ASSET MANAGEMENT MASTER CLASS

PRESENTATION BY MCMILLAN SHAKESPEARE LIMITED
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Agenda

- Outcomes
- Australian and UK market
- Basel III
- Customer Requirements
- Solutions
- Income Streams
- Risk Management
- Accounting for Leases
- Conclusions

Outcomes

- Maturity of the Australian and UK Market
- Basel 3 presents opportunities
- Understand the life cycle
- Diversity of Income streams
- Income levers can be managed
- Multiple products for different business segments
- Risk management takes a lead role
- Cashflows of a lease explained

Australian Market

The Market

- The Australian Fleet Lessors Association (AFLA) members represent the major share of the leasing and fleet management market in Australia
- Members of AFLA:

Alphabet Fleet (BMW)
GE Custom Fleet
Fleetcare
FleetPartners
FleetPlus
Interleasing/Holden Leasing
LeasePlan
Smart Salary
NLC
ORIX
Selectus
SG Fleet
NSW State Fleet
Summit Auto Lease
Toyota Fleet Management
Q Fleet

The Market – Funded Vehicles

Table 1: Units Held*

As at End	Total Cost $ Million	Total Number	Average Cost ($)
Dec 2010	$13,353	353,403	$37,784
June 2011	$13,653	354,865	$38,474
Dec 2011	$13,823	354,867	$38,953
June 2012	$14,154	355,943	$39,765
Dec 2012	$14,444	359,170	$40,215
June 2013	$14,574	358,105	$40,698
Dec 2013	$14,517	355,631	$40,820
June 2014	$14,394	351,212	$40,984

**Includes units funded but does not include fleet managed*

- $14.4 billion of funded assets
- 7.8% growth over period

The Market - Units

Table 2: Total Portfolio – By Type of Facility-Number of Units

As at End	Operating Leases - Funding only (1)	Operating Leases - Other (2)	Finance Leases (3)	Novated Leases (4)	Total Funded (1)+(2)+(3)+(4)	Fleet Managed (5)	Total Portfolio (1)+(2)+(3)+(4)+(5)	'Fleet Managed' Funded by other AFLA Members
Dec 10	41,473	185,739	50,000	76,191	353,403	155,260	508,663	4,892
June 11	39,558	185,593	53,571	76,143	354,865	156,253	511,118	4,987
Dec 11	38,431	185,278	56,388	74,770	354,867	162,216	517,083	5,701
June 12	38,414	185,550	57,904	74,075	355,943	163,535	519,478	5,944
Dec 12	38,481	185,058	60,636	74,995	359,170	179,576	538,746	4,763
June 13	38,853	183,242	60,144	75,866	358,105	182,848	540,953	4,426
Dec 13	39,949	181,830	58,844	75,008	355,631	182,048	537,679	4,150
June 14	38,903	181,509	57,233	73,567	351,212	184,507	535,719	3,785

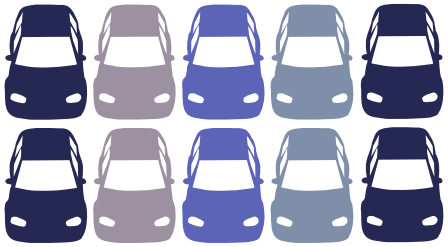
'Other Funding' is hire purchase, chattel mortgage/other

Managed units – 5.3% growth over period

Source: Australian Fleet Lessors Association

UK Market

UK market



Annual new car finance

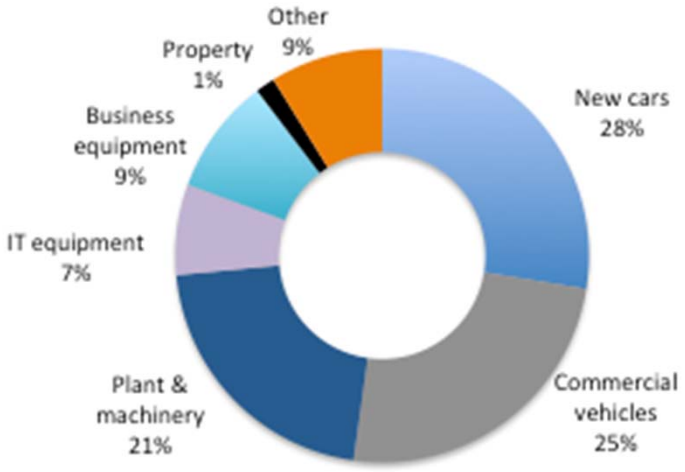
£18.35 billion

(business & consumer)

