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CBRE Group, Inc. (CBRE)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the CBRE Second Quarter 2018 Conference Call. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Brad Burke, Investor Relations for CBRE. Please go ahead.

Brad Burke

Head of Investor Relations, CBRE Group, Inc.

Thank you and welcome to CBRE's second quarter 2018 earnings conference call. Earlier today, we issued a press release announcing our financial results and it is posted on our website, cbre.com. On the Investor Relations page of our website, you will find a presentation slide deck that you can use to follow along with our prepared remarks.

This presentation contains forward-looking statements. These include statements regarding CBRE's future growth momentum, operations, market share, business outlook, investment levels and expectations for the financial performance of both our acquisitions and our company overall. These statements should be considered estimates only and actual results may ultimately differ from these estimates. For a full discussion of the risks and other factors that may impact these forward-looking statements, please refer to our second quarter 2018 earnings report furnished on Form 8-K and our most recent annual and quarterly reports filed on Form 10-K and Form 10-Q.

During our remarks, we may refer to certain non-GAAP financial measures, as defined by SEC regulations. Where required by these regulations, we have provided reconciliations to what we believe are the most directly comparable GAAP measures. These reconciliations, together with explanations of these measures, can be found

within the appendix of this presentation. Additionally, all growth rate percentages cited in our remarks are in local currency unless otherwise stated.

Please turn to slide 3. Participating on our call today are Bob Sulentic, our President and Chief Executive Officer; and Jim Groch, our Chief Financial Officer and Head of Corporate Development.

Now, please turn to slide 4 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. We were pleased to have produced another quarter of double-digit adjusted earnings per share growth. Our results benefited from the diversity and strength of our business and the focus of our people on delivering differentiated outcomes for our clients, the key pillar of our strategy.

I'll call out a few of the notable drivers of our performance in the quarter. The first is leasing, which realized 18% revenue growth, including 19% in the Americas. This growth reflects the gains we are making in attracting talented professionals to CBRE and in leveraging our advisory capabilities such as workplace strategies, labor analytics and supply chain consulting. Second, Occupier Outsourcing posted a 20% fee revenue increase. This continuing strong growth is attributable to the secular trend of occupier's increasingly embracing outsourced commercial real estate services and the advancement of CBRE's capabilities.

I'd like to also comment on our Development Services business, which grew EBITDA by 20% in the quarter. This is an outstanding business that has delivered over 30% annualized returns for our capital partners in the current business cycle. Further, it has generated strong profits that have bolstered our balance sheet and put us in an excellent position to make strategic investments in our business.

CBRE continues to make gains through investments in digital and technology capabilities and strategic acquisitions. I'll highlight two of our key investments. The first is CBRE 360, a personalized platform that delivers an enhanced and connected workplace experience. CBRE 360 allows users to navigate the workplace, set up meetings with colleagues, reserve workspaces and access concierge services. We have built a secure, scalable, enterprise-grade app and software platform. Our clients can pick experiences that reflect their individual brand.

Since its launch in January, CBRE 360 has received strong interest from occupiers, who believe workplace experience is central to their ability to attract and retain talent. Interest has been even stronger from property investors who want to develop stickier relationships with their tenants.

All of this is very good for CBRE's business. Our first clients went live in the second quarter and we have a large pipeline of prospective client activity. As an example of the fanfare CBRE 360 is generating, Microsoft featured a demonstration of the app at its Global Developers Conference last month.

Second, our acquisition of FacilitySource addresses a growing segment of the facility's management market. The company serves clients by utilizing a proprietary technology platform with 13 years of data, a 24/7 operation center, and a network of more than 25,000 certified service providers. It is particularly effective for managing large numbers of geographically dispersed assets, such as retail stores and bank branches. Our clients love this capability. FacilitySource is performing above our expectations in its first 45 days and has exceeded its second quarter sales target.

Before I conclude, I'll comment further on our financial results for the quarter. While we had strong revenue and earnings growth, we also experienced negative operating leverage in our combined regional services business, that is, expenses grew faster than revenues. We pay close attention to this metric and our target is to generate neutral to positive operating leverage over time. However, in the second quarter, strong revenue growth in Occupier Outsourcing and a decline in high-margin property sales in EMEA and Asia Pacific versus exceptional growth in the prior year, weighed on margins.

