



IFRS 16 Leases – the impact

23 May 2019

Introduction

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Technical Manager

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Today's presenters

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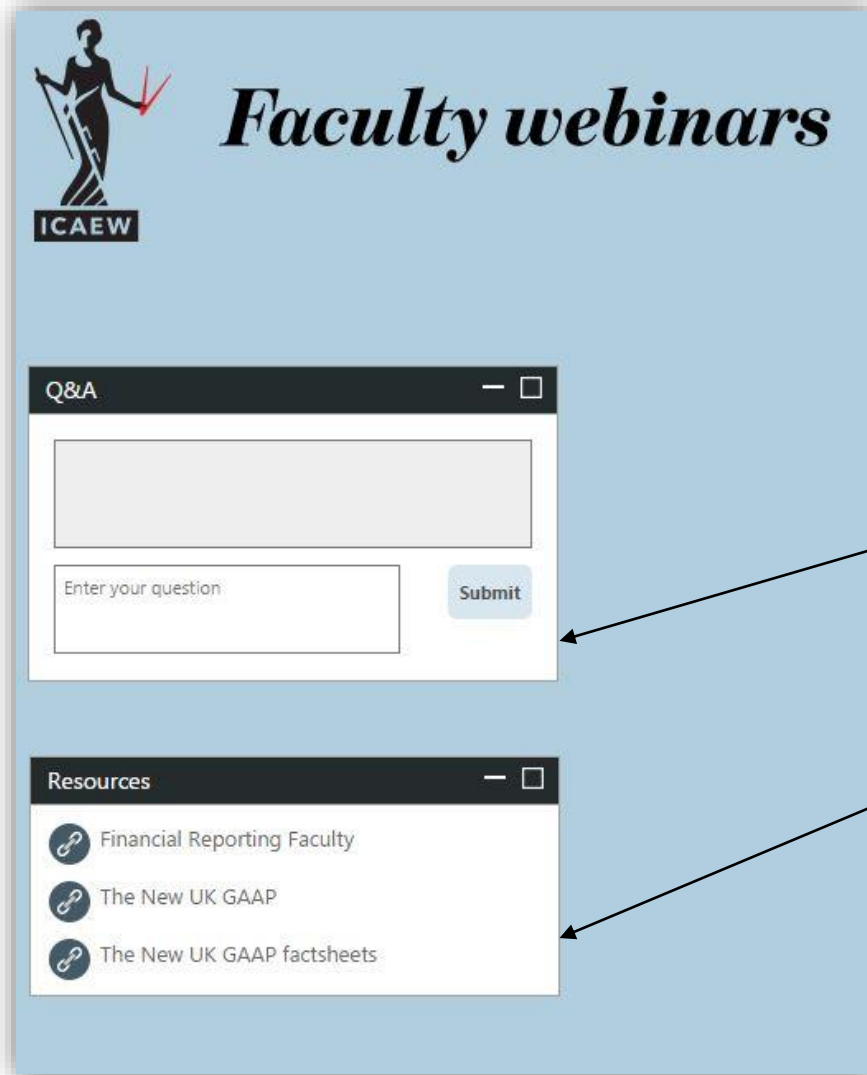
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Director

