2018 Reporting Changes Podcast

Tuesday, May 1st, 2018

Introduction

Grace Chang

Managing Director, Investor Relations, JLL

Opening Remarks

Hello everyone and thank you for joining our podcast. This is Grace Chang, Managing Director of Investor Relations, and with me today is Louis Bowers, our Global Controller. During this podcast, we'll talk through some changes you will see in our financials, starting in the first quarter this year, which are primarily related to the FASB's new revenue recognition standard, ASC 606. A slide deck intended to be read along with this podcast has been posted to the JLL Investor Relations website, ir.jll.com, and has also been filed with the Securities and Exchange Commission on form 8-K.

Unless noted, changes related to other accounting standards that are or will be implemented during 2018 are not reflected within this podcast or the accompanying slide deck. Should you have any questions, contact information for our Investor Relations department will be provided at the end of the podcast. A replay and transcript have also been posted to the Investor Relations website and will be available for the next 90 days.

Safe Harbor statement

Forward-looking statements made on this podcast, including predictions, projections or other statements about future events, are based on current expectations and assumptions that are subject to risks and uncertainty. Actual results could differ materially because of factors discussed in today's podcast, and because of risk factors discussed in our most recent annual report on form 10-K, quarterly reports on form 10-Q and current reports on form 8-K, filed with the Securities and Exchange Commission.

We do not undertake any duty to publicly update any forward-looking statements discussed in today's call. During this podcast, we will also reference certain non-GAAP financial measures, which we believe provide usual information for investors. We include reconciliations of non-GAAP financial measures to the most comparable GAAP measure, where appropriate, in the appendix to the slide deck.

ASC 606 Overview

Slide three summarizes our agenda for today. The podcast is intended to bridge to our upcoming first-quarter 2018 reporting, building on our previous disclosures, particularly about our adoption of ASC 606. We will start with a summary of what is changing, and then address some of the specifics of each component of change, including impacts to our balance sheet. Slide 4 provides an overview of ASC 606, which has been disclosed previously in the 10-K, and it summarizes the most notable impacts to JLL, which Louis will discuss in further detail. And with that, I will turn the discussion over to Louis.

Impacts of Adoption of ASC 606

Louis Bowers

Financial Controller, JLL

Regulatory and non-GAAP Reporting Changes

Thank you Grace, and hello everyone. For those of you who are following along, I am starting on slide 5. Effective 1st January 2018, we adopted the new US GAAP revenue recognition standard, ASC 606. The method we followed in our adoption was the full retrospective approach, meaning that alongside our 2018 reporting this year, we will present recast comparative to 2017 and 2016 income statements as if they had originally been reported under the new standard.

Our 2017 recast income statements will be provided on a quarterly basis, while the recast 2016 income statement will only be presented on an annual basis. We will also present a recast balance sheet as of 31st December 2017. Throughout this podcast, I will reference certain new financial statement captions we will introduce to facilitate some of these changes.

The adoption of ASC 606 has two primary impacts on our income statement. First, and as disclosed in previous filings, our results will reflect a material increase in grossed-up, pass-through expenses and associated reimbursement revenue. This is primarily related to our facility management business; however, this change will have no impact on our net measures of profit, such as GAAP net income and non-GAAP adjusted EBITDA. Second, the timing of recognition for certain revenue streams will change, most notably in our US leasing business. In such situations, we will recognize revenue and the related commission expense earlier than we have historically.

Beginning in the first quarter of 2018, we will also incorporate certain changes to our presentation of non-GAAP fee revenue. The timing of these changes are largely in response to ASC 606, but also reflect the continued growth of our annuity businesses. Specifically, in addition to the revenue associated with third-party vendor costs, which we have historically excluded from GAAP revenue to arrive at non-GAAP fee revenue, we will now also exclude the labor costs of client-dedicated JLL personnel. Presentation of our 2017 and 2016 results, and future public filings with earnings information about our company, will reflect these changes. More to come in a few minutes.

