

AFP®



# Annual Conference

OCTOBER 27-30, 2013 | LAS VEGAS

ORIGINAL→ESSENTIAL→UNBIASED→**INFORMATION**

## Leasing as Alternative to Debt or Equity

James Burns  
CEO  
Blue Sky Capital

Jim Cross  
President  
Blue Sky Capital

Jeff Fender  
VP & Treasurer  
Performance Food  
Group

# James Burns - Founder and CEO

James F. Burns has twenty years of corporate finance experience providing financial leadership to diverse group of Fortune 500 companies. He and his partner, jim Cross, founded Blue Sky Capital Strategies, LLC in May 2007 following a successful career in global treasury operations. Blue Sky provides capital structure advisory services, specializing in development and management of lease finance programs for a broad range of clients.

Previously, work experience included roles as Vice President, Treasury and Tax of XM Satellite Radio in Washington, D.C. where he was responsible for the treasury, tax, risk insurance and real estate functions, Treasurer of TRW Automotive, a \$12 billion auto supplier in Michigan and Assistant Treasurer of Engelhard Corporation (now part of the BASF Group) Work encompassing capital markets, cash management and investment management. Earlier work history also includes treasury assignments at Diageo, plc and AT&T.

James received a Bachelor of Science degree from the Wharton School at University of Pennsylvania with a major in finance.

He is a member of the National Association of Corporate Treasurers as well as the Financial Executive International and the Association for Financial Professionals.

# Jim Cross – Founder and President

With over fifteen years experience in the equipment leasing business, as a Senior Vice President with Comdisco, Jim managed a diversified portfolio of assets prior to founding Lakefront Capital, LLC in 2001. Over the past ten years Jim has been instrumental in developing Managed Lease Advisory programs with nearly one billion dollars of leases in thirteen countries under management with clients ranging from Fortune 50, Fortune 500 to several smaller public and private companies . Jim has developed proprietary web based lease management software systems, documented processes, procedures and best in class contract terms and conditions for every facet of leasing to help clients save money, mitigate risk and realize the benefits of equipment leasing vs equipment ownership.

Jim has extensive experience in negotiating contracts and lease structures that deliver best in class terms and conditions to his clients. Jim is trained and certified in lease vs purchase analysis as well as various linear pricing optimization methodologies which has enabled him to provide board room level after tax cash flow analysis and decision support for lease vs purchase decisions on assets ranging from real estate, manufacturing equipment, medical equipment, information technology equipment to satellites. .

Jim has been responsible for advising corporate clientele as well as debt and equity investors in single lease transactions for a variety of assets in various countries.

# Jeff Fender – Vice President & Treasurer Performance Food Group

Jeff Fender is Vice-President and Treasurer with Performance Food Group and is a CPA. He has been with PFG since 2002. Prior to PFG, Jeff spent 10 years in corporate finance and accounting with two Fortune 500 companies, and six years in public accounting.

Performance Food Group (PFG) is the third largest foodservice distributor in the U.S. with 69 distribution centers operated across three distinct business segments. PFG was publicly traded on the Nasdaq until May 2008 when it was acquired and taken private in a merger with Vistar Corporation, a company owned by The Blackstone Group and Wellspring Capital Management.

As a senior finance executive at PFG, Jeff has provided broad-based finance leadership with responsibilities changing to meet the needs of the company. Experience includes Finance Strategy, Treasury Operations, Tax, Credit, M&A, Leasing, Corporate Structuring, Real Estate, Financial Planning & Analysis, Hedging, Risk and Captive Insurance Management, Retirement Plans, Equity Plans, Investor Relations, Working Capital Management, Investment and Debt Management

# Introduction

- ❑ Blue Sky Capital Strategies, LLC is an international corporate finance and capital structure advisory company with offices in New York, Utah, Central New Jersey & Washington, DC
- ❑ We provide strategic financial advice to companies seeking to raise capital, expand funding alternatives, monetize cash flow or mitigate financial risk
- ❑ We specialize in designing tax-efficient lease finance solutions tailored to meet the needs of capital intensive companies and/or high yield credit profiles
- ❑ Senior management has over eighty years of combined leasing experience in both lessor and lessee roles, closing over \$2 billion of diverse lease transactions
- ❑ A successful leasing program requires the participation of a broad range of stakeholders including; business units, treasury, tax, FP&A, legal & procurement

# Why some choose not to lease?

- ☐ Unfavorable experience with a lease or lessor
- ☐ Not aware of the financial benefits or flexibility a lease can offer
- ☐ Always “paid cash” legacy
- ☐ Lack of resources to manage the portfolio
- ☐ Managing to financial metrics (EBITDA sensitive)
- ☐ Typically solving for ownership

# ....while others make common mistakes

- ☐ Absence of policy & procedures
- ☐ One-sided master lease
- ☐ Decentralized decision making
- ☐ End-of-lease mismanagement
- ☐ Managing to financial metrics (Opex vs. Capex budget)
- ☐ Flawed buy versus lease analysis

# Why Lease?

- ❑ Prudent fiscal stewardship mandates corporations actively pursue methods to creatively augment borrowing capacity and diversify liquidity sources
- ❑ Leasing enables a company to realize economic benefits and/or achieve financial flexibility not available through conventional debt or equity alternatives
- ❑ Leasing enables a company to realize economic benefits and/or achieve financial flexibility not available through conventional debt or equity financing
- ❑ Both single investor and leveraged lease structures provide access to incremental liquidity outside of traditional funding sources, such as “tax equity” investors
- ❑ Under MACRS, a lack of currently taxable income, AMT status or a net operating loss (“NOL”) carry-forward position each will limit a company’s ability to effectively monetize the economic benefits associated with tax ownership



