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Jones Lang LaSalle, Inc. (JLL)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to the Q4 2022 Jones Lang LaSalle Fourth Quarter Earnings Conference Call. My name is Jacqueta. I will be your moderator for today's call. All lines will be muted during the presentation portion of the call, with an opportunity for questions and answers at the end. [Operator Instructions]

I would now like to pass the conference over to your host, Scott Einberger with JLL. Scott, please go ahead.

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

Thank you and good morning. Welcome to the fourth quarter and full year 2022 earnings conference call for Jones Lang LaSalle Incorporated. Earlier this morning, we issued our earnings release along with a slide presentation and Excel file intended to supplement our prepared remarks. 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 will reference certain non-GAAP financial measures, which we believe provide useful information for investors. We include reconciliations of non-GAAP financial measures to GAAP in our earnings release and slide presentation.

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 years ended

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December 31, 2021 and 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 fourth quarter 2022 earnings call. Before we begin today's call, I would like to take a moment to express our sympathy to the people of Turkey and Syria who have been impacted by multiple earthquakes. We are focused on supporting our people, clients and suppliers in the region.

Over the past 12 months, rising interest rates, currency headwinds and geopolitical events have continued to put downward pressure on the macroeconomic environment. For real estate markets, a rapid rise in interest rates has led to a slowdown in Investment Sales activity. According to JLL Research, global commercial real estate investments totaled $203 billion in the fourth quarter, a year-over-year decline of 56%.

Bid-ask spreads across asset classes remain wider than normal and reflect the need for continued price discovery to occur. A lack of transactions is limiting liquidity in some markets, with investors expected to remain patient as prices settle, at which point liquidity will improve.

Dry powder is at near record levels with $386 billion sitting on the sidelines, down slightly from the end of 2021. We expect this dry powder to be deployed once interest rates stabilize and bid-ask spreads normalize.

The macroeconomic pressures are also being felt in the global office leasing market, where volume was down 19% year-over-year in the fourth quarter according to JLL Research. Tenants are delaying decisions or taking short-term actions in light of the macroeconomic uncertainty. Global office vacancy rates ticked up modestly to 14.9% in the fourth quarter.

In most markets, high-quality, premium assets continued to significantly outperform the rest of the market as occupiers focus on upgrading space.

In the industrial space, occupiers are taking a more cautious approach with demand slowing across all three regions in the fourth quarter. However, market fundamentals remained strong in the industrial space, with low vacancy rates and healthy rental growth in many markets.

The retail and hotel sectors outperformed on a relative basis in the fourth quarter. Retail demand picked up in the US after a slow third quarter. And in Asia Pacific, retail continues to perform well in many major markets. Hotels continued the recovery that began early in 2022 as consumer spending on travel persists.

JLL's financial results for the fourth quarter reflect the points I just discussed. We saw a decline in our Investment Sales business as inflation and rising interest rates continued to slow the transaction market. Our leasing business also saw a slowdown both in volume and average deal size.

As we have spoken about in the past, the magnitude of a slowdown is more pronounced in our Investment Sales business than in our leasing business, as our leasing business has a more resilient revenue base. This dynamic is reflected in our fourth quarter results, both Investment Sales and leasing were lapping record results from the fourth quarter of 2021, impacting the year-over-year decline on a percentage basis.

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In contrast, our more resilient business lines such as Property Management, Workplace Management, Valuation Advisory, Loan Servicing, and JLL Technologies, in total delivered positive fee revenue growth during the quarter despite the economic headwinds. We have worked hard over the last decade to diversify our business lines and add more resilient revenue streams to our portfolio.

Finally, LaSalle grew advisory fee revenue during the quarter, highlighting the annuity-like nature of this revenue stream.

We remain focused on our adjusted EBITDA margin and we'll continue to make targeted investments to drive future growth. In addition, we have taken steps to drive operational efficiencies across our business and reduce our cost base. The cost actions we have taken to date occurred across business segments and have been focused on non-revenue-generating growth.

Our change to a segment reporting structure has allowed us to quickly identify and take action to remove these costs. As a result of these actions, we have removed approximately $140 million of cost on an annualized basis. Some of the cost actions have an immediate impact, while others take time to materialize. Based on the timing of these actions, we expect to realize $125 million of the cost savings in 2023. We have carefully balanced the need to reduce our costs without impacting our ability to immediately return to growth mode as conditions improved and will continue to identify further opportunities to drive efficiencies in 2023.

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 in local currency, unless otherwise noted.

