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Jones Lang LaSalle, Inc. (JLL)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Christy and I will be your conference operator today. At this time, I would like to welcome everyone to the Q1 2023 JLL Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Scott Einberger, Investor Relations Officer, you may begin your conference.

Scott Einberger
Investor Relations Officer, Jones Lang LaSalle, Inc.

Thank you and good morning. Welcome to the first quarter 2023 earnings conference call for Jones Lang LaSalle, Incorporated.

Earlier this morning, we issued our earnings release along with the slide presentation and Excel file intended to supplement our prepared remarks. Please note that we are now providing an enhanced version of the supplemental Excel file that includes a historical view of JLL's financial results by segment, including a view of fee-based comp and benefits and total operating expenses. In addition, the Excel file now includes the full balance sheet, statement of cash flows, and other relevant operating metrics. We hope this enhanced Excel file will make modeling our business easier. These materials are available on the Investor Relations section of our website. Please visit ir.jll.com.

During the call and in our slide presentation and our accompanying Excel file, we reference certain non-GAAP financial measures, which we believe provide useful information for investors. We will include reconciliations of non-GAAP financial measures to GAAP in our earnings release and slide presentation.

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As a reminder, today's call is being webcast live and recorded. A transcript and recording of this conference call will be posted to our website. Any statements made about future results and performance, plans, expectations and objectives are forward-looking statements. Actual results and performance may differ from those forward-looking statements as a result of factors discussed in our Annual Report on Form 10-K for the fiscal year December 31, 2022, and in other reports filed with the SEC. The company disclaims any undertaking to publicly update or revise any forward-looking statements.

I will now turn the call over to Christian Ulbrich, our President and Chief Executive Officer, for opening remarks.

Christian Ulbrich

President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

Thank you, Scott. Hello and thank you all for joining our first quarter 2023 earnings call.

I'm pleased with our first quarter as we were able to deliver results broadly in line with our plan despite the further deteriorating operating environment. At the beginning of the quarter, several green shoots emerged in the commercial real estate market, highlighting investor's willingness to deploy capital when market conditions warrant.

Rising interest rates and turmoil in the banking sector had a dampening effect on sentiment in the second half of the quarter. The real estate markets, elevated borrowing cost, and a continuation of the tightening in lending standards, limited investment sales activity in the first quarter. According to JLL Research, global commercial real estate investments totaled $128 billion in the first quarter, a year-over-year decline of 54%.

Institutional investors remain cautious, while private capital has been slightly more active, with an increased focus on sponsor sector and asset quality. Although global fundraising has slowed, elevated levels of capital remain on the sideline with dry powder in closed-end funds now at $389 billion globally. Looking ahead, it appears that debt cost will become more predictable and bid-ask spreads can begin to compress. This process is already underway with global real estate asset prices declining around 20% on average from their 2022 peak. Additional price adjustments are likely needed to bring bid-ask spreads back to more normal levels.

Capital remains available and lenders are active in appropriately priced assets, especially in growth sectors such as industrial and multifamily. Macroeconomic pressures are also being felt in the global office leasing market where volume was down 18% year-over-year in the first quarter, according to JLL Research. Return-to-office assets are driving an uptick in attendance rates across much of the US. But this trend was offset by softening labor markets in certain sectors and delays in decision-making amid macroeconomic uncertainty. Global office vacancy rates ticked up modestly to 15.3% in the first quarter. In most markets, high-quality premium assets continue to significantly outperform the rest of the market as occupiers focus on upgrading space. These types of best-in-class sustainable assets continue to be a focus area for JLL.

In the industrial sector, demand slowed in many markets during the first quarter with declines in the US and Europe as a result of limited supply and occupiers' desire to take a more cautious approach given the macroeconomic environment. In Asia Pacific, net absorption was positive compared to both the fourth quarter and prior year. Overall, market fundamentals remained strong in the industrial sector with low vacancy rates and healthy rental growth in many markets.

In the retail and hotel sectors, high-quality retail space is in demand from growth-orientated retailers, and hotels are benefiting from pent-up leisure travel and growing group and corporate demand.

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JLL's first quarter financial results reflect the continued slowdown in our Capital Markets business as the tightening in lending standards and rising debt cost impacted the transaction market. Similarly, our Leasing business saw declines both in volume and average deal size. In contrast, our resilient business lines collectively deliver positive revenue growth during the quarter despite economic headwinds. Our Work Dynamics business continues to show underlying strength, and we have recently won several new mandates that will take effect later this year. JLL Technologies also demonstrated an acceleration of fee revenue growth in the quarter.

As we talked about at our November 2022 investor briefing, JLL uses a built-by-partner investment technology strategy, both for the benefit of our clients and to create a material differentiation for our overall business. For example, our Capital Markets team is now leveraging our new AI-powered platform to identify, analyze, and source pipeline opportunities. In the first quarter, one in five of all-comer markets pipeline opportunities globally was enabled by our AI-powered platform. Lastly, LaSalle grew advisory fee revenue during the quarter, highlighting the resilient nature of this revenue stream.