# Advantages of Lease Finance

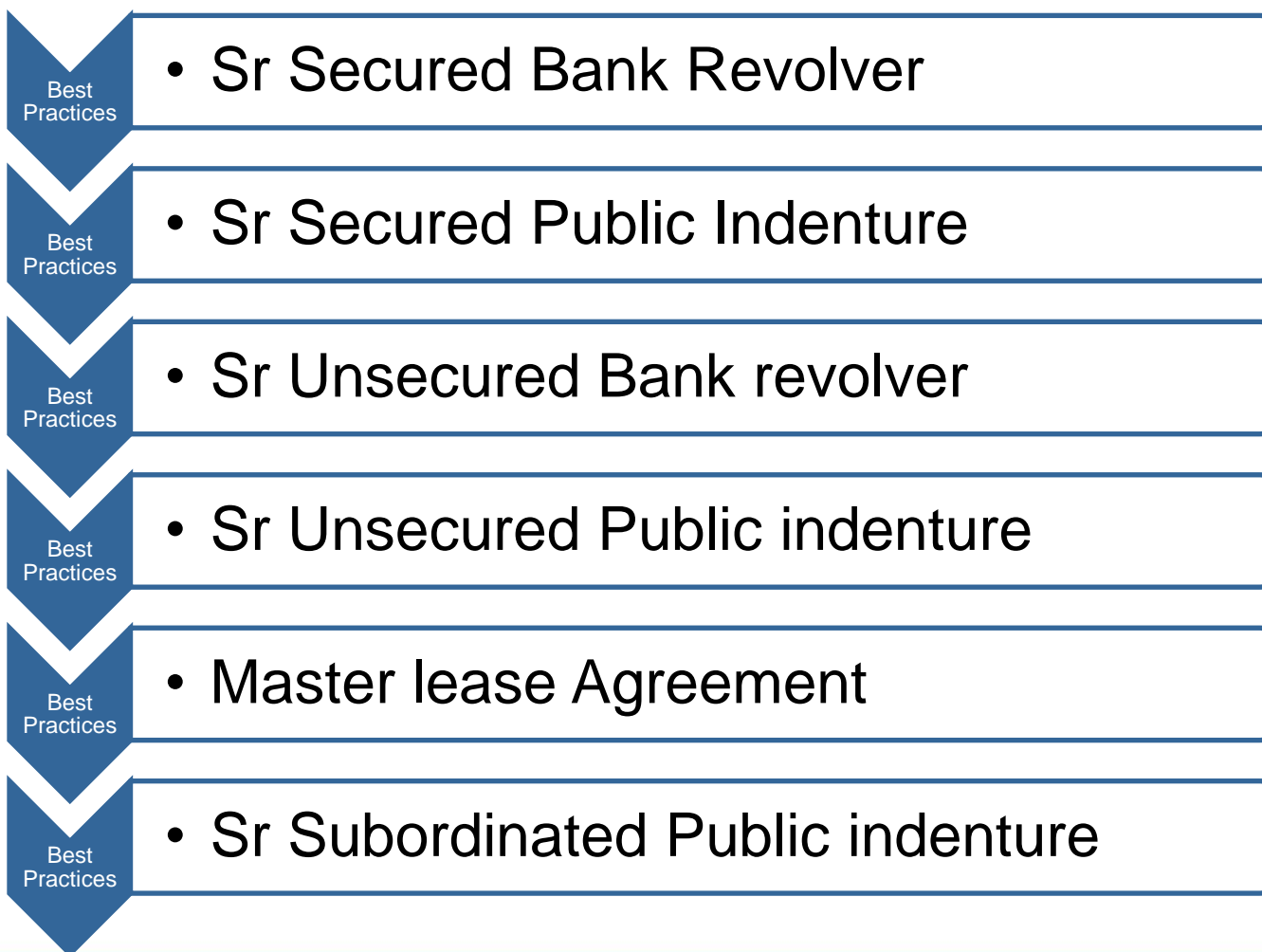
## **Enhance Capital Structure**

- ✓ Preserve liquidity
- ✓ Lower cost of capital
- ✓ Transfer obsolescence risk
- ✓ Enhance financial flexibility
- ✓ Expand funding sources

## **Support Financial Metrics**

- ✓ Equity analysts
- ✓ Rating agencies
- ✓ Bank lenders
- ✓ Bond holders
- ✓ Senior management

# Corporate Capital Structure



# Covenants Comparison

## Negative Covenants

Negative Pledge  
Change of Control  
Limitation of Indebtedness  
Merger Restrictions  
Restricted Payments  
Business Activities  
Asset Sales

## Affirmative Covenants

Litigation  
Insurance  
Percentage of Bondholders

## Events of Default

Payment Default  
% of bondholders  
Cross-Default

## Other Considerations

Up-front legal expense  
Minimum size required  
Tax Indemnity

## Bond Indenture

## Master Lease

X  
X  
X  
X  
X  
X  
X

X  
X  
X

X  
X  
X

X  
X  
X

X

X

X

# Economics behind “Buy vs. Lease”

- ❑ There are some critical distinctions between owning title to an asset and simply securing the rights to use it (through a covenant of “quiet enjoyment”)
- ❑ Three primary variables underpin the results of a buy vs. lease analysis:
  - I. *Credit profile*     *BB S&P   BB- Fitch   Baa3 Moodys*
  - II. *Tax position*     *ETR - 34.4%*
  - III. *Residual value*
- ❑ In addition, the impact of “soft costs” embedded in a leasing agreement (such as notification and return provisions) should also be factored into the analysis
- ❑ Lessees should utilize a financial modeling application such as SuperTRUMP<sup>®</sup> to perform the analysis to offset Lessor’s advantages of employing similar tools

# I. Credit Profile

|   |                      |
|---|----------------------|
| GRAB  | EquityCRPR           |
| Enter # <GO> for historical ratings.  |                      |
| Related Functions   | Company Tree Ratings |
| Alert   | CREDIT PROFILE       |
| Church & Dwight Co Inc  |                      |
| Page 1/1  |                      |
| MOODY'S   |                      |
| 1) Outlook  | STABLE               |
| 2) Issuer Rating  | WR                   |
| 3) Long Term Rating   | Ba1                  |
| 4) LT Corp Family Rating  | Ba1                  |
| 5) Senior Unsecured Debt  | Ba2                  |
| 6) Senior Subordinate   | Ba2                  |
| 7) Probability of Default   | Ba1                  |
| STANDARD & POOR'S   |                      |
| 8) Outlook  | STABLE               |
| 9) LT Foreign Issuer Credit   | BB+                  |
| 10) LT Local Issuer Credit  | BB+                  |
| Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000<br>Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2010 Bloomberg Finance L.P.<br>SN 521206 H192-250-2 12-Apr-10 21:49:15 |                      |

