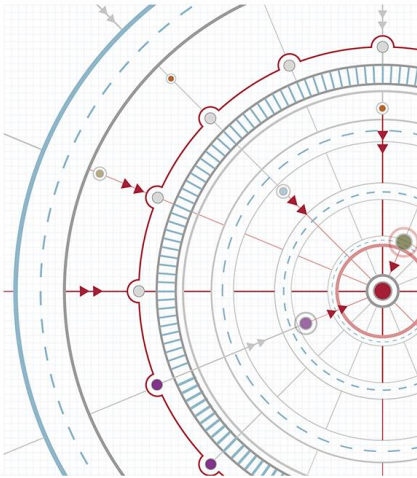


IFRS® Foundation



What is new in accounting for leases?

Joint Investor Outreach Event hosted by:
AIAF, EFRAG, EFFAS, and OIC
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Milan, Italy

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IFRS 16 *Leases*

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Agenda

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1. Key facts about IFRS 16
2. Where we are today
3. Essentials on IFRS 16 Leases
4. Overview of new disclosure requirements
5. How will restatement work?
6. Overview of the effect of IFRS 16 on different industry sectors



Key Facts about IFRS 16



Key Facts About IFRS 16

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- Whose financial statements are most affected?
 - Expect the following sectors: airlines, retailers, travel & leisure
- When does IFRS 16 become effective?
 - Mandatory for annual periods beginning 1.1.2019
 - In Europe, awaiting endorsement by EU Parliament
- Mainly affects Lessees
 - Accounting for Lessors is substantially unchanged
- Convergence with US GAAP
 - IASB and FASB reached same conclusions in many areas (eg recognising all leases on Balance Sheet)
 - Different conclusions with respect to recognition of expenses and presentation in statement of cash flows



Many companies will be affected

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% of companies* who disclose off balance sheet leases (IFRS & US GAAP)	
North America	62%
Europe	47%
Asia / Pacific	43%
Africa / Middle East	23%
Latin America	23%
Total future minimum lease payments (undiscounted)	USD 2.86 Trillion
Total Future Minimum Lease Payments (discounted)	USD 2.18 Trillion

* Listed companies only



Where we are today

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A lack of information

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- Examples of retail chains that ultimately went into liquidation

Retailer	Country	Off balance sheet leases		On balance sheet debt	Off balance sheet leases (discounted) as a multiple of on balance sheet debt
		undiscounted	discounted		
Borders	US	\$2,796M	\$2,152M	\$379M	5.7x
Circuit City	US	\$4,537M	\$3,293M	\$50M	65.9x
Clinton Cards	UK	£652M	£525M	£58M	9.1x
HMV	UK	£1,016M	£809M	£115M	7x
Praktiker	Germany	€2,268M	€1,776M	€481M	3.7x
Woolworths	UK	£2,432M	£1,602M	£147M	10.9x

Based on averaged published financial statements data available in the 5 years before the company entered Chapter 11 (US), liquidation (UK) or bankruptcy (Germany).



Most investors adjust reported figures

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- Use rough estimation techniques (eg multiple of rent expense)
- Liabilities of individual companies often overstated but some understated

1,022 entities ⁽¹⁾	Reported on balance sheet	If all leases on balance sheet	Common market practice (rent x8)
Long-term (LT) debt (In millions of US dollars)	6,440,942	8,102,729	9,063,971
LT debt to equity	59%	74%	82%

(1) 1,022 IFRS/US GAAP listed entities (excluding banks and insurance companies) each with estimated operating lease liabilities of >\$300M (discounted basis). Data obtained from financial data aggregators that may contain errors; this information should, therefore, be used with a degree of caution.



Essentials on IFRS 16 Lease Model



Definition and Scope

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- Definition of a lease under IFRS 16 is broadly retained (compared to IAS 17)
- Are there exceptions?
 - Yes IFRS 16 does not require a lessee to recognise assets and liabilities for:
 - (a) short term leases (ie < 12months)
 - (b) leases of low-value assets (eg laptops etc.)



Recognising leases on balance sheet

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- IFRS 16 requires a lessee to recognise assets and liabilities arising⁽¹⁾ from all leases on the balance sheet.

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Assets	→ 🏠		→ ✈️ 🚗 🚚 🏠 🏠 🏠
Liabilities	\$\$		\$\$\$\$\$\$
Off balance sheet rights & obligations	---	✈️ 🚗 → 🏠 🏠 \$\$\$\$	---



Income statement will offer more detail

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- Lease expense will be split into 2 components

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Revenue	x	x	x
Operating costs (excluding depreciation and amortisation)	---	Single expense	---
EBITDA			↑↑
Depreciation and amortisation	Depreciation	---	Depreciation
Operating profit			↑
Finance costs	Interest	---	Interest
Profit before tax			↔