- UK financial sector recovering from crisis
- Borrowing still challenging in some sectors
- Market fragmented with lots of providers
- Little differentiation in market

Estimated 4.5 million private sector businesses

Approx **£15 billion** of other (non car) asset finance annually



Market Participants

- British Vehicle Lease and Rental Association (BVLRA)
- 1,250,000 vehicles managed
- Top 5 players comprise **56%**, the top 10 players **77%**
- Bottom 45 comprise remaining
- Potential consolidation

Basel III

Basel III and implications

- Regulatory standard on bank capital adequacy, stress testing and market liquidity risk
- Basel Committee on Banking Supervision agreed to a 3rd set of accords, due for implementation from 2013-15 but delayed to 2018-19
- Aims to:
  - improve banking sector's ability to absorb shocks arising from financial and economic stress
  - improve risk management and governance
  - strengthen banks' transparency and disclosures
- Focus on Operational Risks
- Capital allocated against Operating lease risks

Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Basel III phase-in arrangements

(All dates are as of 1 January)

	Phases	2013	2014	2015	2016	2017	2018	2019
Capital	Leverage Ratio		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015				Migration to Pillar 1	
	Minimum Common Equity Capital Ratio	3.5%	4.0%	4.5%				4.5%
	Capital Conservation Buffer				0.625%	1.25%	1.875%	2.5%
	Minimum common equity plus capital conservation buffer	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
	Phase-in of deductions from CET1*		20%	40%	60%	80%	100%	100%
	Minimum Tier 1 Capital	4.5%	5.5%	6.0%				6.0%
	Minimum Total Capital		8.0%					8.0%
	Minimum Total Capital plus conservation buffer		8.0%		8.625%	9.25%	9.875%	10.5%
	Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital		Phased out over 10 year horizon beginning 2013					
Liquidity	Liquidity coverage ratio – minimum requirement			60%	70%	80%	90%	100%
	Net stable funding ratio						Introduce minimum standard	

* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.