## II. Tax Considerations

- ❑ Tax attributes often play a principal or determinative role in the decision to lease
- ❑ The basic tax benefit of leasing (for lessors) is tax deferral; the generation of tax losses in the early years, offset by tax income in the later years of equal amounts
- ❑ **Objective of “True” Lease:** Provide financing party with right to claim tax benefits of ownership intended for use by another party so benefits can be shared through lower rentals payments which reflects a “borrowing cost” less than a market interest rate
  - Step 1 - identify benefits
  - Step 2 - structure transaction to pass benefits
  - Step 3 - enhance value through leverage
- ❑ Taxes to model in the Buy vs. Lease analysis:
  - Federal income tax
  - State and local income tax
  - Property tax
  - Sales and use tax
  - I.T.C.
  - Enterprise Zone Credits

# III. Residual Value

- 
- I.T. Infrastructure
  - Materials Handling
  - Health Care Equipment
  - Security Equipment
  - Aircraft
  - Point of Sale
  - Telecom Equipment
  - Containers
  - Fleet Vehicles
  - Furniture and Fixtures

❑ *The transfer of obsolescence risk often yields significant savings for the lessee*

# How to construct an optimal leasing program....



# Leasing Best Practices



Lessor Selection  
Process

Coordination of  
Stakeholders

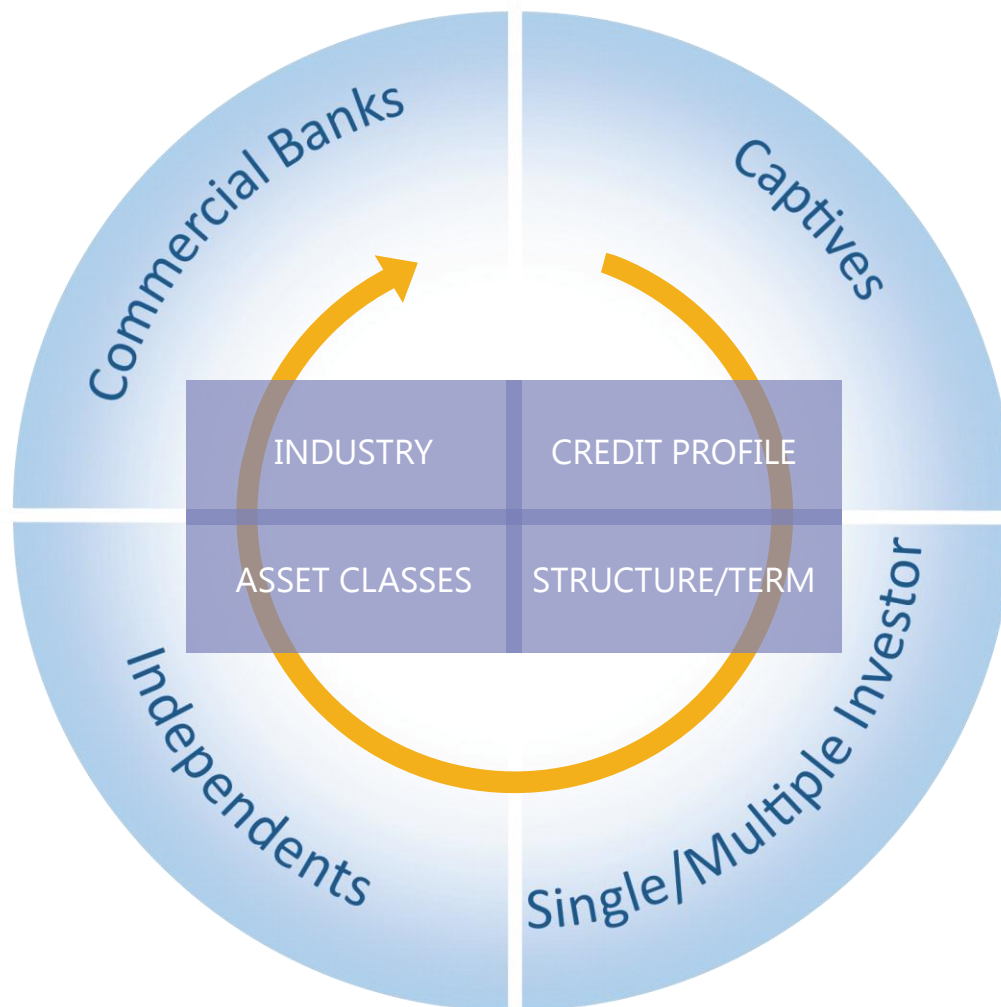
Lease vs Purchase Analysis

Lease Management System

Lease Documentation

# Lessor Selection Process

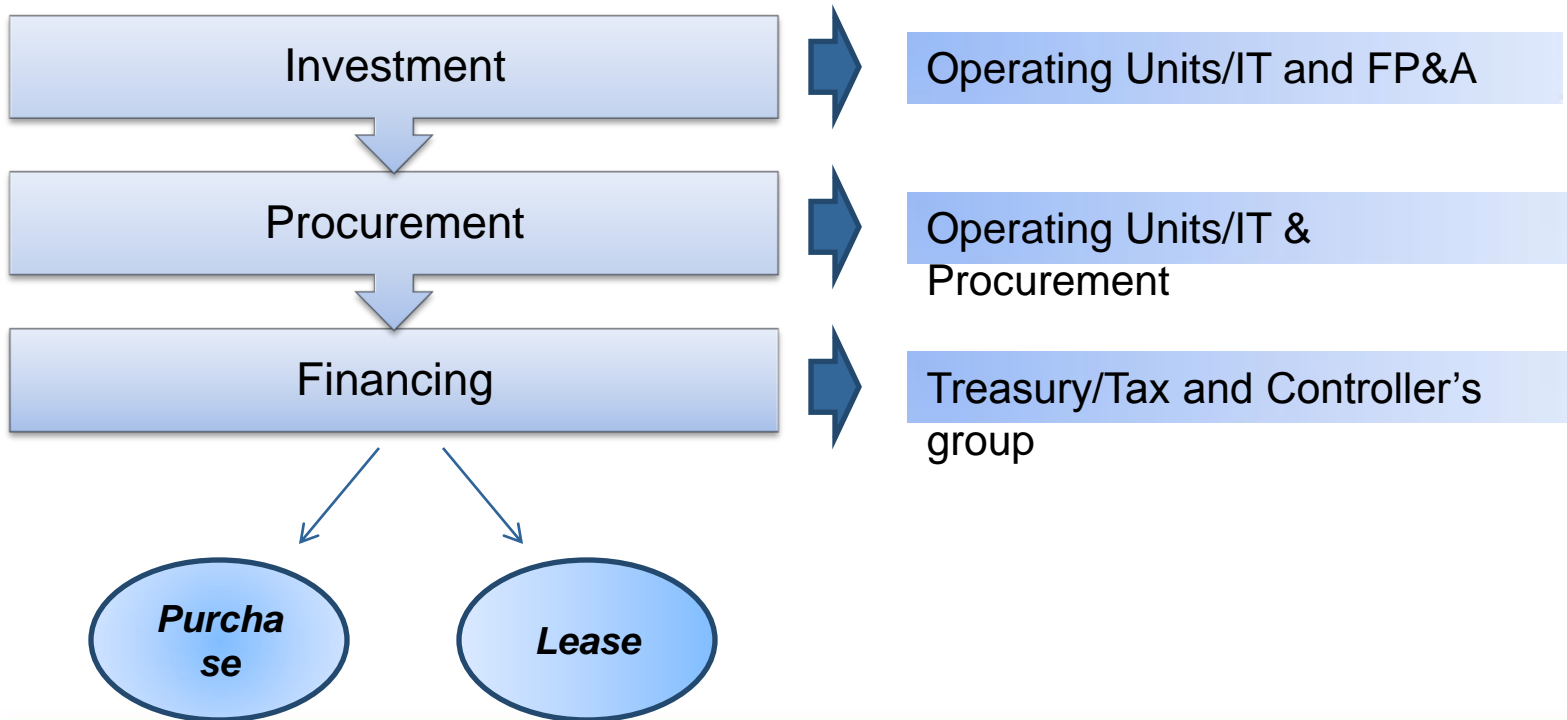
Domestic leasing volume totals \$400 Billion annually with over a thousand active lessors...choosing the most appropriate lessors is critical to achieving the best rates