Comparing IFRS 16 to new US GAAP

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		IFRS 16	US GAAP model ⁵	
			Former ON balance sheet leases	Former OFF balance sheet leases
Balance sheet				
1 Recognition	All leases on balance sheet	✓	✓	✓
	Exemption for short-term leases	✓	✓	✓
	Exemption for leases of low-value assets	✓	—	—
2 Measurement	Lease liabilities on a discounted basis	✓ ⁶	✓ ⁶	✓ ⁶
	Initial lease asset = lease liability	✓	✓	✓
3 Presentation	Depreciation of lease assets	Typically straight-line	Typically straight-line	Typically increasing ⁷
	Lease liabilities	IAS 1 ⁸	Separate presentation (from former off balance sheet leases)	Separate presentation (from former on balance sheet leases)
6 Income statement	Operating costs	Depreciation	Depreciation	Single expense
	Finance costs	Interest	Interest	—
7 Cash flow statement	Operating activities	Interest ¹⁰	Interest	Interest and principal
	Financing activities	Principal	Principal	—

Source: "A New Lease of Life" Investor Perspectives article by the IASB



Potential impacts on analysis

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P&L metrics, margins and ratios	IFRS 16 "New Accounting"
EBITDAR	No change
EBITDA	Higher ↑
EBIT	Higher ↑
Net income	...it depends ↔
ROA	Lower ↓
Asset Turnover	Lower ↓
ROE	...it depends ↔

Comparison of metrics & ratios under IFRS 16 relative to the status quo

Leverage analysis	IFRS 16 "New Accounting"
Debt/Equity	Higher ↑
Interest coverage (EBIT/Interest)	Lower ↓



Potential impacts on analysis (cont'd)

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Cash flow metrics	IFRS 16 "New Accounting"
Cash from operating activities	Higher ↑
Cash from financing activities	Lower ↓
Net cash flow	No change
Unlevered free cash flow*	Higher ↑

Comparison of metrics & ratios under IFRS 16 relative to the status quo

* Assumes that adjustments to calculate free cash flow do not include lease liability principal repayments, which are included within financing activities under IFRS 16.



Intended benefits: Improved comparability

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- Recognise assets and liabilities for ALL⁽¹⁾ LEASES
- Measure all lease assets and liabilities in the same way
- Recognise only the rights that are obtained (liabilities that are incurred)
- Company management's operating decisions will be reflected in financial statements

⁽¹⁾ With the exception of short-term leases and leases of low-value assets



Overview of new disclosure requirements



Lease Disclosures

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- Disclosure requirements focus on the most relevant information:

INCOME STATEMENT	Breakdown of lease costs (3-4 different items)
CASH FLOW	Total lease cash flow
BALANCE SHEET	Information about ROU assets by class of underlying asset Maturity analysis of undiscounted commitments

- Additional disclosures address on complex features:



Example: Information about Lease Liabilities

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- All lessees will disclose:
 - discounted lease liabilities (balance sheet)
 - undiscounted maturity analysis (notes)
- When relevant lessees will disclose:
 - additional information about their individual portfolio (eg potential future cashflows in optional periods)

	Lease Liability		Example additional information: potential payments in optional periods		
	Undiscounted (Notes)	Discounted (Balance Sheet)	1-5 years	6-10 years	Total
IAS 17	✓	✗	✗	✗	✗
IFRS 16	✓	✓	✓	✓	✓



How will restatement work

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IFRS 16: Transition, effective date

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		PY2 (2017)	PY1 (2018)		CY (2019)	CY notes to financial statements
Retrospective (with optional practical expedients)	Cumulative catch-up	Contracts restated under new standard				IAS 8 disclosures
Cumulative catch-up at date of application (with optional practical expedients)				Cumulative catch-up		Additional disclosures to explain effect of applying IFRS 16

- Effective date: annual reporting periods beginning on or after 1 January 2019
- Early application permitted



Overview of the effect of IFRS 16 on different industry sectors



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Balance Sheet Impact

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USD billions	Airlines (50 companies)	Travel & Leisure (69 companies)	Retailers (204 companies)
Total assets	527	404	2,019
Future payments for off balance sheet leases	152	115	572
Future payments for off balance sheet leases as a % of total assets	28.8%	28.6%	28.3%

Source: Effects Analysis IFRS 16: Leases



Airlines: Key Figures

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Fleet	Air France – KLM (€m)	British Airways Plc (*)	Lufthansa Group (€m)	Easy Jet Plc (€m)
Total aircraft in service	571	279	615	226
Of which - owned or financed by leases on balance sheet	327	231	598 (of which 38 under finance leases)	154 (of which 11 under finance leases)
Of which - operated off balance sheet (operating leases)	244	48	17	72
% off balance sheet / Total	43%	17%	3%	32%
TOTAL REVENUES (as reported)	24,930	20,170 <i>IAG consolidated (*)</i>	30,011	4,527 (€m)
TOTAL ASSETS (on balance sheet)	23,230	23,652	30,474	4,482 (€m)
Revenues/Assets	1.07x	0.85x	0.98x	1.01x
<i>Revenues/ Adj. Assets</i>	0.83x	0.72x	0.89x	0.86x

- Note (*) BA Plc is the most significant airline of the IAG Group (which also includes Iberia and Vueling) which operates 459 aircraft in total. The fleet data presented here relate only to the BA part of the IAG Group and data for the other entities have not been included. BA's revenues represent 66% of the IAG's consolidated revenues. IAG reports in €.

