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# EDITED TRANSCRIPT

CBG - Q2 2013 CBRE Group, Inc. Earnings Conference Call

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## CORPORATE PARTICIPANTS

**Nick Kormleuk** *CBRE, Inc. - SVP of IR*

**Bob Sulentic** *CBRE, Inc. - President and CEO*

**Gil Borok** *CBRE, Inc. - CFO*

**Cal Frese** *CBRE, Inc. - CEO, the Americas*

## CONFERENCE CALL PARTICIPANTS

**Brandon Dobell** *William Blair & Co. - Analyst*

**Joe Dazio** *JP Morgan - Analyst*

**Will Marks** *JMP Securities - Analyst*

**David Ridley-Lane** *Bank of America Merrill Lynch - Analyst*

## PRESENTATION

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### Operator

Ladies and gentlemen, thank you for standing by. And welcome the CBRE Q2 earnings conference call. (operator instructions). Also as a reminder, this teleconference is being recorded. At this time, I will turn the conference call over to your host, Mr. Nick Kormleuk. Please go ahead, sir.

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### Nick Kormleuk - *CBRE, Inc. - SVP of IR*

Thank you, and welcome to CBRE's second-quarter 2013 earnings conference call. About an hour ago, we issued a press release announcing our Q2 financial results. This release is available on the homepage of our website at [www.CBRE.com](http://www.CBRE.com). This conference call is being webcast and is available on the investor relations section of our website. Also available is a presentation slide deck, which you can use to follow along with our prepared remarks. An archived audio of the webcast and a PDF version of the slide presentation will be posted to the website later today, and a transcript of our call will be posted tomorrow.

Please turn to the slide labeled Forward-looking Statements. This presentation contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our future growth momentum, operations, financial performance, and business outlook. These statements should be considered as estimates only, and actual results may ultimately differ from these estimates. Except to the extent required by applicable securities laws, we undertake no obligation to update or publicly revise any of the forward-looking statements that you may hear today. Please refer to our second-quarter earnings report filed on Form 8-K, our current annual report on Form 10-K, and our current quarterly report on Form 10-Q -- in particular any discussion of risk factors or forward-looking statements, which are filed with the SEC and available at the SEC's website [www.SEC.gov](http://www.SEC.gov) -- for a full discussion of the risks and other factors that may impact any estimates that you may hear today. We may make certain statements during the course of this presentation which include references to non-GAAP financial measures as defined by SEC regulations. As required by these regulations, we have provided reconciliations of these measures to what we believe are the most directly comparable GAAP measures, which are attached hereto within the appendix.

Please turn to slide 3. Participating with me today are Bob Sulentic, our President and Chief Executive Officer; Gil Borok, our Chief Financial Officer; and Cal Frese, our Americas Chief Executive Officer. I will now turn the call over to Bob.

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### Bob Sulentic - *CBRE, Inc. - President and CEO*

Thank you Nick. Please turn to slide 4. CBRE achieved another quarter of solid growth in the second quarter of 2013. Our performance was especially noteworthy coming against the backdrop of continued weak global economic growth, as well as heightened financial market volatility and rising US interest rates following Fed chairman Bernanke's remarks about the quantitative easing program in late May. Our improved performance amid this macro environment is a testament to our well-balanced service offering and our people's energy and creativity in collaborating across markets and disciplines to produce outstanding results for our clients. Nothing is more important to our Company.



Overall revenue growth of 9% was fueled by meaningful improvement in all three global regions. We also saw continued strength in our capital markets and occupy our outsourcing businesses. Asia-Pacific led the global regions with 16% revenue growth, extending its healthy rebound from a relatively soft first half in 2012. It was particularly gratifying to see a very strong growth in greater China for the second consecutive quarter. The Americas region achieved 10% revenue growth for the second quarter in a row. Cal Frese, CEO of our Americas business, will take you through these results later. More importantly, he will discuss our strategy for sustaining growth and improving market share through our focus on better serving clients. EMEA also continued to recover from a difficult 2012. Although higher revenue in France and the United Kingdom was tempered by the recessionary environment across most of continental Europe, overall revenue in the region rose 9%.

Turning to our global service lines, the capital-markets based businesses continued to be growth engines for us. Global property sales revenue rose 20% and was driven by Asia-Pacific and the Americas. Commercial mortgage brokerage revenue improved 22%, as investor appetite for debt financing remained strong throughout the quarter despite the long-term interest rate spike later in the period.

Appraisal and evaluation revenue, which is closely tied to investment activity, improved 10%, led by Asia-Pacific. Real estate outsourcing continues to be a growth catalyst as well. Overall, property facilities and project management revenue rose 11% globally, with notable strength in EMEA. Our global corporate services, or GCS business, which is our occupier outsourcing service line, saw revenues rise 11% globally. GCS revenue generally includes commissions from sales and lease transactions associated with GCS accounts, in addition to facilities and project management fees. A high degree of occupier caution amid weak global economic growth continued to restrain global leasing performance. Despite generally soft market conditions, however, global leasing revenue rose 4%, paced by the Americas. Achieving more robust growth in leasing -- in our leasing business despite the lackluster microenvironment is one of CBRE's strategic priorities.