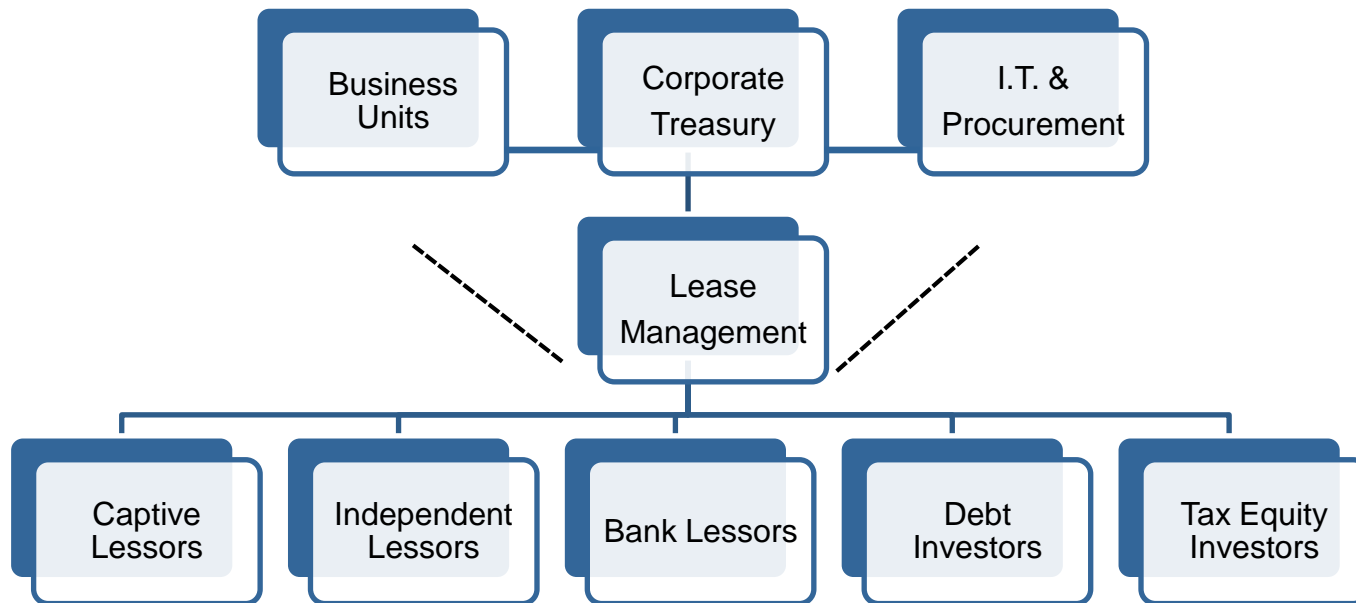
# Coordination of Stakeholders

## Decision Making Process

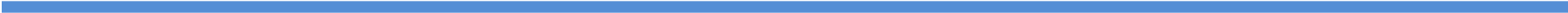
## Stakeholders



# Coordination of Resources



# **Buy vs. Lease Examples**



# Understand disclosure...Leasing 101

Leasing transactions encompass three distinct perspectives

