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Global Experience Provides Direction for Equipment Leasing and Asset Finance

Through collective knowledge and experience, The Alta Group provides value for its clients in the global equipment leasing and finance industry in outcomes that increase revenue, control expenditures, and improve productivity and profitability.

Decision Points...Brief

September 2010

Alta Highlights Business Impact of Exposure Draft



Shawn Halladay

The FASB Exposure Draft on accounting for leases issued earlier this summer has created serious concern for The Alta Group's clients. This article highlights what the consultancy views as its impact on the equipment leasing industry and suggest some potential business consequences.

Provisions

The exposure draft applies to leases of property, plant and equipment, although those that represent financed purchases are excluded from its scope. Interestingly, although the four criteria of FAS 13 were explicitly deleted, they were implicitly retained.

Lessees

The primary change for lessees is the requirement to recognize an asset and a liability for the obligation to pay rentals on all leases at the present value of the estimated lease payments. Payments for this purpose include those over the most likely term, contingent rents and residual value guarantees. The payments are discounted using the lessee's incremental borrowing rate. Under the new rules, lessors that offer residual-based products will be able to create product differentiation through partial off-balance-sheet financing.

The lessee will amortize the asset and obligation over the life of the lease, which is similar to capital lease treatment under FAS 13. The lessee must reassess its estimate of the lease term and payments if it perceives there

Online Accounting Rules Resource Expands

Leasing professionals looking for comprehensive information on the new lease accounting rules and the impact on their businesses are invited to visit The Alta Group's online collection of articles, presentations and other background materials on the subject. It also includes a summary of the exposure draft of the rules jointly prepared by the U.S. and international accounting boards.

The material is managed by The Alta Group's new accounting compliance and implementation division, led by Principal Shawn Halladay. He has written articles on the subject for numerous equipment leasing and finance trade publications, which can be found in the collection. Halladay currently is developing a research paper about the significant impact of the accounting rules, "Changes to Lease Accounting: Rules, Reactions & Realities", to be published later this year by the Equipment Leasing and Finance Foundation. He also will be speaking on the subject at the industry's national convention in October.

has been a significant change to its liability to pay rents, which creates more effort associated with the lease financing option.

Lessors

The requirements to measure the lease term and estimated payments using a probability-weighted methodology and then periodically reassess these assumptions also apply to lessors. The proposed rules also significantly change lessor accounting, and not just due to the elimination of leveraged lease accounting.

The exposure draft requires lessors to classify the lease as either a performance obligation lease (e.g. operating leases) or a derecognition lease (e.g. direct financing leases). Performance obligation accounting is required for leases in which the lessor retains significant risks or benefits associated with the underlying asset.

Under performance obligation accounting, the lessor records a right to receive payments and an obligation to perform under the lease, both at the present value of the payments. The physical asset remains on the books. Over the term of the lease, the lessor recognizes interest income, income from the performance obligation and depreciation expense. There is no separate residual value in a performance obligation lease, since it is captured in the net book value of the physical asset.

Derecognition accounting requires the lessor to record the present value of the payments as a right to receive payments and then offset this amount against the book value of the physical asset. There is no separate residual, as it is represented by the net of the lessor's right to receive payments and the book value of the physical asset. Residual income is no longer accreted over the lease term.

Impact

The new rules will cause a decrease in volume for those customers that actively seek off-balance-sheet financing. The additional evaluation and assessment requirements of the exposure draft also may cause lessees to reevaluate their usage of leases. The primary reasons for leasing, such as cash flow, tax considerations and asset management, still exist, however, and will continue to drive leasing volumes.

The partial off-balance-sheet benefit that remains will most likely truncate lease terms for customers attempting to minimize the present value of the lease payments on their balance sheets. More transaction structuring also may be required. This phenomenon will create opportunities for lessors who are willing to take on the role of true asset managers.

There are several lessor issues of which everyone should be aware:

- Lease income recognition
 1. Uneven income for performance obligation leases
 2. Back-loaded income for derecognition leases
 3. Front-loaded income based on estimates of lease terms and contingent rents
- Sales-type leases
 1. Potentially limited in scope

To access the collection, [click here](#).



Out of the Comfort Zone

The *Exposure Draft on Leases* is dominating the agenda in Europe, EMEA chairman Malcolm Ogle reports. "Alarm bells are ringing throughout the leasing industry. The new approach not only impacts the whole of the industry, including customers, parent organisations and funders, but also has widespread ramifications throughout organisations, beyond the obvious accounting implications. The business challenges must not be underestimated."

It has not removed the layers of complexity nor the multiple approaches. A new regime means that every current lease would need to be re-analysed and the transition could be an extremely costly exercise for many organisations. It is therefore crucial that organisations evaluate the implications across the business *now* and have a clear vision and strategy for action.

LAR 100 Shows 25% Leap in Growth

Latin America's equipment leasing industry grew significantly in 2009, despite the global economic downturn. According to The Alta Group's sixth annual LAR 100 report, the industry expanded by an estimated 25.3 percent in the region, or 19.7 percent when adjusted for exchange rate fluctuations.

