

# **Lease Accounting**

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Considerations for Treasurers

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FINANCE & TREASURY ASSOCIATION

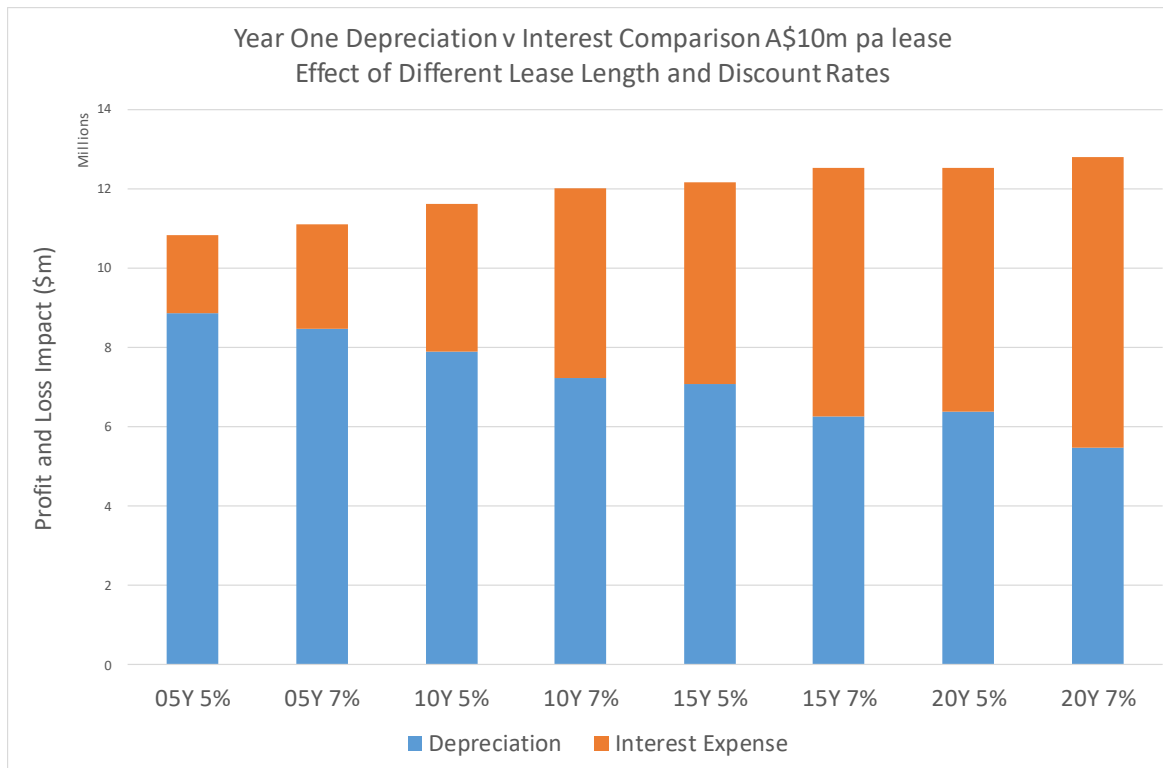
# Alistair McLean

- Outgoing Group Treasurer of Metcash Limited
- Non-executive Director of Macarthur Credit Union
- Treasurer with an interest in Financial Mathematics surrounding AASB16
- <https://treasury.blog>
- <https://treasury.blog/2018/03/22/ifrs16-how-to-make-the-financial-mathematics-work/>