## Classifications

Financial Reporting (FASB)  Capital or Operating\*

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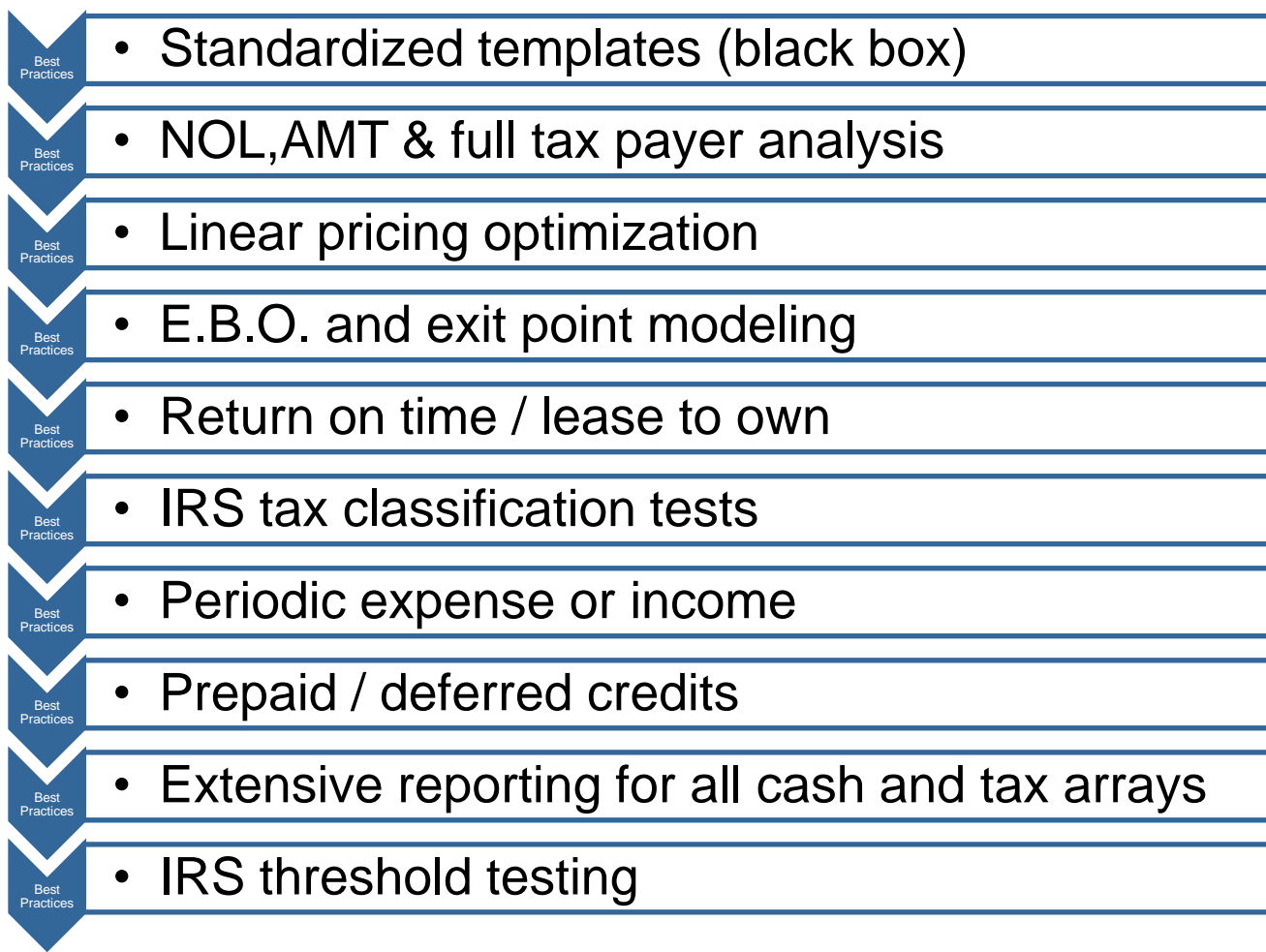
Statutory Reporting (IRS)  True or Conditional Sale

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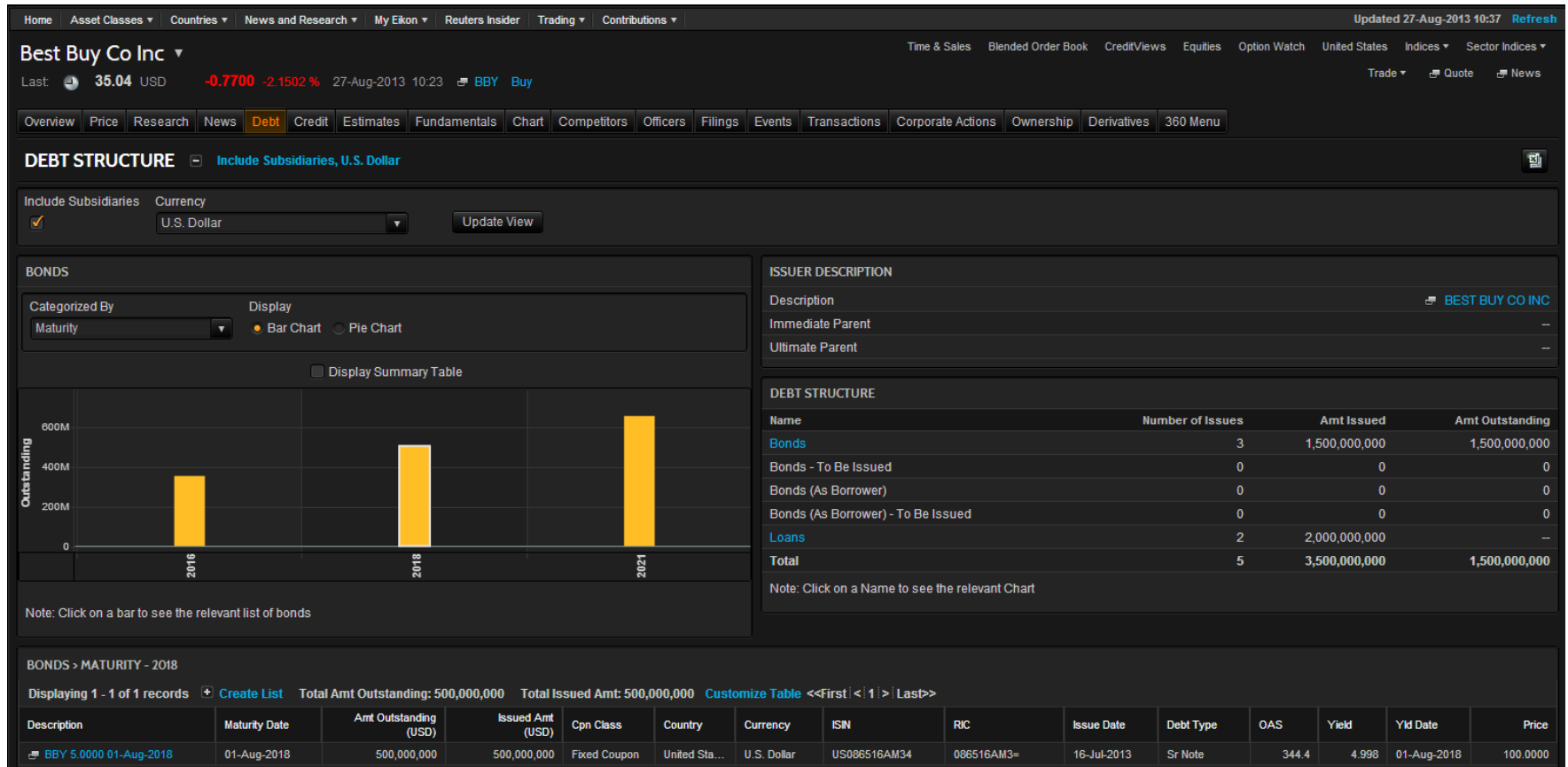
Legal (UCC)  Article 2A or Article 9