As planned, last month, we paid down all \$450 million of our 11.625% Senior Subordinated Notes due in 2017. This was the final step in our recent refinancing actions that have materially lowered our annualized interest expense while nearly doubling our borrowing capacity. These actions have markedly strengthened our financial position and have given us increased flexibility to execute our growth strategy.

Now I'll turn the call over to Gil, who will review the quarter's financial results and discuss the refinancing actions in more detail.

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**Gil Borok - CBRE, Inc. - CFO**

Thank you Bob. Please advance to slide 5. Total revenue was approximately \$1.75 billion for the second quarter of 2013, up 9% from last year. This increase is at the upper end of our expectations for long-term growth and was generally well-balanced among service lines, with good growth around the world. Cost of services increased to 58.5% of total revenue in the second quarter of 2013 versus 56.7% in the second quarter of 2012. This increase was driven by declining transaction revenue in a few geographies that have a largely fixed cost structure and lower revenue in our principal businesses, where all costs are classified as operating expense. Largely because of this, cost of services did not decline commensurate with revenue.

Second quarter 2013 operating expenses were 28.7% of total revenue, down from 30.1% in the second quarter of 2012. It should be noted that \$9.1 million of integration and other costs related to the ING REIM acquisition were included in the second quarter of 2012, while there were no such costs in the second quarter of 2013. Excluding integration costs, operating expenses were 29.6% of revenue in the second quarter of 2012. The current-year decrease was achieved despite incremental investments in our operating platform. Interest expense was down 15% versus the second quarter of 2012, reflecting the effects of our refinancing activities this year. In the second quarter of 2013, we normalized costs totaling \$42.7 million associated with the early redemption of our \$450 million 11.625% senior subordinated notes.

Our second-quarter 2013 tax rate was approximately 40%, consistent with the second quarter of 2012. The tax rate this quarter was elevated due to a shift in earnings to higher tax jurisdictions and losses in certain countries in Europe, where no tax benefit could be provided. However, as we have previously noted, we have been focused on the tax efficiency of our legal entity and operating structure. Given this and the normal seasonality of our transaction revenue, we expect the full-year 2013 tax rate to approximate 35%. Depreciation and amortization expense rose by approximately \$5 million to \$43.6 million, driven by increased technology-related capital expenditures and mortgage servicing rights. Adjusted diluted earnings per share rose 15% to \$0.31 in the second quarter of 2013 from \$0.27 in the second quarter of 2012. However, costs associated with the early redemption of the 11.625% notes reduced GAAP earnings-per-share by \$0.08. As a result, second-quarter 2013 GAAP diluted earnings per share was \$0.21, compared with \$0.23 in last year's second quarter.

Normalized EBITDA rose 10% to \$243.1 million in the second quarter of 2013, resulting in a normalized EBITDA margin of 13.9%, a slight improvement from 13.8% in the second quarter of 2012.

Please turn to slide 6. Property, facilities, and project management revenue increased 11% for the quarter. It was once again our largest service line, representing 35% of total revenue. Leasing was our second largest service line, comprising 28% of total revenue for the quarter. Overall leasing growth was moderate at 4%, reflecting



continued occupier caution in many parts of the world. However, in light of the macro environment, we were pleased to see leasing revenue improve in local currencies in all three global regions. Property sales grew by 20% in the second quarter of 2013, paced by Asia-Pacific and the Americas. This reflects healthy growth at a time when investment markets in much of the world remain challenged. Global investment management revenue decreased 1% versus the prior-year period. We will discuss these results in detail later. Appraisal and evaluation revenue increased 10% for the quarter. While growth was achieved in all three global regions, it was especially strong in Asia-Pacific.

Commercial mortgage brokerage revenue grew 22% year-over-year. US loan origination activity was robust through the quarter, notwithstanding the long-term interest rate rise late in the period. Development services revenues decreased 19% to \$12.6 million, attributable to lower rental income resulting from property dispositions. Recurring revenue comprised approximately 61% of total revenue for the same quarter of 2013. This included leasing commissions from existing clients, property and facilities management fees, asset management fees, and loan servicing fees, which are all largely recurring.

Please turn to slide 7, which shows the continued stable and vacancy rates and ongoing positive absorption, trends that CBRE economists expect to continue over the next 24 months. Average national cap rates remained relatively stable in the second quarter of 2013, versus both the second quarter of 2012 and the first quarter of 2013. Year-over-year volumes improved in all three property sectors, most notably in office.

I will now hand the Cal, who will address our Americas performance and strategy.

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

Thanks Gil. Please turn to slide 8. We achieved solid growth across the Americas in the second quarter of 2013. Overall revenue growth of 10% was particularly notable, considering the moderately improving economic conditions that continued to prevail. In the heightened financial market volatility that developed over the final month of the quarter. Property sales continue to be a strong growth engine for the region. Sales revenues increased 19% in the second quarter of 2013, as investor demand was generally strong throughout the quarter and has remained so despite the recent run-up in long-term interest rates. While the recent widening of CMBS spreads could temper liquidity in some secondary markets, core properties remain in high demand and capital flows into real estate remain strong as investors continue to search for yield.

Leasing revenue rose by 5% during the quarter. This performance comes against a backdrop of mixed local market conditions, with modest overall improvement in employment, availability, and rental rates. We believe that we can continue to gain market share in the face of generally soft overall market activity. Continued steady growth of our occupier outsourcing business drove an increase in property, facilities, and project management revenue of 9% during the quarter.