2022 was a tale of two halves, similar to what we experienced in 2021, but in reverse. Our strong performance in the first half of 2022 was offset by headwinds in the second half, particularly the fourth quarter, which saw a rapid slowdown in investment sales and Leasing volumes. Despite the industry-wide slowdown, we delivered solid full year fee revenue growth and continue to make progress in strengthening our platform for long-term value creation. Using our strong investment-grade balance sheet, we returned about $600 million of capital to shareholders via share repurchases over the course of the year, while also making incremental investments in our people and platform. I'll expand on these topics later in my remarks.

For the full year, consolidated fee revenue rose 7% to $8.3 billion. Our more resilient business lines collectively grew 16%, including 14% organic growth. Transaction-oriented fee revenue grew 4%, led by 7% growth in leasing. Adjusted EBITDA for the full year declined 14% to $1.2 billion, with 8% of the decline from lower equity earnings.

The full year adjusted EBITDA margin declined 370 basis points to 15.0%, with fee revenue growth more than offset by approximately 190 basis points from lower equity earnings, 140 basis points from higher travel, entertainment and marketing expenses, 80 basis points from incremental investment in our people and platforms, and 30 basis points from our changes to commission structures within Capital Markets. Adjusted EPS of $15.71 declined 17%, driven by higher interest and amortization expenses on top of the lower adjusted EBITDA, partially offset by a 5% reduction in the average share count.

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Shifting to the fourth quarter performance. Fee revenue declined 16% over a record fourth quarter 2021. The macroeconomic factors that Christian described drove a 40% decline in Investment Sales, Debt and Equity Advisory fee revenue, and an 18% decline in leasing. In contrast, our resilient business lines collectively grew 12% with notable strength in our Workplace Management business line within Work Dynamics as well as in JLL Technologies and in LaSalle advisory fees.

Adjusted EBITDA fell 42% from the prior year quarter to $339 million, mostly due to a $124 million adverse swing in equity earnings. Our adjusted EBITDA margin of 15.5% is down 710 basis points from the fourth quarter of 2021, a period which generated the highest quarterly margin in over 15 years. Lower equity earnings contributed approximately 550 basis points to the margin decline. Additional drivers of the decrease included lower transaction-based fee revenue and higher fixed compensation expense largely tied to investments to drive future growth over the past several quarters, partially offset by lower performance-based incentive compensation.

Moving to a detailed review of operating performance by segment, beginning with Markets Advisory. Fourth quarter leasing fee revenue declined 18%, following a 68% growth rate in the prior year quarter. As macro conditions varied across regions, so too did our leasing fee revenue declines across geographies, with the Americas down 20%, Asia Pacific down 16% and EMEA down 10%, all on comparison to strong growth rates in the prior year quarter.

On a global basis, all primary asset classes saw transaction volume decline, along with lower average deal size, particularly in the office sector. Of note, large-scale office leases in the US saw a pronounced decline. Our fourth quarter office sector fee revenue fell 17%, though compared favorably with a 19% contraction in global office leasing volume according to JLL Research.

In the industrial sector, fee revenue growth declined 21%, a move directionally consistent with expectations given the tight supply and significant growth seen over the past several years. This compares favorably with a 26% decrease in global industrial market activity from a year ago according to JLL Research.

As Christian described, we're seeing more sustained leasing demand for high-quality assets despite softer demand more broadly. In addition, leasing activity varies by sector and geography. For instance, our gross US leasing pipeline is larger from this time a year ago, with comparatively stronger growth in industrial and retail versus the office sector. While the gross leasing pipeline provides cautious optimism for the full year 2023, near-term activity is likely to be subdued, especially when comparing to the strength we saw in the first half of 2022.

Also within Markets Advisory, Property Management fee revenue for the fourth quarter grew 8%, primarily organic and generally consistent with a full year growth rate of 9%, which speaks to the resiliency of the business line.

I do note that at the end of 2022, we disposed of a business that accounted for nearly $23 million of the advisory and consulting fee revenue annually. Its contribution to adjusted EBITDA was immaterial.

The Markets Advisory fourth quarter adjusted EBITDA margin declined 230 basis points from a year ago to 17.4%, primarily due to lower leasing fee revenue, investments in talent to match growth in our business over the past year and incremental T&E and marketing expenses. Despite full year fee revenue growth of 8% within Markets Advisory, the adjusted EBITDA margin declined 110 basis points to 16.0% on the same factors impacting the movement in the quarter as well as investments in our technology platform.

Shifting to our Capital Markets segment. The market conditions Christian described were a key factor and a 34% decline in segment fee revenue for the fourth quarter. I note the contraction was off a fourth quarter 2021 growth

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rate of 53%. Indicative of the strength and breadth of our global Capital Markets platform, JLL's global Investment Sales fee revenue decline of 45% compared favorably to the 56% fall in global deal volume Christian referenced.