I will now turn the call over to Karen, who will provide more detail on our results for the quarter.

Karen Brennan

Chief Financial Officer, Jones Lang LaSalle, Inc.

Thank you, Christian. Before I begin, a reminder that variances are against the prior-year period and local currency unless otherwise noted.

The first quarter was generally consistent with the fourth quarter trends we discussed on our February call. While the macro environment has presented challenges to growth in certain areas of our business over the past couple of quarters, we see strong underlying momentum building across our entire business. Our growth-oriented investments in our people and platform over the past several years provide a strong foundation for the eventual rebound in our transactional business line, as well as continued growth of our more cyclically resilient business line. We remain focused on delivering a high level of client service and capturing the significant market opportunities to drive both near-term and long-term growth, profitability and cash flow.

At the consolidated level, first quarter fee revenue was $1.6 billion, a 15% decline from a particularly strong first quarter of 2022. Looking at the two periods on a stacked year-over-year growth basis in USD, they totaled a 17% increase. First quarter adjusted EBITDA was $109 million, down 61% and the adjusted EBITDA margin contracted 780 basis points to 6.6%. The declines were mostly attributable to the drop in fee revenue in our leasing and investment sales, debt and equity advisory business lines, as well as the $21 million adverse change in equity earnings.

The lower equity earnings contributed approximately 130 basis points to the margin decline. Higher fixed compensation expense, tied to growth-related investments and head count during the first nine months of 2022, was also a headwind to profitability, partially offset by the ongoing cost reduction action we discussed last quarter. Adjusted EPS of $0.65 declined 84%, driven in part by higher interest on top of the lower adjusted EBITDA, partially offset by a 5% reduction in the average share count.

Putting the first quarter results in perspective, our investment sales, debt and equity advisory fee revenues were the lowest since the second quarter of 2020, the most heavily impacted pandemic period. Additionally, over the past six quarters, we have been investing in our Capital Markets and other businesses, which has an amplified headwind effect on the quarter's profitability when combined with the decline in fee revenue. We expect the investments to help accelerate growth as the recovery unfolds.

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We continue to actively manage our business to drive further long-term improvements in efficiency. Of the $125 million of cost savings we discussed last quarter, we achieved approximately $15 million of cost savings in the first quarter and anticipate the remaining $110 million to be fairly evenly split over the last three quarters of the year. In other words, the full run rate effect of the $140 million in annualized cost savings we previously announced is expected to commence in the second quarter.

The cost actions are largely focused on non-revenue-generating role that we identified as part of our global realignment of our business lines last year. We continue to opportunistically invest in areas that we believe have attractive growth and return prospects.

Moving to a detailed review of our operating performance by segment beginning with Markets Advisory. First quarter Leasing fee revenue declined 18%, following a 46% growth rate in the prior-year quarter for a two-year stacked USD growth rate of 26%. As macro conditions varied across regions, so too did our Leasing fee revenue with the America down 21% and EMEA falling 12%, while Asia Pacific grew 23%. The strength in Asia Pacific was largely driven by the recovery in Greater China.

Globally, all primary asset classes saw transaction volume decline, along with lower average deal size, so this was most pronounced in the office sector. Our first quarter office sector fee revenue fell 17%, slightly better than the 18% contraction in global office leasing volume, according to JLL Research. In the industrial sector, fee revenue declined 14%, which compares favorably with a 37% decrease in global industrial market activity, according to JLL Research.

The contraction in industrial sector leasing activity is directionally consistent with expectations, given a tight supply and significant growth seen over the past several years. As Christian described, we're seeing more sustained leasing demand for high-quality assets despite softer demand more broadly. Our global growth leasing pipeline continues to show resilience, getting cost for cautious optimism for the full year 2023. However, near-term activity is likely to be subdued considering the economic backdrop.

Also within Markets Advisory, Property Management fee revenue for the first quarter grew 12%, attributable in part to portfolio expansions in the Americas and incremental fees from interest rate sensitive contracts in the UK. The decline in the Advisory Consulting and other fee revenue was primarily due to the absence of revenues associated with the exit of a business that was previously announced in the fourth quarter of last year. The Markets Advisory first quarter adjusted EBITDA margin declined 380 basis points from a year ago to 11.2%, primarily due to lower Leasing fee revenue.

Shifting to our Capital Markets segment. The market conditions Christian described were a key factor in the 39% decline in segment fee revenue. The contraction is off a very strong first quarter 2022 growth rate of 54%, resulting in a two-year stacked USD growth rate of 10%. Our global investment sales fee revenue, which accounted for approximately 35% of segment fee revenue, fell 56%. The decline was broad based across nearly all geographies and asset classes and compares with a 54% decline in the global sales volume Christian referenced.