Please turn to slide 9. Our results in the second quarter underscore the well-balanced service offering we have assembled in the Americas as the business has evolved over the past six years. As you can see, property sales and leasing comprised almost three-quarters of our revenue in 2006. Today, they are business mainstays with short -- with strong near- and long-term growth prospects. But as a result of the dramatic growth of the GCS business, sales and leasing now make up 48% of total revenue. The dark green slice you see here primarily reflects revenue from facilities and project management services. It does not include transaction commissions associated with our GCS accounts, which are reflected in sales and leasing revenue. On this basis alone, GCS now accounts for 28% of Americas revenue.

Please turn to slide 10. The GCS business continues to benefit from excellent underlying momentum. As Bob mentioned, GCS achieved revenue growth of approximately 11% in the Americas during the second quarter of 2013. We have developed a robust occupier outsourcing business over many years as this trend has grown. Although some major companies have been outsourcing real estate services for many years, adoption remains in its early stages for much of corporate America and has only just begun in such sectors as healthcare and government. The pressures to reduce cost and improve efficiencies in these sectors should drive increased opportunities for some time. We believe occupier outsourcing has the potential to be a more than \$50 billion global market with, at best, a 20% current penetration rate. CBRE is ideally positioned to capitalize on the considerable upside potential in this market. Reflecting this, GCS signed 55 total contracts on a global basis in the second quarter of 2013. Of these, the majority had an Americas component. Our Americas GCS business signed up many new clients during the second quarter including JCPenney, Booz Allen Hamilton, and the state of New York, and expanded our services for such clients as Dell and AT&T.

Now please turn to slide 11. Our asset services business contributes significantly to property, facilities, and project management revenue. This business generally grows more modestly than GCS. However, we have amassed by far the largest third-party property management portfolio in the industry, which gives our clients a distinct advantage in terms of our breadth of expertise and ability to achieve economies of scale. Asset services is strategically important, as it enables us to provide property owners with an integrated leasing and management service offering across a broad portfolio. We are particularly focused on urban high-rise and trophy assets through our premier properties initiative. We added 16 such properties in the first six months of this year and now service a portfolio of more than 200 of these large landmark properties. We are also concentrating on growing our relationships with strategic institutional property owners, some of which you see represented here.



Please turn to slide 12. Leasing services on behalf of property occupiers and owners has been a core offering for CBRE for more than 100 years. In the Americas, we have more than 2400 specialized professionals providing this service. Included among the occupiers they serve are clients of our GCS business. A year ago, we made the decision to increase our investment in the leasing business, launching a number of initiatives including an expansion of our managed brokerage strategy and midmarket initiative. We are highly focused on growing our revenue and market share. Jack Durburg, our Global President of Transaction Services, described our systematic approach to agency and occupier pursuits in detail last quarter.

CBRE is renowned for large, complex transactions such as the ones you see identified here. We take a highly strategic, consultative approach to every assignment. This goes far beyond finding space and negotiating lease terms. These activities are preceded by sophisticated client advisory work that requires thorough knowledge of market activity and trends, complex financial and qualitative analysis of space alternatives, and then cycled strategies to engage the marketplace. Such broad-ranging expertise is typically beyond the scope of any one individual. Therefore, nearly all cases are services delivered through collaboration among our professionals who have access to a depth of resources and organizational support that many competitors have difficulty replicating. Our go-to-market strategy and reputation for quality services continue to catalyze future growth.

Now on to slide 13. The same sophisticated approach underpins our work in the real estate investment market. Much like the leasing market, our 650 investment sales and mortgage brokerage professionals are organized around property-type expertise, and teamwork is emphasized to ensure success in both strategic advice and execution. The results of our efforts are clear. Real Capital Analytics has identified CBRE as the number one US investment firm for the past seven consecutive years. Based on RCA data for the first half of 2013, we are once again the leading firm, with market share of 16.9%, an increase of 110 basis points from the same period of 2012. In addition, Real Estate Alert ranked us number one at midyear for office property sales valued at \$25 million or higher. As this track record demonstrates, we are highly active at all price points within the market, executing transactions valued between a few million dollars and a few billion dollars. Our commercial mortgage brokerage business consists of large origination activity to facilitate asset acquisitions or refinancings, and loan sales for lenders who want to remove these assets from their balance sheets. We also have a sizable loan servicing portfolio of more than \$100 billion. Our overall loan activity has been strong this year, with volume rising from 27% to \$11.6 billion at midyear. We do business across all property types and have deep relationships with banks, life companies, conduits, private equity firms, and government agencies, all of whom increased their commercial mortgage portfolios this year.

Increasingly, what sets CBRE apart is our ability to deliver sophisticated integrated capital market solutions for buyers and sellers of real estate. A good example of this is the sale of 1 Wells Fargo Center in Charlotte, where we arranged both the sale and financing of the property. Few firms can match CBRE's strength in real estate capital markets. As a result, we believe we are poised for further market share gains and revenue growth in this business.

Now I will turn the call back to Gil, who will continue to review our second-quarter performance.