More significantly, as we indicated at the beginning of the year, we are making incremental investments in our business to support future growth, streamline operations, and share some of the benefits of tax reform with our people through an enhanced 401(k) match, higher merit salary increases for rank-and-file employees and other actions.

We do not expect to increase the current level of run rate investment for the foreseeable future and therefore do not expect these incremental investments to put negative pressure on operating leverage in our combined regional services business in 2019. CBRE has realized strong earnings growth year-to-date, and we continue to see positive momentum across our business. We are therefore increasing our outlook for full-year 2018 adjusted EPS to a range of \$3.10 to \$3.20, reflecting 15% growth over 2017 at the midpoint.

Now, I'll turn the call over to Jim, who will discuss the second quarter in more detail.

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

Thanks, Bob. Please turn to slide 5 for a discussion of our financial performance. Fee revenue increased 15% in U.S. dollars and 12% in local currency, driven by strong organic growth, with M&A contributing 2% growth in the quarter. Adjusted EBITDA rose 5% and adjusted EPS grew by 10%, both in USD. Results in the quarter benefited from lower interest expense and a lower tax rate, partially offset by higher depreciation and amortization expense. These items, in total, had a \$0.03 positive impact to adjusted earnings in Q2.

Besides the FacilitySource acquisition, which Bob described, we completed two other infill M&A deals in the quarter and one more in July. Our M&A pipeline remains healthy. In our regional services businesses, fee revenue growth of 13% outpaced adjusted EBITDA growth of 4%.

Adjusted EBITDA in EMEA and Asia Pacific declined by a total of \$5.5 million. The decline in EMEA was primarily driven by two items. First, a decline in UK property sales against a 69% increase in the prior year, and second, \$5.5 million of incremental investments, which include the consolidation of three ERP systems.

In Asia Pacific profitability was impacted first, by a decline in property sales, down 14% against a 45% increase in the prior year and second, a negative \$4 million mark-to-market of intercompany loans due to FX volatility. Even with these drags on profits in EMEA and Asia Pacific, adjusted EBITDA for the combined regional services businesses would have increased 13% in local currency absent the incremental investments.

Please turn to slide 6, which at the bottom of the page highlights our revenue growth by line of business for Q2. Leasing revenue rose 18% globally and 19% in the Americas. Growth in the Americas is attributable to larger transactions, continued recruiting, and an easier compare against a challenging second quarter in the prior year. We also benefited from market share gains in the quarter and an approximate 3% lift from M&A. Our Americas leasing business has strong momentum, but comparisons become more challenging in the second half of the year, which achieved mid-teens growth in the prior year.

Commercial mortgage origination grew 15%, driven by strong activity from banks and government agencies as well as market share gains. Recurring revenue from loan servicing increased 10% and we continue to expect mid-teens revenue growth for the full year. Property management grew fee revenue 9%, supported by the growth of our fund administration business. Global property sales revenue dipped 2% against a difficult comparison, particularly in EMEA and Asia Pacific, both of which saw revenue surge more than 40% in Q2 of the prior year.

Slide 7 highlights our Occupier Outsourcing business. Fee revenue increased 20%, reflecting very strong momentum in the business, and our pipeline remains robust. Bob mentioned that FacilitySource has materially strengthened our ability to provide solutions to a large group of our clients. This is a very high-growth, technology-driven offering, and we will back it with the aggressive early investment a business of this nature deserves.

FacilitySource had 2017 revenues of approximately \$150 million and we are targeting 2018 yearend run rate revenue approaching \$270 million. We will invest to achieve a high rate of growth in this business over the next few years. We expect to approximately break even in 2018, achieve modest earnings in 2019, and \$50 million of annual EBITDA within four to five years as we invest to bring this business up to its full potential.

Slide 8 summarizes the results for our Global Investment Management segment. Adjusted EBITDA totaled \$16 million. The prior year compare benefited from \$7 million of carried interest revenue versus almost no carried interest being realized in the current quarter. Additionally, we incurred approximately \$5 million of employee-related costs recognized due to a legacy contractual obligation, which reduced our adjusted EBITDA.