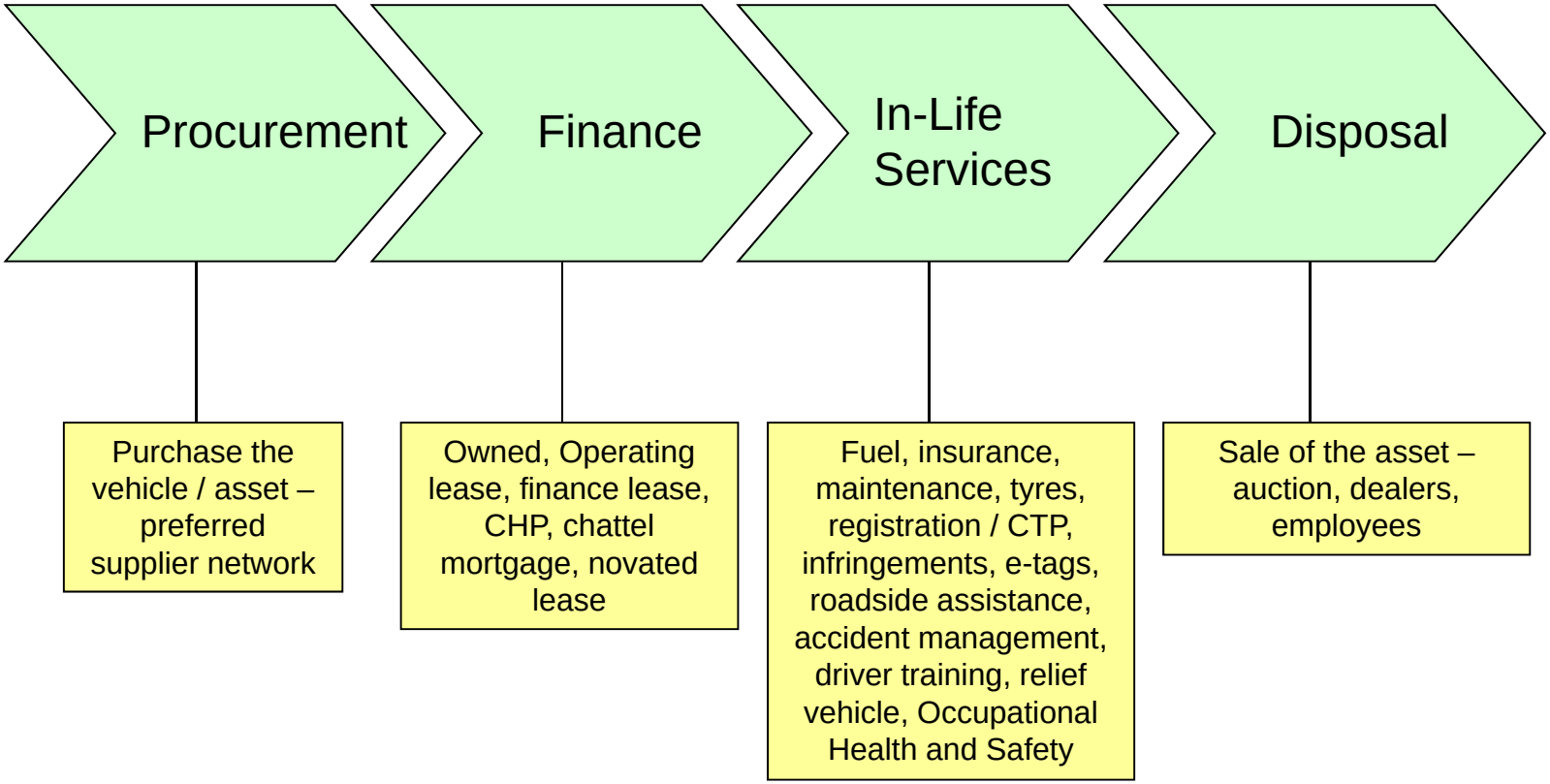
– – transition periods

Customer Requirements

Customer Requirements

- A financier can provide funding but this ignores the management of the asset during its life
- Fleet Management Organisations (FMOs) bring funding and management together; from purchasing an asset, managing it operationally and finally disposal
- FMOs also deliver to the customer:
  - Knowledge via its experienced staff
  - Systems to manage and report
  - Buying power
  - Risk Management

The Asset Life Cycle



Procurement and Finance

- Procurement:
  - Experienced staff – assist in vehicle selection, options and accessories
  - National network of preferred suppliers
  - Buying Power can be passed on in full or part
- Finance:
  - Customer may self fund by acquiring for cash
  - FMO facilitated:
    - Finance lease, operating lease or novated lease
    - Chattel mortgage – preferred SME financing option

Operational Events Need Expert Managing

In-Life Services:

- Fuel – cards and discounts
- Insurance – comprehensive, gap, redundancy protection (novated)
- Maintenance – scheduled servicing and preventative
- Tyres
- Registration / CTP
- Infringements – speeding, tolls, etc
- E-tags – national coverage
- Roadside assistance and accident management – 24/7 support
- Driver training

FMO’s have stronger buying power for operational services than an organisation does in their own right

