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# CB Richard Ellis Group, Inc. CBG [NYSE]

Morningstar Rating	Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat	Stewardship Grade	Industry	Sector
★★★ Hold	4.54	6.50	0.00	0.00	Extreme	None	B	Real Estate	Financial Services

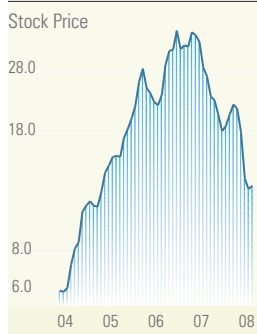
Per share prices in USD

Its debt load and the commercial real estate downturn put CB Richard Ellis in a precarious position.

by Todd Lukasik, CFA  
Stock Analyst  
Analysts covering this company do not own its stock.

Pricing data through October 23, 2008.  
Rating updated as of October 23, 2008.

Currency amounts expressed with "\$" are in U.S. dollars (USD) unless otherwise denoted.



## Thesis Oct. 24, 2008

Although CB Richard Ellis enjoys some advantages from its global commercial real estate service capabilities, its business prospects are tied to the cyclicity of the commercial real estate market. Furthermore, the firm's massive debt load poses a risk of financial distress, which leads to our extreme fair value uncertainty rating for its shares.

CB Richard Ellis is well positioned to win a larger share of real estate services business. Organizations are increasingly willing to outsource the noncore tasks of managing their property needs, but they prefer to consolidate their relationships with as few vendors as possible. We believe its global operating infrastructure and broad service offerings provide CB Richard Ellis advantages relative to smaller, regional operators. But we don't expect those advantages to translate into returns on invested capital that exceed its funding costs, particularly during the next few years. Therefore, we believe CB Richard Ellis lacks a moat.

Furthermore, the real estate services pie may be shrinking. The recent bull run in commercial real estate has come to an end with the tightening of credit markets and recent economic weakness. With many traditional sources of funding for commercial real estate transactions currently withdrawn from the market, the volume of commercial property transactions has plummeted. We estimate that as much as 40% of CB Richard Ellis' revenue is linked to the volume of commercial real estate transactions. In addition, as the global economy slows and employment weakens, leasing activity and rental rates--which drive value in the other 60% of its business--could fall.

On top of the uncertainty related to the commercial real estate market and the economy, CB Richard Ellis' debt load adds additional concern. It has about \$2.6 billion in debt outstanding, and our forecasts suggest that the firm

will need to refinance as much as \$1 billion in 2011, and another \$1.2 billion in 2013, when debt comes due. Additionally, cash flow has deteriorated significantly. Cash from operations was negative \$380 million through the first half of 2008, relative to positive \$163 million in the first half of 2007. Given the historically seasonal nature of commercial real estate transactions, cash flow could suffer through the end of the year if the transaction market remains depressed, as we expect. Because we view financial distress as a possible outcome, we assign an extreme uncertainty rating to our fair value estimate, and we incorporate the possibility of a \$0-per-share value in our fair value estimate.

## Valuation

Our fair value estimate for CB Richard Ellis is \$6.50 per share. We assign a 20% probability that the firm could go bankrupt and equityholders' value would be wiped out. (Even if the firm avoids bankruptcy--which we believe is very likely--it needs to service more than \$2.6 billion in debt through a cyclical downturn, and we forecast refinancing requirements of \$1 billion in 2011 and \$1.2 billion in 2013.) Our base-case forecasts result in a fair value estimate of \$8 per share, to which we assign an 80% probability. In our base scenario, we assume revenue contracts by double digits in 2008 and 2009. We also assume lower profitability in those years, with the operating margin bottoming out at 3% in 2009, as expense reductions fail to keep pace with revenue contraction. Over the longer term, we expect revenue growth in the mid-single digits and a margin that tops out in the 9% range, both metrics well below recent historical averages. This reflects our belief that the favorable operating environment that real estate services firms operated within during the last few years will not return anytime soon, if ever.