We continue to attract significant investment capital with new equity commitments totaling \$9.1 billion for the 12 months ending Q2. Assets under management rose \$700 million during the quarter in local currency. However, the stronger dollar caused AUM to decline by \$2.5 billion in U.S. dollars to \$101.7 billion. As a reminder, more than half of our AUM is denominated in euro and pounds.

Slide 9 summarizes the results for our Development Services segment. Our strong results for the quarter were driven several large asset sales. Our combined in-process and pipeline portfolio reached a record \$11.9 billion. Projects in-process increased by approximately \$300 million in the quarter and the pipeline declined by approximately \$200 million, reflecting the continued conversion of pipeline activity to in-process.

Before I return the call back to Bob, I'd like to highlight that this quarter represents the three-year anniversary of investment sales volume speaking in the United States. U.S. volumes are down approximately 6% on a trailing year basis since that peak according to Real Capital Analytics. Despite the softness in U.S. investment sales, CBRE's adjusted EBITDA has grown more than 40% over this same period. This growth speaks to the strength of our globally diversified business.

Now, please turn to slide 11 as I turn the call back over to Bob for closing remarks.

Robert E. Sulentic

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

Thank you, Jim. We began the second half of the year with positive momentum across our business. The macro-environment remains favorable with solid economic growth. While we are mindful of potential risks on the horizon, particularly from heightened trade tensions, we have thus far seen no discernible impact to our business.

As I mentioned earlier, we are raising our outlook for full year 2018 adjusted EPS to a range of \$3.10 to \$3.20, up from \$3 to \$3.15. This represents a 15% increase over 2017 at the midpoint and would result in our ninth consecutive year of double-digit adjusted earnings growth.

We have raised guidance despite unfavorable shifts in currency since the beginning of the year. Absent adverse movements in currency, the midpoint of our updated guidance would have been approximately \$0.08 to \$0.10 higher.

In closing, our people around the world have never been more energized. They are embracing our strategy and increasingly working together across business lines and geographic boundaries to produce exceptional outcomes for our clients. This is the key to our future, and we are very excited about it.

With that, operator, we'll now take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question is coming from Anthony Paolone from JPMorgan. Your line is now live.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Thanks and good morning. My first question is on the margins, and just to make sure I understand some of the commentary around the drag there. So, if I look at your incremental margins in 2Q versus a year ago is about 10%, 11% in the regions, excluding the principal businesses. So, is that kind of roughly what to expect over the balance of this year until you anniversary these costs in 2019?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Hey, Anthony. It's Jim. I wouldn't get quite that specific as to the second quarter. What I would say is that, big picture, we gave guidance for the year of 17.5%. We have some modest headwinds to that. FacilitySource is a little bit of a headwind. The very strong growth in the outsourcing business is a little bit of a headwind when it comes to mix. But despite that, I think that that guidance is still achievable.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

But in terms of thinking about some of the costs, you mentioned sharing some of the tax savings and just investing in the organization, like is that a tens of millions of dollars item that just kind of flat-lines when you look ahead, or what's the order of magnitude that you guys are seeing on that front?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

When we gave our guidance at the beginning of year, we spoke about that quite a bit. And it's certainly in the tens of millions on any given quarter as you go through the year, and it's reasonably flat-lined. But if you look at where the pressure was this quarter, it was quite specifically in EMEA and Asia Pacific, and in both cases, around a couple of fairly specific things that were going on. I think I mentioned Asia-Pac and EMEA declined in total by about \$5.5 million from an EBITDA standpoint.

In EMEA, that was really driven by a big swing in the UK where sales revenues went from up roughly 70% in Q2 of last year to down about 14% in this quarter, so a big swing there. And then, we had about \$5.5 million of incremental investments along the lines that you were just asking about. And the biggest project in EMEA right now is we are taking three existing ERP systems and upgrading and moving all of that into one new system.