Disposal of Assets is Complex

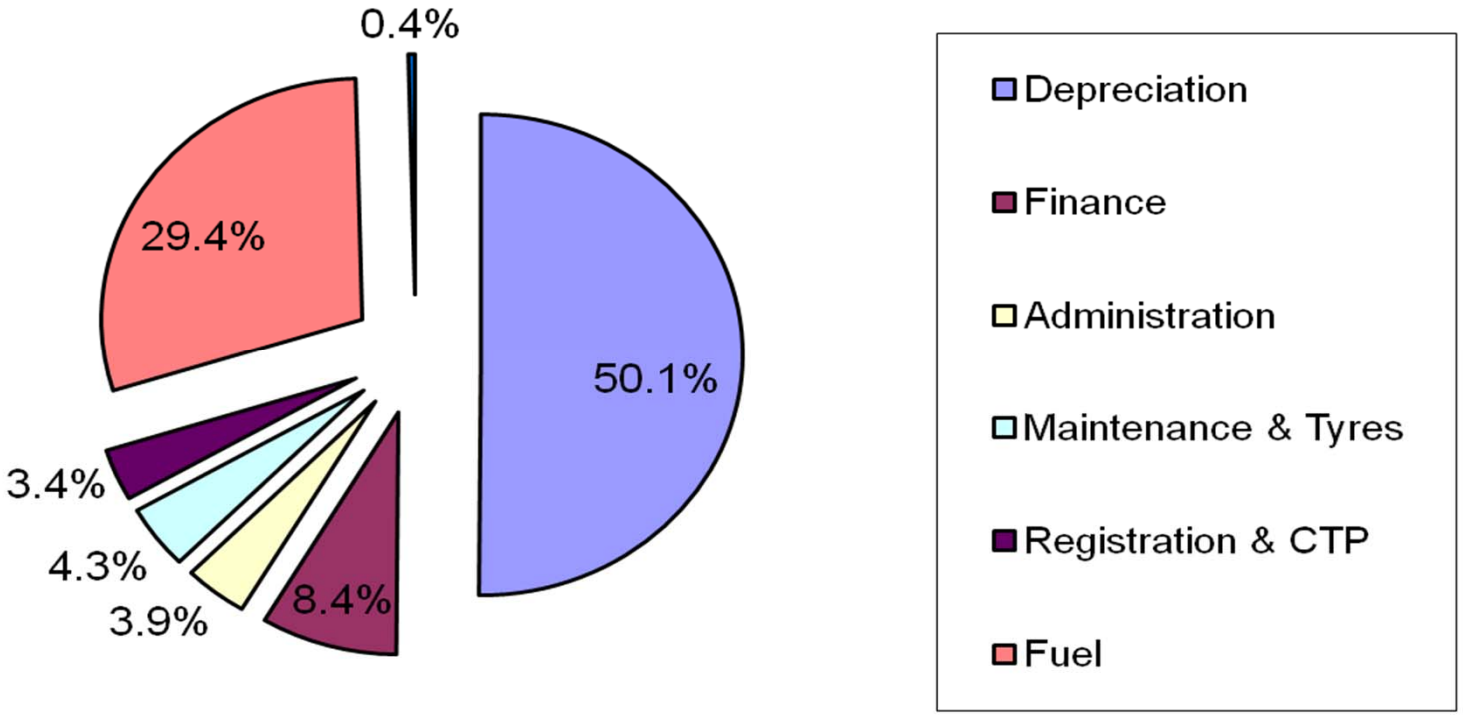
- Disposal (also known as Remarketing)
  - Core activity of an FMO – staff experienced in used vehicles
  - Channels:
    - Driver direct – discount to retail for the Driver – vehicle history known
    - Dealer direct – at wholesale – eliminates disposal costs
    - Fixed price – above wholesale
    - Auction – wholesale spot market (most liquid)
- Remarketing:
  - Operating lease – FMOs responsibility
  - Finance, CHP, Chattel mortgage or managed asset – service to the customer

Knowing the best place to sell a particular type of asset is a managers area of expertise and achieves the best price