Consolidated Recast

On slide 6, we have included a summary of the impact of these changes on our 2017 and 2016 income statements. The key takeaways are that total GAAP revenue and total GAAP operating expenses for these periods increased materially as a result of ASC 606. Further, non-GAAP fee revenue notably decreased, due to our change in definition. Net income, earnings per share measures and adjusted EBITDA also changed, reflecting the revenue recognition timing impact of ASC 606. As these changes were due to transactional activity, and are consistent with our historical approach of not giving guidance, we will make no comment as to how revenue timing changes will impact our 2018 results.

ASC 606 'Gross Up'

Diving into these changes in a bit more detail, you may now reference slide 7. ASC 606 revised the criteria to determine whether a contract is reported gross or net. The principal versus agent determination, otherwise known as our gross versus net model under ASC 606, focuses on performance risk by requiring an assessment in a multi-party arrangement to determine which party to a contract is ultimately in control of and responsible for service delivery. In our case, the responsible party is either JLL or the third-party vendors engaged to assist in service delivery to a client.

Examples of reporting under ASC 606

As a simple example, suppose a client engages JLL to provide facility management services, which typically includes the provision of security services: to supplement our own JLL personnel, we engage a third-party security vendor on behalf of the client. JLL is thus deemed to control the security vendor's service delivery, and is responsible for that vendor's performance, particularly through the perspective of the client. Under ASC 606, we reflect the expenses charged by the security vendor, and the associated reimbursement revenue from our client, of an equal amount, on a gross basis. The presentation on the balance sheet follows the same model.

Conversely, if the security vendor is responsible for service delivery, and JLL is merely arranging the service on behalf of the client, the costs of the security vendor, and associated reimbursement revenue, would be presented net on both our income statements and balance sheet. ASC 606 reflects a change from the past, where we considered payment arrangements or credit risk to determine gross versus net accounting.

As another practical example, consider a facility management contract where we are engaged to manage a client's real-estate operation. We frequently negotiate the costs of JLL labor and outsourced third-party vendors to be fully reimbursed by our clients. We also negotiate credit terms with third-party vendors, such as 'pay when paid,' that limit our obligation to pay such vendors until cash is received from our client. Thus, in this example, given our very limited credit risk, our historical accounting model likely would have resulted in the JLL labor and outsourced third-party vendor expenses to be netted against the associated reimbursement revenue in our income statements.

As mentioned previously, within the ASC 606 gross versus net framework, a service provider who controls the delivery of services reports the costs of delivery and associated reimbursement revenue on a gross basis. The related assets and liabilities are also presented on a gross basis on our balance sheets. ASC 606 dropped the legacy credit risk criteria, which had a significant impact on our adoption of ASC 606. To add clarity to our external financial statements, client-reimbursed costs, together with related reimbursement revenue, will be presented in separate income statement line items. We will also reflect the corresponding balance sheet activity in distinct accounts.

It is important to reiterate that the gross up from ASC 606 does not change GAAP net revenue, diluted earnings per share or adjusted EBITDA, as the incremental expenses are offset entirely by an equal amount of incremental reimbursements revenue. Nor does it change the underlying economics of our contracts with clients.

ASC 606 Revenue Timing

Moving to slide 8, the second change from ASC 606 is what we refer to as 'the revenue-timing impact.' Compared to previous frameworks, ASC 606 better aligns the timing of revenue recognition with the completion of our contractual performance obligations. As a result, for most transactions in our leasing brokerage services, we will now recognize 100% of revenue upon execution of a lease agreement between a landlord and a tenant. In the past, certain ordinary course lease contingencies, such as a tenant's occupancy or payment of first month's rent, held back revenue recognition until satisfaction. As mentioned earlier, our America's leasing service line is most impacted on a revenue timing basis by ASC 606.

Note that when we have historically recognized leasing revenue, a corresponding lease commission expense, payable to our brokers, was accrued but not paid; rather, payments of commissions to brokers occurred only upon cash receipt of our fee. As it pertains to ASC 606, when transactions result in an acceleration of revenue recognition, we follow this pattern, accelerating the recognition of the corresponding commission expense.