For perspective, the first quarter market volume decline was the sharpest since the first quarter of 2009, and in terms of dollars, was the lowest overall market volume since the first quarter of 2012. Growth in EMEA Valuation Advisory fee revenue mostly offset declines in Asia Pacific and the Americas, leading to a 3% reduction in the total Valuation Advisory fee revenue. Our Loan Servicing fee revenue fell 6% on approximately $5 million of lower prepayment fees, which masked about 5% growth of recurring servicing fees. The decline of the prepayment fees

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coincide with the rise in interest rates, which dampens refinancing activity. The underlying growth of the servicing fees was driven by the growth in our Fannie Mae portfolio.

The Capital Markets adjusted EBITDA margin contraction was predominantly driven by lower fee revenue and the impact of the growth-oriented head count additions we made in early to mid-2022. With our investment in our Capital Markets' talent and platform over the past several years, we are well-prepared for a strong recovery when transaction volumes return.

Looking ahead, the global Capital Markets, Investment Sales, and Debt and Equity Advisory pipeline is building at a slower rate than historical trends in a typical year and is down mid-teens compared with this time last year. While we do see early signs of improving pipeline activity, particularly within the US, the amount and pace of revenue growth throughout the year will be heavily influenced by the factors impacting deal timing and closing rates like Christian described.

Moving next to Work Dynamics. Fee revenue growth of 11% was consistent with the prior quarter. The growth was led by a 24% increase in Project Management, mostly attributable to continued project demand, particularly in the US, France, and the Middle East. Workplace Management exhibited continued resilience, growing 3% on the back of a strong growth a year earlier. The slowdown in Leasing activity, particularly in the Americas, adversely impacted portfolio services fee revenue growth in the quarter.

The Work Dynamics adjusted EBITDA margin contracted 350 basis points from a year ago, driven by $9 million of losses on Tetris contract in Europe, as well as incremental investment in sustainability and technology, partially offset by the higher fee revenue. Overall, we are pleased with the underlying performance of our Work Dynamics business and are confident in the segment's growth trajectory.

The first quarter was one of the strongest on record for [ph] new sales (00:18:05), as measured by contract wins and expansion and had a 98% contract renewal rate, supporting growing momentum for the rest of the year and into 2024. The near-term Project Management pipeline remains solid and we are focused on securing mandates for the latter part of the year. As Christian mentioned, within Workplace Management, we secured several new contracts from Fortune 100 companies, which will begin in the latter part of the year. And our pipeline continues to build as the demand for professional management of corporate real estate increases.

Turning to JLL Technologies. Fee revenue grew 29%, an acceleration from fourth quarter 2022 organic growth of 21%, as existing large enterprise clients continue to increase their utilization of our platform, particularly our solutions and services offerings. As a reminder, the majority of JLL Technologies revenue is recurring in nature and we continue to see strong retention. The path to segment profitability remains a priority.

Indicative of our focus, JLL Technologies' fee-based operating expenses, excluding carried interest, grew just 7%. The combination of the fee revenue growth and operating efficiency gains drove an improvement in JLL Technologies' adjusted EBITDA margin, tampered by an $8 million adverse swing in equity earnings, net of carried interest. Equity earnings in the quarter were driven by a handful of valuation increases, largely reflecting subsequent financing rounds at increased valuation.

Now, to LaSalle. Assets under management rose 8% from strong capital deployment and valuation increases over the prior 12 months, which translated to a 9% rise in advisory fee revenue, mostly within our core open-end funds. Given the evolving market environment, new capital deployment is subdued and impacting transaction revenues compared to the prior year. The pace of capital deployment may also impact how quickly growth of new mandates will offset the loss of the UK separate account mentioned last year.

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Moderating asset valuations broadly drove a $7 million decline in equity earnings from the prior year. The lower equity earnings were a 640-basis-point headwind to LaSalle adjusted EBITDA margin, which contracted at 507 basis points. The increase in advisory fee revenue and platform scale benefits were offset by lower transaction fee revenue. Cost mitigation actions over the past few quarters lifted profitability.

Shifting to free cash flow. Net outflow in the quarter was $766 million, consistent with the year earlier, as a $130 million improvement in net working capital was offset by $130 million in lower cash from earnings. The lower cash from earnings was in part due to the decline in Capital Markets and Markets Advisory business performance. The better working capital was driven by lower annual incentive compensation and commission payments in 2023, compared with 2022, and incremental cash inflow from trade receivables, partly offset by an additional pay period in the current quarter and incremental cash outflow and not reimbursable tied to growth of the Workplace Management business line within Work Dynamics. Cash flow conversion is a high priority and we remain focused on improving our working capital efficiency.

Now, for an update on our balance sheet and capital allocation, as of March 31, reported net leverage was 1.9 times below the high end of our target range and up from 0.8 times a year earlier, primarily due to net investment activity and share repurchases, together with lower free cash flow over the trailing 12 months. As a reminder, our leverage ratio typically peaks in the first part of the year, and we have a history of deleveraging as the year progresses.