In Asia Pacific the big driver was, again, a big swing in sales versus a tough compare from the prior year. So, Asia Pacific coincidentally was also down 14%. That's against increase in the prior year of about 45%. And then, we had a couple of other items that are a little more unusual. We had a mark-to-market of a couple of loans in Asia Pacific that was about a \$4 million hit. We had a \$1 million total deal costs on the infill acquisition. As you know, we don't normalize deal costs unless we have a very large transaction typically. So, on the infill M&A, we don't normalize deal costs. We're also not normalizing any of the types of projects that I just mentioned.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Thanks for that color. On the leasing side, you mentioned some of the things specific to CBRE that drove the strong results. I think a couple of your peers have put out some leasing numbers for the second quarter, but some of those were strong, too. Can you talk about just kind of what you're seeing more broadly there, because it seems to have been a business line, the cycle that's been a little more touch-and-go in terms of the underlying strength? Is anything changing?

Robert E. Sulentic

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

A

Anthony, a couple of things are going on with us and then a couple of things are going on in the market. First of all, we have introduced, two or three years ago, what we call our Advisory & Transaction Services. This is a set of capabilities that are centrally led by one of our most experienced people to connect our big outsourcing clients with our local brokers, who do transactional work and support both with a bunch of advisory capabilities, like workplace solutions, labor analytics, government incentives. We are getting a lot of traction with that initiative. We are landing a lot of count-based work as a result of that initiative. We believe it allows us to do things for our clients that are really not easily duplicated in the marketplace.

Secondly, all the stuff that you're seeing that's driving this co-working and experience dynamic is helping our business. Occupiers all over the world, and particularly in the big markets around the world, are really focused on creating experiences for their employees, because they view this as central to attracting and retaining employees. This is creating a lot of change in the way space is used. When there's change in the way space is used, there's real opportunity for us to do new leases for our clients. By the way, our competitors have that same opportunity, and companies like WeWork have that same opportunity.

There's opportunity to do leases. There's opportunity to advise them. There's opportunity to change the space they're in now, which leads to property management work. All of that has been unique to this cycle and a real driver for our business in this cycle. If you go back to that statistic Jim gave about when the capital markets peaked three years ago and all the growth we've had since then, well, that's not typical of what you saw in prior cycles, but you're seeing that now because there's so much going on in our sector and in our company that's allowing us to grow independent of what's going on in the capital markets.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

And so, is that kind of – so when we read about WeWork offering up their look and feel on what they do to occupiers, is that effectively what you're talking about that you all are doing for the clients as well? And with that, how does that come in through leasing versus, say, like project management or outsourcing revenues?

Robert E. Sulentic

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

A

Well, it comes in through all of them, comes in through all three of those areas. And I would tell you that the dynamics that are helping drive WeWork and that their strategy addresses are helping drive our business. Keep in mind, we manage space with about 9 million people in it, right? All of the co-working memberships around the world by all of the companies that do co-working don't add up to anything close to that.

So, what are we doing with that 9 million people worth of occupancy? We're doing all kinds of alternative space for them. We're doing all kinds of experience work for them. We've got this new CBRE 360 solution that we're offering for those occupiers that's got real excitement from our clients. By the way, it's got real excitement from landlords too that need that kind of capability to attract clients.

So what again, what does that mean? That means more work for our outsourcing people. That means more work for our leasing people. It means lots more work for our project management people that do moves as changes, construct new space, change the way space is configured. It's about experience for occupiers and it's about a different way to use space. And all that creates opportunity for us, but it creates opportunity in the market for others as well.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. And then, last question on FacilitySource. Why wasn't the business profitable or why isn't the business profitable day one, and what precisely do you need to do to make it profitable? Like what wasn't happening?

Robert E. Sulentic

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

A

Well, first of all, that is a big, big growth business, right. Jim gave the numbers, \$150 million of revenue last year. It's going to push double that this year. We are treating it like a super high-growth technology-oriented business, because that's exactly what it is. What do you do with a business like that? You invest heavily in it upfront to make sure that it works extremely well for your clients and that it's positioned for growth. We bought that business for that reason. We have a large base of clients that find that capability to be attractive and find that capability something that was lacking in the marketplace for a long period of time. So, we've very explicitly adopted a strategy around that business to invest aggressively in it, to grow it rapidly, to make sure that it's exceptional and very differentiated in the market. And as a result, we don't expect a lot of profitability in the short run. But a few years out, we think that business that we bought for \$300 million is going to be a \$50 million EBITDA business and growing rapidly from there. And what doesn't show up in that \$50 million of EBITDA is all the help that gives us in growing other parts of our outsourcing business.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

Operator: Thank you. Our next question is coming from Jason Green from Evercore ISI. Your line is now live.