PwC



Ask a question



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Ask a question

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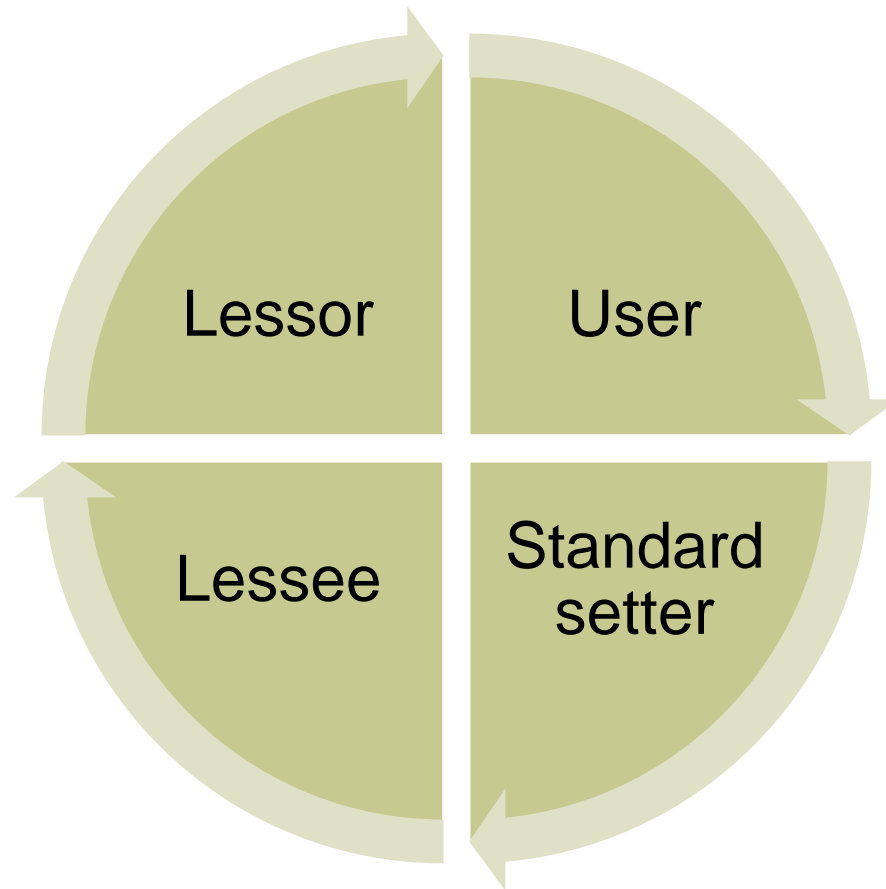
Impact on Financial Metrics

Technical Accounting Challenges

Business Model Case Studies

Questions

Why IFRS 16 and what is the benefit?



IFRS 16 will impact some sectors more than others

Industry	Median increase debt ¹ %	Median increase EBITDA %	Median change leverage ²		Median decrease in solvency ³	
			Before standard	After standard	Before standard %	After standard %
All companies	22	13	2.03	2.14	35	32
Retailers	98	41	1.17	2.47	41	28
Airlines	47	33	3.26	3.63	25	19
Professional services	42	15	0.53	0.96	40	37
Healthcare	36	24	2.11	2.92	22	19
Wholesale	28	17	2.04	2.31	31	29
Transport and infrastructure	24	20	2.21	2.52	36	30
Entertainment	23	15	1.78	1.30	30	25
Telecommunications	21	8	1.65	2.00	23	21

Source: PwC Global Lease Capitalisation study of 3,199 listed IFRS reporters.