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**Gil Borok - CBRE, Inc. - CFO**

Thanks Cal. Please turn to slide 14. EMEA overall revenue growth was 9% in the second quarter of 2013. This is very solid growth, considering the recessionary macro environment across most of Europe. France and the UK were the primary drivers of this revenue increase. Property sales revenue was flat for the quarter, following exceptionally strong growth in the first quarter. Our performance was split during the quarter. In the UK, CBRE was the most active firm in the investment market in the second quarter according to property data, which led to double-digit revenue growth. However, our activity was lower in much of continental Europe, with the exception of Belgium, Spain, and Switzerland. The leveling off of growth reflects the fact that investors remain cautious and highly selective in their acquisition decisions, although sentiment has improved somewhat over the past few quarters.

Leasing revenue grew 3% across EMEA, paced by gains in France and the UK. Belgium and Ireland also saw growth. While modest, this growth comes at a time when occupiers remain hesitant to make long-term commitments and rent growth remains largely stuck in neutral. Property facilities and project management was our largest business within the region during the second quarter. Revenue growth was robust at 22%. This strong performance is the result of our hard work over several years to build a broad, market-leading platform to meet the real estate needs of property owners and occupiers.

Please turn to slide 15. Asia-Pacific was our fastest growing business segment in the second quarter of 2013, continuing a rebound from muted performance in 2012. Overall revenue growth of 16% is particularly noteworthy, in light of slowing economic activity in much of the region and the impact of a stronger dollar. In local currencies, total revenue in Asia-Pacific was up 20%. Property sales were strong growth catalysts, rising by 62%, or 67% in local currencies, reflecting our progress in taking market share. Activity was strung across the entire region, especially in greater China and Japan. Australia and Singapore also saw good growth. This is our second consecutive quarter of robust sales growth in Asia-Pacific. This is particularly gratifying considering that investment activity remained subdued across much of the region.

In contrast, leasing revenue was essentially flat in dollar terms but did show growth of 3% in local currencies. Demand for space remains tepid, especially for multinational companies. Nevertheless, we saw higher leasing revenue in Australia and greater China, which was partly offset by a notable decrease in Japan. However,



approximately half of the decline in Japan was caused by the yen's depreciation against the dollar. Property facilities and project management revenue rose by 8% in the second quarter of 2013, or 12% in local currencies. Our outsourcing business is growing nicely across this region. Recent assignments include Citigroup, Macquarie Group, and Oracle.

Please turn to slide 16. Revenue for the development services segment, including discontinued operations, totaled \$14 million in the second quarter of 2013 versus \$17.8 million in the second quarter of 2012. The lower amount resulted from property dispositions, which reduced rental revenue. However, normalized EBITDA improved to \$7.4 million due to higher earnings from property sales, primarily reflected in real estate gains. Development projects in process totaled \$4.7 billion, up \$400 million from the first quarter and \$500 million from the year-end 2012. The inventory of pipeline deals totaled \$1.7 billion, down \$200 million from the first quarter and \$400 million from year-end 2012. Our equity co-investments at the end of the second quarter of 2013 in the development services business totaled \$72.4 million and our recourse debt stood at \$6.2 million.

Please turn to slide 17. Second-quarter 2013 global investment management revenue totaled \$115.9 million, compared with \$119.7 million in the second quarter of 2012. The decrease was primarily due to lower asset management fees and lower rental income, following property dispositions partially offset by higher acquisition and disposition fees. Global investment management assets under management, or AUM, totaled \$88.2 billion at the end of the second quarter of 2013. A decrease of \$3.8 billion from year-end 2012. Included in the current AUM is \$23.6 billion of listed securities. The decrease from year-end 2012 reflected portfolio dispositions of \$4.6 billion, as we helped our clients take advantage of the current sales environment to harvest gains in their portfolios, as well as negative foreign-currency effect of \$1.8 billion. These were partly offset by gains of \$300 million in the value of the real estate securities and direct investment portfolios and acquisitions of \$2.3 billion. We remain active buyers of value-added product in the US.

During the second quarter of 2013, we raised new equity capital of approximately \$500 million in the direct real estate business and had approximately \$2.8 billion of equity capital to deploy at the end of the quarter. Our core investments in this business at the end of the quarter totaled \$191.8 million.

Our global investment management EBITDA reconciliation detail is shown on slide 18. As of June 30, 2013, we maintained a cumulative accrual of carried interest compensation expense of approximately \$47 million, which pertains to anticipated future carried interest revenue. For the second quarter of 2013, the net carried interest incentive compensation expense totaled \$2.9 million. We normalized \$2.6 million of carried interest compensation expense, which pertains to a fund for which no carried interest expense had previously been recognized. It is our intention to follow those conventions for new funds going forward. We did not normalize \$300,000 of carried interest compensation expense, which pertains to an existing fund for which carried interest compensation expense had previously been taken. This business operated with a pro forma normalized EBITDA margin of 30% for the second quarter of 2013, an increase of 500 basis points for the second quarter of 2012. The increase was driven by improved coinvestment returns and lower provisions for bad debts and legal matters, as compared to the second quarter of 2012.

Slide 19 shows our liquidity position at June 30, as well as our amortization and debt maturity schedule for all outstanding corporate debt. As you will recall, in March 2013 we completed a series of refinancing transactions. At that time, we amended our credit agreement to provide for \$715 million of partly delayed draw-term loans and a \$1.2 billion revolving credit facility. This nearly doubled the borrowing capacity we had under the old revolver. We also sold \$800 million of new 10-year, 5% fixed-rate senior unsecured notes.