*\* New rules for lease accounting now scheduled for adoption in 2014*

# Lease vs. Purchase Analysis



# Buy versus Lease





# Buy versus Lease - 60 Month Example

SuperTRUMP - "demo data" [ Davinci Robot 60mo \$1 out ]

File Edit View Parameters Controls Process Report Window Help

Quick Screen

Assets:

Total asset ..... 2,750,000.00

Delivery ..... Oct-01-12

Depr. term (class not selected) ..... 5.000

Residual ..... 0.00

Payments:

Commencement ..... Oct-01-12 60 months

Monthly ..... Periods ... 60 Advance

Payment (1.8528%) ..... 50,953.00

Structure Level Skips

Purchase:

Total loan (100.0000%) ..... 2,750,000.00

Debt rate ..... 5.2500

Fee expense ..... 0.00

P.V. discount rate ..... 3.2419

Lessee's inc. borrowing rate ..... 5.2500

Preferred ..... Lease

Equipment ..... Sell/Return

FAS class ..... Capital lease

— Purchase — — Lease —

Assets ..... 2,750,000

Rent ..... 3,057,180

Loans ..... 2,750,000

Interest ..... 382,687

Debt service ..... 3,132,687

Pre-tax ..... -3,132,687

After-tax ..... -1,934,434

Present value

ATCF ..... -1,763,351

Advantage ..... 12,767

PV of MLP @ 5.2500% ..... 2,695,458 (98.0166%)

Rates

Full term rate ..... 4.3971

with residual ..... 4.3971

Break-Even

Discount rate (at) ..... 4.60876

Zoom Statistics Close Help

## After Tax Economics

- NPV positive - \$12.7K
- PV of rents - \$2.695M
- Implicit rate – 4.397%
- Cost of Capital – 5.25%
- Full tax pay position

# Buy versus Lease - 36 Month Example

Quick Screen \*

|                                       |                                   |
|---------------------------------------|-----------------------------------|
| Assets:                               |                                   |
| Total asset .....                     | 3,962,000.00                      |
| Delivery .....                        | Jan-01-13                         |
| Depr. term (class not selected) ..... | 5.000                             |
| Residual (8.0000%) .....              | 316,960.00                        |
| Payments:                             |                                   |
| Commencement .....                    | Jan-01-13      36 months          |
| Monthly .....                         | Periods ... 36      Arrears ..... |
| Average payment (2.4456%) ..          | 96,894.67                         |
| Structure ... Other .....             | Skips                             |
| Purchase:                             |                                   |
| Total loan (100.0000%) .....          | 3,962,000.00                      |
| Debt rate .....                       | 4.2000                            |
| Fee expense .....                     | 0.00                              |
| P.V. discount rate .....              | 4.2000                            |
| Lessee's inc. borrowing rate .....    | 4.2000                            |

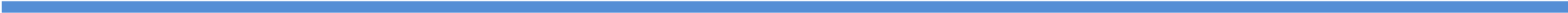
|                             |                      |
|-----------------------------|----------------------|
| Preferred .....             | Lease                |
| Equipment .....             | Keep (forever)       |
| FAS class .....             | Operating lease      |
| — Purchase —      — Lease — |                      |
| Assets .....                | 3,962,000            |
| Rent .....                  | 3,488,208            |
| Residual .....              | 316,960              |
| Loans .....                 | 3,962,000            |
| Interest .....              | 261,767              |
| Debt service .....          | 4,223,767            |
| Pre-tax .....               | -4,223,767           |
| After-tax .....             | -2,745,448           |
| — Present value —           |                      |
| ATCF .....                  | -2,618,245           |
| Advantage .....             | 281,889              |
| PV of MLP @ 4.2000% .....   | 3,296,394 (83.2002%) |
| — Rates —                   |                      |
| Full term rate .....        | -9.1082              |
| with residual .....         | -2.6719              |
| — Break-Even —              |                      |
| Discount rate (at) .....    | -28.84397            |

