

23-Feb-2023

CBRE Group, Inc. (CBRE)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the CBRE's Q4 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Brad Burke, Senior Vice President of Investor Relations and Strategic Finance at CBRE. Thank you. You may begin.

Brad Burke

Senior Vice President-Investor Relations & Strategic Finance, CBRE Group, Inc.

Good morning, everyone, and welcome to CBRE's fourth quarter 2022 earnings conference call. Earlier today, we posted a presentation deck on our website that you can use to follow along with our prepared remarks and an Excel file that contains additional supplemental materials.

Before we kick off today's call, I'll remind you that today's presentation contains forward-looking statements, including, without limitation the statements concerning our earnings outlook. Forward-looking statements are predictions, projections, or other statements about future events. These statements involve risks and uncertainties that may cause actual results and trends to differ materially from those projected. 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 SEC filings. We have provided reconciliations of the non-GAAP financial measures discussed on our call to the most directly comparable GAAP measures, together with explanations of these measures in our presentation deck appendix

I'm joined on today's call by Bob Sulentic, our President and CEO, and Emma Giamartino, our Chief Financial Officer.

Now, please turn to slide 5, as I turn the call over to Bob.

Robert E. Sulentic

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

Thank you, Brad, and good morning, everyone. As you've seen, we reported core EPS of \$1.33 for the fourth quarter. While down significantly from a year ago, core earnings were slightly above the estimate we provided at the end of the third quarter. This outcome was driven by several of the more cyclically resilient elements of our business, like outsourcing and others that are secularly favored like project management and the logistics asset class. These businesses, which together comprise about 45% of our core EBITDA, grew revenue more than we expected, offset by a slightly larger than expected decline in transactional revenue.

Full year core EPS rose 7% to \$5.69. This is a solid growth rate considering the more than doubling of long-term interest rates, sharp equity market decline, and the credit crunch that constrained investment activity for most of the second half. Notably, we ended 2022 with virtually no leverage, despite making share repurchases, infill M&A and strategic investments that together totaled approximately \$2.1 billion during the year.

Looking at the macro environment, cap rates are up 100 basis points to 150 basis points, perhaps a bit more for office. And we expect them to expand another 25 basis points or so before peaking likely in Q2. While capital largely remains on the sidelines, we are beginning to see signs of asset repricing helped along by the narrowing of spreads. Among property types, multifamily and industrial fundamentals should remain strong, albeit with occupancy declining slightly from peak levels and rent growth continuing at a more modest clip than then the double-digit pace set in 2022. Office will remain the most challenged property type as we do not expect occupancy to come close to pre-pandemic levels in the short-term.

Globally, we expect significant sales and leasing weakness in the first half before adverse conditions begin to ease later in 2023. Relative to 2022, we expect both Europe and Asia Pacific to outperform the Americas this year. For 2023, we expect core EPS to decline by low-to-mid double-digits, but still to be the third highest in CBRE's history.

As we've pointed out before, this would be a meaningfully better performance than in prior recessions such as the global financial crisis when core EPS decreased more than 60%. In all, 2023 will be a transition year and we feel good about where we'll be when we get to the other side of the downturn. While the macro environment can certainly change, we expect core EPS to grow strongly in 2024, exceeding the 2022 peak and reaching a record level in just the first year after a recession.

With that, I'll hand the call to Emma, who will discuss our quarter and our outlook in greater detail. Emma?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

Thank you, Bob. Before turning to our 2023 outlook, I'll first discuss fourth quarter results for each of our segments, starting with Advisory on slide 6.

Advisory net revenue and SOP declined by 21% and 33% respectively, driven by a slightly more pronounced decline in our higher margin transactional businesses than originally expected, which was partially offset by

healthy growth from our property management business. For capital markets, sales and mortgage origination combined, revenue declined by 46% in line with our expectations. Capital markets revenue growth was robust in last year's Q4 increasing by 53% which accentuated the extent of this year's decline. Leasing revenue was down 7% both globally and in the Americas. A slightly bigger decline than we expected with a notable slowdown in office activity in New York, Boston, San Francisco and Seattle. In total, global office leasing revenue was 14% below prior year, after increasing by nearly 50% year-to-date through the third quarter, albeit against relatively easy prior-year comparisons. Outside the US, leasing revenue was down 6%, wholly due to FX translation headwinds. In local currency, lease revenue increased in both EMEA and Asia Pacific. The 19% decline in loan servicing was attributable to fewer prepayments amid rising mortgage rates versus record prepayments in Q4 2021. Excluding prepayments, loan servicing revenue increased by 2%. Overall cost in Advisory declined by 18%, but this was not enough to offset the 21% decrease in total net revenue.