For perspective, the fourth quarter market volume decline was the sharpest since the fourth quarter of 2008, and in terms of dollars, was the lowest overall market volume since fourth quarter 2011. Fee revenue from US Investment Sales fell about 61%, slightly better than the 62% decline in US market volumes according to JLL Research.

Valuation Advisory fee revenue, which is more resilient than Investment Sales, Debt and Equity Advisory, grew 3% in the fourth quarter. Growth was broad-based across regions and sectors. Our Loan Servicing fee revenue fell 10% on approximately $7 million of lower prepayment fees, which more than offset about 8% of ordinary servicing fees. Our Loan Servicing portfolio increased 2%, driven largely by Fannie Mae originations.

The fourth quarter Capital Markets adjusted EBITDA margin contracted 440 basis points from a year ago to 19.3% on lower fee revenue, higher commission expense from the change in our compensation mix to more commissions from cash bonus, higher T&E expense, an increase in our multifamily loan reserve and incremental investment in head count to drive future growth over the past several quarters.

For the full year, with Capital Markets fee revenue flat, the adjusted EBITDA margin fell 340 basis points to 18.2%, driven primarily by the same expense factors as well as incremental investments in technology. Looking ahead, the global Capital Markets' Investment Sales, Debt and Equity Advisory pipeline is consistent with this time last year, as modest growth in the Americas and Asia Pacific is offset by a slight decline in EMEA. The amount and pace of revenue growth through the year will be heavily influenced by the factors impacting deal timing and closing rates that Christian described. I also remind you of the tougher growth comparisons for the first half of the year.

Moving next to Work Dynamics. Fourth quarter fee revenue grew 11% with double-digit growth across our annuity and transactional revenue streams within the segment. Client wins and global contract expansions in prior periods led to 19% fee revenue growth in Workplace Management. Project Management fee revenue grew 13%, propelled by improvements in the return-to-work trends.

The slowdown in leasing activity adversely impacted Portfolio Services fee revenue growth in the quarter. The Work Dynamics fourth quarter adjusted EBITDA margin expanded 110 basis points from a year ago, driven by increased scale and cost management strategies enacted over the past year, partially offset by incremental investment in technology and people.

For the full year, large-scale client wins and global contract expansions in 2021 helped drive 15% Work Dynamics fee revenue growth. The segment's adjusted EBITDA margin expanded 80 basis points to 11.6% in 2022. The drivers of the full year margin expansion were consistent with those for the quarter. The 2022 client wins and expansions within Workplace Management, which are indicative of future demand given contract lead times, exhibited solid growth, though they were more moderate in scale than the prior year.

The Project Management pipeline is currently strong. However, growth trends are generally linked to leasing, albeit lagged. Therefore, the current moderation in overall leasing activity reduces certainty of pipeline conversion in the latter part of the year.

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Turning to JLL Technologies. Fee revenue, inclusive of M&A, increased 36% in the fourth quarter. Organic growth of 21% was driven largely by enterprise clients. Looking at the full year, fee revenue grew 47%, of which 23% was organic, driven by new customers and client expansions.

As a reminder, JLL Technologies also influence its fee revenue across JLL through software that differentiates our services.

Equity earnings in the quarter were driven by a handful of impairment or valuation declines, partially offset by more modest valuation increases and a few investments. An approximate $100 million adverse [indiscernible] (00:19:57) in equity earnings, net of carried interest, from the prior year period drove over 90% of the contraction in the JLL Technologies' adjusted EBITDA margin in the quarter. The primary drivers of the full year adjusted EBITDA margin decline were consistent with the quarter.

As for LaSalle, strong capital deployment and fair value increases over the past 12 months drove 3% growth in assets under management, which translated to a 16% rise in advisory fee revenue mostly within our core open-end funds. Equity earnings for the fourth quarter were $21 million lower than the prior year, driven by moderating asset valuations broadly, which are likely to be a headwind to near-term advisory fee revenue growth and incentive fee generation. The increase in advisory fee revenue and platform scale benefit were more than offset by the lower equity earnings and lower transaction and incentive fee revenue, resulting in a decline in LaSalle's adjusted EBITDA margin for the quarter.

For the year, LaSalle's adjusted EBITDA declined 40%, as lower equity earnings and incentive fee revenue more than offset a 17% increase in advisory fee revenue and platform scale benefit. The lower equity earnings and incentive fee revenue drove substantially all of the full year adjusted EBITDA margin contraction.