- Data as of year ended 31/12/14, except EasyJet 30/09/14.



Example – Air France – KLM (2014)

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Net debt		
Balance sheet at	31 December 2014	31 December 2013
(in million euros)		
Current and non-current financial debt	9,879	10,733
Deposits on aircraft under finance lease	(584)	(626)
Financial assets pledged (OCEANE swap)	(196)	(393)
Currency hedge on financial debt	(21)	8
Accrued interest	(123)	(144)
Gross financial debt (A)	8,955	9,578
Cash and cash equivalents	3,159	3,684
Marketable securities	73	126
Cash pledges	399	432
Deposits (bonds)	166	154
Bank overdrafts	(249)	(166)
Net cash (B)	3,548	4,230
Net debt (A) – (B)	5,407	5,348

Adjusted net debt and adjusted net debt/EBITDAR ratio		
	31 December 2014	31 December 2013
Net debt (in €m)	5,407	5,348
Aircraft operating leases x 7 (in €m)	6,111	6,391
Adjusted net debt (in €m)	11,518	11,739
EBITDAR (in €m)	2,462	2,768
Adjusted net debt/EBITDAR ratio	4.7x	4.2x

Operating free cash flow		
	2014	2013*
(in million euros)		
Net cash flow from operating activities	998	1,471
Investment in property, plant, equipment and intangible assets	(1,431)	(1,186)
Proceeds on disposal of property, plant, equipment and intangible assets	269	245
Operating free cash flow excluding discontinued operations	(164)	530

* Restated for IFRIC 21, CityJet reclassified as discontinued operation

7x



Example – IAG Group slide deck (2014)

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Balance sheet: improved debt coverage

€m	Dec 2014	Dec 2013
Adjusted equity	5,759	5,772
Gross debt	6,617	5,122
Cash, cash equivalents & interest bearing deposits	4,944	3,633
On balance sheet net debt	1,673	1,489
Gearing	23%	21%
Aircraft lease capitalisation (x8)	4,408	4,212
Adjusted net debt	6,081	5,701
Adjusted gearing	51%	50%
Adjusted net debt / EBITDAR	1.9x	2.5x
RoIC	7.9%	5.3%

- Excludes IAS 19 amendments
- Gross debt increase as result of new fleet deliveries in BA
- Cash: BA £2.5bn (Dec 13: £1.9bn), Iberia €0.9bn (Dec 13: €0.7bn), Vueling €0.7bn (Dec 13: €0.5bn)



8x

IAG

Q4 results

Balance sheet

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Where can you find more?

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IASB Has Resources for Investors

- IASB Articles for investors
 - Investor Perspectives
 - Project Snapshot
 - Investor Update newsletter
- On the web:
 - go.ifrs.org/Investor-Centre
 - <https://twitter.com/IFRSinvestors>



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Additional Reference

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Some investor FAQs

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- What is the discount rate used to measure lease assets and liabilities?
 - Rate in the lease, or in absence of this the entity's incremental borrowing rate
- Can lease contracts be shortened to <12 months to avoid balance sheet recognition?
 - companies will not only include non-cancellable lease payments on balance sheet – they will also have to include optional payments to the extent that they are reasonably certain to extend the lease.



Institutional investors are preparing for this change

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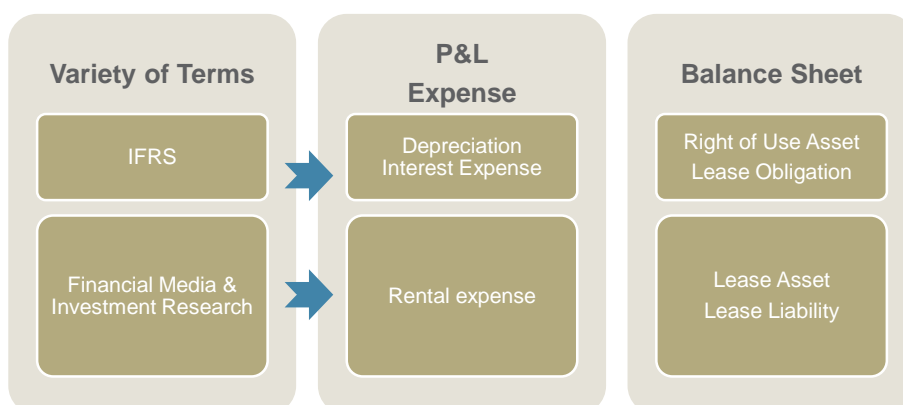
Examples of reactions to the change in research reports

- “Lease Accounting Rule Changes Won't Hit Corporate Ratings”
 - Fitch Ratings, 29 February 2016
- “We do not expect any impact on debt ratings. The ratings agencies have had plenty of time to adjust their approaches and pre-empt this accounting change...”
 - JP Morgan Cazenove note 15 January 2016
- “For most companies, we do not expect a significant impact on EPS”
 - Citigroup research note 14 January 2016





Jargon Busting

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