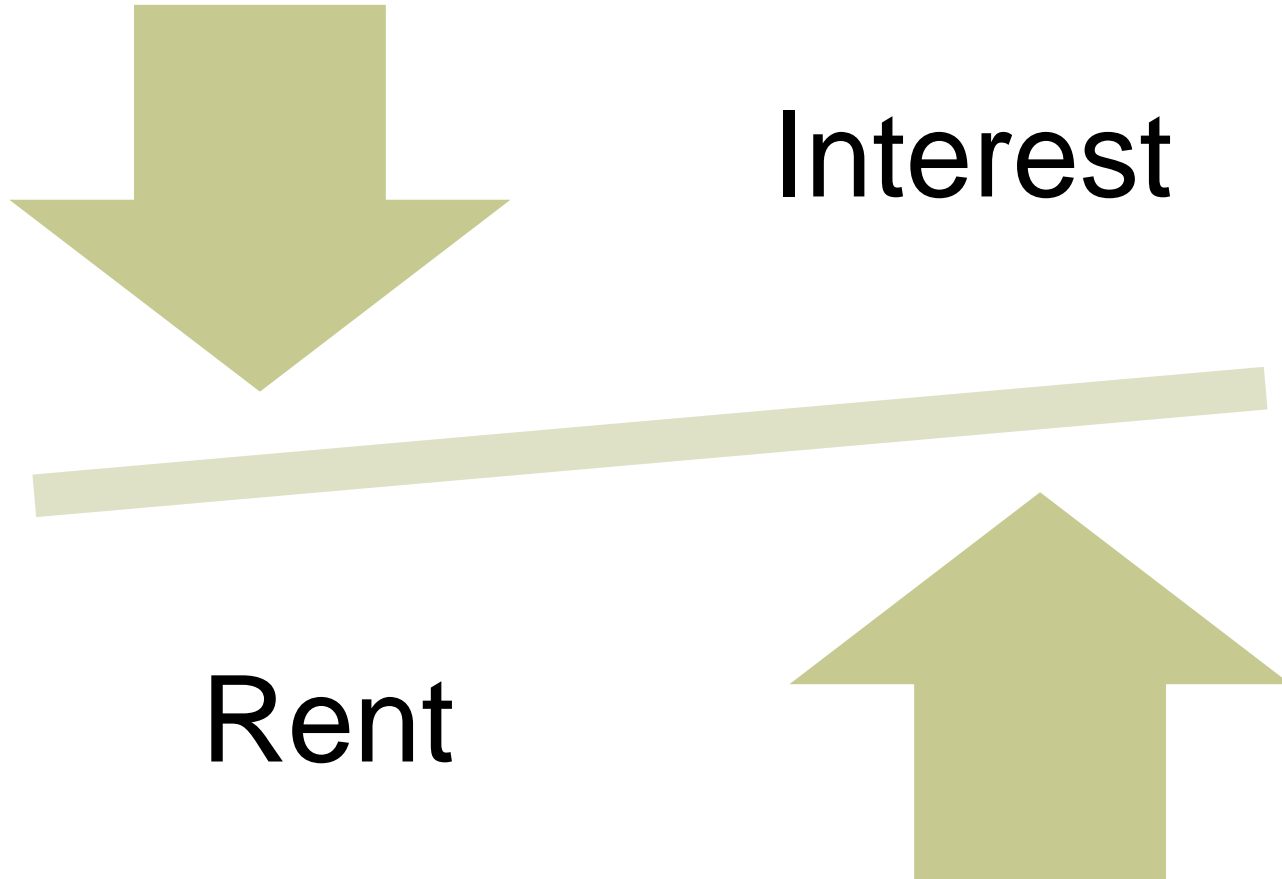
Notes:

¹ Interest-bearing debt

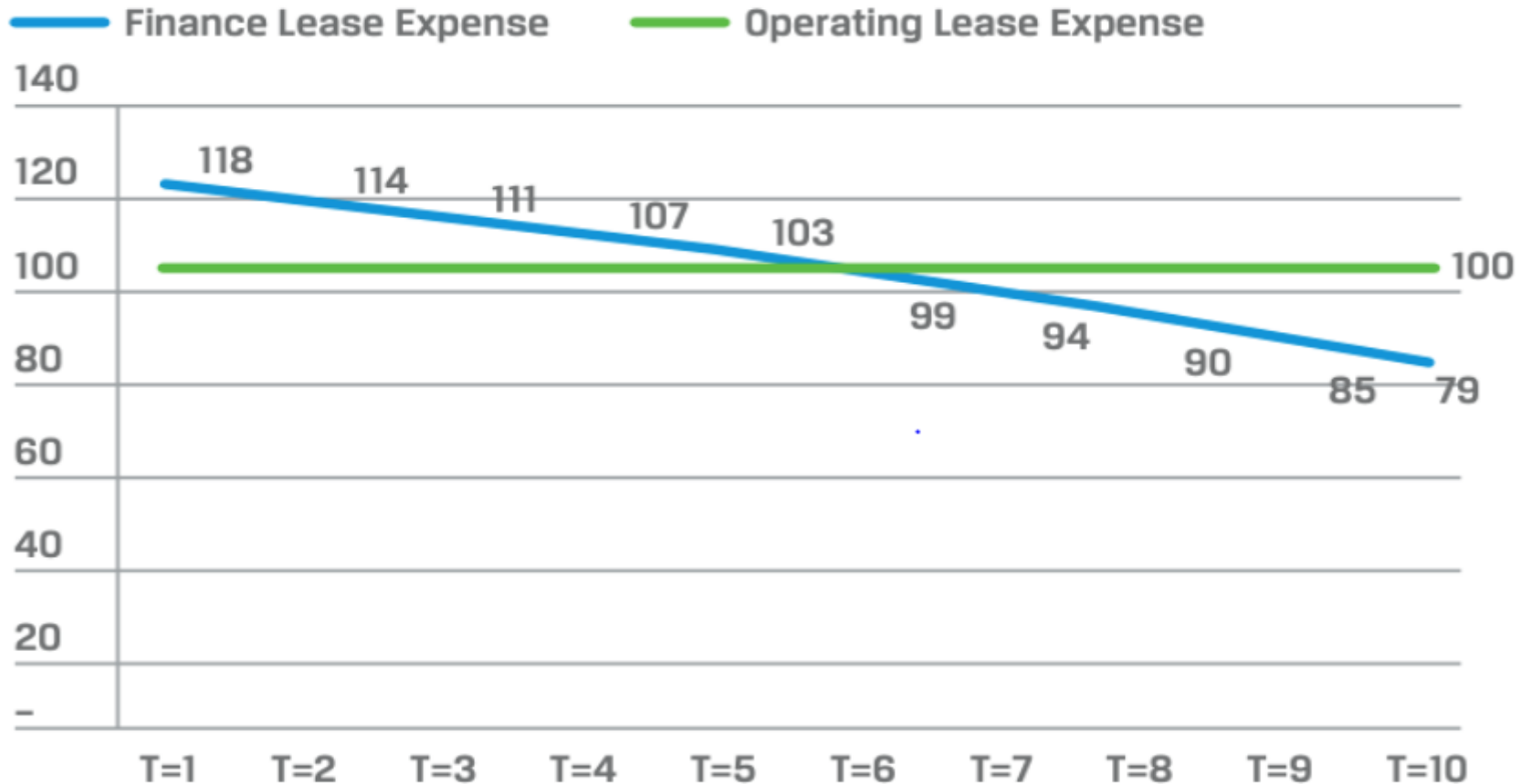
² Net debt/EBITDA

³ Equity less Intangibles/Total Assets

Difference – rent versus interest



Profit and Loss A/C - Impact on Financial Metrics



Analytical Adjustments For Operating Leases Before IFRS 16

- Rating Agency 8 multiple – 6% discount rate and full economic life of 30 years
- EBITDA versus EBITDAR – performance ratio
- Leases adjusted debt / EBITDAR – leverage ratio
- EBITDAR / interest expense + lease rent – coverage ratio

IFRS 16 Impact on Financial Metrics

Ratio		Immature Lease Portfolio		Mature Lease Portfolio
<u>Profitability</u>				
Gross Profit Margin		Higher		Higher
Net Profit Margin		Lower		Higher
<u>Coverage</u>				
Interest Coverage		Lower		Higher
<u>Non-GAAP</u>				
EBITDAR		Same		Same
EBITDA		Higher		Higher
EBT		Lower		Higher

Polling Question 1 – Have you adjusted the performance metrics that you report to the market as a result of the effects of IFRS 16?

- Yes – our metrics have already been adjusted
- Yes – adjusted metrics are not yet finalised but we are in the process of doing so
- No – this isn't something that has been considered
- Don't know/unsure

Identifying a lease – Key judgement!