Our liquidity totaled $1.7 billion at the end of the first quarter, including $1.3 billion of undrawn credit facility capacity. Though we did not repurchase any shares in the first quarter, our period-end share count was down about 4% from a year earlier as a result of our approximate $450 million of share repurchases over the past 12 months. We have reinstated our share repurchase program beginning in the second quarter. Expect to repurchase a modest amount of share in the quarter. The amount of share repurchases over the full year will be dependent on the evolution of the market recovery and the performance of our business, particularly cash generation. Approximately $1.2 billion remained on our share repurchase authorization as of March 31, 2023.

Over the past two to three months, we've seen general stability in a number of key market indicators and business trends, even considering the recent bank stresses. So, the prevailing economic conditions lead us to expect the softness and our more transaction-oriented fee revenues will persist into the second half of the year. All considered, we remain focused on achieving our full-year 2023 target adjusted EBITDA margin range of 14% to 16%. We are navigating a shifting macro environment that creates short-term headwind for certain areas of our business. The industry tailwinds we've previously highlighted remain intact, and we do not expect the current macro pressures to undermine growth trends over the medium and long-term. Accordingly, we continue to proactively position our people and our platform to both emerge stronger through the market recovery and enhance the growth of our cyclically resilient business lines.

Christian, back to you.

Christian Ulbrich

President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

Thank you, Karen.

The commercial real estate market is in a much stronger position today than it was following the global financial crisis. Overall, banks are well-capitalized, balance sheets are strong, and lending standards in recent years have been much more conservative. In addition, borrowers have a more diverse set of debt sources.

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While there will be pockets of distress due to declining property values and the rising cost of debt will likely be contained to lower quality assets in select markets. This turmoil in the banking sector has created an opportunity for our industry-leading Debt and Equity Advisory business lines. As banks pulled back on lending to commercial real estate, we are well-positioned to help clients find alternative sources of capital. With an estimated 15% to 20% of commercial real estate debt maturing over the next 12 months, our Debt and Equity Advisory services will be needed more than ever.

According to the Mortgage Brokers Association, JLL has the top US debt origination platform by a factor of two, as well as the leading equity placement platform, which makes us uniquely positioned to manage this upcoming wave of debt maturities. Meanwhile, inflation is moderating across Continental Europe and the US, which will likely result in an end to the current rate hiking cycle that many central banks have been operating under. Our pipelines have been growing as clients prepare for a more stable interest rate environment and a narrowing of the bid-ask spread. These factors, in addition to the significant amount of dry powder sitting on the sideline, provides a clear path for recovery in transaction activity.

Today, you have heard about our resilient business lines, as well as on our ongoing commitment to improving margins, free cash flow and returning capital to shareholders. We continue to benefit from the platform investments and organizational changes we have put in place over the last couple of years. Our actions have been targeted and we are not reducing roles, which we would need to rehire when the markets recover.

While clients put huge trust into our One JLL global platform as well in our data and technology capabilities to help them navigate the current macroeconomic environment. This trust is demonstrated by the new client engagements we have won since the beginning of the year. And confident that we are well-positioned to accelerate growth as the commercial real estate industry comes out of the current down cycle.

Before I close, I would like to thank all our employees across the world for their commitment and hard work, which has positioned JLL to take advantage of the coming recovery in the commercial real estate market.

Operator, please explain the Q&A process.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Anthony Paolone with JPMorgan.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Great. Thank you. My first question relates to the margin guidance that you capped at 14% to 16% for the year. And I was wondering if you can talk to how much reliance you need on the, say, the second half of the year showing some improvement to get into that range. Just trying to understand if it's sort of the trajectory we started the year on here would still allow you to get to that range.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Hi, Anthony. It's Christian. Let me answer that question with a bit more detail, and I want to kick it off going through the different business lines we have. Starting off with JLLT, we are very confident that they will deliver according to our own plans. The same is true for Work Dynamics where we are very confident.

I then move to Markets, I want to split up Markets between Property Management and Leasing, we are, again, very confident that we deliver on our Property Management plan, and we are confident that we deliver on that Leasing plan. Obviously, that is very much driven by transactional revenues and so there is some risk in it. But still, we are confident that we deliver against our own plan.

Then I move to LaSalle. LaSalle, we have the Advisory side; again, we are very confident that we deliver on our Advisory plan. There is some risk around the transaction fees and the incentive fees we're getting within the LaSalle business, but that is a reasonably small risk to the overall result of LaSalle.

And then, we come to Capital Markets. The easy part of our Capital Markets of all performance is the Valuation Advisory business where we are confident that they will deliver. On the Debt/Equity side, we should be fine. So the major risk in our Capital Markets business is clearly the Investment Sales side.

And then before I explain that more deeply, I just want to quickly, briefly touch on the Equity earnings side, which is fairly hard to predict on a quarter-by-quarter basis. We made a very thorough review of our LaSalle business and the portfolio where we have Equity in there and the vast majority of that looks good. And even if we have to take some write-downs on a quarter basis, we are very confident that we will recover that over the coming years; and so that is obviously noncash.