As Bob mentioned, last month we took the final step in our 2013 refinancing plan, paying down our \$450 million, 11.625% senior subordinated notes, which were due in 2017. You can see here the benefits of these actions. We have extended maturities far into the future, with little debt coming due for three years. We reduced total corporate debt by about \$500 million and cut annualized interest expense by approximately \$50 million, when compared to annualized interest expense before the refinancing actions. These actions leave us well positioned to make strategic investments to drive further growth, with increased financial flexibility to be opportunistic and continue navigating an uncertain recovery.

Please turn to slide 20. Excluding cash within consolidated funds and other entities not available for Company use, and excluding our nonrecourse real estate loans and our mortgage brokerage warehouse facilities, our total net debt at the end of the second quarter of 2013 was approximately \$1.7 billion. While this represents an increase of \$136.7 million from year-end 2012 due to seasonal incentive compensation payments, net debt is down \$272 million from the second quarter of 2012. At the end of the second quarter 2013, our weighted average interest rate was approximately 5%. This is a 60-basis-point decrease from year-end 2012. Our leverage ratio on a covenant basis as of the end of the second quarter of 2013 stood at 1.65 times on a trailing 12-month basis. Our total Company net debt to trailing twelve-month normalized EBITDA stood at 1.7 times. This is a marked improvement from 2.19 times in the second quarter of 2012. Consistent with the historical trends, we expect net debt to decrease during the course of the year.

I'll now turn the call back over to Bob for closing remarks.

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**Bob Sulentic - CBRE, Inc. - President and CEO**



Thanks Gil. Please turn to slide 21. As we reach the year's midway point, we see that our performance in 2013 is generally unfolding consistent with our expectations. Like many business people around the world, we continue to be disappointed in the lack of sustained improvement in the global economy. The more recent heightened concerns about the US Federal Reserve's monetary policies have added another dimension to existing challenges. Nonetheless, CBRE's strengths including our brand, people, flexible capital structure, and balanced service offering give us confidence in our continued success amid a historically slow and uneven market recovery. We remain highly focused on improving our industry-leading margins while making the kind of operational investments that will help us to better serve our clients and execute our growth strategy.

CBRE remains on course to achieve full-year revenue growth in the mid to high single digits, consistent with our long-term business model. Among our major business lines, we expect that property sales will remain strong. Even with slightly higher borrowing costs, institutional and entrepreneurial investors remain highly attracted to the yields available from commercial property relative to other income oriented investments. Property facilities and project management services should sustain steady low double-digit growth rates, paced by growing global adoption of occupier outsourcing. Leasing should gain momentum as we realize the benefits of our strategic growth initiatives in this business and underlying fundamentals continue to slowly heal. Investment management should create significant carried interest revenue, much of which was anticipated in our initial expectations for 2013.

We continue to expect margins to expand by around 50 basis points for the full year, driven by contributions from our investment management business as well as the normal acceleration in transaction services activity in the second half of the year. We also remain disciplined around managing operating expenses to a level appropriate, given revenue expectations. In light of the strong current sales environment and the opportunity this affords to harvest gains in our investment management portfolio, we may exceed our initial expectations for carried interest revenue for the full year. If this happens, we could modestly exceed our original expectations of earnings-per-share as adjusted of \$1.40 to \$1.45 for the full year 2013. With that, operator, we'll take questions.

## QUESTION AND ANSWER

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### Operator

(operator instructions). Brandon Dobell, William Blair.

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### Brandon Dobell - William Blair & Co. - Analyst

Maybe to start with from a personnel point of view, how should we expect the pace of broker additions or personnel additions second half of the year versus first half of the year?

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### Bob Sulentic - CBRE, Inc. - President and CEO

Well Brandon, Cal Frese, who runs our Americas, is obviously with us today. And the biggest bulk of our brokers work for Cal, so I think he's the best one to answer that. Then when he's done with that, I'll add on for EMEA and Asia-Pacific.

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### Brandon Dobell - William Blair & Co. - Analyst

Okay.

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### Cal Frese - CBRE, Inc. - CEO, the Americas

Hey Brandon. I guess as we've talked about before, we have an aggressive strategy right now to be attracting A-players into gaps in open spaces in our platform. And through June, we've attracted approximately 100 new professionals into the business. Now, I have to say that our strategy is not to bulk up here but to really add key players in key markets or key sectors in the business. We think that that track record will continue over the course of the year, and we feel good about our ability to attract new people into the industry.

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### Bob Sulentic - CBRE, Inc. - President and CEO



And Brandon, this is Bob adding on with regard to EMEA and Asia-Pacific. The philosophy and initiatives we are following in Americas, we are following around the world. And we're meeting with success adding good people to our team everywhere. Last quarter, we had Jack Durburg on the call, our global President of brokerage. And what we've asked Jack to do for us is to drive this initiative around the world. So we're seeing around the world what Cal is seeing here in Americas, and we are quite pleased with it. As we -- when we talk about this incremental investment in our business, this is one of the areas we're really focused on is adding production talent. In addition to that, we are adding management talent and investing in technology and some other platform aspects of our business. But we really focused on adding production talent.

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**Brandon Dobell - William Blair & Co. - Analyst**

Shifting gears a little bit. Any lingering effects you guys have seen as you've worked into July from all the noise in kind of May and June around rates picking up? Have you seen pipeline conversion rates change here in the US, or I guess in the UK also?

