



A Calcbench Analysis

Operating Leases: What Lies Beneath

Next Generation Interactive Financial Data

Introduction

Operating Leases

- Do not appear on the balance sheet today. However, under the new FASB regulation [ASU 2016-02](#), companies will now have to include lease assets and lease liabilities beginning after December 15, 2018
- FASB focused on increasing “transparency and comparability among organizations” with this update*

Calcbench can help expose the details

- Access to every lease footnote filed to the SEC
- Term structures of leasing arrangements
- Sector level summaries
- Changes in leasing obligations over time
- Using our exclusive Excel template, analyze present value of all lease obligations across firms

Our Process

- Using a discount function**, calculated total lease liabilities for over 3,000 companies
- Implied lease years generated by taking a weighted average of the remaining lease term***
- Computed implied liability increase (if total lease liability was included in the total liabilities)

*https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167901010&acceptedDisclaimer=true

**Our discount function used an interest rate of 3% that was scaled by 50 basis points per year

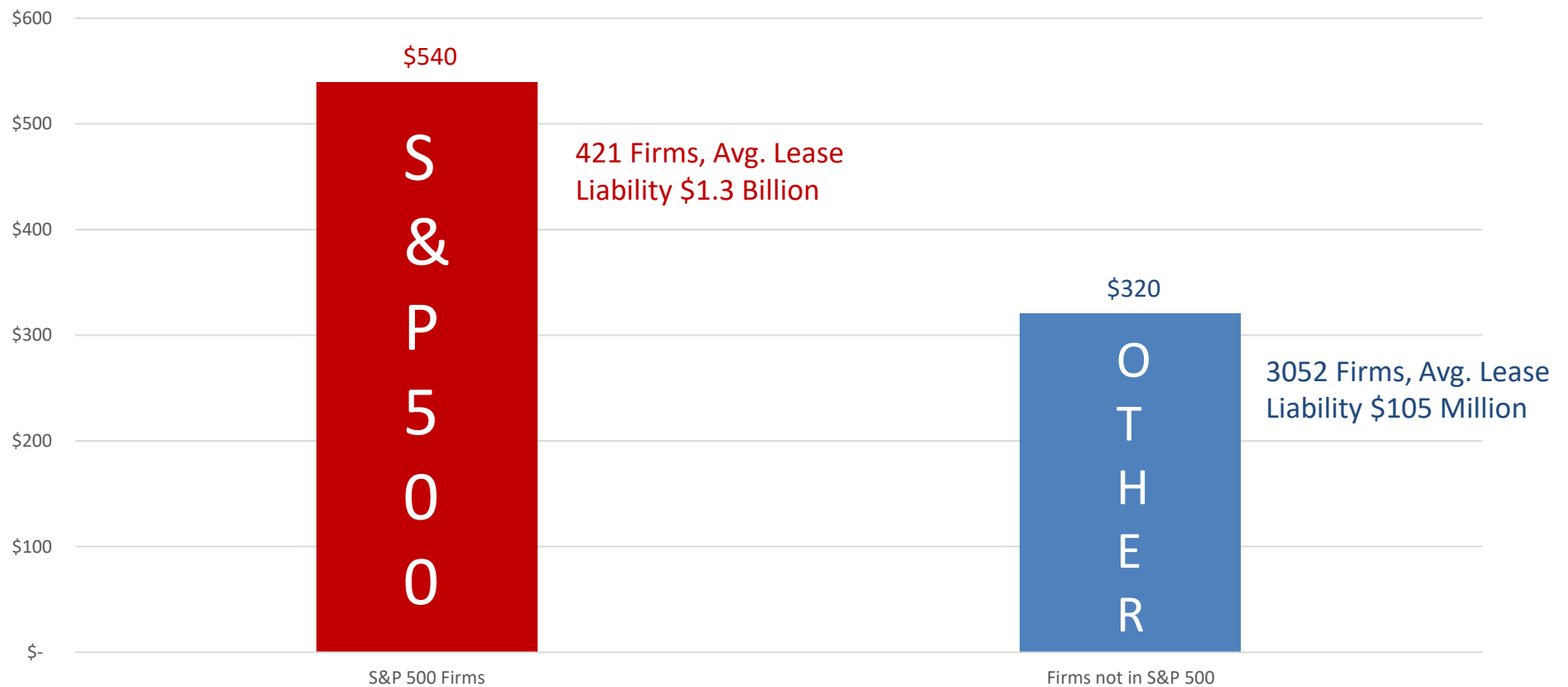
***The equation to find implied lease years is as follows: thereafter period lease payment divided by the average first five years of lease payments plus five

Accounting

Capitalizing operating leases will affect financial statements

- **Balance Sheet Impact**
 - Increase liabilities
 - Will impact capital structure – with no changes to shareholders equity (see page 7)
 - Will impact financial leverage calculation – perceived financial risk will increase
 - Any financial models using financial leverage may need to be adjusted
 - May impact debt covenants
 - Increase Assets
 - Return on Assets impacted (↓ for profit makers, ↑ for loss makers) (see page 7)
- **Income Statement Impact**
 - (new) Right of use assets subject to impairment (like all assets)
 - May lead to negative earnings surprises
 - If lease is renegotiated (favorably), liabilities decrease and recognize gain in net income
 - Greater risk for recognizing an impairment (or gain) therefore lowering (or increasing) net income
 - Amortization expense of new asset(s) may be similar to operating lease payments and have minimal impact to net income.

