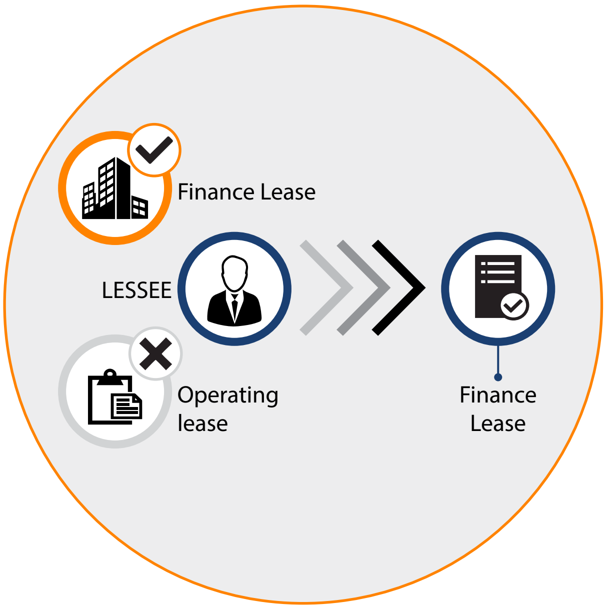
Leases Exposure



Substantially all Aircraft and major asset leases to be recognised on-balance sheet, with some exceptions for short-term leases and "small assets"
Lease liability and asset initially measured at present value of unavoidable lease payments and some variable payments
Recognise amortisation of lease assets and interest on lease liability over the term of the lease
Arrangements containing leases including many "outsourcing" agreements still within the leases definition and those affected now to be on-balance sheet
Most Airlines will see balance sheet leverage ratios worsen depending on the extent the fleet that is carried off-balance sheet
Reported operating profits before finance costs for most Airlines with significant off-balance sheet fleets will improve as the lease expense previously recognised shall now be split between operating expenses (amortisation of asset) and interest expenses (on lease liability)

No substantial changes to the accounting for lessors
Leases where substantial risks and rewards are transferred to the lessee shall be treated as finance leases and a lease receivable recognised
Leases that do not transfer significant risks and rewards to the lessee shall be treated as operating leases

Impact on Earnings

- Increase in EBITDA as previous operating lease aircraft costs will be replaced by depreciation charge and finance costs which are not reflected in this key sub-total.
- A likely increase in EBIT (Operating Profit) as the decrease in operating lease aircraft costs will likely not be offset by increase in depreciation costs
- Impact on EBIT and Operating Profit dependent items such as debt covenants and employee compensation schemes therefore management should start to consider this and communicate with affected stakeholders
- Impact on profit is difficult to model as much will be dependent on discount rates applied to capitalise leases and decisions regarding useful live of recognised aircraft assets

Impact on Statement of Financial Position

- Deterioration of gearing ratios such as debt/equity measures
- Net negative impact on equity in early years after adoption as the lease liability will decline at a slower pace that the carrying amount of assets which will be depreciated on a (mostly) straight-line basis, ignoring the effect of any revaluations which may occur. Trend will reverse in latter period of leases
- Negative impact expected on working capital ratios as current portion of lease liability will be a current liability

Statement of Cash flows

- Generally there will be an improved operating cash flow result as part of the operating lease payments fully classified as operating cash flows will now be partially recognised as financing cash flows relating to the lease liability
- For entities that classify finance costs as part of operating cash flows the impact on operating cash flows will be negative compared to those entities that recogniser's it as part of financing cash flows
- For entities that classify finance costs as part of financing cash flows the impact on financing cash flows will be negative

Assuming an off-balance sheet fleet exposure some of the highlights would be as follows between the statement of financial position and statement of profit or loss:

- An increase in net liabilities relative to the past year ends
- A deterioration in the net debt/equity ratio
- Based on an increase in the aircraft assets and liabilities, depreciation and finance costs would increase whilst the operating lease expense would decrease
- Operating profit/loss likely to improve

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