

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

Speaker: Scott Einberger, Investor Relations Officer

Thank you and good morning. Welcome to the second quarter 2023 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 accompanying excel file, we 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 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.

Speaker: Christian Ulbrich, President and Chief Executive Officer

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

Conditions impacting global real estate markets were largely unchanged in the second quarter. The consistent tone coming from the U.S. Federal Reserve with regards to inflation and the interest rate tightening cycle has kept real estate markets muted. Overall, higher costs of capital, tighter lending standards and elevated price uncertainty has limited transaction volumes. During the second quarter, we grew our resilient business lines, while also effectively managing through the industry wide slowdown in Investment Sales and Leasing activity. To put this into perspective, global commercial real estate investments totaled 139 billion dollars in the second quarter, a year-over-year decline of 53 percent, according to JLL Research. The second quarter decline in investment dollars was in line with the deceleration seen over the last two quarters, which would support the view that the market has found its bottom with regards to transaction volumes.

On the leasing side, volume for the global office market was down 14 percent year-over-year in the second quarter, according to JLL Research. Occupiers continue to have a cautious outlook on the macro-economic environment and as a result are extending their timeline to make decisions. Large scale leasing activity remains slower than normal but is showing signs of improvement with second quarter activity up sequentially from the first quarter. Global office vacancy rates are up modestly to 15.6 percent in the second quarter compared to 14.4 percent last year. Asia Pacific leasing volumes remained stable compared with last year, but volumes declined in both Europe and the U.S. Demand, particularly in the U.S., continues to be focused on high-quality and sustainable spaces in prime

Jones Lang LaSalle Incorporated
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locations. These types of best-in-class assets have proven to be much more resilient than the overall market with rental growth remaining positive despite the slowdown in office leasing activity. We are observing Corporates shedding lower quality space while also directing employees to return to the office at least 3 days a week, which is leading to peak occupancy rates at or near capacity in high-quality buildings for many of our clients. As a reminder, a significant percentage of JLL's office leasing fee revenue comes from transactions in these high-quality or Class A buildings.

Turning to the industrial sector, global leasing activity moderated during the second quarter. Asia Pacific showed positive net absorption during the quarter while gross leasing volumes in the U.S. and Europe slowed. Overall, market fundamentals in the industrial sector remain healthy with low vacancy rates and positive rental growth in many markets. The industrial sector has grown to become one-third of our total leasing fee revenue and we expect growth in this asset class to continue in the coming years. The hotel and retail sectors have benefited from healthy consumer spending on experiences and services. A rebound in international travel has also boosted the hotel and retail markets globally, particularly in the tourist corridors of Europe and Asia Pacific.

Overall, these macro and industry specific trends are playing out largely as we expected when the year began, though we had forecasted a slightly stronger advancement of transactions in the second quarter. In contrast, our resilient business lines collectively delivered positive fee revenue growth during the second quarter, highlighted by growth in our Property Management, Workplace Management and JLL Technologies business lines. LaSalle's business performed well given the decline in real estate asset values and incentive fees were better than expected, demonstrating the diversification and strength of this portfolio.

Before I turn the call over to Karen who will share more detail on the quarter, I want to touch on the JLL Technologies segment. While it is the smallest of our five business segments, the value it brings to our company and our clients is substantial. At the core of this business is our build-buy-partner-invest strategy, which we spoke about at our Investor Briefing last fall. A perfect example of this strategy coming to life is the AI-powered platform our Capital Markets team is using to identify, analyze and source pipeline opportunities. Earlier this week our JLL Technologies team took this one step further with the unveiling of JLL GPT, a secure, generative AI model for commercial real estate that we built in-house. Our teams are beginning to use this new tool to provide clients with even better insights into the current market. These are just a few examples of projects our technology team is working on that we believe will translate into long-term shareholder value, especially when you consider the tech-driven transformation that is playing out in the commercial real estate sector.

