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.

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

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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

- Sr Secured Bank Revolver
- Sr Secured Public Indenture
- Sr Unsecured Bank Revolver
- Sr Unsecured Public Indenture
- Master lease Agreement
- Sr Subordinated Public Indenture
# Covenants Comparison

<table>
<thead>
<tr>
<th>Negative Covenants</th>
<th>Bond Indenture</th>
<th>Master Lease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative Pledge</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Change of Control</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Limitation of Indebtedness</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Merger Restrictions</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Restricted Payments</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Business Activities</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Asset Sales</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

| Affirmative Covenants                  |               |              |
| Litigation                             | X             | X            |
| Insurance                              | X             |              |
| Percentage of Bondholders              | X             | X            |

| Events of Default                      |               |              |
| Payment Default                        | X             | X            |
| % of bondholders                       | X             | X            |
| Cross-Default                          | X             |              |

| Other Considerations                   |               |              |
| Up-front legal expense                 | X             |              |
| Minimum size required                  | X             |              |
| Tax Indemnity                          | 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:
  1. Credit profile  
     - BB S&P, BB-Fitch, Baa3 Moody’s
  2. Tax position  
     - ETR - 34.4%
  3. 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® to perform the analysis to offset Lessor’s advantages of employing similar tools.
I. Credit Profile

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+
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
  - Property tax
  - State and local income 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 obsolesce risk often yields significant savings for the lessee.
How to construct an optimal leasing program....
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**

1. Investment
2. Procurement
3. Financing

**Stakeholders**

1. Operating Units/IT and FP&A
2. Operating Units/IT & Procurement
3. Treasury/Tax and Controller’s group

- Purchase
- Lease
Coordination of Resources

- Business Units
- Corporate Treasury
- I.T. & Procurement
- Lease Management
  - Captive Lessors
  - Independent Lessors
  - Bank Lessors
  - Debt Investors
  - Tax Equity Investors
Buy vs. Lease Examples
Understand disclosure...Leasing 101

Leasing transactions encompass three distinct perspectives

- **Financial Reporting (FASB)**: Capital or Operating*
- **Statutory Reporting (IRS)**: True or Conditional Sale
- **Legal (UCC)**: Article 2A or Article 9

* New rules for lease accounting now scheduled for adoption in 2014
Lease vs. Purchase Analysis

- Standardized templates (black box)
- NOL, AMT & full tax payer analysis
- Linear pricing optimization
- E.B.O. and exit point modeling
- Return on time / lease to own
- IRS tax classification tests
- Periodic expense or income
- Prepaid / deferred credits
- Extensive reporting for all cash and tax arrays
- IRS threshold testing
Buy versus Lease

Best Buy Co Inc

Last: $35.04 USD  -0.7770  -2.1500%  27-Aug-2013 10:23

Overview  Price  Research  News  Debt  Credit  Estimates  Fundamentals  Chart  Competitors  Officers  Filings  Events  Transactions  Corporate Actions  Ownership  Derivatives  360 Menu

DEBT STRUCTURE
- Include Subsidiaries, U.S. Dollar

Include Subsidiaries

Currency: U.S. Dollar

Update View

BONDS

Categorized By: Maturity

Display: Bar Chart  Pie Chart

Display Summary Table

Note: Click on a bar to see the relevant list of bonds

BONDS > MATURITY - 2018

Displaying 1 of 1 records

<table>
<thead>
<tr>
<th>Description</th>
<th>Maturity Date</th>
<th>Amt Outstanding (USD)</th>
<th>Issued Amt (USD)</th>
<th>Coupon Class</th>
<th>Country</th>
<th>Currency</th>
<th>ISIN</th>
<th>RC</th>
<th>Issue Date</th>
<th>Debt Type</th>
<th>OAS</th>
<th>Yield</th>
<th>Yld Date</th>
<th>Price</th>
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<tbody>
<tr>
<td>BUY 5.0000</td>
<td>01-Aug-2018</td>
<td>500,000,000</td>
<td>500,000,000</td>
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<td>United Sta...</td>
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<td>099616AM34-</td>
<td>10-Jul-2013</td>
<td>Sr Note</td>
<td>3.44</td>
<td>4.99%</td>
<td>01-Aug-2018</td>
<td>100.000</td>
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</table>

ISUER DESCRIPTION

Description  Immediate Parent  Ultimate Parent

DEBT STRUCTURE

Name  Number of Issues  Amt Issued  Amt Outstanding

Bonds  3  1,500,000,000  1,500,000,000
Bonds - To Be Issued  0  0  0
Bonds (As Borrower)  0  0  0
Bonds (As Borrower) - To Be Issued  0  0  0
Loans  2  2,000,000,000  2,000,000,000
Total  5  3,500,000,000  1,500,000,000

Note: Click on a Name to see the relevant Chart
Buy versus Lease - 60 Month Example

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

- 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

- Delivery and Acceptance Controls
- Events of Default & Remedies
- Notification Provisions
- Tax Indemnities
- Insurance requirements
- Lessor Assignments
- Early Terminations & EBO Points
- SLV and Casualty loss tables
Lease Management System

- Centralized Lease Portfolio
- Document Repository
- Automated Notices
- Financial Reporting
- Tax Reporting
- Bid tracking & reporting
- Sarbox reporting
- Treasury Workstation Compatible
- Business Unit Chargeback Allocations
Precise tracking of the timing of each cash flow associated with the lease is imperative for both auditing and cash management functions.

