turning to slide 9. Our Global Workplace Solutions segment posted 3% fee revenue growth as a 7% increase in both facilities and project management offset a steep decline in GWS transactional revenue. Despite limited transaction revenue in the fourth quarter, our GWS adjusted EBITDA margin expanded over 350 basis points to nearly 18%, marking our third consecutive quarter of record profitability. GWS margins continue to benefit from lower discretionary spending and structural changes to the cost base. While our new business pipeline remains solid, COVID restrictions continue to hamper new GWS client onboarding.

We expect GWS growth to gain momentum in the middle part of this year as the economies continues to reopen. Despite these recent operational challenges, we expect our GWS business to continue benefiting from greater diversification across client sectors and property types. For example, our focus on specialized services for life sciences and healthcare assets resulted in a 240 basis point increase in revenue contribution from these clients in these sectors in 2020. In addition, our data center services business delivered notably strong revenue growth in 2020.

Turning to slide 10, our Real Estate Investments segment achieved \$110 million of adjusted EBITDA, a \$68 million increase from the prior year Q4. Investment management adjusted EBITDA rose over 228% to nearly \$53 million. This reflected continued strong growth in assets under management, which reached a new record at nearly \$123 billion, driving 15% growth in asset management fees.

Importantly, just 20% of total AUM is invested in office, while industrial and logistics comprise our largest investments. Additionally, carried interest surged to \$31.5 million versus just \$9.7 million in the prior year quarter primarily as a result of the disposition of a retail property portfolio in South Korea.

Development adjusted EBITDA rose to over \$67 million, reflecting an elevated level of industrial asset sales in the quarter. Our in-process development portfolio continued to grow driven by strong demand from industrial clients

reaching a new record at \$14.9 billion. Importantly, fee development and build-to-suit projects comprise more than half of this in-process portfolio offering greater visibility and predictability into our future development earnings.

Lastly, Hana's adjusted EBITDA loss of over \$10 million was slightly more than that in Q3. Hana's results were impacted by the pandemic and the costs of building out new units. As Bob detailed earlier, we expect demand for flexible solutions to ramp up as the pandemic recedes and occupiers act on their desire for optionality in their real estate portfolios. Our investment and partnership with Industrious positions us to capitalize on this opportunity.

Turning to slide 11. We've ended 2020 with record free cash flow generation, a healthy balance sheet, and considerable financial capacity. During 2020, free cash flow increased 68% to nearly \$1.6 billion. This was partially driven by lower working capital required by our GWS business as new client onboarding slowed from a particularly strong pace in 2019. We expect this to modestly reverse as client onboarding accelerate.

Nevertheless, we will benefit from improved cash management processes and our cost optimization efforts, which generated savings of around \$120 million in 2020. Structural cost changes are expected to deliver over \$100 million of incremental savings in 2021 even after accounting for the reversal of certain actions that were temporary in nature.

These changes will enable us to pursue OpEx investment to enhance growth while preserving strong profitability. We managed our balance sheet prudently heading into the downturn. This, coupled with the strong cash flow generation enabled us to end 2020 with a net cash position and \$4.6 billion of liquidity.

Turning to slide 12. While considerable uncertainty remains, we expect our business's resiliency and the world's continued progress in mitigating the pandemic to benefit our 2021 results. While transaction revenue has been weak, we have fared much better than in prior downturns due to the broad diversification of both deal sizes and property types.

During 2021, we expect continued growth in industrial and multifamily transactions as well as a modest rebound in retail leasing to offset continued pressure in the office market. Within office, we anticipate quicker leasing improvement outside of the Americas. Overall, we expect transactional revenue growth in the mid- to high-single digits for the full-year 2021. From a sequential standpoint, we expect the sales and leasing revenue decline on a combined basis in Q1 relative to prior year to be similar to the pullback we saw in Q4 of 2020.