Jason Green

Analyst, Evercore Group LLC

Q

Good morning. Just on the Occupier Outsourcing front, it seems like EMEA led the group with the U.S. coming in last, although still kind of strong growth. I was wondering, as we think about going forward, which markets is there the most share to be gained? And are any of these markets starting to get pressured in terms of too many entrants or too many kind of real estate companies utilizing these services?

Robert E. Sulentic

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

A

Jason, there is a lot of growth opportunity in all the regions around the world. There's some unique things going on in EMEA. So, let's compare it to what was going on in the Americas a decade ago or even longer. When you go back that far in the Americas, what you saw was a business that was rapidly gaining in terms of acceptance by the occupiers in the marketplace. There were a lot more people coming into the market because of prior experiences that understood how to deal with outsourcing. Our capabilities were growing. You're seeing that exact dynamic unfold now in EMEA. It's becoming a much more accepted practice.

And the confluence of circumstances there really favors what we're doing. It's becoming a much more accepted practice at a time that we've become much better, because we've now fully integrated or nearly fully integrated the GWS acquisition. We've got the Norland acquisition. We've got a bunch of capability on the ground that matches up very well with what's going on there. And that group of circumstances is leading to disproportionate growth over there for us. We think that's going to continue. We've got some vertical capability, like life sciences and manufacturing that we didn't have before, positioning us really well for growth. But we're seeing great growth around the world. We have the biggest pipeline of opportunities that we've ever had by a significant margin. So, you should expect to see growth in each of the three regions in our outsourcing business.

Jason Green

Analyst, Evercore Group LLC

Q

And when we think about that pipeline that you talked about, is that – the visibility in the pipeline, is that 6 months or 12 months or even 18 months, kind of thinking out to how clearly you can see some of that revenue coming in?

Robert E. Sulentic

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

A

Well, it's all three, 6, 12 and 18. We usually think of it in terms of what's out there for the rest of this year and then early into next year as you get deeper into this year. But those are long term. That's a long-term sales cycle business because it's so big and so complex. And some of the things we're working on are a year plus out in the future.

Jason Green

Analyst, Evercore Group LLC

Q

Got it. And then just one last question is, as Occupier Outsourcing is becoming more accepted, has the size of the deals changed? Are they much larger now than they were last year or the year before?

Robert E. Sulentic

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

A

Size of the deals is growing, the complexity of the deals is growing. Our ability to do things for occupiers has grown dramatically. FacilitySource is a good example of that. The A&T, Advisory & Transaction Services, tenant

rep type work we do for them is a big example of that. The verticals that we operate in that I mentioned are a big example of that. So, what's happening at a time that the market's expanding dramatically, our capabilities to do unique services for these clients, by the way, that CBRE 360 is very attractive to those outsourcing clients. So again, there's a lot of things going on that are driving that growth. Some have to do with the market. Some have to do with our offering.

Jason Green
Analyst, Evercore Group LLC

Q

Got it. Thanks.

Operator: Thank you. Our next question is coming from Mitch Germain from JMP Securities. Your line is now live.

Mitchell Germain
Analyst, JMP Securities LLC

Q

Thank you. Bob, maybe just a little more on the investment in FacilitySource. Is it integration into your existing platform? Is it advancing the technology further? Maybe if you can just elaborate what sort of investment you guys are planning there.

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

A

We're making technology advancements. We're bringing people on. Obviously, just to have a business that grows that rapidly, you need to bring people on. It's getting our current clients to adopt it and make sure that we're completely nailing it in terms of execution. One of the things that we believed when we bought that business, we believed deeply was that we could do more with it than they could do themselves or that anybody else in the market could do with it. Part of that is this technology team we've built now under Chandra Dhandapani. So, we're going to take that technology they have. We're going to improve that technology. So, it's a little bit of all those things.