And on the JLLT side, it's a pretty similar picture. There may be some smaller investments which will face some challenges over the coming quarters. But more importantly, some of our very large investments have a really strong medium-term outlook. So even if we have to take there some write-downs in the coming quarters due to some capital events, which we don't know about yet, we are absolutely confident that we get substantial appreciations in the years to come. So we would like to ignore those movements on the Equity earnings side in the next couple of quarters because it's very hard to predict for us.

So going back to what were our assumptions which led to our plan for this year and why we are still so confident that we deliver in our margin guidance between 14% and 16%, we expected a very slow first and a very slow

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second quarter in our own plans. And then, we assume a substantial recovery for our Capital Markets business starting in September, leading to a really vibrant fourth quarter.

And what we delivered in the first quarter was fully in line with our own internal plans. And I said that's a positive one because when we did those plans, we didn't know that SVB would go down and that we would have those crises in the small and medium-sized banking sector. And so, that's why we are fairly happy with the performance in the first quarter.

Now, the risk to our plan for this year, obviously, the geopolitical situation – if there's further geopolitical disruptions beyond what we already see, that can be a risk to our assumptions for this year. But then on top of that, if the crises of the small and regional banks get out of control, which we don't believe is going to happen, but I leave that to you to make your own risk assumption there.

And then second, if the political program offered to all of us around the necessary agreement for the debt ceiling doesn't meet expectations. And again, I don't want to predict that. I leave that to you to make your own predictions. But if those things are not going in the wrong direction, we continue to be confident about the 14% to 16% for the reasons I described.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you for all that color, Christian. And then just maybe a follow-up on that with Karen, can you a bit more detail or some brackets around the cost side, like, was there much actually realized in 1Q or some of the initiatives there, like we'll see it in the run rate in 2Q, or just maybe how to think about that a bit more.

Karen Brennan
Chief Financial Officer, Jones Lang LaSalle, Inc.

A

Sure. So, of the $125 million of cost savings that we referenced last quarter, approximately $15 million of that came through in the first quarter and the remainder will be fairly evenly spread in the remaining three quarters. I do want to also highlight that in the face of continued uncertainty in our multiyear transformation program, we're continuing to drive further cost out in the business as we go through [audio gap] (00:34:14) more update on that we'll provide.

00:34

14

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. If I could just ask one more in Work Dynamics. In Workplace Management, I was under the impression that that's kind of the more recurring fee stream in that business. And it sounds like you all have had a lot of contract wins, but it was pretty flattish growth rate year-over-year. How should we think about that piece of the business?

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Yeah. Listen, they had a very strong start, as you can see on the top line, slightly ahead of our own expectations. And as Karen alluded to, we had some significant contract wins over the last couple of weeks. So that's why I just

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said a moment ago, we are very confident about our Work Dynamics business for the year. We used the outperformance, which we have had against our internal budget in the first quarter, to clean up within our Tetris business on three contracts which were unprotected against inflation-driven cost increases.

That was substantial, the $9 million, but as I said, we decided that this is a good moment to take that risk out. And going forward, we are pretty confident not only around our Tetris business, but around the overall performance of our Work Dynamics business for this year.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. So those Tetris contracts, those are both – like, those coming out affected both the top line and EBITDA for that business line in the quarter? Just trying to see where that works.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

No, they didn't. They didn't affect the topline. We just took provisions because those three contracts were not protected against inflation. So the cost increases which we faced on those contracts, we couldn't lay that over to the clients. And so we had to eat it, and so we took some substantial provisions on those contracts so that we should be fine going forward.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Michael Griffin with Citi.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks. Christian, in your prepared remarks, you highlighted green shoots. [ph] So, you're seeing, I think, (00:36:34) of a transaction activity. It seems like maybe rates are coming more predictable. You talked about bid-ask spreads narrowing, the process being underway. Full say, for a hypothetical bid-ask spreads are at 200 basis points, maybe a bit more narrow for industrial and multi, maybe a bit wider for office, you think you can quantify maybe the second derivative change in where those spreads have come in?

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Well, you almost answered the question yourself. We have seen a real appetite from various sorts of lenders, which the majority is non-banking lenders. But over the last couple of weeks, we also saw the banks now coming back in and also those banks which have been very absent for the first three months have come back now. And just in the last two weeks, we closed a deal where a couple of banks were competing quite hard for the debt side of it.

And so, it depends very much on the underlying assets. We have seen spreads going below 200 basis points on industrial, for example, on multifamily, on some retail assets, where we still see some hesitancies around the majority of the office products where spreads are still above 200 basis points and where just the LTV ratios are still fairly low. But, overall, the moment we have calmness and predictability and what happened this week around

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the fed in the US but also the [indiscernible] (00:38:17) today, this is all within the range of what was predicted, and that will provide confidence to the market, and that will lead to transactions. And if that continues, that would support our case for this year because there is debt available, there's enough product available which wants to trade, and that will then lead also to the closure of those deals.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

And just on the banks that are lending, I mean, what kind of size are those if we've seen some softness and issues in the mid-sized regional bank market? I mean, are they the larger institutions, smaller, international? Any color around who the banks are is helpful.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Well, what we have seen over the last two to three weeks is we were able to close quite a significant deal. And we saw kind of – as I've said, those banks coming back which were more or less absent in the first quarter. So, I just take that, and I don't want to speculate here, but from my personal view, I take that as a sign that the banks seem to believe that both the overall need to devalue the commercial real estate assets is coming close to the point where it has to kind of get to.