Transactional revenue should begin to rebound in Q2, particularly since by then we will be comparing against the depressed levels of the pandemic's first month. Across the rest of Advisory, we expect high-single digit revenue growth with property management and mortgage origination leading the gains. We expect modest margin improvement in Advisory this year, reflecting this revenue growth and the full-year effects of cost optimization partially offset by the reversal of some temporary cost saving measures we imposed during the depth of the crisis as well as select investments.

Moving to GWS. We expect revenue to rise in the high-single-digit range this year with slightly better growth in adjusted EBITDA. The relaxation of COVID restrictions should enable faster client onboarding and catalyze GWS growth across project management and facilities management. Because of this, we expect sequential improvement in our GWS growth as we move through 2021 with the rate expected to accelerate to low-double digits by year-end. We believe this growth rate can be sustainable on a multi-year basis.

Looking at REI, we expect this segment to build on its record-breaking adjusted EBITDA contribution in 2020 with both investment management and development poised for compelling performance. In investment management,

we expect revenue to approximate 2020's \$475 million level with continued increases in recurring revenue being offset by lower carried interest. We expect adjusted EBITDA to rise in the mid- to high-single-digit range compared with \$125 million contributed in 2020. This reflects some operating leverage as well as some incremental operating expense investments to enhance future growth.

We project US development adjusted EBITDA to rise in the mid-single-digit range from the \$142 million generated this year. Our in-process portfolio continues to grow reflecting increased appetite for warehouse and distribution space. We also envision targeted investments this year to expand our geographic reach, deepen our position in growth sectors, and accelerate future growth including a new initiative to launch an industrial and logistics development capability in Continental Europe. We are seeing tremendous demand from US-based capital partners and occupiers for logistics facilities across Europe, and are assembling an experienced team under the highly regarded Trammell Crow Company brand to meet this exploding demand.

For our UK multifamily development business, we expect the pace of construction to pick up as COVID restrictions lift. As a result, we are forecasting this business to produce around \$15 million more in adjusted EBITDA than the \$3 million contribution it generated in 2020. All in, we expect our 2021 adjusted EPS to approach our pre-pandemic peak achieved in 2019 with some potential upside from our capital allocation activities.

Turning to slide 13. Our track record over the last decade and notably over the last 12 months has proven the resiliency of CBRE's business and provides the foundation for enduring average annual earnings growth at a minimum low-double digits through at least 2025 with meaningful upside potential from additional capital allocations. We expect to further enhance our organic earnings growth through a combination of investments and capital returns to shareholders.

Given our diversified business mix, we expect strong organic growth in key parts of our business to more than offset lower demand for office space as hybrid work models result in smaller corporate footprints. We see growth opportunities through increasing broker recruiting, digital and technology investment, and principal and co-investment activity in our REI segment. A good example of this is our co-investment through CBRE Global Investors into private infrastructure programs, which is an area we expect will benefit from secular growth tailwinds.

Initiatives like the SPAC sponsorship and Industrious investment, which partners us with an industry-leader in flexible work spaces, can further jumpstart our growth, while offering younger, developing companies the benefit of aligning with CBRE's extensive platform capabilities.

Finally, we intend to dynamically allocate our capital while preserving our investment grade credit ratings to deliver the best risk adjusted returns for our shareholders. To this end, we view our shares as an attractive investment. If we are unable to identify enough strategic acquisition opportunities at attractive valuations, we intend to resume our programmatic repurchase program and we'll seek to repurchase shares as our financial capacity and valuation allows. We will provide progress updates annually as we pursue this multi-year growth framework.

With that, please turn to slide 14 and I'll turn the call back over to Bob for some closing remarks.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Thank you, Leah. Before we take your questions, I want to briefly touch on CBRE's approach to environmental, social and governance issues. We know from our interactions with you that ESG is extremely important to our shareholders as well as our clients and our people. CBRE is determined to set the pace for our sector on ESG issues particularly sustainability and diversity. Making measurable progress is one of my personal performance objectives for the year.