Turning to slide 7, GWS net revenue grew by 13% with half of that increase coming from organic revenue growth. In local currency, net revenue excluding Turner & Townsend increased by 12%, with facilities management up 9% and project management up 21%.

GWS SOP increased by 30%, with margin improvement driven partly by business mix. Turner & Townsend continued to grow impressively. In the first full year since acquiring a 60% interest, Turner & Townsend has exceeded our original underwriting. 2022 represented our highest ever year for client contracts coming up for renewal, totaling over \$4 billion. GWS renewed 94% of this total, often with increased scope of our client relationships.

Looking forward, we expect 2023 renewals to be just over half the level of 2022. The GWS revenue pipeline ended the year up 11% over year-end 2021, reflecting continued demand from first generation and outsourcing clients as well as expansion mandates from our existing client base.

Turning to slide 8, REI SOP declined to just \$17 million in Q4, against an unusually strong prior year comparison. Our global development business posted a \$6 million SOP loss, primarily due to a \$43 million loss in our Telford UK development business. Lower SOP in US development reflects the timing of asset dispositions, which were heavily weighted to this year's first half, consistent with our expectations going into the year.

Following an in-depth review of the Telford business, we wrote down a handful of projects where we expect costs to exceed our initial underwriting, and we also increased our fire safety reserve. We now believe Telford's financial performance will improve going forward.

Investment management AUM grew \$5 billion sequentially driven by net capital inflows of \$4 billion and positive FX [ph] movement (00:09:20), which offset \$5 billion of mark-to-market declines. Investment management SOP declined due in part to co-investment losses versus gain in the prior year quarter. Excluding co-investment gains and losses, investment management SOP was nearly flat with the prior year quarter.

Turning to slide 9, our 2023 outlook is underpinned by the following macroeconomic assumptions. The US will experience a short, moderate recession in 2023. Unemployment will increase to near 5%. Inflation will end the year above the Fed's 2% target, but clearly trending down. And 10-year US Treasury yields will end the year under 3.5%. Should the economic outlook change from this base case? Our business outlook would also change.

In our Advisory segment, we expect a mid single-digit revenue decline. This will be driven by growth in more resilient lines of business, offset by a mid-to-high single-digit decline in leasing and mid-teens decline in property

sales. We expect SOP to decline by high single-digit to low double-digits as cost savings initiatives partially offset both relatively better growth and lower margin businesses and general cost inflation.

In our property sales business, we expect the number of transactions will be subdued in the first half of the year and accelerate in the back half of the year. We expect our leasing business to continue to benefit from an elevated level of lease expiration. While the return to office has been slow in the US, EMEA and APAC have seen occupancy return at a faster pace. As a result, we expect these regions to be less pressure than the Americas in 2023. For property management and valuations, we expect accelerating revenue growth in both lines of business due to recent investments in sales support and tuck-in acquisitions, as well as less FX pressure.

Within GWS, we expect low double-digit net revenue and SOP growth, with margins increasing slightly as cost savings more than offset inflation and incremental investments to support growth. Our facilities management business is benefiting from new wins and expansion. All major client sectors are expected to grow, notably in healthcare and technology, where the change in use of real estate is driving increased demand for outsourcing services that we believe CBRE is best positioned to deliver. We also expect continued momentum in our project management businesses including double-digit top- and bottom-line growth from our Turner & Townsend business.

Within our REI segment, we expect SOP in the mid \$300 million range with roughly equal contributions from development and investment management. Within our TCC development business, we expect SOP of just over 1% of our nearly \$17 billion in process portfolio, and we've closed over \$100 million of expected SOP in January alone. Our TCC business has developed a portfolio of assets that we believe is extremely well positioned for the current market environment with approximately 75% of our expected SOP in 2023 from industrial deals. While our Telford business remains challenged, we do expect improvement versus 2022 as significant cost inflation is now incorporated into projected results, adding approximately \$20 million to SOP versus 2022.