## Risk

CB Richard Ellis' prospects are tied directly to the cyclical commercial real estate market. A prolonged credit crunch could keep commercial real estate activity at levels far

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Per share prices in USD

Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
<b>CB Richard Ellis Group, Inc.</b>	USD	919	5,876	565	274
<b>Jones Lang LaSalle, Inc.</b>	USD	825	2,709	251	180
<b>Grubb &amp; Ellis Company</b>	USD	88	480	0	-4

Morningstar data as of October 23, 2008.

below those seen in recent years, hurting CB Richard Ellis' financial results. CB Richard Ellis' highly leveraged balance sheet presents real financing concerns. It needs to service more than \$2.6 billion in debt through a cyclical downturn, and we forecast refinancing requirements of \$1 billion in 2011 and \$1.2 billion in 2013.

## Bulls Say

- CB Richard Ellis is one of just a few truly global one-stop-shop real estate service providers, positioning it to win a larger market share as large organizations look to consolidate their property-related contracts with a single vendor.
- The firm boasts a win rate on its global corporate solutions bids of more than 60%.
- CB Richard Ellis' business--while subject to the cyclical nature of the commercial real estate industry--is geographically diversified, with 37% of its 2007 revenue from operations outside the U.S.
- Fees from managing more than \$40 billion in real estate investments provide a stable and profitable revenue stream to CB Richard Ellis.
- CB Richard Ellis estimates that nearly two thirds of its 2007 revenue was repeat business from existing clients. And it estimates that its organic growth rate has averaged 12% per year since 1992.

## Bears Say

- It is very difficult to forecast CB Richard Ellis' near-term prospects. The firm itself says it is unrealistic to give

guidance in the current market conditions.

- Its dependence on the commercial real estate market subjects CB Richard Ellis to the industry's boom-bust cyclical nature.
- CB Richard Ellis' very high leverage is a concern. Our forecasts suggest that the firm will be required to refinance more than \$2 billion in debt coming due between 2011 and 2013.
- About 10% of CB Richard Ellis' 2007 revenue came from California, a state we expect to be particularly hard hit during this commercial real estate downturn.

## Financial Overview

**Growth:** In the five years through 2007, revenue increased more than fivefold, and operating income increased more than sevenfold, with acquisitions playing a big role. We expect revenue to fall by double digits in 2008 and 2009, followed by mid-single-digit growth thereafter.

**Profitability:** Operating margins topped out at 13.6% in 2006. However, we expect operating margins to fall to 3% in 2009 and average only 6.5% during our five-year forecast, as the economic environment has changed dramatically.

**Financial Health:** We're concerned about CB Richard Ellis' financial health. Even though it has borrowing capacity remaining on its revolving line of credit, a continued downturn in the commercial real estate market could stress its finances.

## Company Overview

**Profile:** In terms of sales, CB Richard Ellis is the largest commercial real estate services firm, offering capital markets services, property and facility management, tenant representation, transaction services, valuations and appraisals, investment management, and property

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Per share prices in USD

development services, among others. The firm operates a global network of 29,000 employees in 300 offices worldwide. It claimed 85 of the Fortune 100 as clients in 2007.

Strategy: CB Richard Ellis is a one-stop shop of commercial real estate services for occupiers (tenants), owners, lenders, and investors. It aims to leverage its global network to increase revenue from large clients through cross sales of additional services and greater property management share. The firm will continue to raise funds for its investment management business and pursue small acquisitions.