Moving to free cash flow, which was below our expectation for the year. We generated $532 million of free cash flow in the fourth quarter, bringing the full year to an outflow of $6 million. The full year outflow was driven by: one, higher commission payments in 22, reflecting greater payments in early 2022 for commissions earned from the strong performance in the prior year fourth quarter as well as incremental commissions this year attributable to the full year leasing growth and changes to the Capital Markets incentive compensation structure; two, higher bonus payouts this year tied to 2021 performance; three, higher cash tax payments related to timing and prior year profitability; and four, lower profitability in 2022. 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 December 31, our reported net leverage of 1.0 times is at the midpoint of our target range and up from 0.2 times a year earlier, primarily due to share repurchases, incremental investments in our business and lower free cash flow.

As a reminder, our leverage ratio typically peaks in the first part of the year and we have a history of deleveraging quickly. Our liquidity totaled $2.6 billion at the end of the fourth quarter, including $2.1 billion of undrawn credit facility capacity.

As previously indicated, we did not repurchase any shares in the fourth quarter. Our period-end share count was down about 5% from a year earlier as a result of our approximate $600 million of share repurchases over the course of the first nine months of the year.

As we stated at our investor briefing in November, we are committed to resuming share repurchase activity in 2023. The amount of share repurchases will be dependent on the evolution of the market recovery and the

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performance of our business, particularly cash generation. Approximately $1.2 billion remained on our share repurchase authorization as of December 31, 2022.

Along with share repurchases, reinvestment in our business to further strengthen the resiliency of our diversified platform and drive profitable long-term growth remains a top priority. Despite the sharper and shorter macroeconomic cycles having a pronounced impact on our business in the last three years, we have demonstrated our ability to navigate the rapid changes in the business environment and continue to focus on balancing both short-term and long-term implications for our business growth and profitability. With strong growth comparisons and the broader market environment in mind, we currently anticipate the softness we saw in our more transaction-oriented fee revenue to persist through the first half of the year.

We continue to calibrate both our cost basis and investment priorities to further transform our platform, while also preparing for an anticipated rebound in activity. As Christian noted, we've taken actions to respond to the near-term challenges and reduce our cost base. The approximately $140 million of run rate cost reduction actions to date reflect approximately 2.0% of our 2022 fee-based compensation and benefits and OAO expenses.

Inclusive of these cost actions and a minimal equity earnings assumption, we anticipate our full year 2023 adjusted EBITDA margin to be in the 14% to 16% range. We have a track record of fee revenue growth meaningfully exceeding global GDP growth and healthy margin expansion over the long term. This is largely due to the investments in our people and platform, along with our focus on anticipating our clients' evolving needs, which position us to continue to drive stakeholder value.

Christian, back to you.

Christian Ulbrich

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

Thank you, Karen. As we look forward to 2023, the economic outlook is still uncertain. While inflation rates are beginning to slow, many central banks have not reached the end of their tightening cycles. However, we are entering this slowdown from a position of strength with strong labor markets and corporate balance sheets in good shape.

Overall, we expect Capital Markets activity to recover quickly compared to previous downturns and for the current slowdown to be relatively short. Interest rates are expected to stabilize in the coming months, allowing for bid-ask spreads to normalize in the current phase of price discovery to pass. These factors, when combined with the significant amount of available capital, paint an increasingly optimistic picture for the second half of 2023.

Clients continue to engage in conversations with JLL about current market conditions and are ready to transact when uncertainty abates. As the current period of uncertainty subsides, a higher-than-normal number of expiring leases will help boost office activity. High-growth sectors such as industrial, life sciences and data centers are likely to emerge from a temporary pause to strong demand.

Today, you have heard how we have taken cost actions to manage our business through this slowdown and deliver on our margin targets for 2023 and beyond. We are focused on improving free cash flow and remain committed to returning capital to shareholders.

Before I close, I would like to thank all our employees across the world for their commitment and hard work during the past year. Though we all would have liked 2022 to end on a more positive note, it was our second best year in adjusted EBITDA dollars and our third best year in adjusted EBITDA margin within the last 10 years. The efforts

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of our colleagues have made that possible and position JLL well to take advantage of the coming recovery in the commercial real estate market. We are, therefore, confident in achieving our 2025 financial targets of $10 billion to $11 billion of fee revenue and a 16% to 19% adjusted EBITDA margin.

Operator, please explain the Q&A process.

QUESTION AND ANSWER SECTION

Operator: Absolutely. [Operator Instructions] The first question comes from the line of Michael Griffin with Citi. Michael, your line is now open.