I'm not saying that everything is done, but we have seen overall quite a significant devaluation already and that they also believe that that crisis of the small and midsize banks, regional banks in the US, is under control. And that seems to provide them the confidence that they are back into the market. So we are not dependent on all those deals now on alternative lenders or on international lenders, but it is domestic banks, as well as the large major banks in the US, who are back into the market and providing competitive bids on deals.

And for us, the most encouraging sign was on some of those larger transactions, which we were able to do over the last 2 to 3 weeks, that we had numerous bids coming in from banks. So that is exactly what you want to achieve, that you have a competitive environment again and not only one or two who are offering a proposal.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

And then just one on office, if I may. I think you talked about RTO, return to office, maybe improving some of the US, but I think it lags EMEA and certainly Asia Pac. Do you have a sense, one, of maybe your portfolio maybe of some proprietary data of where RTO is across the US as a whole and then how that compares? I'd imagine that EMEA is sort of above where the US is and then APAC is above that as well. So some color around that would be helpful.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Sure. Let's start with APAC. APAC is, generally speaking, back to pre-COVID levels. In fact, in our own offices in China, where I was just spending some time, we don't have assigned seats there and so we had predicted, when we arranged those offices many, many years ago, a certain ratio on desk we need for the numbers of employees. And at the moment, we have more employees in the office than our desk ratio offers us because they're also keen to be back into the office. That will, hopefully, go back to the normal numbers of occupancy, which we have pre-COVID. But, generally, APAC, this is a nonissue in APAC, the question of return to office.

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In Europe, it depends, as in the US, very much country-by-country and even within countries, it's city-by-city, literally. It's very cultural. I would say we are roughly at a level and this is really thing in the air when you generalize across Europe, but we are roughly at about 65% to 70% of pre-COVID levels. And in the US, we are still, again, very, very cultural, great occupancy in Texas, pretty good in New York, still really, really bad in the San Francisco Bay Area, and also pretty bad kind of in the Chicago area. So, overall, I would say we are sitting at around 50% to 60% of pre-COVID levels. But, as I said, that can be absolutely like pre-COVID levels in Texas and really low still in the 30%, 35%, 40% in the San Francisco Bay Area.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

Right.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

But, again, what is important to reiterate, we see a very strong trend from the most successful companies where we have a very high market share to try to offer their people stunning office space. And that means that they need to do a lot within the existing space with regards to upgrade their existing space, but also move into other locations, move into other buildings, especially when they don't need the green credentials, the well-being credentials. So, there's quite a bit of activity taking place, preplanning taking place. And so, we shouldn't run into the mistake that we think, oh, wow, it's only 50% to 60% of pre-COVID levels, and that means that transaction levels will stay that low; not in the area where we are playing.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

And then just maybe one for Karen on capital allocation. You talked about reauthorizing or putting back into play the share repurchase program in the second quarter. But as you think about other opportunities, maybe that's a bigger M&A opportunity, maybe it's tuck-in acquisition. Has your underwriting criteria and sources [ph] of uses in (00:44:19) capital changed at all?

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Well, let me pick that out on M&A and then Karen can talk about share repurchases. On the M&A front, honestly, we don't have anything to change what we said in the last two quarter calls. We look at our own opportunity to grow organically. We look at our own share price and what return we can achieve when we buy our own stock, and then we look at the opportunities which are in the market and the risk of integration.

And so, we don't find – unlike some of our competitors' comments, we don't see that much opportunity in the M&A environment. And so, we are keeping our underwriting discipline, as we have said over the last couple of quarters. And so, don't expect us to aggressively change that philosophy over the coming months or quarters. But, Karen, do you want to give some highlights on the share repurchasing?

Karen Brennan
Chief Financial Officer, Jones Lang LaSalle, Inc.

A

Sure. So on share repurchases, I mentioned that we are reinstating our share repurchase program beginning in the second quarter. We certainly find our current valuation an attractive price at which to repurchase our shares. As we've mentioned on prior calls, we certainly look at the return [indiscernible] (00:45:47) from repurchasing your own shares relative to that with potential M&A transactions and think about that overall mix and long-term growth

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for the business. So we continue to [audio gap] (00:45:58) share repurchases attractive, and we'll just tailor those based on overall cash flow expectations and as the business evolves over the course of the year.

Michael A. Griffin
Analyst, Citigroup Global Markets, Inc.

Q

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

Operator: Your next question comes from the line of Chandni Luthra with Goldman Sachs.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. Thank you for taking my question. This one is for Karen. Could you give us some free cash flow thoughts for the rest of the year, what are the moving pieces, and how should we think about the free cash conversion rate for 2023? Thank you.

Karen Brennan
Chief Financial Officer, Jones Lang LaSalle, Inc.