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

Can I jump in and grab that again? We're watching this obviously very closely. I'd say day to day, but it seems hour to hour in some ways. But based on the anecdotal evidence so far, we've seen relatively minimal impact on really either pricing or volumes to date, particularly for core assets and in those gateway cities. When you think about it, the capital remains abundant, particularly again for core assets. Real estate remains an attractive asset class for the traditional reasons of diversification and inflation hedge, but also importantly continues to offer attractive returns relative to other asset classes. So we believe a modest -- modestly improving economy will continue the trend of improving fundamentals, which will help. So all in all, we think the second half should continue to be strong in the capital markets business.

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**Bob Sulentic - CBRE, Inc. - President and CEO**

And I would only add to that by saying that there is the environment we operate in and then there's what we're doing within that environment. And this kind of links back into that first question, Brandon, and that is we are aggressively working to improve our capabilities. We are starting to feel that in our results, and so we're hopeful and expecting that the markets will act around the world the way Cal has described. We're also hoping and expecting that we'll perform a little bit better than that because of some of the steps we've taken.

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**Brandon Dobell - William Blair & Co. - Analyst**

Okay, and then final one for me. Within GCS -- and maybe kind of a two-part question -- what is your exposure to, I think it's called, the brick-and-mortar retailers look like? And then any sense of the wins that you talked about in GCS this quarter? A geographic breakdown? Was it all Americas or was it spread across the regions pretty well? Thanks guys.

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**Bob Sulentic - CBRE, Inc. - President and CEO**

Why don't I hit that Cal, just globally on GCS, and then you can talk about the Americas. We do have some exposure to brick-and-mortar retailers within GCS, but actually some of the challenges that they are facing is causing them to be interested in our services. And everything from disposing of spaces to managing space while they get back to focusing on their core businesses, so on and so forth. So we're not feeling, Brandon, any negative effects of the movement to online retail from brick-and-mortar retailing in our business. We do a lot of retail facilities for banks, and that's been very good business and positive business unaffected. On a relative basis, our GCS business is much bigger here in the US than it is in other parts of the world, but we had a very good growth quarter outside the US in GCS, so that was encouraging.

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

All I would add is that, I think, of those contracts, most of them actually had an Americas component to them. But what we're seeing in our pipeline is larger opportunities with international pieces to them. So, it's all been pretty good.

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**Brandon Dobell - William Blair & Co. - Analyst**



Okay. Great. Appreciate it guys. Thanks.

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**Operator**

Anthony Paolone, JPMorgan.

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**Joe Dazio - JP Morgan - Analyst**

It's actually Joe Dazio here with Tony. Wondering if I could dig into the gross margin a little bit again. Gil, can you clarify? I think you said that it went down because there were regions in which there is a fixed-cost competition component for producers that saw a decline in transactions. Did I hear that right?

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**Gil Borok - CBRE, Inc. - CFO**

You did. So you've got a couple of things going on that are affecting the move in terms of cost of services versus revenue. And essentially, as you know, cost of services in general will move with revenue, particularly when it's commission based or transaction based, less so in the outsourcing business. But we had revenue decrease in the principal businesses, which have no cost of services component. So when you have a revenue decrease there, cost of services is not moving down there because it's all in OpEx. And then we also had one or two countries in particular that have more fixed cost structure than, let's say -- using the US as a compare, where we have a commission structure -- we've got a couple of countries where revenue was down, but cost was not down commensurate with revenue. And that's having an impact, if you will, on the ratio of cost of services to revenue because they are not moving in like kind in those two instances.

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**Joe Dazio - JP Morgan - Analyst**

And is that primarily in EMEA where that occurs?

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**Gil Borok - CBRE, Inc. - CFO**

Actually not. The largest one was actually in Brazil.

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**Joe Dazio - JP Morgan - Analyst**

Okay. One other, I guess, margin-related question. The incremental EBITDA margin looked like it was about 16% or so. And I guess just kind of curious how you think that number -- how much you think that number could potentially expand. I guess at the transaction businesses, we've been using the rule of thumb they produce overall margins of about 20, so the incremental margins could be higher. So do you think that 16% could go up from here, or do you think that the impact of the outsourcing business is so great that it kind of pulls that down and there's not a whole lot of upside?

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**Bob Sulentic - CBRE, Inc. - President and CEO**

Joe, this is Bob. Let me comment on that and Gill will probably have some follow-on. First of all, part of what you're seeing in our margins this quarter, and you will see in our margins throughout this year, is this choice we've made about incremental investments in our business. And we very specifically and very strategically, and with the endorsement of our board I might add, put a program in place to invest incrementally in our business because we think we are situated in the marketplace such that we can really benefit from those investments. So investments in talent, investments in some local market managers to drive the business. Investments in IT and research and things like that in our platform. We've articulated in the first quarter, and I'll repeat here, we think that the net incremental investment for the year is about \$40 million. We think that will have an impact on our margins for the year of about 80 basis points, relative to what they would have otherwise been in the second -- excuse me, for about 50 basis points for the year. In the second quarter, we think that impact was about 80 basis points. We are very, very focused on those investments. So when you look this year at the margin associated with incremental dollars of revenue, you're going to see something slightly different than you would have seen from us historically and probably something slightly different than you're going to see from us prospectively. Because this is a year where we're ramping up and catching up a little, making some investments that we need to make. So that's part of what you're seeing in those numbers. And Gill, I don't know what you'd want to add to that.