When it comes to diversity, CBRE's commitment begins at the top. Our 12-person Board of Directors includes three women and four diverse men. Of the 13 executives, who report to me 5 are diverse. These direct reports include Tim Dismond, who is named Chief Diversity Officer last year. We have just expanded Tim's role to Chief Responsibility Officer, and are bringing together all aspects of ESG environmental, sustainability, workplace safety and well-being, philanthropy and public affairs, as well as diversity and inclusion under his leadership. One notable commitment is the use of our massive supply chain to advance diversity by spending \$3 billion annually with minority and women-owned businesses by 2025.

Accelerating our progress with recruiting and developing diverse team members remains a core focus. We're making steady progress as reflected in our earning a place on both the Bloomberg Gender-Equality Index and the Human Rights Campaign's Corporate Equality Index in late January. We've also been recognized for our leadership in sustainability. For example, CBRE is the only commercial real estate services provider to land on the Dow Jones Sustainability World Index. We are determined to make further gains. Late last year, we committed to science-based greenhouse gas reduction targets with the goal of cutting our emissions by more than two-thirds by 2035.

We also pledged to make similarly ambitious reductions in the properties and facilities we manage for clients. As the world's largest manager of commercial properties, CBRE can play an outsized role in helping to limit the rise in global temperatures, improve the efficiency and sustainability of building operations, while benefiting our shareholders given the heightened demand for sustainability services. This is not only good for the planet, it is simply good business practice.

With that operator, please open the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] The first question is from Steve Sakwa from Evercore ISI. Please go ahead.

Steve Sakwa
Analyst, Evercore ISI

Q

Thanks. Good morning, Leah and Bob. I was just wondering if you could maybe touch on I guess that's on slide 11, the second bullet point where you talk about the sort of accelerating future growth and rebalancing the portfolio. I'm just trying to get a little bit more sort of understanding. Is that sort of code for leasing and sales should come down sort of as percentages of the overall business and things like REI and GWS should be growing? Are there other things we should be thinking about as you talk about rebalancing?

Robert E. Sulentic
President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yes, Steve. This gets back to the notion of us operating in a huge industry and having flexibility across four dimensions to adjust where we allocate our capital and focus the energies of our management team. So, to repeat those four dimensions, its product type, for instance, industrial versus office, et cetera; it's line of business, for instance, leasing versus project management versus facilities management; it's geographic spread; and of course, it's client type.

We have done a ton of strategic work over the last year in response to COVID. The crisis has caused us to really get focused on what parts of our business are going to be accelerated given the current circumstance and the likely circumstance over the next few years and what parts are going to be under pressure. We got a management that's very well equipped to adjust focus, and we got a balance sheet with lots of capacity to help us drive that adjustment to our focus.

And yes, we believe that we'll be moving in the direction of elements of our business across those four dimensions that have secular advantage or at least neutral as it relates to being resilient. And Leah can talk to you more about that. But we've really doubled down and thinking that way as it relates to our balance sheet and using the \$4 billion of capacity we have. Leah, do you want to add to that?

Leah C. Stearns
Chief Financial Officer, CBRE Group, Inc.

A

No. I would just add, Steve, that from my perspective this is really about ensuring that we're seeking to achieve the best total return from the investments that we make. And as we think about that, we will continue to evaluate our capital deployment strategy along the lines of ensuring that the returns that we seek are at or better than those presented by simply buying our stock back. So, ensuring that we're investing in areas where we'll accelerate growth for the business. And as Bob just outlined, that is certainly aligned around our four dimensions of diversification as well as areas of secular tailwinds.

Steve Sakwa
Analyst, Evercore ISI

Q

Okay. And then, I guess the second question sort of maybe piggybacks on that last statement just about the capital deployment because I think you said in your comments that you'd also look to maybe reinstitute a more

programmatic share buyback, but I know you didn't buy back stock in the fourth quarter. So, just given the surge in the stock price, but obviously earnings are clearly trending in the right direction, I guess, how are you weighing the investment opportunities versus kind of the share buyback?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

Absolutely. We have a programmatic program. We have about \$350 million remaining under our existing authorization. We will resume programmatic repurchases in the first quarter subject to it meeting our valuation target. And we look at that as the fact that we're currently in a net cash position, and we believe we have ample liquidity to pursue both our M&A pipeline, as well as begin returning capital back to shareholders through our share repurchase program. So, we feel we're in a very good position to be able to do that today. And given our view on the long-term growth of our business, we believe that it's an appropriate time to do so.