Solutions

Typical Fleet Costs – Need Management

Large passenger vehicle

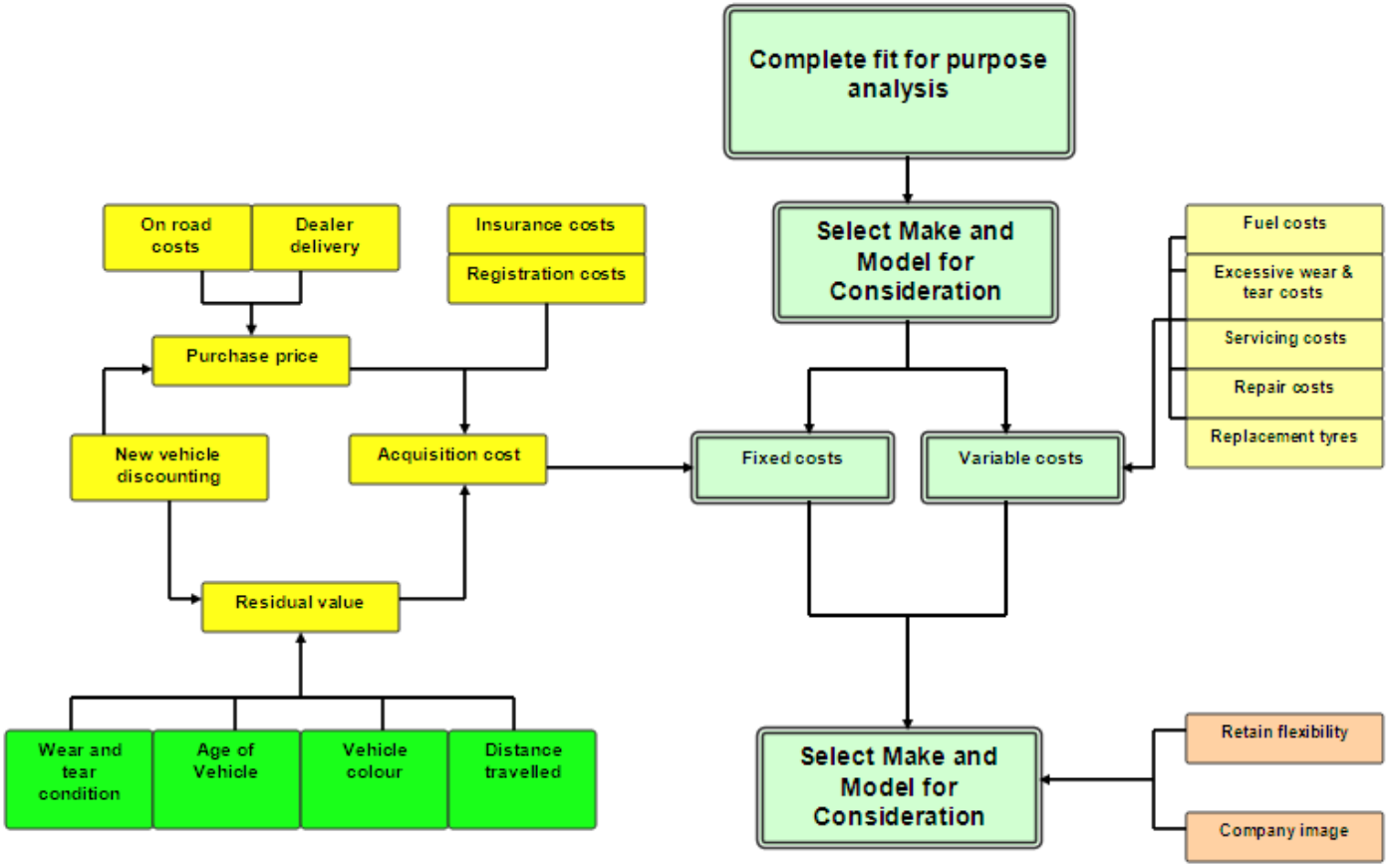


Solutions - Lifecycle Management

FMO’s adopt a holistic approach to cost management of the fleet lifecycle:

- Environmental strategies
- Full fleet audit and consultation
- Benchmarking and analysis
- Purchase negotiations
- Fuel management and negotiation
- Insurance management and negotiation
- Accident management and prevention
- Driver level reporting and benchmarking

Solutions - Whole of Life Costing



Income Streams

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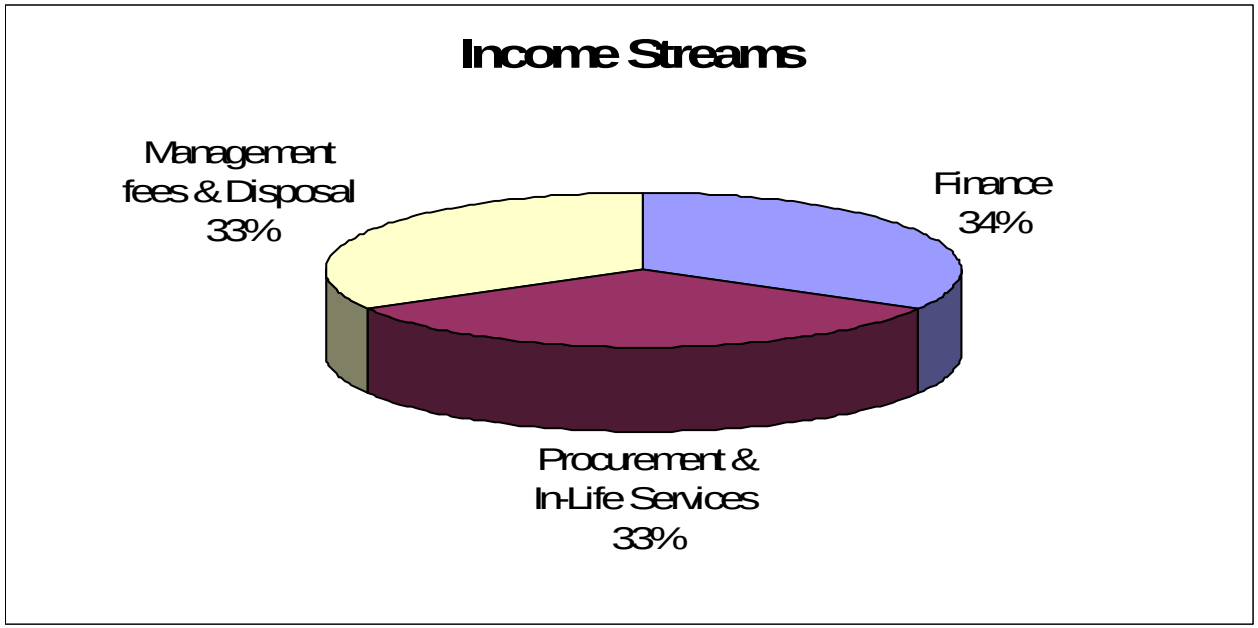

Income streams – more than interest margin!