Management: CB Richard Ellis receives good marks in our stewardship model. We like that the firm's directors serve one-year terms, stand for re-election under majority voting rules, and receive about half their compensation in stock instead of cash. Directors and executives represent about 17% of shares outstanding, so their own financial interests seem well aligned with those of shareholders. Furthermore, executives have stock ownership guidelines that range from 3 to 5 times their annual salaries, and performance bonuses are based on earnings before interest, taxes, depreciation, and amortization, measured for the area of influence of each eligible manager. On the other hand, the company does have some annoying related-party transactions (including loans to employees and a legal advisor affiliated with a director). The company repurchased \$635 million of its shares in the end of 2007 at an average price of \$22 per share, and its recent acquisition of Trammell Crow saddled the firm with debt which it may not be able to service from the combined company's operating cash flow.

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Per share prices in USD

## Analyst Notes

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**Jul. 15, 2008**

### CB Richard Ellis under Review

We are placing our fair value estimate for CB Richard Ellis

under review as we transfer coverage to a new analyst.

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**Apr. 30, 2008**

### CB Richard Ellis Reports 1Q

After reviewing CB Richard Ellis

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## Disclaimers & Disclosures

No Morningstar employees are officers or directors of this company. Morningstar Inc. does not own more than 1% of the shares of this company. Analysts covering this company do not own its stock. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security.

# CB Richard Ellis Group, Inc. CBG

<b>Sales Mil</b>	<b>Mkt Cap Mil</b>	<b>Industry</b>	<b>Sector</b>
\$5,876	\$919	Real Estate	Financial Services

In terms of sales, CB Richard Ellis is the largest commercial real estate services firm, offering capital markets services, property and facility management, tenant representation, transaction services, valuations and appraisals, investment management, and property development services, among others. The firm operates a global network of 29,000 employees in 300 offices worldwide. It claimed 85 of the Fortune 100 as clients in 2007.

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Growth Rates Compound Annual					
Grade: B	1 Yr	3 Yr	5 Yr	10 Yr	
Revenue %	49.7	36.6	38.8	—	
Operating Income %	27.1	59.9	45.8	—	
Earnings/Share %	22.2	75.9	32.1	—	
Dividends %	—	—	—	—	
Book Value/Share %	-18.1	17.5	-5.9	—	
Stock Total Return %	-82.2	-33.3	—	—	
+/- Industry	-18.5	-8.9	—	—	
+/- Market	-42.0	-25.0	—	—	

Profitability Analysis				
Grade: B	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	22.5	20.6	1.1	22.4
Return on Assets %	4.4	4.6	0.3	9.3
Fixed Asset Turns	14.2	16.2	0.7	7.0
Inventory Turns	—	—	2.4	12.3
Revenue/Employee \$K	202.6	192.5*	159.5	980.2
Gross Margin %	45.5	48.9	25.9	28.6
Operating Margin %	9.6	9.5	6.3	16.7
Net Margin %	4.7	4.5	2.7	9.4
Free Cash Flow/Rev %	—	6.1	—	0.1
R&D/Rev %	—	—	—	11.6

Financial Position			
Grade: D	12-07 \$Mil	06-08 \$Mil	
Cash	343	251	
Inventories	—	—	
Receivables	1337	1124	
Current Assets	2361	2219	
Fixed Assets	635	230	
Intangibles	2579	2753	
Total Assets	6243	6440	
Payables	370	305	
Short-Term Debt	707	759	
Current Liabilities	2428	2281	
Long-Term Debt	1992	1971	
Total Liabilities	5254	5373	
Total Equity	989	1067	

Valuation Analysis				
	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	3.7	—	10.2	13.4
Forward P/E	3.4	—	—	10.8
Price/Cash Flow	9.5	—	-1.4	9.1
Price/Free Cash Flow	—	—	-0.8	16.4
Dividend Yield %	—	—	0.6	3.6
Price/Book	0.9	—	1.6	2.9
Price/Sales	0.2	—	0.2	1.9
PEG Ratio	0.4	—	—	1.1

<b>Morningstar Rating</b>	<b>Last Price</b>	<b>Fair Value</b>	<b>Uncertainty</b>	<b>Economic Moat</b>	<b>Stewardship Grade</b>
Under Review	\$4.54	\$6.50	Extreme	None	B