Steve Sakwa

Analyst, Evercore ISI

Q

Great. That's it for me. Thanks.

Operator: The next question is from Anthony Paolone of JPMorgan. Please go ahead.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Yeah. Thanks. Good morning. My first question is on Industrious. Can you talk about their specific business model whether it is currently in a profitable state or money losing state or like what that impact will be on CBRE in the near-term?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah, Tony. We'll only say with regard to Industrious' financials that we expect that acquisition to be accretive this year. Not in a major way and then grow from there. But as it relates to their business model, it is so overlapping with what we've been trying to do with Hana. It was the perfect flex space operator for us to invest in. They have an asset light model. That means that they provide flex space as a service, as a service to landlord, as a service to tenants. They are not taking long term leases, and then turning around and doing short term leases with occupiers.

They are very, very riveted on client service. We were super proud of Hana's client service. They beat us, they topped us, they were the one-off operator in the marketplace that had better client service. They have a footprint of 100 units. It'll be well over 100 with Hana and growing nicely from there, so that there'll be some scale to offer our occupier clients. And if you were to talk to Jamie Hodari, their CEO, he would tell you that one of the things he was excited about our ability to bring to the table is deep and broad relations across the occupiers around the world.

So, we think that strategically Industrious is the right company for us to invest in and partner with in a sector that we believe is going to have really nice dynamics over the next several years because these occupiers as they rethink their space utilization are going to want flexibility all over the place. They're going to want to be able to get in and out of space relatively quickly. They're going to want to be able to take smaller spaces away from their headquarters, so their people cannot have to come into CBDs in some cases or come into other areas of the CBD

where the headquarter isn't. So, we think they were the perfect partner for us and we love where we've ended up there. And I think, if you talk to Jamie and their team, they would comment similarly on the situation.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. And then CBRE's \$200 million investment, does that provide enough capital for that to achieve a much larger scale over time or I don't know if the business model, if [indiscernible] (34:36) put up CapEx or how that works?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Tony, it's a capital light model. They put in – it'll provide them with some capital, but they're not spending a lot to expand that business. They're not taking on long-term leases. They're not putting the most of the tenant finish. So, they have the capacity to expand that business. We feel very good about that.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. And then on the M&A side more broadly you've mentioned a few times the pipeline there. Can you talk a bit more specifically on just whether you're seeing larger types of transactions or not just given the financial capacity that you have?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Let me remind you how we think about M&A. We start with – and by the way, M&A and investments that we make for instance the Industrious investments – investment, which clearly wasn't M&A. We first and foremost think about improving our ability to serve our clients, bringing something to the table that we didn't have before because at the core of our strategy is delivering outcomes to our clients they couldn't get elsewhere.

We look across our business all three segments. So, Advisory, GWS or outsourcing and REI and we look for places where we can buy businesses to fill out our capability set. Of course, we're not going to do deals that don't make sense, that don't achieve the hurdle rates we established, so on and so forth. Right now, we think there are some very good opportunities out there. We're being very thoughtful about where we go. You know, Tony we've talked about it so much over the year. There are certain parts of our business we think have better growth profiles than others. So, we're a little more oriented there when we do M&A.

But we think we can find M&A opportunities across all three sectors. And I'm going to highlight one that surprised everybody a year and a half ago when we did the Telford Homes acquisition in the UK. That was an area where we came in. We realized that there was a real need for institutional quality multifamily housing in London that wasn't being fulfilled. We had the opportunity to buy that business. We loved the long-term profile of that business.