A

So, first, let's just recap what happened in the first quarter. On the positive, we had improvements in our working capital that were primarily from improvements in trade receivables collections and then also lower accrued comp because we have lower bonus and commission payments in the first quarter relating to the prior year. We also had some headwinds in our working capital, an extra pay period, and then some growth in the Work Dynamics business impacting the reimbursable and the timing of that reimbursable cycle. And we also had lower earnings kind of offsetting some of the gains we made in the working capital side of things.

From an overall full-year perspective, we are planning to be cash flow positive, looking at the levers we can pull over the course of the year while we're managing for growth, certainly closely tracking our DSO, managing our CapEx and really [audio gap] (00:47:32) a strong cash flow conversion ratio as we can.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And as a follow-up, I think, Christian, you mentioned this last quarter, you talked about record office leases expiring in the near term. Could you discuss what you're seeing with respect to discussions between landlords and tenants as these leases are coming to? Because data points would suggest that office vacancy rates continue to climb. So we'd love to hear your thoughts on what's going on at the ground level. Thanks.

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Sure. Just to be clear, office vacancy rates, especially in some of the major US markets, will continue to climb, but it is predominantly around those [ph] B to C (00:48:23) office buildings. And unfortunately, the grading of space will evolve, and so what was formerly perceived as AA- will move into that B space because it doesn't meet, going forward, the expectations of tenants anymore. And so, on those buildings, you will see an increase in vacancy rates, but at the same time, we see good demand on the best space in all of those markets. And that's why we still have that very unusual situation, which we saw around the world in every major market in 2022, that vacancy rates went up and the top rents went also up.

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So we had an increase of the highest rents in all major markets around the world whereas also the vacancy rates went up. So we hadn't seen that before, but that will continue to be a trend in 2023 and probably in 2024 that you see top rents move up and vacancy rate moving up.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Great. That's it for me. Thank you.

Operator: Your next question comes from the line of Stephen Sheldon with William Blair.

Stephen Sheldon
Analyst, William Blair & Co. LLC

Q

Hey. Thanks for taking my questions. First one here and probably for Christian, if Capital Markets activity doesn't start to pick back up later this year, what do you think that could mean looking into 2024 [indiscernible] (00:49:59) barring any major macro changes? And what's your level of optimism about Capital Markets activity recovering and then maybe benefiting from some pent-up demand next year with all the dry powder that's on the sidelines?

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

We don't see a fundamental shift in the interest to invest into real estate as an asset class. As you heard earlier from us, the dry powder is still near record levels. We have amazing amounts of money waiting at the sidelines to get invested into real estate as an asset class. So, whenever there's a delay in the recovery of the transaction volumes, it will only be a delay from today's perspective, it will not be a fundamental shift; so taking your point, if everything moves two quarters out into 2024, then we will have a pretty stunning 2024 because you will have the pent-up demand, as you call it, plus, what would have happened in 2024 anyway.

So we cannot see today any fundamental shift in the underlying interest to invest into real estate. And as you know, a lot of those investments sit in funds which have a term. And so they want to transact at some point. They want to liquidate those funds. And so, something will happen eventually, and that's what we already see. Despite the pretty rapid decline in values, we have quite enough – a large number of willing sellers which is very important. And the US has adapted first to that, that you have enough willing sellers.

In contrary to that, in Europe, we still have a couple of countries where we don't have enough willing sellers who are accepting the new price levels. And that is a reason why those markets are also still very muted. It's more on the on the seller side and not so much on the debt side.

In the US, there was that issue that we didn't have enough debt available and a combination of the other two factors. But now the debt market, as I alluded to earlier, is coming back. We have enough willing seller, so we expect transaction volumes to improve now month-by-month, and as we said earlier, and really picking up in September.

Stephen Sheldon
Analyst, William Blair & Co. LLC

Q

Got it. That's incredibly helpful. And then as a follow-up and kind of looking at segment level profit trends and specifically in Work Dynamics, I guess, how should we think about the profit progression in Work Dynamics over the rest of the year, especially with the visibility you might have in new contracts ramping? And then, would also love some more detail on some of the investments, I think, sustainability and technology investments that you're

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making in that business that you mentioned. What are those? Any way to roughly quantify the impacts of those? Thanks.

Christian Ulbrich

President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

I kick it off from a high level and then, I hand it over to Karen for more detail. As we said, we had a couple of pretty significant wins over the last weeks. And the usual pattern is when you onboard those contracts, you have a lot of costs and then over the time of the contract, which is usually five years, you kind of – we earn those losses of the beginning to onboard those contracts. And so, if you have significantly more wins than you would have expected in your budget at the beginning of the year, that may have a slightly muted impact on the overall year's performance.

We made quite a significant improvement of our margins next year, and we are planning for more margin improvement this year. We have to look at that now because we had so many wins the last couple of weeks that this, what I just described, could impact it. But generally speaking, as I said earlier, we are very confident for that Work Dynamics business. And that is not only for this year, this is for the coming years where we expect that trend to prevail, that we take higher market share, and that we can expand our margin. For the detail, I hand over to Karen now.