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**Gil Borok - CBRE, Inc. - CFO**

The only thing I would add for you to consider, of course, is we're in the second quarter and it's a 90-day period. So what you're sort of suggesting in terms of as the year goes on, it is true that the pie shift naturally with the seasonality of the transaction business and, accordingly, the impact on the full-year basis will be different than just on the second quarter or the first quarter.

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

Can I just? Do you mind if I --? This is Cal, CEO of the Americas. I simply would say that there's tremendous alignment among the management team on these strategic investments that Bob's talking about. And everyone across the world is intensely focused on managing the business extremely carefully, because we are laying in these strategic investments which we believe will be high-yield investments. So we are on it. I think we have this reputation And I've been here for 15 years and was COO of the Americas at one point in my career, and we are very focused on running an efficient business.

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**Joe Dazio - JP Morgan - Analyst**

Is there any, I guess, goal with respect to incremental margins? I know in prior years, you've talked about the sort of the 20% corporate margin goal being out there. But with these investments, does that kind of change any of the thinking as to how that could trend over the next couple of years?

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**Bob Sulentic - CBRE, Inc. - President and CEO**

What we've talked about is where we think we are going to get to this year, Joe, which is 50 basis points of margin increment above last year after taking into account those investments. And again, we think those investments are going to cost us about 50 basis points of margin this year. So, said differently, we think we would've expanded about a % this year in the absence of those investments.

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**Joe Dazio - JP Morgan - Analyst**

All right. And then last question, the leasing growth that it looks like it's kind of in the low to mid single digits globally. Is there a way you can roughly break that out, and maybe do it regionally if you can, by the different buckets that drive leasing revenues up? So in other words, how much of that growth is from rents going up versus lease durations going up versus square footage going up?

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**Gil Borok - CBRE, Inc. - CFO**

Joe, the short answer is essentially it's still a volume velocity driver. So it's really more about the number of transactions being up, because the rental rates are up in some places; but you know in the US, they're up a little bit, not very much. And in Europe, they're pretty much flat and I think more or less the same for Asia. So it really is still about volume more than anything else.

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

What we do know is that in the second quarter, the volume of leases we did was up slightly, and the size of those leases in terms of dollars was up slightly. So you had the cumulative effect of those two things. But that's an aggregate answer for what we saw around the world and across product types.

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**Joe Dazio - JP Morgan - Analyst**

Okay, thank you.

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**Operator**

Will Marks, JMP Securities.



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**Will Marks - JPM Securities - Analyst**

I'm going to first ask Gil on would -- do you ever comment on where net debt could be year-end in terms of -- based on hitting your guidance or just any related thoughts?

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**Gil Borok - CBRE, Inc. - CFO**

Well, no. The only statement that we've made is actually net debt will go down as the year progresses because of the seasonality. But we haven't given a number in terms of where net debt would be at 12-31.

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**Bob Sulentic - CBRE, Inc. - President and CEO**

And let me say, Will, we talk about the investments we're ranking. The investments that Cal and Gill and I have been talking about so far in this call are income statement investments, and we're foregoing some short-term income. We also have an aggressive plan for making balance sheet investments with our capital. We are co-investing in our investment management business, we are co-investing in our development business, we have M&A we are looking at. And we are doing capital expenditures for technology. So all that's going to play into that net debt picture between now and the end of the year.

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**Will Marks - JPM Securities - Analyst**

Okay that makes sense. Second question on the guidance, just to be clear, I think you have been clear, the potential upside in guidance does not relate to your particular investment sales revenues being higher than expected. It's rather how that drives the asset management revenues.

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**Gil Borok - CBRE, Inc. - CFO**

Well, the incremental -- if there is an incremental, it's purely related to CBRE global investors and carried interest. It's got nothing to do with capital markets. So just to be clear, it's all about the potential for carried interest that we see as high. That's what's driving that comment about the possibility of exceeding where we are at.

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**Will Marks - JPM Securities - Analyst**

Okay great, thanks. And then last question, more big picture on leasing conditions. I don't want to put words in your mouth because it may not have been you guys have commented, but we have heard, from at least others, the second half leasing revenues. Maybe it's just domestic. Should be higher than first half, meaning our growth rates should be higher. Do you think that's a fair assumption, and can you talk about outlook overseas as well?

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**Bob Sulentic - CBRE, Inc. - President and CEO**

Let me start in the Americas. We did, at the beginning of the year, forecast that the economy would improve during the year and leasing would get stronger as the year progressed. And really notwithstanding the choppiness that we see today, anecdotally and from everything we see in market, we continue to believe the second half will be better. Job growth and improvement in housing have an impact on the consumer and the related specialties, particularly warehousing and retail. Sentiment is improving based on what's happening in Europe. Sovereign debt issues and consumer confidence is actually higher today than a year ago and is at a five-year high. So with real estate fundamentals improving, and the activity levels that we see, we really have a general confidence that second half is going to be better.