Mitchell Germain
Analyst, JMP Securities LLC

Q

And this is a capability that is brand new to CBRE, or is there something that you were developing on your end that may have been competitive?

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

A

It's a capability that we had a little bit of, but this takes us to a whole new place, dramatically beyond where we were before. And it's something that we've been trying to get for years – to build.

Mitchell Germain
Analyst, JMP Securities LLC

Q

Excellent. That's helpful. I know that you guys talked about some tough comps and Asia on investment sales, but I know you referenced the UK specifically. And I'm curious, because obviously there's news coming out of there with regards to Brexit. And has there created any hesitation in the market again as a result of some of these discussions?

Robert E. Sulentic

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

A

Well, the Brexit situation has been ebbing and flowing for two years now. I mean, when you go back to the summer of 2016 when that thing unfolded, we went through a really tough period. Then it settled down and it got better, and it's kind of come and gone since then. We're going through a period now with uncertainty around Brexit. And our people that run the UK watch it, obviously, what they obsess over, and they think it's probably going to put pressure on our business for the remainder of this year. But everything we talked about in terms of guidance, in terms of our expectations for our performance for the rest of the year bakes that in.

Mitchell Germain

Analyst, JMP Securities LLC

Q

Great. And then my last question, I'm just curious about some of the ins and outs on guidance. It seems like Development possibly running a bit further ahead. Just curious about the revised outlook and has anything changed relative to where your original assumptions rested?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

So, we gave guidance on capital markets, leasing, outsourcing and our investment businesses at the beginning of the year, and we now expect to exceed that guidance for the full year for each of those businesses. And that's what's reflected in our updated guidance.

Mitchell Germain

Analyst, JMP Securities LLC

Q

Thank you.

Operator: Thank you. Our next question is coming from Stephen Sheldon from William Blair. Your line is now live.

Stephen Hardy Sheldon

Analyst, William Blair & Co. LLC

Q

Yeah. Hi. Good morning. First, I was hoping you could provide some more color on the impact of acquisitions that you've embedded into guidance for the full year. It looks like there have been a boost of about 2 percentage points to revenue growth over the last two quarters. So, I guess, what level of impact would you expect from acquisitions in the second half of the year now, including FacilitySource and the smaller acquisitions? And is any of the EPS guidance increase related to acquisitions? I think you talked FacilitySource is going to be breakeven, so guessing that didn't impact it much, but just any color there.

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Yeah. Fairly modest. I mean, we've had some relatively steady positive impact over the last couple of years with infill, but like the 2% that you've seen from us year-to-date, it's likely to be in that range. As we said, FacilitySource will be a headwind to margin, plus or minus, neutral impact to the EBITDA. And we're continuing to maybe make – to run on average a new acquisition a month, but they tend to be smaller infill acquisitions. So, nothing significant expected to come from the M&A activity outside of our normal activity.

Stephen Hardy Sheldon

Analyst, William Blair & Co. LLC

Q

Okay. That's helpful. And then, on FacilitySource, you talked about that business outperforming your expectations so far and beating its own, I think, internal sales forecast. So, I guess, what do you attribute that to? And has the business already started to benefit from kind of cross-selling into your existing customer base?

Robert E. Sulentic

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

A

We attribute it to a couple of things. Number one, what's unfolding in the marketplace is what we thought would unfold. That's a service that a lot of people want that hasn't been that available in the past. And when you bring that service on to the CBRE platform and you have our marketing/salespeople helping drive the growth of that business, you start to get a dynamic like this, when you start to roll that out across our existing client base. Think of the clients we have that have dispersed facilities, small dispersed facilities around the U.S., a lot of opportunity. And so, you have those things combined creating growth that's a little better than they expected or we expected. And we're really enthused by it, but we really – again, I'm going to repeat what Jim said and what I said. But we're really, really attentive to the fact that we're going to invest into that thing so that it can take on that level of business and do a great job with it.

Stephen Hardy Sheldon

Analyst, William Blair & Co. LLC

Q

Got it. Thanks.