And now, we're using our presence there to – and Leah commented on this – to expand into industrial development in the UK and Europe and very consistent with our model. That will be more of an organic expansion. But we think there's going to be opportunities across all three of our segments, some infill and some larger.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Thanks. And then, last question maybe for Leah. I don't know if you explicitly mentioned margins, EBITDA margins for 2021, I may have missed it, but it seems like from all the [ph] brackets (37:18) you provided on the business lines and so forth, it's pointing to margins being higher in 2021 versus 2019 and 2020 full-year numbers. Is that a fair assessment or is there anything I'm missing that could be an offset?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

We – correct. We did not speak specifically to margins. However, we have said that we do expect growth in GWS EBITDA to slightly outpace that revenue, as well as some slight margin improvement in Advisory. So, we are – we do expect slightly higher revenues that are pass-through in nature. In our REI business related to Telford, that will create a little bit of margin pressure in REI. But net-net, I think, it's fair to say that we expect flat to positive operating leverage for the year.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Great. Thanks a lot for the help.

Operator: The next question is from Rick Skidmore from Goldman Sachs. Please go ahead.

Richard Skidmore

Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Just to follow up on the 2025 framework, Bob. Could you just maybe talk a little bit about what that mix of organic versus call it inorganic growth might be that's embedded in that low-double-digit growth rate expectation?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. I'm going to make a broad comment on that, Rick, and then I'm going to let Leah comment more specifically. But to get to that double-digit average growth rate between now and 2025, that threshold will be dominated by organic growth. It'll include some capital investment in our REI businesses, co-investment, et cetera, and some M&A, but there's other capacity available beyond that. And I'm going to let Leah speak about that.

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

Thanks, Bob. So, the way we think about the base case is that we're effectively adding our organic growth from both the existing business we have and the benefit of a substantial portion of our free cash flow. We still have our investment capacity given where our balance sheet sits today with a net cash position and we think about leverage and the current position we are with respect to the cycle. We think we can operate around a 1 turn leverage through deploying capital as it relates to M&A. And if we saw a strategic transaction, we would potentially take that to 2 times, but would quickly de-lever from there back down. So, that's how we're thinking about the base case, the opportunity for additional capital deployment as it relates to investments as well as capital return to shareholders.

Richard Skidmore

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you. And then just to follow-up on that, the comment about the projected decline of office, what's the base case assumption for how office demand changes over time and the impact on the business?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

So, we've taken a hard look at what we believe to be the impact to office for our business. We certainly expect that to create some headwind from the secular decline. Today, our base case assumes the 200 basis point or 300 basis point decline across our EPS CAGR as a result of that decline in office. And we are still able to offset that and achieve – we expect to be able to achieve a low-double digit EPS growth rate even given that headwind.

Richard Skidmore

Analyst, Goldman Sachs & Co. LLC

Q

Thank you very much.

Operator: The next question is from Jade Rahmani from KBW. Please go ahead.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. On the M&A side, would you characterize the opportunities you're seeing as within those four silos you laid out in your outlook, or are there areas potentially in logistics infrastructure business services that you might consider to further diversify the company?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Jade, we always are open to M&A that would be adjacent to our business, not, not far adjacent, but near adjacent to our business. And I'm going to, I'm going to highlight again that Telford multi-family deal in the UK a year and a half ago. But for the most part, we want to stay within the things we do because we have so much headroom for growth in the areas that we're already good, but could be better at. We think that's the preferred place to deploy our capital.

We think that's where the highest odds of the success are. But we will look at things that are adjacent. I think you'll remember three years or so ago, we did it in our investment management business. We did an infrastructure investment acquisition that we're very happy with. And I think that gives us opportunity for expansion. But we try to stay within our footprint for the most part when we do M&A.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

And semantically speaking, are you looking to strategies that would be considered more asset light type of businesses, or would the majority of opportunities include, you know, balance sheet capital intensive businesses such as the Telford?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Well, Telford is not – is not particularly an asset heavy business. We'll have small co-investments in that like we do in the rest of our development business, we have \$14 billion or so of development in process. And, Leah, how much capital do we have invested in it?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

Into, Telford?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

No, in our total development. \$200 million roughly. So, Jade, that is not a capital intensive development model that we deploy. However, I will say that across our REI business, we generated such strong returns on our co-investments. For instance, in our development business over the last 8 years or so, over 30% compounded IRRs on capital invest – in capital invested. We will look to put a little more money into the development business, we will look to put a little more money into co-investments in our REI business where we've generated strong returns.