1

There is an **identified asset**



No identified asset if supplier has *substantive right to substitute* asset

and

2

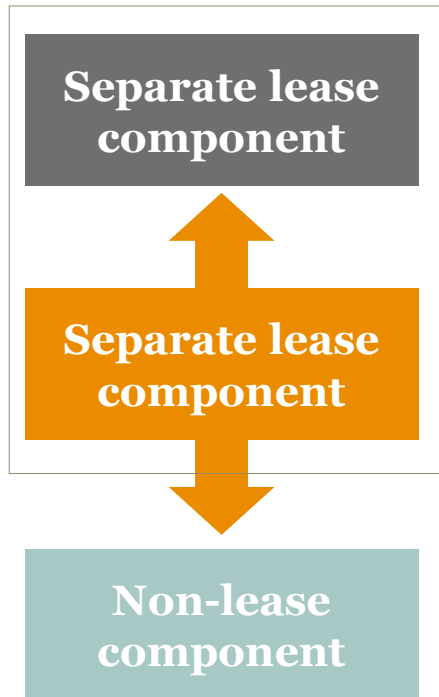
Contract conveys the **right to control the use** of an identified asset



Right to obtain *substantially all of the economic benefits* from use of the identified asset throughout the period of use *and*

Right to direct the use of the identified asset throughout the period of use

Separating components of a contract



Allocation of consideration
Based on relative *stand-alone prices*

Apply IFRS 16

Practical expedient **for lessees only:**
Treat lease + non-lease components as a single lease component

Apply other applicable standards

Some important decisions to make?

Should I take the expedients to:

- Low-value assets?
- Short-term leases?

Should I separate non-lease components of contracts?

No

Yes

**EBITDA
and
net debt**



Discount rate

If the rate implicit in the lease cannot be readily determined by the lessee

use

Lessee's incremental borrowing rate

Rate of interest that a lessee would have to pay to borrow over a **similar term**, and with a **similar security**, the **funds necessary** to obtain an asset of a **similar value** to the right-of-use asset in a **similar economic environment**.

Lease term – Key judgement!

Non-cancellable period of lease

+

Periods covered by option to extend

+

*Periods covered by option
to terminate*

if lessee is **reasonably certain**
to exercise option

if lessee is **reasonably certain**
not to exercise option

Polling Question 2 – Will IFRS 16 impact your lease negotiations in the future?

- We expect no or minor changes to negotiations
- We expect significant modifications compared to current terms and conditions negotiated
- We expect the standard will result in decreased use of lease contracts
- Don't know/unsure

Retail Shopping Evolution



WSJ: Sears Case Study

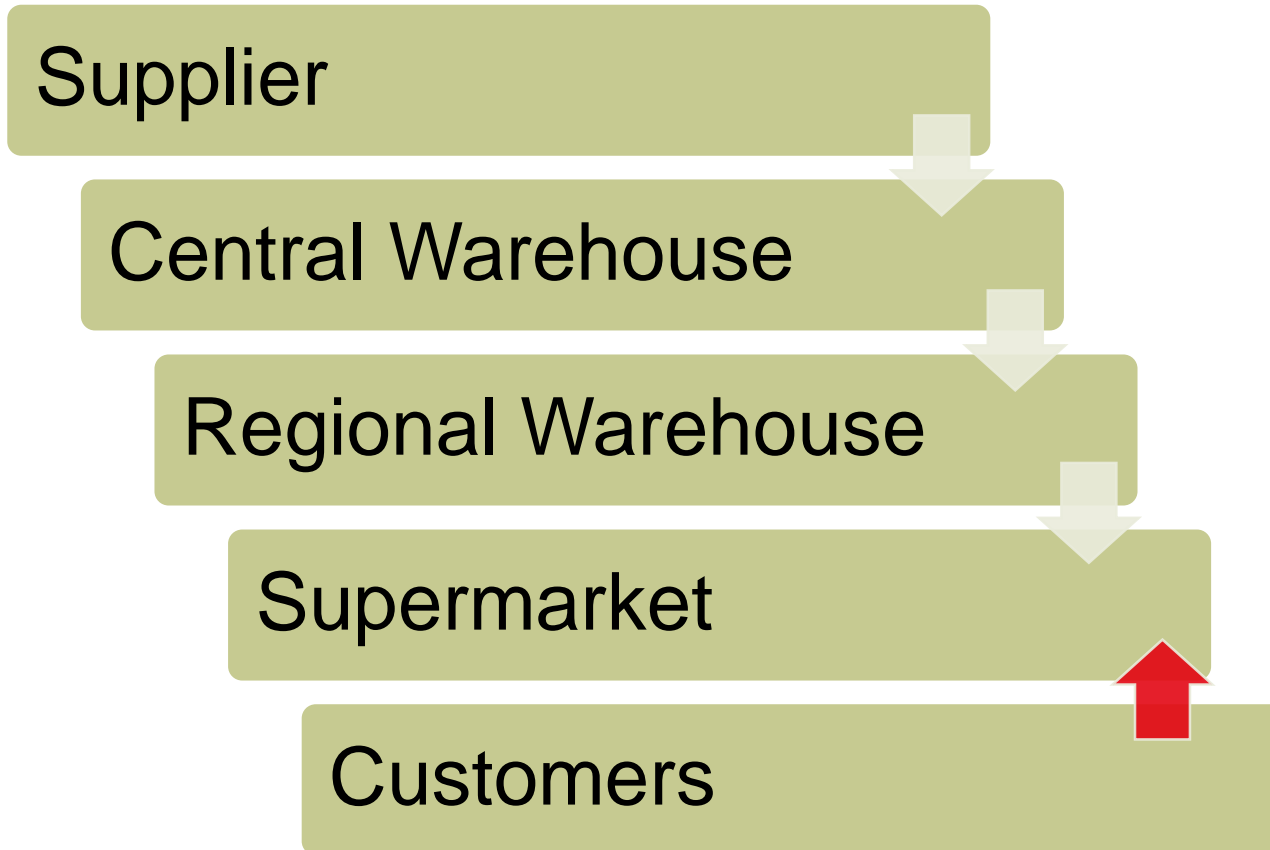
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Inc. All rights reserved.