1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	YTD	Stock Performance
—	—	—	—	—	—	75.4	69.2	-35.1	-78.9	Total Return %	
—	—	—	—	—	—	72.4	55.6	-38.6	-40.8	+/- Market	
—	—	—	—	—	—	62.0	44.7	-12.0	-20.0	+/- Industry	
—	—	—	—	—	—	—	—	—	—	Dividend Yield %	
—	—	—	—	—	—	2363	4309	7481	4959	919	Market Cap \$Mil

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	TTM	Financials
—	—	—	563	1170	1630	2365	2911	4032	6034	5876	Revenue \$Mil
—	—	—	—	—	51.1	49.1	49.5	47.7	47.0	45.5	Gross Margin %
—	—	—	63	106	40	171	372	550	699	565	Oper Income \$Mil
—	—	—	11.1	9.1	2.5	7.2	12.8	13.6	11.6	9.6	Operating Margin %
—	—	—	17	19	-35	65	217	319	391	274	Net Income \$Mil
—	—	—	0.73	0.41	-0.63	0.30	0.95	1.35	1.66	1.25	Earnings Per Share \$
—	—	—	0.00	0.00	0.00	0.00	0.00	0.00	0.00	—	Dividends \$
—	—	—	23	45	55	214	229	235	234	220	Shares Mil
—	—	—	—	—	—	2.65	3.61	5.24	4.30	5.27	Book Value Per Share \$
—	—	—	95	65	64	182	360	370	648	105	Oper Cash Flow \$Mil
—	—	—	-51	-14	-27	-53	-103	-55	-283	-282	Cap Spending \$Mil
—	—	—	45	51	37	129	257	315	366	-177	Free Cash Flow \$Mil

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	TTM	Profitability
—	—	—	1.3	1.4	-2.0	2.9	8.5	7.3	6.4	4.4	Return on Assets %
—	—	—	6.8	7.4	-11.9	14.5	32.1	32.3	36.0	22.5	Return on Equity %
—	—	—	3.1	1.6	-2.1	2.7	7.5	7.9	6.5	4.7	Net Margin %
—	—	—	0.41	0.87	0.92	1.05	1.14	0.92	0.99	0.95	Asset Turnover
—	—	—	5.3	5.3	6.7	4.1	3.5	5.0	6.3	6.0	Financial Leverage

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	06-08	Financial Health
—	—	—	-63	-61	6	55	155	306	-68	-62	Working Capital \$Mil
—	—	—	522	511	791	601	549	2067	1992	1971	Long-Term Debt \$Mil
—	—	—	257	251	333	560	794	1182	989	1067	Total Equity \$Mil
—	—	—	2.03	2.03	2.38	1.07	0.69	1.75	2.01	1.85	Debt/Equity

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	TTM	Valuation
—	—	—	—	—	—	36.9	20.7	24.6	13.1	3.7	Price/Earnings
—	—	—	—	—	—	1.9	1.2	1.5	0.8	0.3	P/E vs. Market
—	—	—	—	—	—	1.0	1.4	1.9	0.8	0.2	Price/Sales
—	—	—	—	—	—	4.2	5.4	6.3	5.0	0.9	Price/Book
—	—	—	—	—	—	13.1	11.7	20.7	7.8	9.5	Price/Cash Flow

Quarterly Results						
Revenue \$Mil	Sep 07	Dec 07	Mar 08	Jun 08		
Most Recent Period	1492.8	1837.1	1230.9	1314.9		
Prior Year Period	903.9	1611.8	1214.0	1490.4		
Rev Growth %	Sep 07	Dec 07	Mar 08	Jun 08		
Most Recent Period	65.2	14.0	1.4	-11.8		
Prior Year Period	21.5	68.6	78.5	78.2		
Earnings Per Share \$	Sep 07	Dec 07	Mar 08	Jun 08		
Most Recent Period	0.48	0.54	0.10	0.08		
Prior Year Period	0.39	0.52	0.05	0.59		