Zoom      Statistics      Close      Help

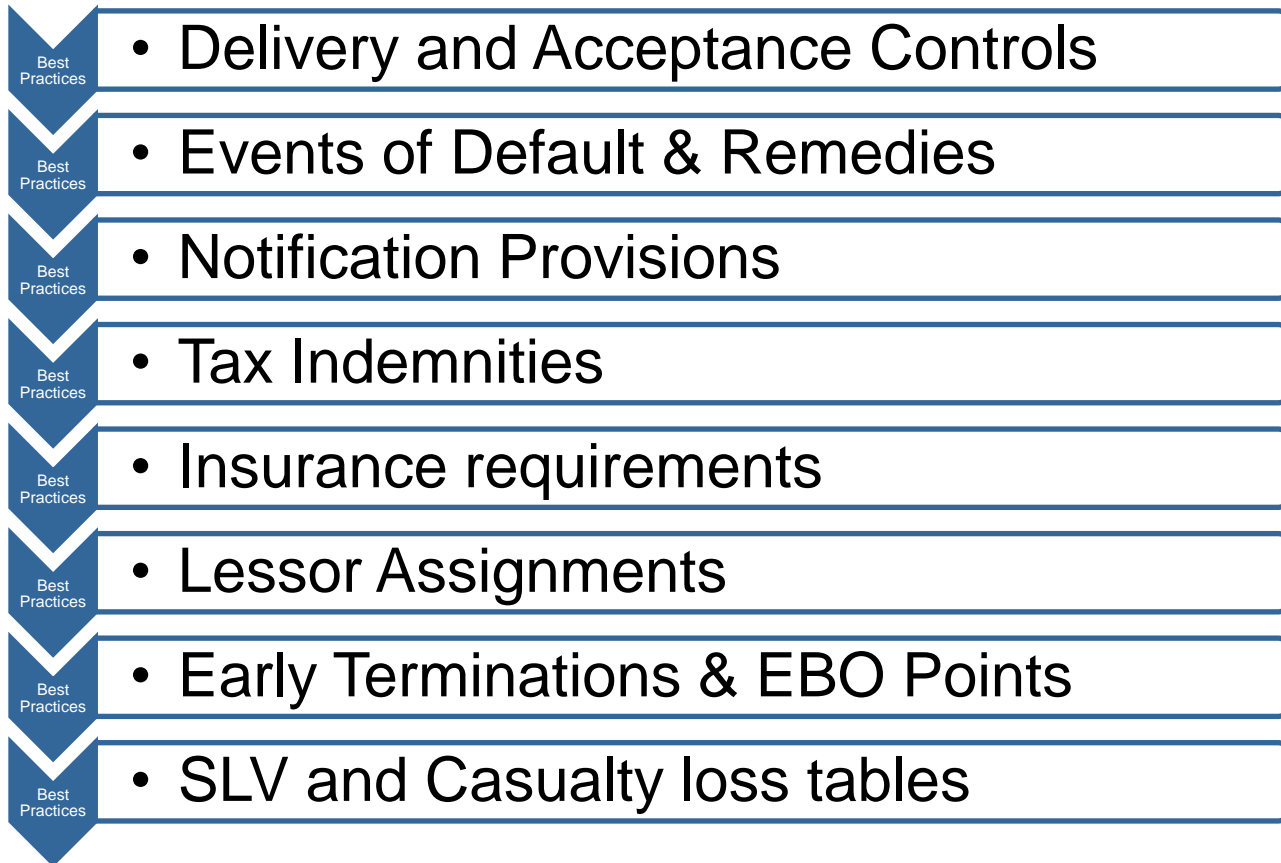
## After -tax Economics

- NPV positive - \$281K
- PV of rents - \$3.296M
- Implicit rate – (-9.1082)%
- Cost of Capital – 4.2%
- Full tax pay position

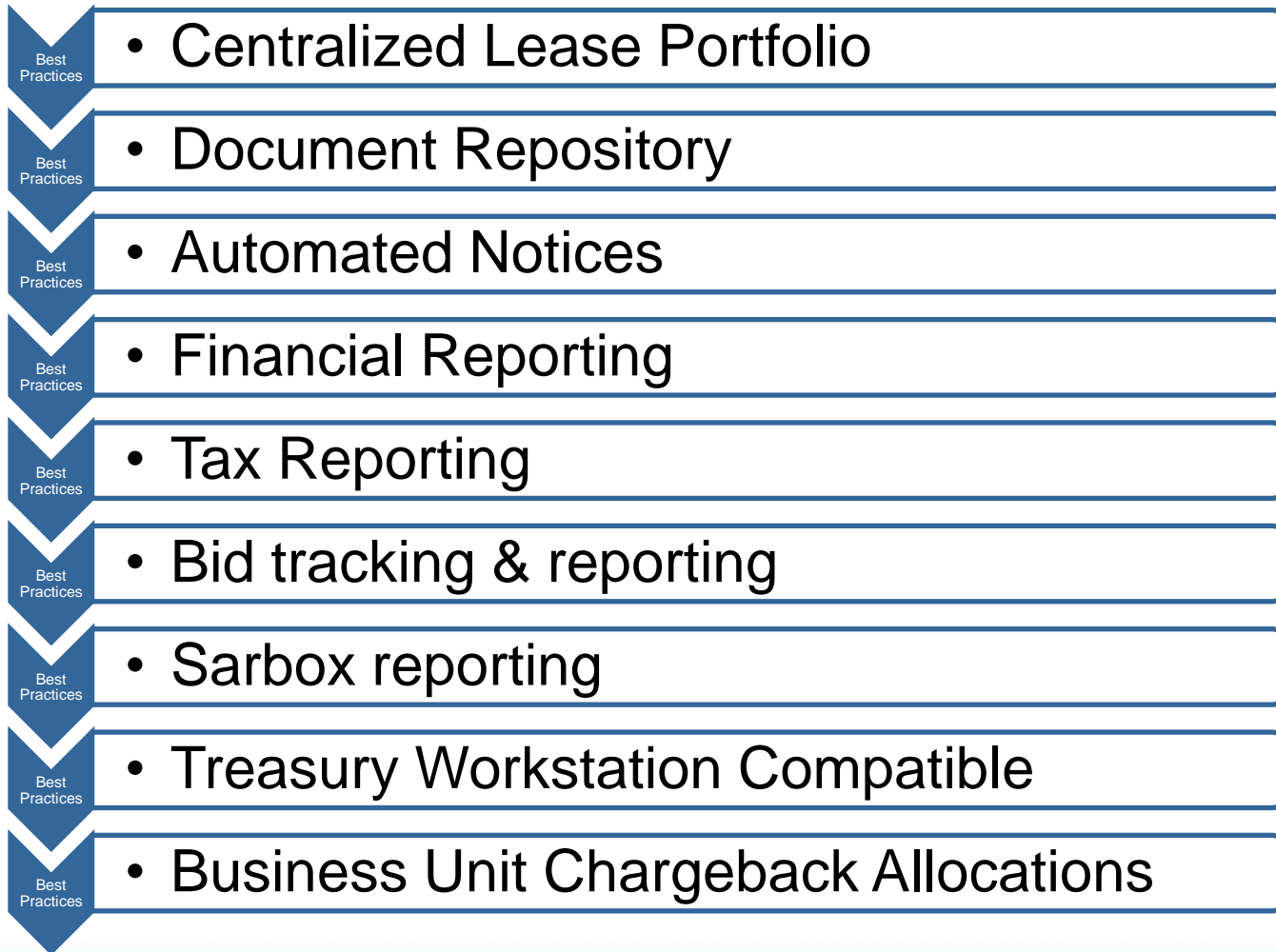
# **Company Policies & Controls**



# Standardized In-house Lease Documentation



# Lease Management System



# Lease Management Software

Welcome Jcross!  
My Info | Sign Out

+ Add New Asset

Q Search

TT Requests

Reports

Documents

Utilities

Open Projects

Serial or VIN #: 82982924842982AAJL

Schedule #: 10109

Overview

Details

Open Projects

Location

Financs

EOT Notification

Payment Details

Documents

Maintenance

History

Leased

Yes

Leasing Company

Wells Fargo Equipment Finance

Payment Frequency

Monthly

EBO Date

Currency

USD

Lessor

Key Bank

Vendor #

Purchase Price

\$ 1750000.00

Residual Guarantee

Present Value

\$1537563.31

Early Termination

No

Lease SAP GL Exp #

Interest Rate

8.375

# of Payments

36

Start Date

2009-10-01

EBO Amount

Term Notice

90 days

Master #

44989584985

Sales Tax

\$ 0.00

Lease SAP Cost Center

Chargeback Cost Center

None Selected

Chargeback Amount

\$ 0.00

Interest Interval

12 Months Advanced

Type

Operating

End Date

2012-10-01

Payment

\$ 48125.00

EOT Opt

RMV

Schedule #

10109

Billing Reference

Lease Intnlum GL Exp #

ChargeBack Cost Centers

|   | ChargeBack Cost Center | Chargeback Amount |     |
|---|------------------------|-------------------|-----|
| 1 | 100                    | \$ 1750000.00     | ✓ x |
| 2 | 200                    | \$ 1750000.00     | ✓ x |