Karen Brennan

Chief Financial Officer, Jones Lang LaSalle, Inc.

A

Yeah. I'll just talk a little bit more about specific quarter. So, first, just a reminder that, historically, the first quarter of the year is a relatively smaller portion of the Work Dynamics for the full year in any event. So these investments that we have made and are making in anticipation of the growth that we have in the latter part of the year, certainly, have a disproportionate impact. So we – and the contract timing in terms of when certain wins will come on, right, they'll be staged over a number of quarters, but they'll be largely, in this year, in the third quarter and fourth quarter, so second half of the year. So the dynamics for the first half of the year in terms of the profit margin expectation should reflect what Christian and I have just talked about in terms of investments for growth ahead of the growth coming through.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Q

Great. Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Jade Rahmani with KBW.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. You talked about record dry powder in commercial real estate and investors eager to get into the sector. I just wanted to ask some follow-ups on that. What are you really hearing from institutional investors? I think your own slides do show quite a substantial decline in global fundraising for closed-end funds, I believe down around 50%. And then, dry powder, as it stands as of 1Q 2023, down around 7% from the peak. At the same time, this is one of the first years, I suppose 2022 was, in which allocations to commercial real estate are too high because of the pressure on equities. And that continues with what's going on now. So, curious if you still think that thesis holds.

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Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Yes. I mean, all of what you said is correct, but you have to put it into perspective. Fundraising is significantly down, but there's $390 billion of dry powder sitting at the sideline and there is a very muted transaction volume; and so why would you assign more money to funds who can't invest your money because there's nothing going on? And so, that it is down at the moment by 50%, frankly, means nothing going forward, because [ph] those (00:57:08) things have to be invested, which are already sitting at the sideline.

Secondly, yes, you're right. For some investors, the allocations to real estate are above what they would like to see, not because they invested so much into real estate, but the pricing of equities went down and so the relativity has shifted. That will change very quickly again, because we have, at the moment, a devaluation of their real estate assets. And in some countries, they include that faster than in others.

But if we see the same kind of devaluation, which we have roughly seen in the US in the portfolios of those investors of 20%, they will be in line without selling a single asset. But then, if equities are picking up again, then in relative terms they are back to square one, that they have an under allocation to real estate, which is generally globally the case that they have a higher percentage [ph] pinned (00:58:11) down for real estate than they had invested in the past.

Now, we have these short-term shifts, which we just discussed. But once we are back to normality around that, then they are still under invested. And then you will see fundraising being very vibrant again. And there are still exceptions to the rule. You have seen what Blackstone's ability was to raise a new record number for the new private equity fund in real estate. And so, frankly, this is not a concern for us that we don't see enough interest of money being invested into real estate.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. Second question would be just on the margin trajectory. Looking back, historically, periods such as 2014 through 2017, you did have margins similar to this level in the first quarter. And to achieve your margin guidance of 14% to 16%, even though low-end, I think would require margins in the 13%, 14% range for the next two quarters and then very strong performance in the fourth quarter, 18% plus, that would be to achieve something close to a 14% margin. So really, I think the premise's stability/sequential improvement in the next two quarters and then a strong year-on-year growth in the fourth quarter. Do you disagree with that? And my main question would be, if anything, in the last few weeks in the bank sector and what's unfolding causes you to be more cautious and change that thinking?

Christian Ulbrich
President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

A

Well, first of all, we tend to be very conservative and we wouldn't reinstate our 14% to 16% margin guidance if we weren't believing in it. We clearly have looked at all of our assumptions. We made various scenario plannings, what could happen along those lines, obviously, which was much more detailed, how I kind of explained it to you earlier, business line by business line within the business line by segment, what type of risk do we see if something goes wrong this year. And we came out of that assessment that we can hold up to that margin guidance for the rest of this year under the assumptions I have made earlier.

What you said with regards to how quarters have to come in, I would caution you on the second quarter I said earlier, we expected a very slow first quarter and a very slow second quarter, and that is still the case. But we do

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expect a significant uptick in our performance in the third quarter and then a very, very strong fourth quarter. We have always been a business which has that cyclicality around the year with a weak first quarter, slightly better second quarter, third quarter even better and then a pretty stunning fourth quarter. That wasn't the case last year for the reasons you all know. This year will be particularly pronounced on relying on that fourth quarter performance. But for the time being, we have no reason to believe that it will not come because our working hand in the different business lines give us the confidence that we can still hold up to that 14% to 16%.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you.

Operator: There are no further questions at this time. I'd like to turn the call back over to Christian for closing remarks.

Christian Ulbrich

President, Chief Executive Officer & Director, Jones Lang LaSalle, Inc.

Sure. Thank you, operator. With no further question, we will close today's call. On behalf of the entire JLL team, we thank you all for participating on the call today. Karen and I look forward to speaking with you again following the second quarter.

Operator: This concludes today's conference call. You may now disconnect.

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