Not reflected, however, in our recast 2017 and 2016 financial statements are the indirect impacts from changes to historical financial information, such as changes to general employee bonus pools. Traditionally, many of our bonus plans are influenced by incremental earnings. While the recast 2017 and 2016 financials reflect incremental earnings from ASC 606 revenue timing changes, compared to what was originally filed, we were precluded by US GAAP from accruing any additional bonus expense. Thus, the incremental revenue recognized to recast for ASC 606 during 2017 and 2016 had a much higher flow-through rate to the bottom line than we would expect during ordinary reporting periods. This impacts the comparability of the recast historical financial results, including some quarterly phasing in 2017 to comparative future periods. We expect bonus expense recognized in 2018, attributable to the revenue timing changes reflected in our recast annual 2017 and 2016 financial statement, to not be material. However, we will continue to monitor and provide disclosure as necessary.

Beyond leasing, many contracts in our facility management business include certain revenues that have historically been recognized during the fourth quarter; incentive fees, for example. Under ASC 606, the quarterly revenue recognition pattern for this business will normalize a bit, as we can now recognize some of these fees throughout the year. The summary impact of 2017, for example, was to recognize approximately $15 million less revenue for the fourth quarter of 2017, with increases of approximately one-third of that amount across the first through third quarters of 2017.

Non-GAAP Reporting Presentation Change – Fee Revenue

Moving to slide 9, how will we reflect these changes in our income statements? First, and as previously mentioned, we will show in distinct financial statement lines the fully reimbursed expenses we incur on behalf of clients, as well as the corresponding reimbursement revenue to which we are entitled. Similar presentation will be reflected in our balance sheets. Historically, to calculate fee revenue, we started with GAAP revenue and deducted certain third-party vendor and subcontractor costs incurred on behalf of property and facility management and project and development services clients. For the updated fee revenue definition, effective for the first quarter of 2018, costs associated with client-dedicated JLL labor will also be excluded. To reiterate once more, we will recast prior periods for consistency.

The fee revenue definition update applies to all of our external service lines, with the greatest impact on property and facility management. We considered this change necessary, given the additional gross presentation of pass-through costs from ASC 606, as well as the continued shift in our business mix. Reiterating the messaging on slide 5, the key takeaways are that nominal fee revenue declines and, because adjusted EBITDA does not change, the adjusted EBITDA margin percentage, calculated using fee revenue, increases. It is important to keep in mind that the fee revenue definition change has no effect on how we record US GAAP revenue, operating income, nominal adjusted EBITDA or earnings per share.

ASC 606 Balance Sheet

On slide 10, and as mentioned earlier, the impact of ASC 606 also extends to the balance sheets. This includes the introduction of three new financial statement captions that will formally be reflected in our first-quarter 2018 balance sheets. The first is contract assets, which reflect the impact of revenue timing changes. The second is reimbursed accounts receivable, to account for the expected gross-up of reimbursement activity from clients; and finally, reimbursable accounts payable, to account for gross-up payments due to third-party vendors and subcontractors.

Additionally, you will notice an increase in other current assets, which represents cash funded from clients, which is restricted in its use for payments only to third-party subcontractors that service our newly designated gross accounts. In the table we have provided on slide t10, we simplified the impact summary by only focusing on certain accounts and removing current and non-current classifications. However, our full consolidated balance sheets that we will present in our formal earnings filings, going forward, will retain our historical level of detail, as well as current and non-current bifurcation.

With that, I will now turn it back over to Grace.

Closing Remarks

Grace Chang

Managing Director, Investor Relations, JLL

Thank you Louis. Before we end, as mentioned previously, please note the additional information provided in our appendix and in the materials on our investor relations website. We have also provided some frequently asked questions and our response to them, on slide 12. If you have any additional questions regarding today's contents, please email those to JLLinvestorrelations@jll.com. This wraps up our podcast. We hope this was useful information and helps you transition into our new reporting environment. Many thanks for joining the podcast.

[END OF TRANSCRIPT]