Part of our strategy is investments in proptech companies that are positioned to drive further efficiencies or in some cases disrupt the commercial real estate industry. As a reminder, the three main reasons we invest in these companies are, first, to enable our business with technology tools that will drive growth and improve productivity. Second, to provide clients with best-in-class technology solutions and third, to gain insight into technology that will potentially disrupt the industry and inform our strategic direction. While we have a disciplined approach to these investments, venture capital investing is subject to increased volatility during economic cycles. As a result, we have to be comfortable with equity gains and losses associated with these investments.

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

In the second quarter, our JLL Technologies' investment portfolio generated a non-cash equity loss that primarily resulted from two companies raising capital in down rounds. These losses came after approximately 200 million dollars of gains over the past few years. Even after reflecting these recent equity losses, this portfolio is valued at 1.2 times the original investment amount of 405 million dollars. Today we have built out a mature portfolio that includes more than 50 companies and while we will continue to invest in proptech companies, the dollar amount of incremental investments will be notably less than the past three years. The medium-term outlook remains healthy for many of the companies we have invested in and we are focused on bringing the strategic benefits of these investments to our company and clients.

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

Speaker: Karen Brennan, Chief Financial Officer

Thank you, Christian.

Before I begin, a reminder that variances are against the prior year period in local currency, unless otherwise noted.

Overall, I'm pleased with our fundamental operating performance in the quarter, which was consistent with the trends of the past two quarters, particularly considering the continuation of the challenging market backdrop Christian described. At the same time, we are making good progress on a number of important fronts, including improving working capital efficiency, reducing fixed-costs, and enhancing the resiliency of our global platform. As momentum builds across our business, 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, second quarter fee revenue was \$1.8 billion, a 13% decline from a year earlier. Adjusted EBITDA totaled \$116 million, down 68%, and reflected a margin of 6.2% compared with 16.8% a year ago. A \$137 million adverse non-cash change in our equity earnings, net of carried interest, accounted for over 70% of the margin reduction. Beyond the equity loss headwinds, the lower margin was predominantly due to the decline in fee revenue in our Investment Sales, Debt, and Equity Advisory and Leasing business lines. Our ongoing cost reduction actions mostly offset investments in the business made over the past 12 months to drive future growth. Adjusted Diluted EPS of \$0.50 reflected the equity losses, higher interest expense, and lower contributions from our transactional business lines. The equity losses were a \$1.69 per share headwind to the quarter's Adjusted EPS.

Moving to a detailed review of our operating performance by segment. Beginning with Markets Advisory, the 13% decline in segment fee revenue was mainly due to a contraction in Leasing activity, most notably in the Americas and EMEA. Leasing fee revenue declined 16% following a 24% growth rate in the prior year quarter. Both the office and industrial sectors saw material fee revenue declines while retail and mixed use grew modestly in comparison. Transaction volumes declined across asset types, especially in the office and industrial sectors, while average deal size also decreased across

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

most asset types, particularly in the U.S. industrial sector. The decline in our second quarter office sector fee revenue was largely in line with the 14% contraction in global office leasing volume according to JLL Research. In the Industrial sector, fee revenue declined 26%, which compares favorably with a 34% decrease in global industrial market activity, according to JLL Research. The contraction in Industrial sector leasing activity is consistent with expectations given the tight supply and significant growth seen over the past several years.

As Christian described, we continue to see more sustained leasing demand for high-quality assets, which represents the majority of our business. Our global gross Leasing pipeline continues to hold up, which gives us optimism for continued sequential improvement in revenues, however, the pace of acceleration is uncertain considering the economic backdrop.

Also within Markets Advisory, Property Management fee revenue grew 9%, attributable in part to portfolio expansions in the Americas and incremental fees from interest-rate sensitive contracts in the U.K. 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 we previously announced in the fourth quarter of last year.

The Markets Advisory second quarter Adjusted EBITDA margin contraction was primarily due to lower Leasing fee revenue.

Shifting to our Capital Markets segment. The market conditions Christian described were a key factor in the 34% decline in segment fee revenue. The contraction is off a strong second quarter 2022 growth rate of 24%. Our global Investment Sales fee revenue, which accounted for approximately 35% of segment fee revenue, fell 45%. The decline was across most geographies and asset classes and compares favorably with the 53% decline in the global sales volume Christian referenced. For perspective, the second quarter market volume was just 2% above the first quarter 2023.