Notes

The two departments Human Resources and Administration are splitting the expense of this equipment schedule 50/50 -

# Lease Management Software

TT Requests

Reports

Documents

Utilities

Open Projects

Estimated Equipment Cost

\$2,300,000.00

EOT NTE Buyout

47900

Soft Costs

12000

Maintenance Costs

18000

Equipment Lease Term

48

Depreciation

48

Lease Term as % of Depreciation

100

%

Rents P.V.(c)

\$1,725,000.00

Leasing Advantage NPV(c)

\$55,000.00

Notes

Paccar quote includes 75000 annual mileage Ryders quote includes onsite replacements for breakdowns and 80000 annual mileage

Country

United States

Description

Buyer Requested

2013-01-01

RFP Sent

2013-01-04

RFP Received

2013-01-11

LtB to Client

2013-01-11

Bid Status

B.U. Decision

Project Status

Open

Present Value of MLP

75

%

Save

Leasing Companies Enquired

|                      | Wells Fargo                                     | Paccar                   | Ryder                    | Wells Fargo              | None                     |
|----------------------|---|--------------------------|--------------------------|--------------------------|--------------------------|
| Lease Rate Factor    | 0.015   | 0.015                    | 0.0152                   | 0.0155                   |                          |
| Proposed Payment     | \$34,500.00                                     | \$34,500.00              | \$34,960.00              | \$35,680.00              |                          |
| Lease term (Months)  | 60  | 60                       | 60                       | 60                       |                          |
| End of lease options | FMV   | FMV                      | FMV                      | 60/25 T.R.A.C.           |                          |
| End of Term FMV Cap  | 20  | 20                       | 22                       |                          |                          |
| Advance or Amstars   | amstars   | amstars                  | amstars                  | amstars                  |                          |
| Implicit Rate        | -4.070325%                                      | -4.070325%               | -3.566635%               | -2.819286%               |                          |
| Winning Bid          | <input checked="" type="checkbox"/> WINNING BID | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

A key to maximizing NPV savings is implementation of a competitive bid process.

# The “Leaky Pipe” of Leasing Contracts





# Impact from Interim Rent

Proposed implicit rate of **-9.0%** for a 36 month FMV lease

|                      |  |
|----------------------|--|
| 30 days Interim Rent | Increases the implicit rate 189 basis points |
| 60 days Interim Rent | Increases the implicit rate 365 basis points |
| 90 days Interim Rent | Increases the implicit rate 530 basis points |

The alternative is to agree to a fixed interim Interest rate –

|                                  |                                     |
|----------------------------------|-------------------------------------|
| 30 days Interim Rent fixed at 4% | Increases the implicit rate 96 bps  |
| 60 days Interim Rent fixed at 4% | Increases the implicit rate 185 bps |
| 90 days Interim Rent fixed at 4% | Increases the implicit rate 266 bps |

Fixed Interim interest is approx. 50% less than interim rent

# Impact from missed notification

Proposed implicit rate of **-9.0%** for a 36 month FMV lease

If Missed Termination triggers an automatic *90 day extension*  
Increase the implicit rate by 530 basis points

If Missed Termination triggers an automatic *180 day extension*  
Increase the implicit rate by 965 basis points

# Leasing Platform Essentials

## Master Lease T's & C's

- Delivery & Acceptance controls
- Events of default and remedies
- Flexible returns provisions
- Notifications provisions
- Tax indemnities
- Interim rent controls
- Lessor assignment controls
- Early terminations / EBO points
- SLV / casualty loss tables

## Lease Management

- Centralized lease portfolio tracking
- Documentation repository
- Automated notices
- Financial reporting tool
- Tax reporting tool
- Bid tracking and reporting
- SARBOX reporting
- Treasury Workstation compatible
- XML or Batch import / export

## Lease vs Purchase

- A.T. Lease vs. Purchase analysis
- NOL, AMT, full tax pay analysis
- Linear pricing optimization
- E.B.O. and exit point modeling
- Return on time / lease to own
- IRS Tax classification test
- FASB 13 classification test
- Cash Flow Arrays
- Periodic expenses or income

# Three Stages of Leasing Support

## Implementation of Best Practices

### Lease Origination

- Identify “right” lessors
- Implement MLA
- Develop road show materials
- Competitive bid process
- Transaction structuring
- Lease vs. purchase analysis
- Appropriate scheduling
- Managed closing process

### Lifecycle Management

- Recording of leases
- Financial reporting
- Tax reporting
- Negotiate casualty losses
- Negotiate early re-writes / buyouts
- Merger / acquisition / divestitures
- FP&A / covenant compliance
- Data entry – lease mgt. system

### End of Lease

- Administer end of lease
- Ensure returns compliance
- FMV strategy for buyouts
- FMV strategy for extensions
- Asset disposition
- Negotiate all end of term events
- Documentation management
- Data entry – lease mgt. system

# Conclusion

- ❑ Lease finance remains an underutilized & overlooked part of the capital structure
- ❑ Most companies are ideal candidates to capitalize on the benefits from leasing by securing incremental liquidity at lower rates & on better terms than conventional debt financing
- ❑ Leasing is most often the cheapest form of liquidity in the capital structure
- ❑ Incorporate leasing into the capital structure to;
  - ✓ *Lower cost of capital*
  - ✓ *Enhance financial flexibility*
  - ✓ *Diversify funding sources/increase liquidity*
  - ✓ *Lower total cost of ownership*