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

Q

Great. Thanks. Christian, I wanted to expand on your comments just the end of the prepared remarks about the number of leases expiring in the near-term, potentially boosting office activity. I mean, is that a read-through of what you might think office leasing demand is going to be for 2023 and [ph] maybe that we're going to incur in (00:28:54) 2024 just given the challenges the sector faces? And anything you could spend on there would be helpful?

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

A

Hi, Mike. Good morning. Well, listen, what we are seeing is that there's still that trend continuing that the best companies are trying to offer their employees the best possible space in each market they're active in as a way to improve the return to offices and the well-being of their employees. And that in itself will be a driver of our office leasing business because we are very active in the Grade A space.

And we should also not forget that this current recessionary environment, which we see predominantly in the Western world is not happening in Asia. The whole of Asia is back to the offices at a very normal level comparable to 2019 pre-pandemic, and the overall environment there is very strong. And so, as you know, the Americas is slightly last on return to office. EMEA sits in the middle and Asia is very strong.

So, overall, we are kind of cautiously optimistic that the leasing markets will pick up over the course of this year. But maybe Karen wants to provide a little bit more commentary.

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

A

Yeah. We're really seeing differences in our pipeline around the world and by property type. And one thing that's really important to highlight is this flight to quality point that we keep bringing up over the last few quarters. Particularly for buildings constructed since 2015, that's the only category from an age perspective that is recording strong positive net absorption since the pandemic, with the other categories and older buildings more than offsetting that amount.

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

Q

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And Karen, can you remind us how much of the leasing revenue is driven by office? I think you gave us the year-over-year decline in the prepared remarks, but just the percentage of that leasing revenue that might come from the office sector.

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

A

Yeah. It's between 50% and 60% roughly, from a full year basis.

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

Q

Great. And then just for my next question. You touched on kind of the external growth opportunities being selective, just given the current capital markets environment that we're in for 2023. I mean, any sense if you were to execute on any opportunities of what business lines you'd like to expand on where maybe you see the most opportunity in?

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

A

Well, overall, we are very happy with the footprint we are having in the different business lines. There are always some tuck-in opportunities, but there's nothing which we are really missing. And I want to put right at the start that we feel that pricing is still very high, given the environment. So we have been cautious around M&A for some time now and we will continue to be over the course of this year and going forward. But what we are seeing is that many of our clients have super ambitious ESG targets and that will force them – if they are not moving their real estate space and move into more modern buildings, as Karen just described, they will have to significantly upgrade their spaces. And so generally speaking, one of the most interesting opportunities sits around that project and development services as we call that business line. But again, we are very happy with our existing capacity. But if there's something coming around the corner, we would certainly look at it.

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

Q

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

Operator: Thank you. The next question comes from the line of Anthony Paolone with JPMorgan. You may proceed.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Great. Thank you. My first question relates to Work Dynamics and I'm just trying to put together some of the comments around project management, I guess, tying to leasing activity, but also some of the wins in Workplace Management. I guess, bottom line, do you have visibility on growth in Work Dynamics revenue for 2023?

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

A

Well, we are – first of all, we are very happy with the performance of our Work Dynamics business in 2022. And we expressed at our investor meeting in November that we are confident that we will be able to expand margins in that business pretty consistently over the coming years, and nothing has changed about that view over the last couple of months.

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So, first of all, I would say we put margins over top line growth within that business, but we are – we continue to be confident about that top line growth. What is important to understand here, despite the fact that the return to office is still relatively slow in the US that those companies who are outsourcing their real estate to service providers like us are usually also those companies who are very active on expanding and doing M&A. So we will see more buildings coming to us from our existing clients overall despite a potential reduction in their office footprint per person per employee. And so that will drive the top line growth.

Then, as I alluded to earlier, that whole notion around the E of the ESG is driving a lot of activity from our clients, which helps us to drive further top line growth. So there are numerous services which we offer to those clients and all of their activities is helping us to grow our top line.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. So, I mean, is it fair to say that that Work Dynamics should be probably the way you're seeing things right now, the brightest spot in the business segments for 2023?

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

A

Well, it depends how you define brightest spot. It's a very important part of our business, and the proportion of that business will continue to grow over the next couple of years. But as you know, once the transactional markets are returning to a more normalized activity probability of our Capital Markets and our leasing business tends to be still significantly higher. So I'm careful to make a category around what's brightest here.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. I understand. And then with regards to the $140 million of cost saves, can you give us a little more context around whether you see those as being permanent or are they coming by way of lower, say, T&E costs just due to less activity levels? Just any more depth there would be great.