- Finance – brokerage / interest margin
- Management fees & disposal income
- Procurement & In-life services – commissions, rebates, maintenance & tyre margins

Asset management earns income across diverse areas, reducing reliance on one primary income source.
Targeting a one-third split in each category group is a general aim of Asset Managers.

Income Streams

- Finance – spread or brokerage
  - On balance sheet funding – interest spread
  - Off balance sheet (principal and agency; securitisation; sale and purchase) - brokerage
- Management (including disposal)
  - Customers need the fleet on the road to produce income
  - Customers do not have reporting systems capable of end to end management
- Procurement & In-Life Services
  - Scale delivers financial benefits which are shared between the customer and FMO
  - Management of the supply chain delivers volume rebates to the FMO

Risk Management

Residual Value Risk
Managing In Life Service Risks

Residual Value Risk

The risk that the estimated future value used to calculate the monthly rental is higher than the actual sales proceeds received on disposal of the asset

- Approach used – highly professional
- People assessing and monitoring are car people with car knowledge
- Monitoring of resale prices on a month to month basis using data from multiple sources, including auction centres
- Reviewing future values of current leases on a quarterly basis
- Monthly rental can be re-priced during term via reviewing actual versus estimated usage of the asset, as determined at inception.
- Legal contract allows for adjustment to rentals in event of imposition of taxes (ie: GST, potential environmental taxes)

Risks – Operating Lease Residual Values

- Under an operating lease the risk / reward between the book value of the vehicle at lease end and market value is an FMO's loss or profit
- The desired objective is to have a balanced portfolio – marque, customer type, industry exposure, etc
- If the average residual value per lease is overstated compared with the market value at lease end

  >>>>> 100 vehicles * $500 loss / vehicle = **$50K Loss**
- If the average residual value per lease is understated compared with the market value at lease end

  >>>>> 100 vehicles * $500 profit / vehicle = **$50K Profit**
- Accurately forecasting residual values is THE most important process

Managing Residual Values

Managing the Risks

- Residual Values are set for term and kilometres by a Residual Value Committee
- The Committee typically comprises: Heads of Finance, Operations, Pricing, Remarketing and specialist Analyst(s)
- The Committee reviews high volume vehicles every three months and half yearly for lower volume vehicles (e.g. light commercial vehicles)
- All analysis is conducted in light of performance of vehicles in the used vehicle market and independent sources such as Glass's, Red Book, auction data
- Proactive contract re-writes are undertaken to mark-to-market residual values where parameters vary to that at inception
- A portfolio revaluation is performed to assess the future value of operating leases in the light of macro / micro economic conditions – taxes, fuel, employment, GDP, new vehicle volumes, model changes
- Black Swan and sensitivity

Managing Residual Values during the lease term

Contract Re-Writes

- Invariably the initial contract term and kilometres will differ to the actual operating performance
- Fuel data and service intervals provide evidence of the actual operating kilometres during the term of each lease
- Kilometre readings identify if a vehicle is operating above or below its pro-rata kilometres during the lease. Re-write if under / over pro-rata kilometres drift 10% +/- from the original contract
- If a vehicle is operating below its pro-rata kilometres then the customer is paying too much for their lease, at lease end they may not utilise the original contract kilometres (including maintenance and tyre allocations)
- If a vehicle is operating above its pro-rata kilometres then the customer is likely to incur an excess kilometre charge at lease end
- Improves risk position

Example: contract re-write – increase in kms

	Original Contract	Modified Contract 1st Period	2nd Period	Total	Difference
Start date	27-Jul-12			27-Jul-08	
End date	26-Jul-15			26-Jul-11	
Months	36	27	9	36	0
Mileage (kilometres)	150,000	150,000	50,000	200,000	50,000
NAF	$51,772			$51,772	$0
RV	$18,518			$13,132	$(5,386)
Interest rate	6.95%	6.95%	6.95%	6.95%	0.00%
Rental components					
- Depreciation	$33,254	$24,940	$13,700	$38,640	$5,386
- Other components	$18,767	$14,075	$5,440	$19,515	$748
Sub-Total	$52,021	$39,016	$19,140	$58,155	$6,134
Excess kilometre charge	$7,000	$0	$0	$0	$(7,000)
Total (inc excess charges)	**$59,021**	**$39,016**	**$19,140**	**$58,155**	**$(866)**