But for the most part, when we buy services businesses they'll be asset-light. As Leah said in her prepared remarks, when you buy GWS or outsourcing businesses you need some working capital to fund the growth of those individual client relationships. But we're mostly pretty asset light, and I'm going to say it again, one of the things we like so much about Industrious, very asset light.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And how much is the cumulative investment in Hana thus far?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

So, in terms of Hana, we have invested approximately – I have to get to the exact number, Jade. But in terms of the current year, we had a loss of about \$40 million related to Hana. And I'll get to the balance sheet number.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Do you anticipate any internal reaction from the leasing broker sales force with respect to the Industrious strategy? What do you think the implications are for the sales team?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Well, we have two areas. You're talking about the leasing team that would either help the flex base operators get space in multitenant buildings or fill their space, right? Is that the group, you're talking about?

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yes.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Okay.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Yes.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

So, the bottom line is we do not think this will impact that much at all. We serve some really good flex space operators out there, help them find space and help them fill their space. They'll still be very anxious to have us do that. And, of course, we're going to continue to do that with Industrious and look for ways to do some creative stuff on the services we provide to occupiers with that industrious partnership. We don't think it will have a big impact on our brokers' relationship with others. It's just the nature of the businesses. It's a very large opportunity.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you very much. On the transaction outlook, I'm curious as to why you would only expect mid- to high-single-digits growth in transaction revenue? I assume that's a blend of what you're anticipating in leasing which would probably be at the lower end or perhaps below that and capital markets which would probably be at the high end or above that range. Is that why you're saying mid- to high-single-digit growth?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

Yes. That is – that's exactly correct. I would also note that you mentioned capital markets, but the transaction is just leasing and sales. So, we do expect sales to be above that level and we do expect leasing to be below. That does not include our debt and structured finance business which we do expect to grow at a healthy clip.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Okay. Thank you very much for that. And just lastly the transformational expenses, \$120 million. Can you give what the full year number was and is it possible to group that spend in categories so that we have a more specific understanding of what those initiatives relate to?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

Yeah. Absolutely. So, we had really two types of costs this year or in 2020 related to our optimization of our cost structure. First was workforce optimization, that was early in the year. It was really meant to address the immediate needs to respond to the changing demand environment that was presented by COVID. We spent about \$38 million on workforce optimization.

We then turned our sights on transformation initiatives that were specifically targeted at changing the shape and the structure of parts of our business that are effectively positioning us to be more agile going forward. We invested about \$176 million into those transformation initiatives. We expect that the total run rate benefit from the \$214 million of investment will be around \$369 million of costs. That's being offset in 2021 by the resumption or we've some temporary costs that were cut in 2020 that will come back. But net-net, we think, there will be about \$100 million of incremental savings in 2021 from the full work that we did in 2020 related to cost management.

And this is spread across all three of our segments. Advisory was the largest. We estimate about 60% of our cost take-out was from Advisory with about 30% in GWS, and the rest in our REI and corporate functions.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you very much.

Q

Operator: The next question is from Stephen Sheldon from William Blair. Please go ahead.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Good morning. Thanks. Great to hear about the continued trend in large customers purchasing more services from CBRE. I guess how much opportunity is there for CBRE to continue expanding relationships with these large customers? And how much does that factor into your confidence and the solid multi-year profit outlook?

Q

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

It factors massively into our confidence. We do work of some nature for virtually all of the Fortune 500 companies and all of the comparably large companies around the world. But we only do most of the real estate work for a very small handful of those companies. And there's some we don't do any for at all. And as I commented in my prepared remarks, if you went back a few years, we – a quarter of our clients we were doing multiple services for four or more services.