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

A

Sure. I'll take that one. So that's $140 million on a run rate basis. And again, approximately $125 million of that will come through in the calendar year 2023. It's primarily related to reductions in compensation and benefits from the restructuring of our business, so reductions in head count.

And as we look at where that's from, it's really primarily non-producer head count and it's associated with positions that we really no longer require as we shifted our business operating model from a geographic to the business line focus.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. And then just last one real quick. You talked about just being careful with capital allocation. Can you just comment on just any expectations for investments into JLL Tech and CapEx for the year?

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

A

Well, we continue to invest into the long-term performance of JLL and we have a strong conviction that it is very important to have the leading tech platform within our industry. We believe we have it, but we want to stay ahead of our competition with that and so we will continue to invest there. But we are applying the same kind of discipline around those investments, as we apply to all other investments we do. They have to create shareholder value and so they have to compete for capital as all the other areas of our business have to compete for capital.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. And maintenance CapEx?

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

A

Yeah. We're continuing to invest in our platform and our people, and we don't expect significant increases from where we've been trending historically. We tend to look at sizing that on an annual basis within a certain band. So keeping that, an amount that's reasonable for the size of our business and our activities.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: Thank you. The next question comes from the line of Chandni Luthra with Goldman Sachs. You may proceed.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. Thank you for taking my question. I'd like to stick with the theme of capital allocation, little bit in 2023. When do you expect to bring buyback in the mix? And how should we think about free cash conversion in 2023, especially, as you know, sort of the changes that you made last year, you'll be lapping those? So help us understand that a bit, please. Thank you.

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

A

Yeah. Sure. So on share repurchases, I mentioned in the remarks that we intend to resume our share repurchases over the course of 2023. We'll certainly be looking at the broader macro environment, our free cash flow and our overall debt levels as we think about the size and timing of those amounts that we're repurchasing.

As it relates to driving free cash flow, it's certainly an area of focus for us going forward. I listed out the number of specific factors that impacted that in 2022. And as you think about the first couple of those, I ticked off, which were, one, the higher commissions related to strong record fourth quarter activity in 2021 as well as higher bonus and incentive compensation payments in March of 2022 [ph] and were (00:40:09) also related to 2021. You'll have the reverse effect in the first quarter of 2023.

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So to have that factor at play. And the other element that we'll be watching carefully is how the recovery of the transaction businesses manifest over the course of the year because that obviously has a significant impact on our cash flow overall.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And Karen, would it be possible for you to give us some guide post around fee revenue in 2023, especially as we think about Investment Sales and Leasing? I understand you're not giving revenue guidance, but help us understand how should we model perhaps first quarter with respect to the fourth quarter that you guys just reported or frame the year in terms of first half versus second half? Any guide post would be helpful. Thank you.

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

A

Sure. It's certainly – it's a great question because it's certainly a challenging year that we're heading into. Right now, we're expecting a continued set of headwinds for particularly Investment Sales and Leasing in the first and second quarter of the year and are planning accordingly.

Based on what we know right now and sentiment from our clients as we talk to them and based on expectations for the broader market, we expect that things will begin to recover in the second half of the year. We'll obviously be watching that very closely and looking at our pipelines, which still look healthy and are growing as we continue to have conversations with clients, but the time to convert that to actual transaction is really being extended in this period of uncertainty.

So we're looking at our conversion rates and monitoring that closely and report [ph] – report (00:41:58) back each quarter on progress we're making and what we're seeing in each of those lines.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And I'll squeeze one more as well. Christian, this one's for you. Could you give us a sense of where our cap rates now across different property types and how much more correction is needed before buyers and sellers meet? I guess what I'm trying to understand is how much is transaction activity a function of cap rates as opposed to capital and debt market availability and lower interest rates. Thank you.

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

A

I can't give you where cap rates are because it depends so much which country and which asset class and then what type of asset within that asset class you're talking about. There is a very, very strong correlation between...

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

I guess, US.

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

A

There's a very strong correlation between interest rates and cap rates. And at the moment, you clearly have the issue of negative leverage. And so that drives a certain type of buyers and that's why you see the best buildings,

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which are actually only trading at the moment, because those are very often bought by buyers who will buy all equity, and they are just waiting how debt markets and especially spreads are developing over the next couple of months. And they will probably put some debt on those assets much later in the year or even wait for next year.

We have seen cap rates kind of growing quite significantly over the last couple of months, but any kind of noise coming from the Fed and coming from the different data sets, which are relevant, are being taken in. And so especially the last two weeks where we saw interest rates moving up again and spreads widening again, immediately create an additional kind of irritation to the market. And so we just have to be patient and let that go away.