Beyond our three main business segments, we also expect roughly flat corporate overhead and our full year core tax rate to rise to 2021 level versus a lower 2022 rate. Consistent with our approach last year, the 2023 outlook assumes only a modest use of capital. That said, we continue to have a strong appetite for M&A and share repurchases, both of which could support incremental earnings growth above our current outlook, and we do not anticipate ending 2023 in a net cash position.

In summary, we expect core EBITDA to decline by high single-digit versus 2022 with over half attributable to the decline in development SOP. We expect core EPS to decline by low-to-mid double-digits versus 2022. This is more than the core EBITDA decline because of higher depreciation and amortization and a higher tax rate than in 2022, when we had a number of one-time benefits that will not recur.

Lastly, we expect nearly two-thirds of full year core EPS in the back half of the year, a more pronounced seasonality to earnings than we historically experienced. The \$400 million cost containment program we announced last quarter is embedded in our guidance. Fourth quarter results saw nearly \$80 million cost benefit and we expect the cost benefit in 2023 of approximately \$300 million with the remainder in 2024. The entirety of the cost containment program will be reflected in our run rate by the end of this year. We expect that our cost containment efforts will allow us to counteract the general inflation pressures and enable us to make continued investments to support future growth.

Last year, we refreshed our 2025 financial guidance, which implied CBRE would achieve core EPS between \$8 and \$9 by year-end 2025 absent meaningful capital allocation. Due to the real estate transaction downturn, our

target is now likely to slip by 12 months to 18 months. As I noted previously, our 2025 targets were established on the basis that there would not be a recession following the COVID recovery.

The drivers of how we achieved this core EPS growth are largely unchanged. At the midpoint of that core EPS target, \$8.50, CBRE will have achieved double-digit compound core EPS growth since 2019, despite needing to manage through two significant downturns. It also represents a high-teens CAGR from our 2023 projection.

In closing, we remain excited about CBRE's prospects for long-term growth. The strength of our brand and our ability to outperform during periods of market weakness.

With that operator, we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question is from the line of Anthony Paolone with JPMorgan. Please go ahead.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Thank you, and good morning. My first question relates to GWS in the outsourcing business. And I was wondering if you can maybe take us inside that business a bit more and help us understand how in an environment where office usage is down and footprints are shrinking, that that business can continue to grow. And so, just like to better understand what additional services clients are taking on to, maybe offset smaller footprints?

Robert E. Sulentic

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

A

Tony, first of all, even if the work you do for a client in a specific portion of their portfolio is shrinking, it likely would result in project management work, potentially transaction management work, portfolio management work. So, even if you have some shrinkage within an account, there are opportunities for revenue. But secondly, there's the addition of new accounts which has been very significant for us for the past year, actually record levels. And we're expecting that going forward, people are giving us more property to manage because they want to save cost. So, the combination of those factors have allowed us to grow that business consistently over the years during downturns, and we expect it's going to be a double-digit grower in 2023 for the same reasons.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. And then, just my second question relates to just perhaps any color you can give us that you're seeing on the ground today in terms of either green shoots or regions or property types where you're starting to see activity levels rebound. I think you alluded to some properties starting to come to market or folks maybe testing the market a bit. I'm just wondering if you could elaborate on that some.

Robert E. Sulentic

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

A

Yeah. And you're asking with regard to property sales?

Anthony Paolone

Analyst, JPMorgan Securities LLC

In leasing, just the more transactional stuff.

Q

Robert E. Sulentic

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

Yeah. Okay. Well, where you're seeing activity in sales is for good assets, even in some cases office assets. If they have – if their Class A buildings fully leased. But, for sure, industrial and multifamily, if you went back to last year or even the end of last year, you get a couple of bidders that would test the waters. But, now, for some of the better quality assets, we're getting several bidders and they're bidding aggressively. And there's anecdotes on multifamily. There's anecdotes on industrial, in particular, where we're seeing that happened is quite a bit different than it was last year. There's a lot of capital that's been on the sidelines wanting to acquire assets. There's a lot of asset owners that have wanted to sell assets, and we're starting to see spreads come in a little bit now and the buyers get a little more aggressive in various cases. So, that's what you're seeing there.