A

Now it's 90%. It's gone up dramatically. And that's generally a trend when we take on work for these clients. We get in the door, we prove to them we can save them money or we can execute for them better on some basis than they've been getting on their own or from a myriad of providers, and we tend to grow those relationships. And it's been a powerful growth driver for us. And there's plenty of headroom for that to continue.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Got it. And I guess maybe related to this, what view do you have into how COVID and the issues of the last year have influenced the trend of customers [ph] swinging (49:53) their vendor list? Is that – did it create any acceleration that has and could continue playing to your benefit as we think about the next few years?

Q

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

I would say one thing COVID has done to everybody is anything they can do to streamline their business, make it simpler, cut cost is front and center for them. And generally speaking, working with fewer vendors is a benefit in that regard and we're benefiting from that. That's been going on for years by the way. But I think, it's been accelerated by COVID.

A

Stephen Sheldon

Analyst, William Blair & Co. LLC

Got it. That's helpful. And then last one from me. I just wanted to – with the high investments and what the industry has announced and I guess how do you envision companies utilizing flexible workspace in their broader

Q

real estate strategies over the next year or so, during this period of uncertainty with remote working and then the longer term?

And what client conversations have you been having there I guess in recent months? Are you seeing them more frequently considering including flexible workspace? Just any detail on the demand trends that you're seeing?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Well, we've had a huge amount of it. One of the things that we've just worn out during COVID is interfacing with these occupier clients about what their expectations are about going back to the office. So, first of all, I want to start with what we think in general. In general, we believe that on kind of a weighted average basis, clients will go back to the office at about 85% of where they were before. In other words, they're weighted average head count will be down maybe 15%. Of course, we're all going to learn a whole lot more about that once COVID is over and there's not that kind of psychological overhang of making those decisions, while we're in the midst of COVID.

We also know that most of the occupiers are going to want to have some remote capability for their people to come into the office. And a lot of them are doing that now, but they're going to want to make that a formal part of their portfolio. So, historically, when we work with these big clients, they had two types of components to their portfolio. They had space they own and space they lease in a traditional long-term way. They started to get into the flex space as a third option toward the end of the last cycle. And now, they're saying that's going to be a more pronounced part of their portfolio of space going forward.

So, we think that means for companies like Industrious, in particular, Industrious, who has a offering that's very high quality, data security oriented towards corporate users that there's going to be big demand for what they do. They're not going to be the only ones, there's other providers that can do good work in that regard too. But we think that this will be a permanent piece in a bigger way of the portfolio of these occupier clients and that'll serve right into the heart of the Industrious strategy.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Q

Great. Very helpful. Appreciate all the color and the guidance.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Thank you.

Operator: The next question is from Michael Funk from Bank of America. Please go ahead.

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

Yeah. Hi. Good morning. Thank you for the questions. First maybe related to an earlier question about market share gains. What type of market share gains are baked into your 2021 revenue estimate?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

So, Michael when we look at our forecast each year, we do factor in our recent performance as it relates to recruiting as well as market share. So, from our perspective, we continue to focus on taking number 1, number 2 positions in really across the key markets in which we operate and we'll continue to allocate capital towards those key recruiting initiatives in 2021.

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

And then I think in your prepared remarks, I think you've mentioned that you're going to be reinvesting some of the savings from 2020 into OpEx in 2021? Can you quantify that investment for us?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

Sure. We're not – I'm not going to get too granular because we're not giving quantitative guidance for 2021. But I would say...

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

Sure.

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

...a key part of our transformation initiative and the principle behind that was to ensure that we were reducing costs in certain areas however that we were – that would preserve our ability to maintain industry-leading margins as we invest into the opportunities and the secular tailwinds that we see presenting themselves as a result of coming out of COVID. So, we believe that even with the investments that we're making, the cost takeout that we executed in 2020 will allow us to preserve those margins.

So, it's really across all three segments. We're investing across the business. It's across the key dimensions that Bob laid out. It's all in response to the intense strategy work that we took on throughout the course of the year. And we feel really good about how those investments are going to position us throughout 2021 to really capture the long-term opportunities presented in the market today.