Operator: Thank you. [Operator Instructions] Our next question today is coming from Jade Rahmani from KBW. Your line is now live.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. Just on Development Services, the Trammell Crow business. Could you give some comments around the geographic mix of projects? And also, if any of the increase in building materials inflation that we're seeing, such as steel and lumber, could impact negatively the outlook for that business?

Robert E. Sulentic

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

A

Yeah. Jade, that business is spread around approximately 16 major markets in the U.S. They're the gateway markets you would expect us to be in. Obviously, Seattle, San Francisco, Los Angeles, all doing quite well for us now. We have a big presence in Texas and we have a presence on the East Coast and New Jersey and Philadelphia, presence in Atlanta, Chicago, Denver. And what we're seeing is a building pipeline in that business – well, building combined pipeline in in-process, because the track record of our people has been so good in this cycle. As I mentioned, we generated on an aggregate basis for all of the third-party capital, and as you know, the vast majority of the capital we use to develop with is third party, in excess of 90% returns in this – excuse me, in excess of 30% returns – that would be pretty high – in excess of 30% returns in this cycle.

And as a result, we've got a lot of capital that wants to work with us. We've got a very experienced team that can find new opportunities, and we expect to see performance that extends in a way we haven't been able to extend it in past cycles. And the projects we're doing are much more core oriented than we've been before. Will we experience pressure from materials and construction costs? That's already happened. But at the same time, cap

rates have come down. So, we're not expecting that dynamic to be particularly punishing from here going forward, but we do watch it closely.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

And the returns on CBRE's co-investments, I assume, are significantly above the 30% because of performance incentive fees.

Robert E. Sulentic

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

A

Well, we get the same returns that our investor clients get. But then, of course, we get a big participation in those deals, and that's what's driven the numbers that you've seen over the past few years, the EBITDA numbers you've seen. We've got a total equity investment in that business of \$150 million or less. And so, if you look at all the EBITDA we've generated in that business, if you were to attribute that all to that co-investment, the returns would be absurdly high. But we don't necessarily think of it that way.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

In terms of the building pipeline, is it mainly weighted toward industrial or is it spread across the property types? That's obviously been a big factor this cycle.

Robert E. Sulentic

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

A

Yeah. Well, it's pretty evenly spread. The biggest is residential, a little over 30%, then office just slightly behind residential, then industrial about 24%. We do a little bit of healthcare. So, it's pretty evenly spread among the products.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. In terms of the investment sales environment, are you seeing consistency in the market, a pickup in major markets? How would you characterize it? And also, just could you comment on the number of bidders on average versus say a year ago?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Yeah. I would say, it's big picture, and particularly if you're talking about the Americas, it's a healthy, stable kind of market, even the peak that I referenced earlier of three years ago, the decline over the three-year period on volumes have been about 6%. Obviously, it can feel quite lumpy quarter to quarter and we felt that, in particular, in this quarter in EMEA and Asia Pacific.

But overall, this quarter for us was down 2% in sales volume and we're seeing pretty solid activity. There's a little bit of anxiety that kind of comes in from time to time as the tenure moves around and touches 3%. But that, in the end, hasn't seemed to have had much impact. And when there is an impact, it seems to be relatively mild and relatively short. And then overall, I would say there's as much or more dry powder targeting commercial real estate at this time than at any time that we can remember. So, it feels like pretty healthy dynamics.

One other point I would make is that lenders are careful, and that's also a very positive dynamic to have that in play at a time when there's so much liquidity in the market.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Turning to margins, can you indicate if adjusted EBITDA margins in outsourcing and leasing were higher than a year ago?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

They've been relatively stable, but for some investments specific to any business in any given region that, the types of investments that roll off. So overall, relatively stable.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

And lastly, on the recruiting environment, we've seen a lot of the smaller competitors make aggressive hires. And there also, at the same time, is a trend, or at least it appears to us that there's a trend of brokers choosing to go independent to form new teams. Could you just comment on the recruiting environment and what do you think is driving those two factors?