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**Bob Sulentic - CBRE, Inc. - President and CEO**

You know, well I'd say this, Bob. I'd say for EMEA, that's where we are at as well. We think that the second half should be better. London is such an important part of the business, not only for ourselves but for the companies we compete with over there. And there is reason to think that that would improve in the second half. Germany, same thing. Obviously southern Europe, Spain, Italy is challenged, but that's not as big a part of our business. We are waiting to see what's going to happen in France and, in particular, in Paris. But I think on balance, we think it should be a little better in EMEA in the second half. Asia-Pacific is a little bit different story. The



domestic companies in the domestic part of the economy is where there is more activity now. And the global companies that operate there, or the multinationals, are the companies where we are seeing less activity. The global real estate companies like ourselves tend to do more of our business with those global companies. And as a result, we are less inclined to think that there's going to be a material pickup in the second half in Asia-Pacific than we are in here in the United States or in EMEA.

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**Will Marks - JMP Securities - Analyst**

Okay great. That's all for me, thank you.

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**Operator**

David Ridley-Lane, Bank of America.

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**David Ridley-Lane - Bank of America Merrill Lynch - Analyst**

So I guess consensus thinking was the first 100 basis points increased in interest rates wouldn't have an impact on investment sales volumes. But I don't think anybody was thinking that that would happen in such brief amount of time. So just wondering historically, what's been the effect of an interest-rate shock on your investment sales in the next three to six months? Have potential buyers stepped away from the table?

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**Bob Sulentic - CBRE, Inc. - President and CEO**

Well it depends on the situation surrounding it. If it's akin to pick up a material pickup in economic activity in the economy getting better, now as my colleague Cal Frese likes to say, it's hard not to feel good about the things that improved economy would do to our business. So we think if there's a material spike up in interest rates, it's probably going to be because there's a materially better view about what's going on in the economy. And so we believe that historically that's kind of been the case. If there was something else going on beyond that that wasn't tied to the economy, then at some point that would be, in all probability, a drag on the capital markets because you know there are significant number of leveraged buyers out there. It also, though, always depends on what the alternative investment classes that are doing that are available to investors. And real estate is becoming an increasingly accepted investment class. Cal, I don't know if you would â€??

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**Cal Frese - CBRE, Inc. - CEO, the Americas**

I would only say that what happened in June was abrupt but anticipated. And I think the world was ready for it. And I'm not saying it hasn't had any impact. But, again, anecdotally looking at our own volumes and demand in the capital in the business, we seem to feel that's pretty good. I think people reasonably expect that interest rates could continue to rise, but so long as they do that in a way that people can anticipate and manage into their forward-looking outlooks, then it can cause a pause from time to time. But it is manageable. And we've seen this over every cycle.

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**Bob Sulentic - CBRE, Inc. - President and CEO**

I think the other interesting thing about this, David, is the place where we think we are most vulnerable to dampening investment properties activity from increased interest rates is in the second-tier markets. Because the first -- the primary markets around the world are being driven by other dynamics. The value of properties. So we think it's the second-tier markets where you'll see the biggest impact from interest rates. Ironically we also think it's the second-tier markets where we'll see the biggest impact from an improved economy. So those two things really should offset each other to a degree. Obviously, if either end of that gets extreme relative to the other, you're going to get results that reflect that.

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**David Ridley-Lane - Bank of America Merrill Lynch - Analyst**

Got it. Okay. And then in investment management, would you expect that disposition is going to outweigh acquisitions in the second half as well?

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**Bob Sulentic - CBRE, Inc. - President and CEO**



Yes. This year.

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**David Ridley-Lane** - *Bank of America Merrill Lynch - Analyst*

This year?

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**Bob Sulentic** - *CBRE, Inc. - President and CEO*

Well, dispositions are going to be very material. There is a chance that we could ramp up acquisitions to be on par with dispositions. But the general expectation of our leadership team in the investment management business is that this is a year we're going to be harvesting, because our clients want us to be harvesting. And then we think that starting next year you'll see the opposite effect take place. But we are in an aggressive harvest mode because that's what the investors that we work for want.

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**David Ridley-Lane** - *Bank of America Merrill Lynch - Analyst*

Got it. And then when you look at the 2013 forecast that you put in your slides for absorption, all those forecasts were up. I think office was up 26 million square feet from 19 million last quarter. And so I'm sort of wondering, if that forecast is realized, are we talking about -- and definitely heard your comments earlier on the call about pickup and leasing momentum. I'm just wondering how substantial that momentum could get. Are we talking about high single-digit here or more sort of in the mid-single-digit range?

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**Bob Sulentic** - *CBRE, Inc. - President and CEO*

It's not high single digits. It's -- it will be in the middle range, maybe improved over where we are. But remember, we are in the low single digit at this point in the US in particular. And so, I think there will be some improvement with an improving economy, but not dramatic. And, again, we believe we are outperforming the overall activity in the market, and we believe that that will continue as well.

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**David Ridley-Lane** - *Bank of America Merrill Lynch - Analyst*

All right. Thank you very much.

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**Operator**

Thank you. At this time there are no additional questions in queue. Please continue.

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**Bob Sulentic** - *CBRE, Inc. - President and CEO*

Okay. Well thanks everyone and we'll talk to you again next quarter.

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**Operator**

Thank you. And ladies and gentlemen that does conclude your conference call for the day. We do thank you for your participation and for using AT&T's executive teleconference. You may now disconnect.



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