And as Karen alluded to, we are relatively kind of pragmatic that this year, we have to wait for the third and the fourth quarter before markets will really return and the first and the second quarter will be slow quarters, and especially if you compare them to 2022 where the first and the second quarter were absolutely record quarters.

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

And I can – if you want to go into specifics on cap rates specific to the US market, we can talk about that a bit for our all the different property types at a high level. The sector that we've seen the most movement in from either the peak or from the – if you look at year-end 2019 would certainly be office where if you say that approximately the range was 3.75% to 4.25%, now cap rate – going in cap rates are 6% to 7%. And again, as Christian mentioned, these numbers can fluctuate depending on where you are and the quality of the property. But broadly speaking, that's the band.

We've seen – it was in industrial, right, if you say, the range was between 2.75% and 3.25%, now the pricing around 4.5% to 5.75%. Multifamily peak was similar to industrial and the range now is similar to industrial, although a bit tighter on the top end. And then finally, in retail, peak pricing [ph] was between (00:45:52) 4.5% to 5.75% in the kind of most recent history and is moved out a little bit to 5.25% to 6.25%.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC
Q

Very helpful. Thank you very much.

Operator: Thank you. The next question comes from the line of Jade Rahmani with KBW. You may proceed.

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

Thanks very much. Wow, those cap rates, that's quite a move, maybe a little bit wider than – of a move than I was thinking, and not just office, but also multi and industrial. Wanted to ask you a bigger picture question just about JLL's valuation and the earnings consensus.

I think there's still significant uncertainty valuing this company, and it relates to the margin profile. Also, there's a wide range of estimates in the consensus. But then also the high historical earnings contribution from equity income, incentive fees, and most recently, over the last few years, the JLL Technologies proptech investments, through mark-to-market valuation gains in the equity income line.

So when you're making internal capital allocation decisions and prioritization setting, what valuation metrics are you benchmarking JLL to when you decide on share buybacks versus pursuing external growth opportunities?

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Are you looking at the adjusted earnings and adjusted EBITDA metrics that you provide to folks like ourselves? Or is there an internal metric that excludes maybe non-recurring items or items that are less recurring?

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

A

Well, thank you for that challenging question early in the morning. A very good one. Listen, we have to take, obviously, different time horizons for the different areas of our business. So if we do tech investments, the time horizon is more between 5 to 10 years than if we were to make investments into our traditional service lines where we can take a much shorter time horizon.

We have had historically – if you just take the average of the last couple of years, we have had historically an average of $100 million of equity earnings contributing to our results. Last year was the lowest over many years. You have to take that in the very long average because, obviously, we cannot influence those equity earnings and incentive fees on a quarter basis or on an annual basis. And therefore, on those, we unfortunately have a lot of volatility, which we have to digest and which makes it hard for the market to make estimates. But it is a very important and lucrative part of our business and therefore, we will continue to work on that and embed that in our strategy.

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

A

And I would just add that from a – we just look at return on invested capital on a risk-adjusted basis and across a portfolio of different things we can pursue. So, obviously, a variety of factors go into that analysis.

And can I go back to your comment just also, Jade, on the size of the movement from peak to current levels of cap rates? If you go back and you look at where cap rates were at the end of 2019, the movement is not as great, particularly if you look at a sector like industrial, they're kind of right in that same zone.

Same for retail. Housing was – multi-housing was a little bit lower and office was certainly lower. But it's easy to look at the most recent history and kind of pricing at the end of 2021, whether it's for cap rates or for debt cost and say, wow, look how far we've moved. But if you go back to our time horizon of 2018, 2019, the movement doesn't – is not as great and people were certainly transacting at those price points not so long ago, although it might feel like a long time ago now, given what's transpired over the last few years.

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

Q

Thank you very much for that clarification. Just again on the capital allocation decisions. So if hypothetically, you were deciding whether to merge with a peer or whether to acquire a business, just say a Capital Markets type of business, and then you're comparing that decision versus buying back the stock, are you looking at the stock valuation relative to the average adjusted earnings or adjusted EBITDA over the last few years? I mean, it wouldn't make sense to use this year because it's a down year. But in that calculation, are you stripping out any of the equity income, say, on the JLL Technology side?

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

A

Yeah. I mean, we're looking – we look at our adjusted EBITDA including/excluding equity earnings, obviously, because of the fluctuation in equity earnings.

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

Q

Okay. And then on the adjusted EPS calculation, I saw a line item I haven't – I don't think I've seen with JLL, which is a subtraction for interest on employee loans net of forgiveness. Can you just give any color on what that relates to and why this new disclosure is here?