Robert E. Sulentic

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

A

Well, Jade, I think the overwhelming trend is for brokers to want to be with the prominent global companies. And we've continued to have very, very strong recruiting. It's driving our results, or at least impacting our results in a significant way. And the fact of matter is when a broker comes to CBRE, they have a global network, they have a brand, they have technology, they have a base of clients, they have a set of advisory capabilities that they can be supported by that they just can't get elsewhere. That allows them to do more business. That allows them to earn more money. And that puts us in a position to recruit brokers far more effectively than others in the market can do it, and retain brokers far more effectively and cost effectively, specifically, than others can't. And it's showing up in our recruiting results and has for several years running. And that has sustained into this year.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks for taking the questions.

Operator: Thank you. [Operator Instructions] Our next question is coming from David Ridley-Lane from Bank of America Merrill Lynch. Your line is now live.

David E. Ridley-Lane

Analyst, Bank of America Merrill Lynch

Q

Sure. So, I heard your view of technology expenditures at the Analyst Day. Could you sort of help us, give some color around the build versus buy versus partner decision that you went through on FacilitySource?

Robert E. Sulentic

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

A

Okay. FacilitySource had a capability and a set of clients and, in particular, a set of vendors that we thought would be extraordinarily hard to build in any compressed period of time, certainly in a period of time that would be adequate for us to serve our clients and our prospective clients the way we wanted to. That very question, David, we went over and over and over with our management team, with our board. Our outsourcing and facilities management people considered it in-depth and ad nauseam, I'd say. And we concluded that building that business was far behind buying it as an opportunity for us.

We also believed, as I said in my earlier comments, that we could acquire that business. And in combination with the capabilities, we have particularly our technology team, particularly our marketing team, particularly our base of existing clients could do meaningfully more with that business than they could do with it themselves. I believe that they believed that. And that's why you're seeing what you're seeing with regard to these growth numbers that are exceeding their expectations and exceeding our expectations for them.

David E. Ridley-Lane

Analyst, Bank of America Merrill Lynch

Q

And then, I guess, curious how you've seen win rates for new deals in the outsourcing space trend over the last 12 to 24 months?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Yeah. I guess the data point I would give you is that we typically talk about averaging about 50% of our growth from existing clients and 50% from new clients. In this quarter, about 75% of our growth came from new clients. So, it feels that the integrations of the businesses that we've acquired are completed, and the set of capabilities we have put together is accelerating the growth rate in the business.

David E. Ridley-Lane

Analyst, Bank of America Merrill Lynch

Q

Okay. And then last one for me, on the sort of 17.5% kind of margin bogey for the year, it does imply that the margins in the second half would be flattening out. Is that a function of lower investment spending or are you – what else would be helpful to seeing flatter margins in the back half?

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

I mean, as we roll up all of our forecasts, it's where we're coming to for the year and it's a combination of a lot of different factors. But part of it is, obviously, our Q4 is our largest quarter and that's helpful. But it's simply a roll-up of all of our forecasts across the world for all of our lines of business.

David E. Ridley-Lane

Analyst, Bank of America Merrill Lynch

Q

Thank you very much.

James R. Groch

Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Thank you.

Operator: Thank you. Our next question is a follow-up from Mitch Germain from JMP Securities. Your line is now live.

Mitchell Germain
Analyst, JMP Securities LLC

Q

Thanks. Just any updated thoughts on capital allocation?

James R. Groch
Chief Financial Officer and Global Director of Corporate Development, CBRE Group, Inc.

A

Mitch, we gave quite a bit more information than we have in the past at our Investor Day. Nothing updated from that point, but just to kind of reiterate what we said then is that we target 1 times to 2 times net debt to EBITDA over the long term. We are comfortable with a lower level of leverage as we get later in the business cycle. We're equally comfortable with a higher level of leverage when we're in the downturn in the early years coming out of a downturn to take advantage of the opportunities there. So, we're running on a more conservative side as we're – later in an extended business cycle.

Mitchell Germain
Analyst, JMP Securities LLC

Q

Thank you.

Operator: Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further closing comments.

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

Thanks, everyone, for being with us and we look forward to talking to you at the end of the third quarter.

Operator: Thank you. That does conclude today's teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.

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