With leasing, there's – we continue to see very strong fundamentals in industrial. There's low vacancy. There are lot of companies out there that still need space for a variety of reasons. And so, we are seeing momentum there. And then you have as we said before, you have a considerable amount of renewal activity around office buildings and retail, in particular.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Okay. Thank you.

Q

Operator: Thank you. Our next question is from the line of Chandni Luthra with Goldman Sachs. Please go ahead.

Chandni Luthra

Analyst, Goldman Sachs & Co. LLC

Hi. Good morning. Thank you for taking my question. Bob, you talked about 2024 EPS recovering to 2022 levels at the least. What gives you confidence on such a recovery just given the macro environment and the uncertain – outlooks that we all have at the moment for the rest of the year? I mean, are you seeing any signs on the ground of improvement? Anything that gives you that confidence to go out and talk about 2024 right now?

Q

Robert E. Sulentic

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

Yeah. Chandni, I'll comment and then I'll give it to Emma. So, first of all, we actually expect 2024 to not go back to 2022 levels, but actually exceed 2022. A big part of that is the large portion of our business that's either secularly benefited or cyclically advantaged. All of that outsourcing business, which in aggregate is now quite large. Anything we're doing for the industrial or multifamily asset classes, we expect to be strong by then. Project management will be strong. We expect the debt business to come back. So, all of those circumstances are driving it. Now, the thing that would cause it to not happen is if we were wrong about the recession, if the recession was worse or lasted longer or started later. But those parts of our business are what we expect to drive that outcome. And, Emma, you may want to add to that?

A

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

Yeah. And to put a lot of context around what those numbers look like, Chandni. If you think about our resilient lines of businesses, we've talked about that being 14% contributor to our SOP, in 2022 with 45% of our SOP, in 2023, that – it's going to be closer to 50% to 55% of our SOP. And those are our lines of business that we expect to continue to grow after a recession. So, that's becoming a larger and larger part of our business.

And then, our transactional business lines, we expect them to rebound starting a little bit at the end of 2023 into 2024. And what's important to know about that is that, the growth that we are – that's embedded in that outlook to get back to above 2022 levels means that our Advisory lines of business, our transactional lines of business would need to grow less than they did in 2021. So, putting them all together is very achievable. And then on top of that, what's not embedded in the 2024 guidance or our outlook is that, is any sort of material capital allocation or M&A which will put us far above 2022 levels.

Chandni Luthra

Analyst, Goldman Sachs & Co. LLC

Q

That's very helpful. And that's exactly what I wanted to talk about for my next question, but more focused on 2023. So, in terms of buybacks and just general capital allocation, you talked about using – you talked about only a modest use of capital in 2023. And that means that buyback is not part of that EPS guide that you've given today. But how would you rank buybacks and M&A in 2023 in terms of priority, and do you think buybacks could look much like 2022 – in 2023? And then, switching gears to M&A a little bit, is M&A were part – were to be part of the calculus. Could you give us some parameters on what that could potentially look like? How much leverage would you be willing to tap into? And what would be the potential business lines that you would like to explore?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

Sure. So, when we look at allocating capital, we look at buybacks and M&A [ph] in line are weighing (00:23:50), which is a better use of our capital and which can drive a greater long-term return for us. In 2022, you saw that there wasn't a significant amount of M&A opportunities, but obviously we're building our pipeline and continue to build our pipeline and are seeing things. Conversations are starting to build and accelerate in a way that they did not in 2022. But because there wasn't a tremendous amount of M&A activity available, we did, we repurchased almost 2 billion worth of shares and our share price was also at an attractive valuation. So, we'll continue to look at that. We are constantly evaluating whether we're going to buy back or we're going to do a more larger transformational acquisition, and we'll continue to do that throughout this year and we'll update you as that progresses. But in our outlook, we didn't include what that would look like because we don't know how it's going to unfold going forward.

In terms of M&A, we are willing to go up to 2 times leverage for a transformational deal that was highly transformational. We'll go slightly above that. But that's the range that we're looking at. And then, with capital allocation overall, we want to at the very least end the year, net leverage neutral, but we're willing to go above that for buybacks as well.