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

A

Yeah, very good reading the footnotes, I'm impressed. So that was an addition this quarter. Previously, the interest amounts – so, first of all, let me take a step back. Those are related to interest amounts on certain employee contracts that we put in place with producers in our business and the interest that is accruing on those and then gets paid back over time based on the conditions for those contracts to be burned off. And so it's really a non-cash item as it relates to us because it's simply increasing the period of time over which that amount needs to be earned back. And we're, therefore, excluding it.

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

Q

Is that going to be an ongoing adjustment?

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

A

Yes, it will be. And one other point. It was previously immaterial because of interest rates, but now that interest rates are increasing, right, that's starting to be a more meaningful number.

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

Q

So, this is going to be a deduction going forward from GAAP earnings to adjusted earnings, or will it become a positive contribution?

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

A

It depends on the timing of the amount of new contracts put in place and any particular quarter and how much interest is accruing on those relative to how much is burned off in the quarter. So because our – and particularly in a period like this, where you have transaction volumes that are fluctuating pretty greatly from quarter-to-quarter, the outcome could be different. In the coming years, we expect it will be a deduction from GAAP.

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

Q

Okay. I'll probably have to follow up with you later on that. And then, the restructuring charges had also a big uptick quarter-over-quarter. I think usually in the fourth quarter, there is an uptick, but definitely outside the range over the last few quarters. Any color you can provide on that and what we would expect for 2023?

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

A

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Yeah. So the uptick in this quarter was really related to – or the last quarter is related to the restructuring activities that I mentioned as it relates to our head count reduction due to the changes in our operating model and roles becoming redundant, different management layers being removed.

As we mentioned at November investor briefing and we're going to reference today, we're continuing to drive forward in terms of operating efficiencies in our business so we can have better operating leverage as our platform scales in the future. Some of that will require investment, some of that will involve restructuring activities. And so I would expect some additional restructuring costs to come through in 2023.

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

Q

Thank you very much.

Operator: Thank you. The final question comes from the line of Patrick Mcilwee with William Blair. You may proceed.

Patrick Mcilwee
Analyst, William Blair & Co. LLC

Q

Hi. I understand that the overarching trends are not ideal. But given some of your peers reported leasing trends that were a bit more stable, can you provide any more color on what drove the deceleration in that business? And kind of as a two part to that, given leasing is generally expected to follow trends in Capital Markets, if you'd expect things to get worse before they get better heading into 2023?

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

A

Yeah, great question. So, first, on the leasing declines. Our business mix really tends to skew to the higher – high-quality, larger transactions. And in the US, anyway, as we looked at from an overall market perspective, the slowdown in office leasing was primarily driven by the large 100,000 square foot plus occupier segment, which is where, right, major corporate requirements are falling. And the overall market leasing levels for that segment, right, that's 100,000 square foot plus, was the lowest recorded since early 2021. So since – right after the recovery started. And it was more than 50% below the pre-pandemic quarterly average for that size segment.

So that really was, for us, a pretty significant impact to our overall revenues. And sorry, remind me of your second – I remember now, it was the timing of declines relative to different segments. So the Investment Sales decline did begin before the leasing declines. And that's typically the way, right? You'll have leasing declines then – sorry, you'll have Investment Sales decline, then Leasing, then Project Management because of the relationship, the project management to leasing. We did have more pronounced declines compared to the prior year beginning in November for leasing as compared to September for Investment Sales.

So that gives you an idea of the kind of time gap between when we really started seeing more significant falloff in activity between those two transaction lines.

Patrick Mcilwee
Analyst, William Blair & Co. LLC

Q

Got it. That's great. Thank you. And then just quickly, you mentioned that you're still on track to achieve your 2025 targets. And in November, you did mention that those assume a recessionary environment in 2023.

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I guess, given the commentary you gave us today, would you say that your expectations in terms of the severity or timing of that environment have changed or would you say that recent developments are baked in for the most part there?

Christian Ulbrich

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

A

For the time being, we are still in line with our expectations expressed in November. We are obviously expecting a pretty strong recovery of the transactional environment in the second half of this year. So let's wait for the second half of this year, whether we have to take anything away from that.

Patrick McIlwee

Analyst, William Blair & Co. LLC

Q

Okay. Thank you, Christian. I'll let you guys close up with that.

Operator: Thank you. There are no questions waiting at this time. I would now like to pass the conference back over to Christian for closing remarks.

Christian Ulbrich

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

Thank you, operator, 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 first quarter.

Operator: That concludes the conference call. Thank you for your participation. You may now disconnect your line.

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