Growth in Valuation Advisory fee revenue in Asia Pacific was more than offset by declines in the Americas and EMEA, leading to a 5% reduction in the total Valuation Advisory fee revenue. Our loan servicing fee revenue fell 3% on approximately \$4 million of lower prepayment fees, which masked about 7% growth of recurring servicing fees. The rise in interest rates has slowed early refinancing activity, which generates prepayment fees. 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 a \$7 million adverse change in our loan loss credit reserve, partially offset by \$5 million of equity earnings which we do not expect to recur. The decremental margin within Capital Markets was in line with our expectations considering the differences in geographic compensation structures, the loan loss reserve impact, and other discrete items. Our investments in our Capital Markets talent and platform over the past several years position us to capitalize on a rebound in transaction volumes.

Looking ahead, the global Capital Markets Investment Sales, Debt, and Equity Advisory pipeline is building at a slower rate than historical trends in a typical year and is down mid-twenties percentage

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

compared with this time last year. While we do see early signs of improving activity, particularly within the U.S., the amount and pace of revenue growth through the remainder of the year will be heavily influenced by the factors impacting deal timing and closing rates that Christian described.

Moving next to Work Dynamics, fee revenue growth of 3% was led by continued strength in Project Management, partially offset by lower Portfolio Services and Other fee revenue. The 8% increase in Project Management fee revenue growth is a result of notable demand in Australia, France, the Middle East, and the U.K. The moderate 2% growth in Workplace Management, on the back of 12% growth a year earlier, was mostly due to timing of new contract revenues. The slowdown in leasing activity, particularly in the Americas, continued to adversely impact Portfolio Services fee revenue growth in the quarter. The decline in higher margin Portfolio Services revenue and continued investments in technology and headcount to support future growth drove the contraction in Work Dynamics Adjusted EBITDA margin.

We are pleased with the underlying performance of our Work Dynamics business and are confident in the segment's growth and margin trajectory over the coming years. We continue to see solid new sales trends and strong contract renewal and expansion rates. Revenue from the new Workplace Management contracts from *Fortune* 100 companies we secured earlier this year will begin to ramp as the year progresses and support solid momentum into 2024. Our pipeline continues to build as the demand for professional management of corporate real estate increases. We remain focused on adding further Project Management mandates amidst the solid demand trends globally despite the moderating economic backdrop.

Turning to JLL Technologies, fee revenue grew 18% as existing large enterprise clients continue to increase their utilization of our platform, including our leading solutions and services offerings. We also saw strong retention rates of JLL Technologies' largely recurring revenue base. Indicative of our focus on segment profitability, JLL Technologies' fee-based operating expenses, excluding carried interest, were consistent with a year earlier despite the strong revenue growth. This quarter, non-cash equity losses related to our investment portfolio totaled \$104 million, which reversed approximately half of the equity gains we had recognized over the past several years. The combination of the fee revenue growth and incremental operating efficiency gains drove an improvement in JLL Technologies' Adjusted EBITDA margin that was masked by the \$129 million adverse swing in equity earnings, net of carried interest. As Christian mentioned, our portfolio is now more mature, and we have been scaling back our investments in proptech companies over the last 18 months. Year-to-date 2023 investments are approximately 50% lower than the first half of 2022. We will continue to invest in proptech companies that meet our strategic priorities.

Now to LaSalle, incentive fees earned on assets managed on behalf of clients, notably in Japan and the United States, drove 28% fee revenue growth. Advisory fee revenue declined 3% primarily on the impact of recent valuation declines of our assets under management. Net capital deployment was largely offset by the reduction in valuations, leading to assets under management that was consistent with a year earlier. Given the evolving market environment, new capital deployment continues to be subdued thereby impacting transaction revenues compared to the prior year. Moderating asset valuations drove a \$12 million adverse change in equity earnings from the prior year. The reduction in

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

LaSalle's Adjusted EBITDA margin was largely due to the change in equity earnings, partially offset by the higher incentive fees.