Chandni Luthra

Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question is from the line of Steve Sakwa with Evercore ISI. Please go ahead.

Steve Sakwa

Analyst, Evercore Group LLC

Q

Hi. Yeah. Thanks. Good morning. Bob, just circling back on the sales activity. I'm just curious, in your mind, is the pickup – potential pickup in activity more a function of the overall level of interest rates or more of a stabilization of rates and spreads where people can actually lower their cost of capital before they start to underwrite transactions. I'm just trying to figure out which one is the bigger lever, the actual rate or the stabilization of rates?

Robert E. Sulentic

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

A

I think probably right now, it's the stabilization of rates. The other thing, Steve, that I think is going on is people are recognizing that with all the concerns about the economy, and obviously, there are considerable concerns, the fundamentals in industrial and multifamily are really strong. Really low vacancy rates, every reason in the world to believe that rental rates will go up at least somewhat. And that's in what's going to be a tough year. And then longer-term, it's going to be better. And then you have this just very human thing about sellers being ready to sell and buyers being ready to buy with capital and sitting on the sidelines for a long time. As soon as two or three circumstances start to line up favorably, fundamental, stabilization of rents – rates, rates coming down a little bit, some talk in the market that maybe the recession won't be as bad as we thought. When you get that confluence of circumstances, things start to shake loose a little bit. And as soon as one or two buyers go into the market, others start to get into the market because they're afraid they'll be left behind.

Steve Sakwa

Analyst, Evercore Group LLC

Q

Okay. Thanks. And then secondly, I was just hoping maybe, Emma, could you provide a little more detail on kind of what happened to Telford? I'm not, it sounded like just maybe costs got out of control and I just thought maybe you could expand on that a little bit just to make sure we understand sort of the problems and I guess what's been rectified moving forward.

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

Yeah, absolutely. And so, I do want to step back and there's two major things going on that are different. So, the first is the UK put in a Fire Safety Act, which is still under review related to a very terrible fire that happened in 2017. So, through that Act, they're requiring all homebuilders, who built a building over a certain size over the past 30 years, to bring those buildings up to the current fire safety standard. And so, as a result, we and all other homebuilders are in the UK are having to go through this process of determining what the cost will be across all of our buildings that we've built over the next five years, 10 years, as long as it takes us to remediate those issues. And that's why you see the non-cash about \$140 million reserve that we took in Q4. And what's important to know about that is that is our best estimate of what we think the cost will be to remediate those. But the actual cash outflow to remediate those issues across those buildings will be over a very long period of time. So, we view that as an isolated anomalous issue that's occurring across all homebuilders in the UK.

The second piece is how the operations of our business are being impacted, and that's primarily related to the external environment, record cost inflation. We have a number of COVID slowdowns that we've talked about over the past number of years within Telford specifically. So, what we did in Q4 is we evaluated all of our projects. We saw that we impaired a number of assets, and we took a \$43 million loss in Q4 for the full year, it was just shy of \$50 million. And we believe that that's contained. That's a very good estimate of the value of those assets going

forward, and that we're at an inflection point going forward. And we expect under new leadership and with the tailwinds behind UK build to rent, that that business will continue to grow going forward.

Steve Sakwa

Analyst, Evercore Group LLC

Q

Okay. Thanks. And are you – I just wonder, are you seeing any green shoots at all in the UK housing market from a demand perspective or has that not yet started to pick up?

Robert E. Sulentic

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

A

A little bit, Steve. The – I mean, we still have the economic circumstance that we have with high interest rates, with concerns about the economy that's causing people to not spend the way they would spend normally. So, that's a little bit of downward pressure on the business. But we're encouraged by what we see in terms of the longer-term trend.

Steve Sakwa

Analyst, Evercore Group LLC

Q

Great. Thanks. That's it for me.

Operator: Thank you. Our next question is from the line of Michael Griffin with Citi. Please go ahead.

Michael Griffin

Analyst, Citi

Q

Great. Thanks. Maybe we can go back to leasing for a second. I'm just curious how your strategy around that might be changing just given the longer-term implications that remote and hybrid work could have on performance and impacting the space? I think, Bob, you've talked about expanding in industrial. So, maybe just how thoughts are on that change. And if you can remind us just what percentage of that – of the leasing revenue comes from the office sector? That'd be helpful.