Increase of 50,000kms and RV reduced by $5,386

Pull forward of excess km charge – avoid surprise to customer at end of lease + cash flow benefits to FMO

Example: contract re-write – reduction in kms

	Original Contract	Modified Contract 1st Period	2nd Period	Total	Difference
Start date	31-Aug-13			17-Oct-07	
End date	30-Aug-17			16-Oct-11	
Months	48	12	36	48	0
Mileage (kilometres)	100,000	18,750	56,250	75,000	(25,000)
NAF	$35,318			$35,318	$0
RV	$13,787			$14,357	$570
Interest rate	6.50%	6.50%	6.50%	6.50%	0.00%
Rental components					
- Depreciation	$21,531	$5,383	$15,578	$20,960	$(570)
- Other components	$16,316	$4,079	$12,427	$16,506	$190
Sub-Total	$37,847	$9,462	$28,005	$37,466	$(381)
Excess kilometre charge	$0	$0	$0	$0	$0
Total (inc excess charges)	**$37,847**	**$9,462**	**$28,005**	**$37,466**	**$(381)**

25% reduction in contract kilometres

4.1% increase in residual value

1% reduction in whole of life lease rentals

Portfolio Revaluation Process

- Periodically an exercise is undertaken to value the operating lease portfolio known as a Portfolio Revaluation
- Process adopted:
  - Apply current outlook of the used car market to determine at a contract level if likely disposal proceeds, net of costs, is above or below the residual value of each lease
  - The impacts on the used market are forecasted based upon the outlook for economic factors and market demand / supply
  - Where available forecasts from Glass's are used determining the future depreciation of the used vehicle market
- To determine A-IFRS treatment the output of the Portfolio Revaluation is used to calculate at contract level the NPV of contract cash flows, future rentals and RV proceeds, to determine if an impairment provision is required.

Managing In Life Service Risks

- The most significant "in life" risk is Maintenance – scheduled servicing and variable costs (unscheduled maintenance and outside of warranty)
- Maintenance Pricing is one key to controlling the risk
  - Normally a Maintenance Committee comprising experts with relevant motor experience sit periodically to review future pricing over all terms and kilometres (passenger & LCV: 1 to 5 years, maximum of 250,000 kms)
- Maintenance Control Team
  - Pre-authorise servicing and repairs –qualified motor mechanics
- Labour and parts discounts are negotiated with largest suppliers
- In respect of maintenance risk some vehicle types or customer usage can cause losses on a per vehicle basis
  - Example: Vans – weight bearing loads have an impact
  - Example: Vehicles operating in mine sites

Accounting for Leases

Accounting for Operating Leases

- Governed by International Financial Reporting Standards (IFRS)
- Rental, comprising principal and interest, management fees and all charges for services such as maintenance, tyres, automobile association membership, registration renewal, insurance, fuel and road toll management are recorded as REVENUE (Lease Rental Services)
- Proceeds on assets sold at termination are included in REVENUE (Proceeds from sale of leased assets)
- Income earned through supply chain management is included as REVENUE (Lease Rental Services)
- Depreciation of the fleet is straight-line. Accordingly each month the depreciation charge is evenly spread. It equals the “principal” component included in the Rental.
- Interest expense is recorded as a cost of operation so is included in EBIT
- Vehicle Expenses include all payments made to suppliers of services to the asset management operation including payments for fuel, maintenance, tyres, registration, insurances, automobile association membership and includes the Written Down Value of all assets disposed of, at disposal date
- Lessor is owner (Non-Current asset “Property Plan and Equipment” on Lessor balance sheet) and Lessee is the user (notes to accounts shows remaining rental commitments)

Accounting for Operating Leases

Impairment

- Impairment of Residual Values tested annually. Impairment loss brought to profit and loss as part of Depreciation and Amortisation and Impairment Expenses
- Impairment amount reduces the “cost” of the Asset
- Each lease contract tested. Loss contracts only brought to account

Impairment provisions are brought to account over the life of the lease term and are, thereafter, upwardly or downwardly revised, as the case may be. Accordingly the effects are recognised progressively rather than actual losses being brought to account, only when they are realised. If a loss reduces in quantum, then impairment provision is reduced accordingly.