[Please insert Sears Video Here]

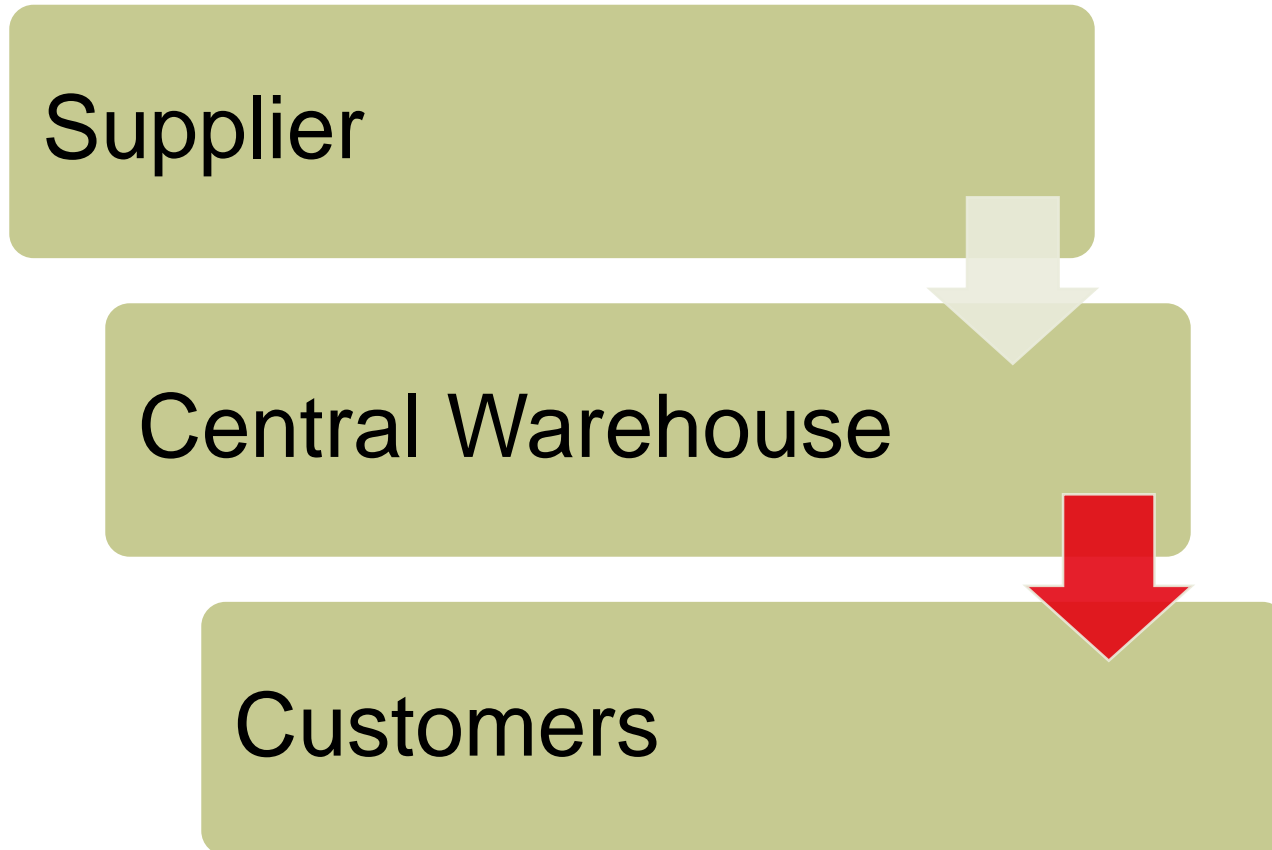
Key point from Sears downfall

- Demographic factor – lack of focus on female shoppers
- Competition – Discounters and online retailers gained market share
- Overcapacity – Increase in online sales will increase pressure on rents
- Flexible leases – [Rents to be linked to store turnover – Paperchase landlord renegotiation]

Retail (Brick & Mortar) – Business Model



Ocado (Asset-light) – Business Model



The Economist: Ocado Case Study

© The Economist Newspaper Limited, London (3 July 2018).

[Please insert The Economist video here]