Robert E. Sulentic

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

A

Okay. Emma, why don't you – do you have that number, the percentage of our leasing that comes from office?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

It is about a little over 50%. And that's come down. If you compare that to 2019, for example, it was closer to 70%. So, that has steadily come down.

Robert E. Sulentic

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

A

Yeah. So, Michael, what I'd say is our current assumption is that this downward pressure that we've seen on office leasing is going to sustain for the time being. We haven't seen much change over the last few months in return to office. We've built a plan for the next several years that assumes that that is going to be the case. We assume that there's going to be a move over time from lesser quality to better quality assets, higher rates, higher rental rates, which will be a positive impact on the business. But definitely going forward, we expect more of our income stream in the leasing business to come from industrial relative to office than it has in – other than in the

last year than it has in the longer-term past. And we don't see that changing in the comments that Emma made about our plan for the next several years. Our growth plan fully incorporate that view.

Michael Griffin

Analyst, Citi

Q

Thanks. That's helpful. And then just one on geographic performance. It seems like your commentary and expectations around EMEA and APAC are maybe a bit incrementally more positive relative to the Americas. I'm just curious if there's anything driving those underlying assumptions or the thoughts about economic growth or potential shallow recession there, but anything you can expand on performance of those other geographic segments, that'd be helpful.

Robert E. Sulentic

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

A

Yeah. Well, first of all, we – we're now not expecting a recession in Europe, and we expect Europe to trend better than the US in terms of return to the office. Then you go to Asia, and we expect Asia to be almost like it was historically as it relates to return to the office. And we have very strong businesses, particularly in Korea, Japan and China, relative to what we've had historically and relative to our competition. We have a very strong business in Japan, and we expect that business – it's become quite large for us and we expect it to continue to grow. So you have the economic backdrop that's positive, relatively speaking, and then you have the circumstance related to return to the office that's positive, relatively speaking, as you move from the US to Europe to Asia. And then you had just the very strong relative business position that we have particularly in Asia, but also our businesses in Europe and the UK have gotten much stronger over the past few years on a relative basis. So, you see all those things coming through.

Michael Griffin

Analyst, Citi

Q

Great. That's it for me. Thanks for the time.

Operator: Thank you. Our next question is from the line of Jade Rahmani with KBW. Please go ahead.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. First question would be if the move in rates in the last couple of weeks has changed anything in terms of tone from major CBRE clients that you're hearing?

Robert E. Sulentic

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

A

I don't think it's had a major impact, Jade. I mean, everybody is in the – of the mindset that things are going to be uncertain for a while. I don't think the view as to how the year is going to play out has changed in any significant way. Certainly, it hasn't for us. So, our view continues to be that we're going to have a relatively mild recession, that we're going to be out of it toward the end of the year, early next year, and that the capital markets are going to come back in the back half of the year. And we've already walked through what we're seeing anecdotally. We are definitively seeing positive anecdotal signs. We don't want to over rotate in terms of extrapolating too much from those anecdotal signs, but we think we'll see more of that in the back half of the year.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. When you look at the REI business overall, investment management and development, how much risk of further impairments do you anticipate? Valuation impairments you mentioned, do you expect cap rates, for example, to increase another 25 basis points? But could you put some parameters around, perhaps, how you're thinking about any risk there?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

[ph] Certainly (00:35:33). I'll walk through development first and then, our investment management business. On the development side, any impairments and we don't think there should be significantly more this year, are embedded in our guidance for that segment. And as I noted in my remarks, we've already generated \$100 million of SOP in January alone in our development business. So, we feel pretty confident in how the development business will pan out for this year. On the investment management side, what we're expecting is slightly positive net flows for this year of \$5 billion, primarily from our listed mandates and then also from infrastructure and from our opportunistic funds to a lesser extent. And then, we're also embedding a slight decrease in the market value of that AUM which will offset some of those net inflows.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. Just regarding the guidance, how much does capital markets and leasing picking up in the back half of the year drive the guidance? Is that really the main uncertainty in the guidance?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

Yeah. And it's primarily in capital markets that we're really expecting to pick up mostly in Q4. And just to give to you a little context around that, if our sales revenue comes in 5% lower than what we're expecting for the full year, that would have about a \$0.02 of EPS impact. And then on the leasing side, what – we don't – we're not relying on a massive rebound in – at the end of the year. But obviously, we're guiding towards less of a decline in leasing for the full year. For leasing, if there's a 5% decline in revenue versus what we're expecting right now, that would have more like a 3% change to the EPS. And I said...