2. Decreased gross margins relative to cash sales
3. Dealer consequences
4. Uneven and fluctuating revenue
5. Income characterization

- Increased processes and internal control requirement
- Systematization of data and statistical methodologies
- Disconnects between economics and accounting
- Funding mismatches
- System quirks such as payoff calculations

What steps should you be taking to prepare for these changes? Of most importance is developing a transition process, including evaluation of the impact of adhering to the new rules on the financial statement. One also should be creating an implementation plan, determining system gaps, and planning system modifications. And finally, do not ignore the sales opportunity to educate customers about the changes and continue to promote the many other benefits of leasing. On the bright side, these changes create opportunities to become more intimate with your customers through your activities to discern their true financing motivations.

For more information contact Shawn Halladay at 801-322-4499 or email shalladay@thealtagroup.com.

SPEED Is Critical To Reset for New Normal 5 Steps to Take Rapidly

Earlier this year, The Alta Group hosted 20 leading executives in the equipment leasing business at an open forum to discuss the myriad of changes rapidly taking place in our industry and the direction it is heading in as a New Normal seemingly takes hold.

Candid and thoughtful insights were shared that led to consensus on some issues and differences in others. The mood was serious and thinking strategic.

Alta Group Principals John Deane, Jonathan Fales and Michael Fleming recently revisited some of the conclusions from the forum. Many of these are indeed, playing out this fall.

"Speed" was a word commonly expressed by the participants. They spoke of the pace of change currently being experienced within our industry, as well as the pace needed to respond and reset themselves to external factors. They must be quick to:

- adjust to the industry's new realities;
- develop new opportunities and relationships;
- tailor products and services to changing customer needs;
- improve operations;
- cut costs; and,
- create a sustainable vision of the future.

"This growth is remarkable, given the 1.9 percent decrease in the region's Gross Domestic Product that was reported by the United Nations Economic Commission for Latin America," remarked Rafael Castillo-Triana, managing principal of The Alta Group's Latin American operations.

Brazil continues to have the region's largest leasing industry. Leasing there grew by 31 percent in 2009. The Dominican Republic saw its leasing industry grow by 48 percent last year, followed by Mexico's 32 percent industry growth. Chile, Columbia, Peru and Bolivia also reported growth.

Castillo-Triana cautioned, however, there are negative trends affecting the industry that should be of concern to leasing executives there. The global economic crisis has decreased overall demand for capital goods, the availability of funding remains an issue, as is the development of industry resources.

Another concern is the region's extreme tendency to give banks preferential treatment over captive and independent leasing companies, Castillo-Triana said. There also are some worrisome economies in the region, in particular those of Venezuela, Argentina, Bolivia and Ecuador.

To learn more about The Alta Group's work in Latin America, [click here](#).

China Market Still Evolving



This summer, Alta Group Principals Rafael Castillo-Triana and Michael Fleming traveled to China to again meet with the leaders of the

The speed of change reflected in such external drivers as tax laws, financial regulation, new accounting standards, regulations and Basel capital requirements are also of concern.

Each of these will have an impact and companies should consider taking these five critical steps to succeed in the current environment:

1. Select the best market segments and customers for the conditions;
2. Determine what value can be delivered to these customers to meet their needs;
3. Determine how your company will make money;
4. Build an effective administration, operations and compliance system, including the best personnel available; and
5. Set a sustainable scale and scope better aligned with the external drivers and today's market realities.

During the forum discussions, a number of ideas were discussed about how to deliver value to these customers and, at the same time, achieve business growth in this period. The group concluded that to deliver value, service would have to be unique, exemplary and priced/packaged appropriately. They also said more integration with customers and partners, flexibility and focus on managing risks would be critical.

The consensus was that to achieve growth, companies will be seeking areas of economic demand, risk tolerance and growth that is sustainable. They discussed the importance of strategic, organic growth and enlarging their "footprints" through partnerships, as well.

Reflecting on the results from the executive forum, The Alta Group also has drawn the following conclusions in regard to resetting to the new normal:

- Customers are not particularly loyal to one leasing company and they expect customized solutions that meet their needs. Depending on size of the customer and its sector, rate is important and the inclusion of soft costs is important.
- Leasing companies are looking for low risk, underserved and emerging opportunities. Identifying potential customers and market sectors to pursue must be done carefully. Presenting a clear value proposition to these companies is the key.
- Each type of leasing company has a clear competitive advantage in today's market:

Captive finance companies benefit from their equipment knowledge; residuals/remarketing capabilities; lifecycle financing; brand loyalty and reputation; flexibility; and usually good channel partners.

Bank finance companies attract bank customers and benefit from a lower cost of funds.