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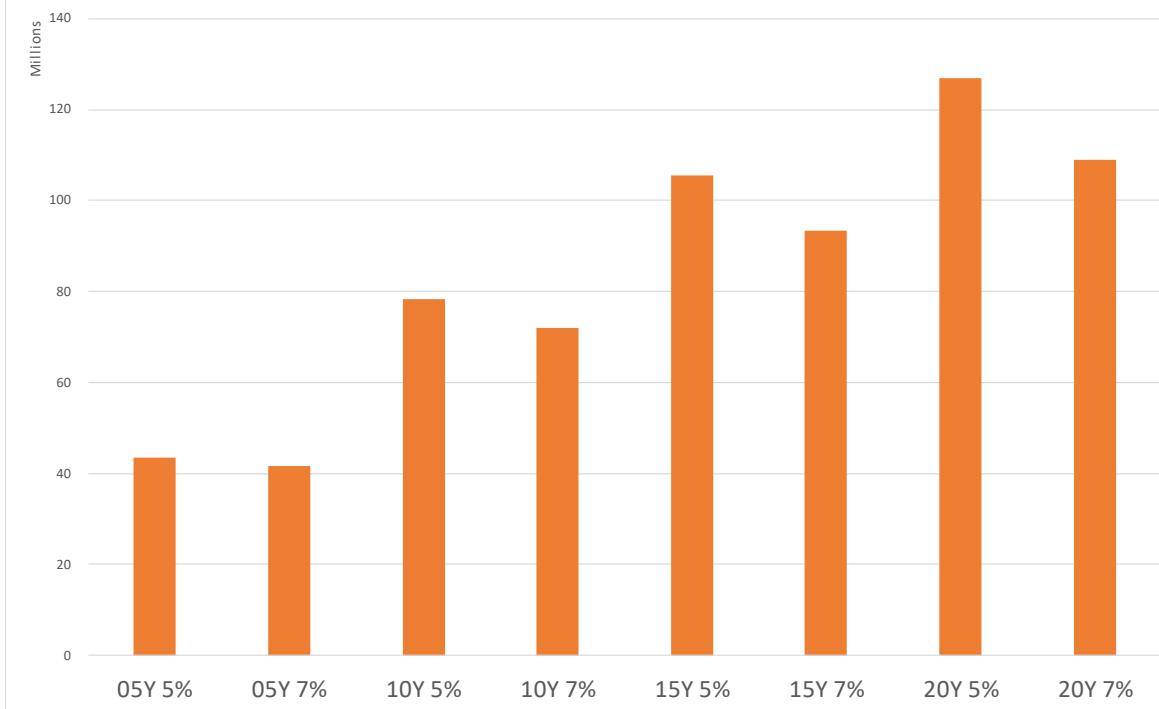
# Example Used

- Rental Expense = \$10m per annum payable monthly
- Lease is for an initial term of 5 years with 3 x 5 year extension options
- Discount Rates Used = 5% and 7%
- Modified Retrospective Transition where ROU Asset = Lease Liability



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ROU Asset Valuations Using Different Lease Lengths and Discount Rates



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# Impact on Financial Covenants

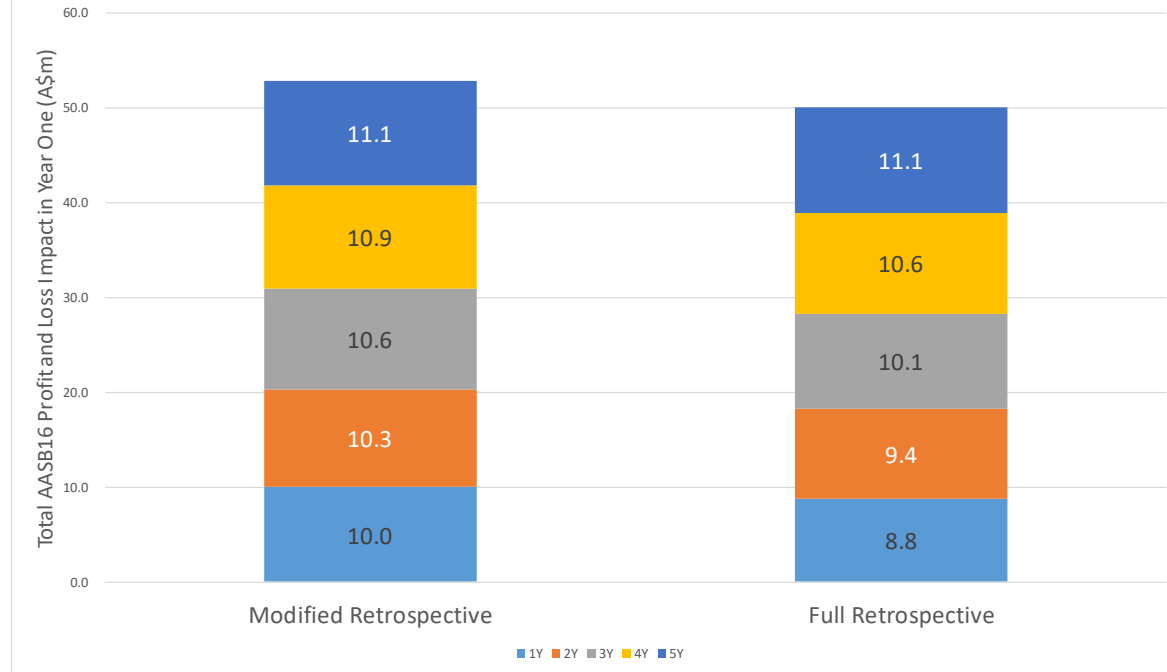
- The impact on accounting presentation is significant (eg EBIT/EBITDA)
- Financial Covenants depend on definitions in debt documents
  - Impact shown in example may be different depending on how these are defined
- Industry standard Senior Leverage Ratio of 3 may no longer make sense
- Standard APLMA clauses in debt documents require negotiation with Lenders around covenants due to accounting standard change
- If agreement cannot be reached then “grandfather” to current standard