Operating Lease Example

- Cost of Asset $25,000
- Residual Value $14,200
- Term 36 months
- Monthly Rental $700 per month
- Includes maintenance; tyres, registration, insurance, automobile association, management fee for services provided
- 100% debt finance – average amount financed over the 3 years

PROFIT AND LOSS

Revenue ($700*12)	$8,400
Less: Depreciation ([$25,000 - $14,200]/36)	($3,600)
Less: Interest	($1,362)
Less: Vehicle Expenses paid	($2,000)
Profit before Income Tax	**$ 1,438**

BALANCE SHEET

Assets under operating Leases	
At Cost	$25,000
Less Accumulated depreciation	($3,600)
	$21,400

3 Year Lease – Returned in Good Condition

Profit & Loss	Yr 1 $	Yr 2 $	Yr 3 $	Total $
Revenue	8,400	8,400	8,400	25,200
Profit on Sale (@ 5%)	0	0	710	710
Depreciation	(3,600)	(3,600)	(3,600)	(10,800)
Interest (6.95%)	(1,439)	(993)	(600)	(3,032)
Vehicle Expenses	(1,250)	(1,750)	(3,000)	(6,000)
Contribution Before Overheads	**2,111**	**2,057**	**1,910**	**6,078**

ROE **25%**

Cash Flow Statement	Yr 1 $	Yr 2 $	Yr 3 $
Open - Cash / (Debt) Position	0	(14,289)	(8,632)
Capital - 20%	5,000	0	0
Acquire Vehicle	(25,000)	0	0
Rental Income	8,400	8,400	8,400
Interest Expense	(1,439)	(993)	(600)
Vehicle Expenses	(1,250)	(1,750)	(3,000)
Disposal Proceeds	0	0	14,910
Close - Cash / (Debt) Position	(14,289)	(8,632)	11,078

Cash return on Equity Invested **222%**

- Assumptions (as per presentation) plus:
- 20% equity
- 5% disposal profit
- Utilisation of in-life services as planned

3 Year Lease – Lower Disposal Result

Profit & Loss	Yr 1 $	Yr 2 $	Yr 3 $	Total $
Revenue	8,400	8,400	8,400	25,200
Profit on Sale (@ 5%)	0	0	142	142
Depreciation	(3,600)	(3,600)	(3,600)	(10,800)
Interest (8%)	(1,439)	(993)	(600)	(3,032)
Vehicle Expenses	(1,250)	(1,750)	(3,000)	(6,000)
Contribution Before Overheads	**2,111**	**2,057**	**1,342**	**5,510**

ROE **24%**

Cash Flow Statement	Yr 1 $	Yr 2 $	Yr 3 $
Open - Cash / (Debt) Position	0	(14,289)	(8,632)
Capital - 20%	5,000	0	0
Acquire Vehicle	(25,000)	0	0
Rental Income	8,400	8,400	8,400
Interest Expense	(1,439)	(993)	(600)
Vehicle Expenses	(1,250)	(1,750)	(3,000)
Disposal Proceeds	0	0	14,342
Close - Cash / (Debt) Position	(14,289)	(8,632)	10,510

Cash return on Equity Invested **210%**

- Assumptions (as per presentation) plus:
- 20% equity
- 1% disposal profit
- Utilisation of in-life services as planned

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3 Year Lease – Under spend on Tyres

Profit & Loss	Yr 1 $	Yr 2 $	Yr 3 $	Total $
Revenue	8,400	8,400	8,400	25,200
Profit on Sale (@ 5%)	0	0	710	710
Depreciation	(3,600)	(3,600)	(3,600)	(10,800)
Interest (6.95%)	(1,439)	(993)	(600)	(3,032)
Vehicle Expenses	(1,250)	(1,750)	(2,200)	(5,200)
Contribution Before Overheads	**2,111**	**2,057**	**2,710**	**6,878**

ROE **27%**

Cash Flow Statement	Yr 1 $	Yr 2 $	Yr 3 $
Open - Cash / (Debt) Position	0	(14,289)	(8,632)
Capital - 20%	5,000	0	0
Acquire Vehicle	(25,000)	0	0
Rental Income	8,400	8,400	8,400
Interest Expense	(1,439)	(993)	(600)
Vehicle Expenses	(1,250)	(1,750)	(2,200)
Disposal Proceeds	0	0	14,910
Close - Cash / (Debt) Position	(14,289)	(8,632)	11,878
Cash return on Equity Invested			**238%**

- Assumptions (as per presentation) plus:
- 20% equity
- 5% disposal profit
- Under utilisation of 1 set of tyres - $800 in year 3

Conclusions

Conclusions

- Income streams are diverse and adjustable
- Fleet management is an outsourced activity which is mature
- Leasing is one form of finance and addresses part of the customer landscape.
- Risks are well managed and can be addressed during the lease term
- Fleet management and financing combined provide a variety of predictable and sustainable cashflows