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay.

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

...I mean – and on the sales side, I mean 2% change to EPS.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Great. That's really helpful to have. On the office side, is the uncertainty there, which seems secular in nature causing a rethink of I guess resource allocation in that space, in that property sector, and any rethink of how that outfit is organized?

Robert E. Sulentic

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

A

Well, we have, Jade, we have multiple places that we play in the office sector. So, we're starting with development. We develop it. We manage it. We sell it. We finance it. And we've sized our business and our capital allocation strategy consistent with the assumptions that we've talked about here today about where that business is going to be. The other place we play in the office sector is in our investment in Industrious. We think Industrious is going to continue to grow at a healthy clip. It's a really good offering with really strong leadership team. And we are looking at that to be a lightly bigger part of our business going forward. But we expect leasing to be, as we described. We don't expect to do much development, although we'll do some development on build-to-suits that will continue to be part of our business and that's great business when you can do office build-to-suits with credit tenants and that's what we would do.

And then, over time there'll be – there's all kinds of uncertainty about what's going to happen in the financing markets. But over time, there'll be a good amount of financing work in the office space as well.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much.

Operator: Thank you. Our next question is from the line of Patrick O'Shaughnessy with Raymond James. Please go ahead.

Patrick Joseph O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning. I was wondering if you could speak to how you're thinking about free cash flow conversion as a percentage of your core net income in 2023.

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

Yeah. So, we expect it to be roughly in line with where we were in 2022, which was about 75% free cash flow conversion. And what's important to note about that is because we're in a [ph] somewhat of (00:39:51) – we are in a declining market. There is inconsistency of timing in terms of how we accrue our bonuses and how we pay them out in cash. And so, if you normalize for that timing in 2023, our free cash flow conversion is closer to mid-80s, which is where we want to be long-term. There's – we should expect coming into 2024 that we should be in a more normalized growth environment in that mid-80% free cash flow conversion range.

Patrick Joseph O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Got it. Thank you. What are you guys seeing right now in terms of talent retention, given kind of slowdown in some of the brokerage areas? Are brokers more inclined to want to move from place to place or do you feel like you are able to retain all the key talent that you want to?

Robert E. Sulentic

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

A

This is the kind of environment that generally plays well for CBRE. When times are uncertain, it's harder to generate commissions on either leases or sales or financing opportunities. Brokers tend to want to go to a

platform that's more likely to support them. So, better information, bigger base of clients, better brand, a company that can be well-positioned to invest in a downturn because they have a strong balance sheet. We're going to generate a lot of cash in 2023 and 2024. And the brokers that pay attention, the most – more sophisticated brokers know that. They know we'll be able to continue to invest in our business. So, it helps us retain and it helps us recruit and – Jack Durburg and the Advisory team had a big year of recruiting last year, and we're expecting that to play out the same way this year.

Patrick Joseph O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you. And then last one from me. Your in-process development projects decreased pretty substantially quarter-over-quarter, and there was some commentary about some reticence given the macro landscape. How are you looking at that as we move into 2023? Could it slide a little bit further in the near-term or would you expect that to start to rebuild?

Emma Giamartino

Chief Financial Officer, CBRE Group, Inc.

A

So, our in-process – just to frame what our in-process is, that is projects that have either started construction or we own the land and it is expected to start construction within 12 months. So, the decline is primarily driven by projects in that latter category that we now believe are going to be more than 12 months off until they've been moved into the pipeline category. We'll continue to evaluate our in-process portfolio. But if things move out of in-process at this point, again, it's the projects that won't be starting for more than 12 months. It will not impact 2023. It would have an impact to 2024 and beyond.

Patrick Joseph O'Shaughnessy

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you.

Operator: Thank you. As there are no further questions at this time, I would like to turn the floor back over to Bob Sulentic for closing comments.

Robert E. Sulentic

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

Thanks, everyone, for joining us, and we look forward to talking to you again when we report on our first quarter.

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

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