Industry Peers by Market Cap				
	Mkt Cap \$Mil	Rev \$Mil	P/E	ROE%
CB Richard Ellis Gro	919	5876	3.7	22.5
Jones Lang LaSalle,	825	2709	4.7	18.1
Grubb & Ellis Compan	88	480	—	-1.0

Major Fund Holders		% of shares
Fidelity Capital Appreciation		3.33
Janus Contrarian		3.23
Ariel		2.71

\*3Yr Avg data is displayed in place of 5Yr Avg

## Morningstar's Approach to Rating Stocks

### Our Key Investing Concepts

- ▶ Economic Moat
- ▶ Discounted Cash Flow
- ▶ Discount Rate
- ▶ Fair Value
- ▶ Uncertainty
- ▶ Margin of Safety
- ▶ Consider Buying/Consider Selling
- ▶ Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based

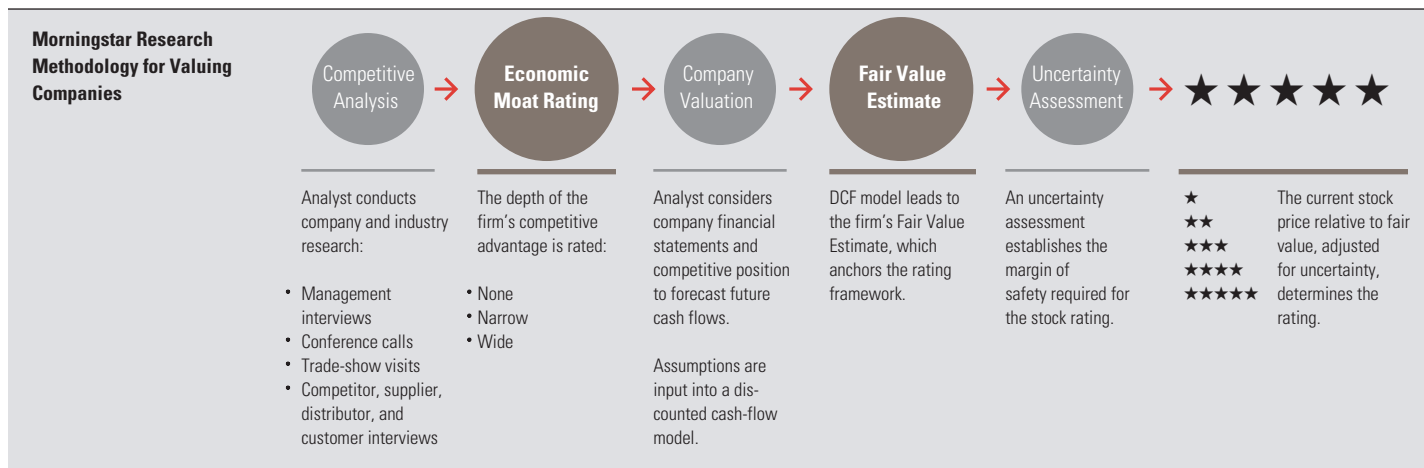
just on movement in the share price. If we think a stock's fair value is \$50, and the shares decline to \$40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at \$40 than they were at \$50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

### Economic Moat

This is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such economic profits, but companies



## Morningstar's Approach to Rating Stocks (continued)

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that can earn them for an extended time by creating a competitive advantage possess an economic moat. We see these companies as superior investments.

We're big fans of companies that are low-cost producers, create high switching costs for their customers, or have strong brands or long-lasting patents, because all of these characteristics allow companies to protect their competitive position. For example, Tiffany is far more profitable than a run-of-the-mill jewelry chain because it has a strong brand that creates a moat around its business, allowing it to charge more than competitors.

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### Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

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### Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

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### Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

### Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

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### Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth. The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

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### Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

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### Stewardship Grades

We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."