# Covenant Calculations under AASB16

Year	1	2	3	4	5
<i>Current Accounting</i>					
EBITDAR	110.0	120.0	130.0	140.0	150.0
Rent Expense	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)
EBITDA	<b>100.0</b>	<b>110.0</b>	<b>120.0</b>	<b>130.0</b>	<b>140.0</b>
D&A on Fixed Asset	(20.0)	(20.0)	(20.0)	(20.0)	(20.0)
EBIT	<b>80.0</b>	<b>90.0</b>	<b>100.0</b>	<b>110.0</b>	<b>120.0</b>
Interest Expense	(10.0)	(11.0)	(12.0)	(13.0)	(14.0)
Profit Before Tax	<b>70.0</b>	<b>79.0</b>	<b>88.0</b>	<b>97.0</b>	<b>106.0</b>
Gross Debt	200.0	220.0	240.0	260.0	280.0
Senior Leverage Ratio (Gross Debt/EBITDA)	2.0x	2.0x	2.0x	2.0x	2.0x
Interest Cover Ratio (EBIT/Interest Expense)	8.0x	8.2x	8.3x	8.5x	8.6x
Fixed Charge Cover Ratio (EBITDAR/(Rent + Interest Expense))	5.5x	5.7x	5.9x	6.1x	6.3x

Year	1	2	3	4	5
<i>IFRS Accounting</i>					
EBITDAR	110.0	120.0	130.0	140.0	150.0
Rent Expense	0.0	0.0	0.0	0.0	0.0
EBITDA	<b>110.0</b>	<b>120.0</b>	<b>130.0</b>	<b>140.0</b>	<b>150.0</b>
D&A on Fixed Asset	(20.0)	(20.0)	(20.0)	(20.0)	(20.0)
D&A on ROU Assets	(8.9)	(8.9)	(8.9)	(8.9)	(8.9)
EBIT	<b>81.1</b>	<b>91.1</b>	<b>101.1</b>	<b>111.1</b>	<b>121.1</b>
Interest Expense (Debt)	(10.0)	(11.0)	(12.0)	(13.0)	(14.0)
Interest Expense (Leases)	(2.0)	(1.6)	(1.2)	(0.7)	(0.3)
Profit Before Tax	<b>69.1</b>	<b>78.5</b>	<b>87.9</b>	<b>97.4</b>	<b>106.8</b>
Gross Debt	200	220	240	260	280
Gross Leases	36	28	19	10	0
Total Indebtedness	<b>236</b>	<b>248</b>	<b>259</b>	<b>270</b>	<b>280</b>
Senior Leverage Ratio (Debt only)	1.8x	1.8x	1.8x	1.9x	1.9x
Senior Leverage Ratio (Debt + Lease)	2.1x	2.1x	2.0x	1.9x	1.9x
Interest Cover Ratio	6.8x	7.2x	7.7x	8.1x	8.5x
Fixed Charge Cover Ratio	9.2x	9.5x	9.8x	10.2x	10.5x

Difference in P&L Impact between Modified and Full Retrospective  
5 x 5 year Leases of A\$10m per annum offset beginning 1 year apart



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