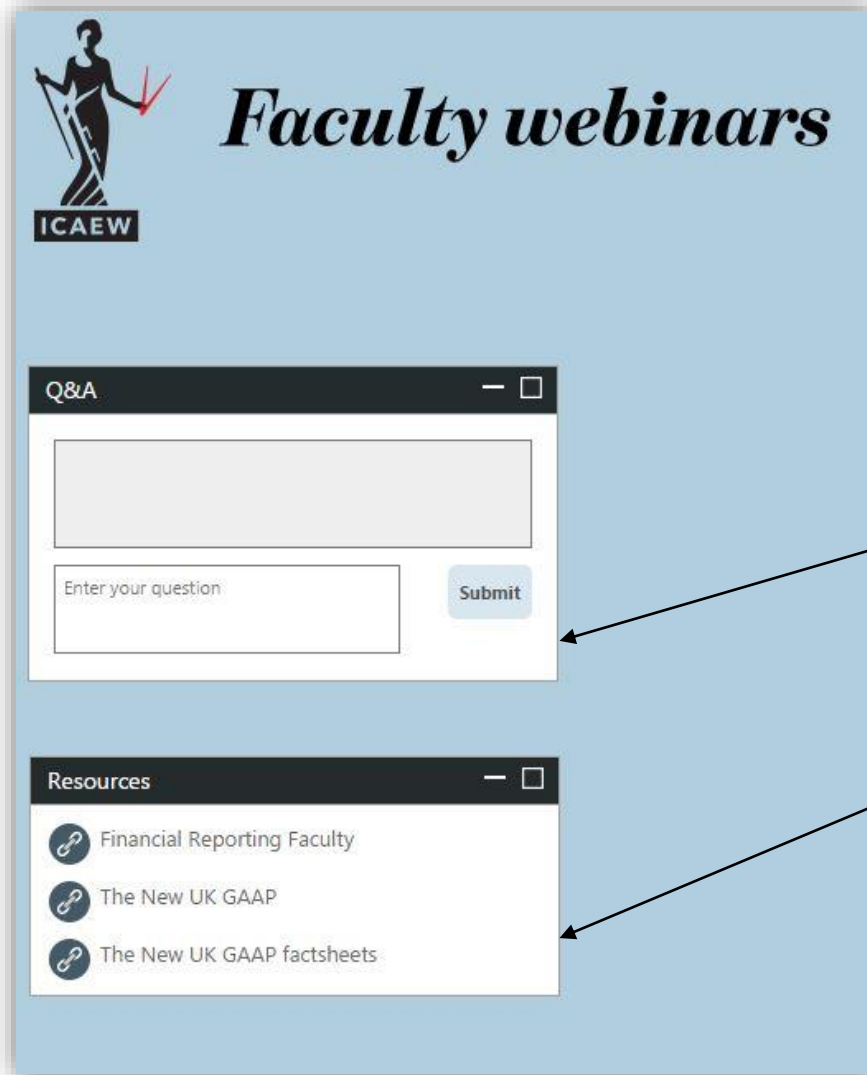
Key points from online disruption

- Demographic changes – diversity; technology; and environment [M&S Ocado £750m Deal]
- Transition – hybrid business models
- Advantages of online model – data; cost efficiencies; economies of scale; and financial flexibility
- Significant implications for real estate leases

Polling Question 3 – How has your shopping evolved?

- Stayed the same – shopping in stores
- Changed – mostly in stores but some online
- Changed – mostly online and reduced visit to stores

Ask a question



The screenshot shows a light blue background with the ICAEW logo (a stylized figure holding a torch and a book) and the text "Faculty webinars" in a large, bold, serif font. Below this, there are two white rectangular boxes with black borders. The top box is titled "Q&A" and contains a large text input field, a smaller input field with the placeholder text "Enter your question", and