### Lease Information

- **Serial or VIN #:** 82982924842982AAJL
- **Schedule #:** 10109

<table>
<thead>
<tr>
<th>Field</th>
<th>Value</th>
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<tbody>
<tr>
<td>Lease</td>
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<tr>
<td>Leasing Company</td>
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<tr>
<td>Make/Purchase Finance</td>
<td>[Details]</td>
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<tr>
<td>Location Requested</td>
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<tr>
<td>Address</td>
<td>[Details]</td>
</tr>
<tr>
<td>EOC Code</td>
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<tr>
<td>Current</td>
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<tr>
<td>Lease</td>
<td>[Details]</td>
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<tr>
<td>Key Data</td>
<td>[Details]</td>
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<tr>
<td>License</td>
<td>[Details]</td>
</tr>
</tbody>
</table>

### Lease Details

- **Purchased Price:** [Details]
- **Lease Term:** [Details]
- **Lease Payment:** [Details]

### ChargeBack Cost Centers

- **ChargeBack Cost Center:** [Details]
- **ChargeBack Status:** [Details]
A key to maximizing NPV savings is implementation of a competitive bid process.

### Leasing Companies Enquired

<table>
<thead>
<tr>
<th>Company</th>
<th>Percentage</th>
<th>Initial ( P )</th>
<th>Payment</th>
<th>Ending ( P )</th>
<th>Total ( P )</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABC Corp</td>
<td>0.1214%</td>
<td>250,000.00</td>
<td>0.1214%</td>
<td>250,000.00</td>
<td>500,000.00</td>
</tr>
<tr>
<td>XYZ Inc</td>
<td>0.2222%</td>
<td>300,000.00</td>
<td>0.2222%</td>
<td>300,000.00</td>
<td>600,000.00</td>
</tr>
</tbody>
</table>

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**Note:**
- NPV includes 70% disposal interest, future points included leap months for breakouts and 60000 annual rentals.

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**Lease Management Software**

- LEASE 1: $2,000,000.00
- LEASE 2: $1,500,000.00
- LEASE 3: $1,000,000.00
- LEASE 4: $500,000.00

---

**Leasing Advantage (NPV):**
- $155,000.00

---

**Number of Units:**
- 75

---

**Number of Leases:**
- 3

---

**Lease Terms:**
- 10 years

---

**Reconciliation:**
- 0.2222%
The “Leaky Pipe” of Leasing Contracts

**Procurement Savings**
- Other savings

**Pre-financing Decisions**
- LvE not considered
- No aggregation
- Uneven master lease terms
- LvE corporate parameters not updated
- No lender updates

**RFP & Award Process**
- Non-competitive bidding
- Interim Rent
- Apples-to-Oranges Analysis
- Monthly, billed quarterly

**Approval & Funding**
- Improper indexing adjustments
- “Subject to” terms missed
- Tax-timing benefits not passed
- Vendor float
- Equipment specs changing affect rate

**Portfolio Management**
- Missed EBOs
- Lost documents
- Refinancing terms unclear
- Automatic extensions
- Expensive FMV negotiation
- Missed early terminations
- Return Fees
- Delayed equipment decisions extend term

**Assumptions:**
- $300mm Portfolio
- 48 mo. Average term
- 2.0% Average Monthly payment factor

**Total Savings:**
- $19,195,000 6.4% missed savings!
- $7,005,000
- $4,445,000
- $2,720,000
- $5,025,000

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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

<table>
<thead>
<tr>
<th>Master Lease T’s &amp; C’s</th>
<th>Lease Management</th>
<th>Lease vs Purchase</th>
</tr>
</thead>
<tbody>
<tr>
<td>o Delivery &amp; Acceptance controls</td>
<td>o Centralized lease portfolio tracking</td>
<td>o A.T. Lease vs. Purchase analysis</td>
</tr>
<tr>
<td>o Events of default and remedies</td>
<td>o Documentation repository</td>
<td>o NOL, AMT, full tax pay analysis</td>
</tr>
<tr>
<td>o Flexible returns provisions</td>
<td>o Automated notices</td>
<td>o Linear pricing optimization</td>
</tr>
<tr>
<td>o Notifications provisions</td>
<td>o Financial reporting tool</td>
<td>o E.B.O. and exit point modeling</td>
</tr>
<tr>
<td>o Tax indemnities</td>
<td>o Tax reporting tool</td>
<td>o Return on time / lease to own</td>
</tr>
<tr>
<td>o Interim rent controls</td>
<td>o Bid tracking and reporting</td>
<td>o IRS Tax classification test</td>
</tr>
<tr>
<td>o Lessor assignment controls</td>
<td>o SARBOX reporting</td>
<td>o FASB 13 classification test</td>
</tr>
<tr>
<td>o Early terminations / EBO points</td>
<td>o Treasury Workstation compatible</td>
<td>o Cash Flow Arrays</td>
</tr>
<tr>
<td>o SLV / casualty loss tables</td>
<td>o XML or Batch import / export</td>
<td>o Periodic expenses or income</td>
</tr>
</tbody>
</table>

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**Association for Financial Professionals**
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