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

And then, clearly, property sale is very strong in industrial, data center, multifamily throughout 2020. Are you seeing a thawing, though, in other property types as there appears to be some glimmer of hope for a reopening? Is there greater interest in other property types?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

We're certainly seeing a glimmer of hope. I think, the vaccine news in late 2020 was certainly a catalyst for investors to begin to come back off the sidelines for investment property sales. However, I think, industrial and multifamily continue to be the real winners in terms of asset classes or property types in the market today. But we are seeing liquidity around other asset classes and we'll continue to monitor that in 2021,

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

And do you think that would be additive to the activity in the starter property types? Or do you think that would somewhat cannibalize that activity as capital moves to other property types?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

I don't see it as being cannibalistic. I think given the level of liquidity that's currently available and dry-powder that's available in the hands of investors I think that it will provide a nice uplift for sales in 2021 and that's reflected in our expectations.

Michael J. Funk

Analyst, BofA Securities, Inc.

Q

Great and thank you very much.

Operator: The next question is from Patrick O'Shaughnessy from Raymond James. Please go ahead.

Patrick O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning. Can you provide any commentary regarding CBRE's thought process for sponsoring the SPAC?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

We can, Patrick, and it's very much tied to that broad base of business we do across those four dimensions. And the fact that we see an awful lot of opportunity out there when we do our M&A work to do business with companies that we can help and can help us. But they simply aren't the type of company for one reason or another that we should be buying in whole. So, maybe it's a company that super entrepreneur, needs to have an ability to serve us and our competitors, has a culture that's best independent, et cetera, et cetera, brand that's best independent. But they can be really helpful to us and we can be really helpful to them.

When we contemplated doing this back, that's what we had in mind, we would make an investment in those kind of companies. We would establish some kind of operating alliance with those type of companies, but we wouldn't buy them outright because of the reasons I just articulated. And we think that that formula is going to work very well. We're seeing a bunch of companies that we think could be good candidates in construction – in the construction services arena, smart buildings, data centers all kinds of things that serve buildings.

We're quite confident we're going to find a good target for that SPAC and there'll be follow on SPACs behind it. We're very different – differently situated than most SPAC sponsors. We're not really thought of as a financial sponsor. We're thought of as a strategic sponsor. And the way the SPAC is financially structured, where our upside comes only when those – the company that we would [ph] "deSPAC" (58:30) grows in value, speaks to our confidence that we can find a target partner and help them grow their business.

Patrick O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Great. That's helpful commentary. Thank you. And then, for my follow-up, to what extent is existing facilities management clients reducing their office footprints posing a near-term headwind on GWS segment fee revenue?

Leah C. Stearns

Chief Financial Officer, CBRE Group, Inc.

A

So, near term, Patrick, that's not a concern. We certainly are staying close to our GWS clients. They are looking to us for our expertise around workplace design and solutions. What it's really created is a pause in their decision making because for them to make significant outsourcing decisions that are long term in nature, they need to have a clear understanding of how the footprint of their real estate needs will evolve over time. And so, it's not about diminution or reduction of our existing revenue. It's more about a delay in our pipeline.

And what's important to appreciate is that we have significant diversification across the clients that we serve within GWS. So, we're not just serving their office footprint. We're also serving their data center needs. We're serving their – for life sciences clients, we're serving their research facility needs. And so, there's a lot of other opportunity out there across other property types and through our client diversification where we see significant opportunities for growth as well.

So, given the overall market size of integrated outsourcing, we currently think we have about a mid-single digit market share in a \$1.6 trillion market. I think – a \$200 billion market of the total asset market, which is about \$1.6 trillion. I think, there's still tremendous opportunity to grow that business and ensure that we're doing it aligned with our client's needs.

Patrick O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Very helpful. Thank you.

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

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Thanks for joining us everyone and we'll talk to you again at the end of the second quarter – at the end of the first quarter, I'm sorry.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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