a blue "Submit" button. The bottom box is titled "Resources" and contains three links, each with a chain-link icon: "Financial Reporting Faculty", "The New UK GAAP", and "The New UK GAAP factsheets".



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Faculty resources

icaew.com/ifrs16

FAQs: IFRS 16 Leases

- available to all ICAEW members

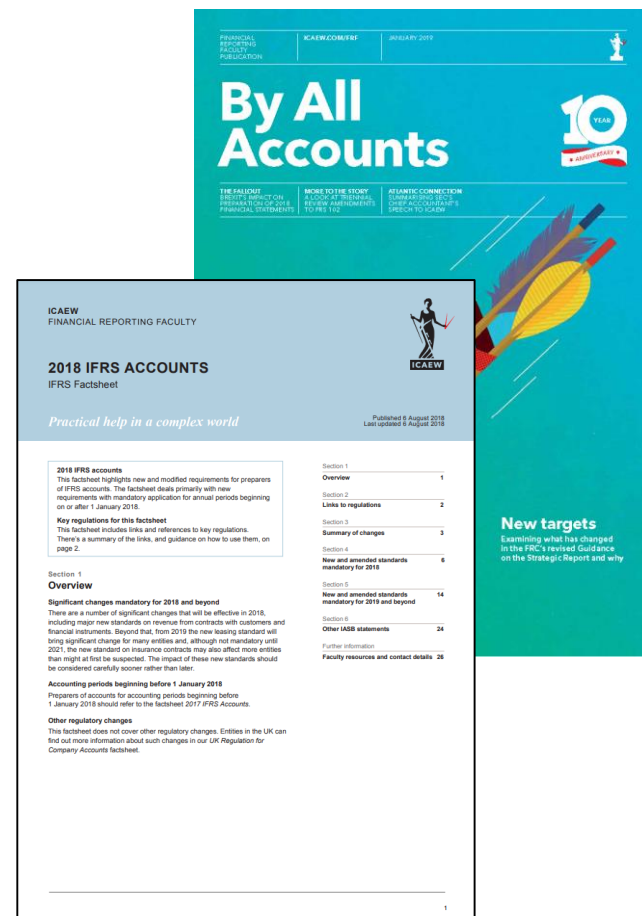
Factsheets icaew.com/ifrsfactsheets

- Introducing IFRS 16 Leases
- 2018 IFRS Accounts

Past webinar recordings icaew.com/frfwebinars

- IFRS update (June 2018)
- IFRS 16 Leases
 - making sense of the new standard (July 2017)

By All Accounts articles icaew.com/byallaccounts



Questions

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Future events

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Bitesize briefings

4 July – Performance metrics



Webinars

20 June – IFRS update



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