Independent finance companies benefit from their innovativeness, risk tolerance based on their equipment specialization, customer knowledge, relationship management focus (vendor and /or end-user) and flexibility.

country's leasing industry, major financial institutions and Chinese manufacturers. What they concluded is there are still plenty of growth opportunities for our industry there, but there are serious realities that must be recognized, among them:

- There is a shortage of trained personnel in China. Alta is increasing its training activity accordingly. A related issue is the need to develop operating systems.
- Strategic partnering is required for non-Chinese companies, both financial and manufacturing, to succeed there. Foreign companies simply do not have the necessary market knowledge to efficiently originate business. Channel partners in China can provide a source of business. Alta is increasing its efforts to help in this area, too.
- Manufacturers of Chinese equipment, particularly in the construction sector, recognize the strategic importance of aligning with equipment leasing and finance companies in foreign markets to enhance their exports. They are turning to Alta for help in this area.

This was Fleming's fourth business trip to China over the past 23 years. "I've seen terrific growth in the knowledge of benefits of leasing and, more importantly, the practice is more disciplined. It's encouraging," he said.

The Alta Group principals left their audience with plenty to think about:

- The importance of the legal and judicial system to an effective equipment leasing and finance business;
- The importance of modern marketing techniques to

- At the same time, the competitive disadvantages of each type of leasing company are clear:

Captives must deal with the sales pressure from their parent companies, while wrestling with restrictive policies in regard to financing non-parent company products. They also face challenges with the cost of capital and their impact on the parent company's balance sheet.

Bank finance companies are in competition for capital, while also continually fighting for the bank's support of equipment leasing and finance as a business. In addition, they struggle with asset knowledge and a low tolerance for risk.

Independent lessors must identify niche opportunities and struggle with the availability and cost of capital.

With so much change taking place in the industry so fast, the forum participants and The Alta Group agree not everyone will be able to reset to the new realities. Those that can, however, may experience renewed energy and focus. This includes careful attention to every facet of the business, driven by professionalism and sound strategy decisions. Fortunately, due to industry consolidation in recent years, there are plenty of solid, well qualified executives available to help companies get there.

Everyone also agreed this careful attention to the current realities must be balanced with short- and long-term goals. Sustained success will be driven by the timely decisions made today, tomorrow and in the coming months and years.

Failing to look beyond the current reality will not bode well for anyone in this competitive environment with dynamic change seemingly the norm. With so much happening at once during this new era of business, speed is surely more critical than ever before.

For more information, contact Michael Fleming at 239-597-5451 or via email, mfleming@thealtagroup.com.

Genuine Change Are We Doing This?			
	TODAY	TOMORROW	FUTURE
Objective	Extend and Defend Core Business	Build Emerging Businesses	Create Visible Options
Focus	Bottom Line Performance	Top Line Growth - Capital Efficiency	Future Potential
People	Business Maintenance	Business Builders	Visionaries

David Wiener joins firm

deliver a clear value proposition; and,

- The importance of effectively developing personnel.

To learn more about The Alta Group's work in China, [click here](#).

Kenya Readies to Embrace Leasing

With a booming economy and government vision to grow it 10 percent annually over the next 20 years, the African nation of Kenya appears ready to embrace the lease financing industry, according to a new report prepared by The Alta Group upon request from the Government of Kenya.

Principal Rafael Castillo-Triana presented his findings on the lease financing environment there to both government and private sector officials. He said demand for equipment is strong in a number of growing industries, including telecommunications, energy, information technology, materials handling, construction, transportation, healthcare and industrial equipment.

A number of obstacles, however, must be overcome by lessors for the lease financing industry to truly take hold in Kenya, Castillo-Triana warned. They involve the availability of credit information, the country's rule of law and the efficiency of the court system.

The Alta principal suggested pragmatic approaches, which were well taken by the Government of Kenya to remove these obstacles. For example, while progress is being slowly made at improving the quality and access to credit information, he suggested that the laws and practice must be enacted that allow for quick repossession of equipment, if necessary.

In his report, Castillo-Triana also said economic policy also needs to be adjusted to enable different types of lessors to coexist. These include bank affiliated companies, independent lessors and captive finance organizations. In July, the



David Wiener

The Alta Group is pleased to announce David S. Wiener has joined the firm as an associate. He is a 30-year veteran in our industry, with extensive expertise in transaction and portfolio pricing, and negotiation execution. Wiener has personally structured and closed more than \$2 billion in volume from more than 700 transactions, in addition to managing and collaborating with capital markets staff to close more than \$50 billion in portfolios and transactions. He also has created full capital markets syndications capabilities for three top-ten vendor leasing organizations in the United States.

"With his vast industry experience and considerable contacts, David is a great addition to our group," said John C. Deane, managing principal of The Alta Group. "One particular focus for him is in the M&A space - funding management and industry benchmarking."

Wiener is an authority on equipment finance demographics. He has participated for 24 years on the Equipment Leasing and Finance Association (ELFA) committee that oversees design and review of the Survey of Equipment Finance Activity benchmarking report. He also has been instrumental in commissioning industry research during his 12-year volunteer trustee role on the Equipment Leasing and Finance Foundation.

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Government started implementing some of the suggestions of Castillo-Triana, including the removal of the withholding tax on domestic leases and opening the door to Government leasing. Now, the private sector and the Government are coordinating the best way to implement legal changes suggested.

To learn more about The Alta Group's work in Africa, [click here](#).

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