Shifting to free cash flow, net inflow in the quarter was nearly \$200 million, approximately \$60 million higher than a year earlier. Incremental cash inflow from net reimbursables and trade receivables drove an improvement in net working capital, which more than offset lower cash from earnings. The lower cash from earnings was largely due to the decline in Capital Markets and Markets Advisory business performance. Cash flow conversion is a high priority, and we remain focused on improving our working capital efficiency.

Turning to our balance sheet and capital allocation. As of June 30th, reported net leverage was 2.3 times, up from 1.0 times a year earlier primarily due to lower free cash flow over the trailing twelve months and the adverse impact of the non-cash equity losses. The equity losses, net of carried interest, over the trailing twelve months had a 0.3 times adverse impact on our second quarter reported net leverage ratio. Our liquidity position remains solid, totaling \$1.9 billion at the end of the second quarter, including \$1.5 billion of undrawn credit facility capacity.

Regarding our capital allocation priorities, we are prioritizing deleveraging our balance sheet in the near term while continuing to selectively deploy capital towards growth initiatives and repurchasing shares. We repurchased \$20 million during the second quarter and are on pace to repurchase enough shares to offset stock comp dilution this year. As long as leverage remains elevated, share repurchases are likely to be modest. Looking further out, the amount of share repurchases will be dependent on the performance of our business, particularly cash generation, and the macroeconomic outlook. Approximately \$1.1 billion remained on our share repurchase authorization as of June 30, 2023.

Before closing, I'd like to provide an update on our long-term operating efficiency improvement goals. As of the end of July, we reduced annualized fixed costs by an additional \$70 million, bringing the total amount to approximately \$210 million, of which \$170 million is expected to be realized in 2023. The cost actions are structural in nature and largely focused on non-revenue generating roles that we identified as part of the global realignment of our business lines last year. Importantly, we continue to opportunistically invest in areas that we believe have attractive growth and return prospects across our business.

Regarding our 2023 financial outlook, we previously articulated a consolidated Adjusted EBITDA margin target of 14-16%, which assumed minimal equity earnings and a recovery in the second half of the year. While we have experienced equity losses year-to-date which would bring our margin below our target, we remain focused on running our core business within our previously stated margin range. If you exclude the equity losses and factor in a slightly more modest ramp in Capital Markets and Leasing activity, we expect our 2023 Adjusted EBITDA margin to be at the lower end of the 14-16% range. With secular industry tailwinds very much intact and our investments in our people and platform, we are confident in our prospects of gaining share and growing our business at a rate which meaningfully exceeds global GDP.

Christian, back to you.

Jones Lang LaSalle Incorporated
Second Quarter 2023 Conference Call
August 3, 2023

Speaker: Christian Ulbrich, President and Chief Executive Officer

Thank you, Karen.

Looking ahead, inflation peaked earlier this year and is now on a swift downward trajectory with interest rates in the U.S. nearing the top of the cycle. Real estate market conditions remain mixed as interest rate volatility and wider than normal bid-ask spreads continue to create uncertainty. However, as we look at the investment sales landscape, we believe there are reasons for optimism. First, markets have developed more certainty over the expected future moves from the U.S. Federal Reserve. Second, credit spreads have started to tighten, helping to make debt costs more predictable and the bid-ask spread has begun to narrow. Third, fundraising for the second quarter was at the highest level in the last year and lenders are active in appropriately priced assets. In addition, our conversations with clients indicate a desire to transact and there is no lack of dry powder. This is supported by the fact that there has been a sequential uptick in bidding activity since the lows seen earlier this year. Weighing these different aspects, we still lean towards a notable uptick in transaction activity this fall.

The investments we have made over the past several years to diversify our business are paying dividends as our more recurring business lines continue to perform well and provide a stable earnings base during the current downturn. The structural changes we have made to the business a couple years ago, continue to allow us to take further costs out and will lead to an even more resilient platform. Downturns often present great opportunities to invest in our business and we have been doing this over the last several months, adding brokerage teams in select markets that will position us to take advantage of the recovery when it transpires. Now more than ever, our clients are relying on our global scale and “One JLL” approach to provide clear and insightful guidance as they manage through the current market environment. Before I close, I would like to thank each of our employees for their hard work and commitment to serving our clients.

Operator, please explain the Q&A process.