Total Lease Liabilities of Firms with Liabilities > \$0 (USD Billion, 2017)



Top 10 Firms with Greatest Total Operating Lease Liability (2017)

Company	Total Lease Liability (\$M)	Implied Lease Years	Total Interest Expense (\$M)	Ratio (1:5)	Total Liabilities (\$M) (from Balance Sheet)
Walgreens Boots Alliance, Inc.	\$22,568	11.66	\$1,037	0.74	\$37,735
At&T Inc.	\$20,982	7.78	\$909	0.67	\$302,090
CVS HEALTH Corp	\$18,174	12.27	\$841	0.78	\$57,436
Verizon Communications Inc	\$16,793	7.81	\$724	0.59	\$212,456
Amazon Com Inc	\$16,526	10.47	\$751	0.75	\$103,601
FedEx Corp	\$13,880	9.13	\$616	0.63	\$32,914
United Continental Holdings, Inc.	\$12,349	9.42	\$547	0.52	\$33,520
Bank Of America Corp /DE/	\$11,780	7.71	\$508	0.61	\$2,014,088
Walmart Inc.	\$11,395	9.95	\$511	0.60	\$123,700
Delta Air Lines Inc /DE/	\$11,189	11.69	\$511	0.60	\$39,382

Top 25 Firms with Greatest Implied Liability Increase (2017)*

Company	Total Lease Liability (\$ Million)	Implied Lease Years	Implied Liability Increase
Five Star Senior Living Inc.	\$1,507.37	9.63	456%
Potbelly Corp	\$239.23	7.17	447%
Chipotle Mexican Grill Inc	\$2,433.83	13.86	357%
Diversicare Healthcare Services, Inc.	\$562.46	17.67	349%
Francesca's Holdings CORP	\$234.96	6.88	332%
Five Below, Inc	\$752.23	8.14	317%
MB Bancorp Inc	\$360.39	5.00	308%
Chuy's Holdings, Inc.	\$222.99	16.70	269%
Foot Locker, Inc.	\$3,761.09	7.91	261%
Vera Bradley, Inc.	\$170.27	6.84	260%
Shoe Carnival Inc	\$276.45	6.35	255%
Tile Shop Holdings, Inc.	\$318.68	16.80	251%
Genesco Inc	\$1,214.02	6.98	250%
Zumiez Inc	\$345.87	6.85	241%
Tilly's, Inc.	\$312.28	6.48	241%
Yelp Inc	\$277.16	6.95	237%
Urban Outfitters Inc	\$1,541.18	7.90	236%
Rigel Pharmaceuticals Inc	\$43.12	6.47	234%
American Eagle Outfitters Inc	\$1,320.15	6.91	232%
Build A Bear Workshop Inc	\$193.90	7.14	214%
Otonomy, Inc.	\$23.23	10.40	210%
DSW Inc.	\$968.63	6.50	209%
Express, Inc.	\$1,092.97	7.22	205%
Christopher & Banks Corp	\$139.16	6.61	202%
Natural Grocers by Vitamin Cottage, Inc.	\$327.87	12.85	197%

*Excluded companies with Assets < 100M or if no lease payments were reported

Top 25 Firms (continued)

Company	Return on Assets (ROA)		Liabilities to Assets Ratio	
	Currently Reported	Adjusted For Lease Assets	Currently Reported	Adjusted For Lease Assets
Five Star Senior Living Inc.	-3.52%	-1.05%	69.53%	92.69%
Potbelly Corp	-3.63%	-1.63%	31.33%	71.40%
Chipotle Mexican Grill Inc	8.66%	3.93%	33.30%	69.54%
Diversicare Healthcare Services, Inc.	-12.43%	-0.66%	96.14%	99.11%
Francesca's Holdings CORP	8.43%	3.70%	38.22%	72.76%
Five Below, Inc	17.13%	7.08%	34.09%	68.33%
MB Bancorp Inc	0.72%	0.01%	79.39%	94.02%
Chuy's Holdings, Inc.	11.33%	5.85%	30.52%	61.82%
Foot Locker, Inc.	7.28%	3.68%	36.40%	67.38%
Vera Bradley, Inc.	1.94%	1.35%	18.65%	45.24%
Shoe Carnival Inc	4.37%	2.74%	26.05%	55.59%
Tile Shop Holdings, Inc.	4.35%	1.84%	46.86%	75.59%
Genesco Inc	-7.68%	-4.42%	36.85%	67.16%
Zumiez Inc	5.79%	3.17%	28.75%	57.90%
Tilly's, Inc.	5.06%	2.44%	44.70%	73.37%
Yelp Inc	14.55%	10.23%	9.61%	26.38%
Urban Outfitters Inc	5.62%	3.10%	33.38%	62.77%
Rigel Pharmaceuticals Inc	0.00%	-48.07%	15.50%	37.96%
American Eagle Outfitters Inc	11.35%	6.51%	31.36%	60.25%
Build A Bear Workshop Inc	3.99%	2.02%	45.80%	72.62%
Otonomy, Inc.	0.00%	-59.45%	8.64%	22.64%
DSW Inc.	4.75%	2.83%	32.77%	60.11%
Express, Inc.	1.76%	0.85%	44.93%	71.32%
Christopher & Banks Corp	-17.23%	-8.52%	57.77%	80.50%
Natural Grocers by Vitamin Cottage, Inc.	3.24%	1.10%	55.37%	78.68%

*Excluded companies with Assets < 100M or if no lease payments were reported

Data by Economic Sector

Economic Sector	Total Lease Liability (\$ Million)	Firm Count	Avg. Total Lease Liability (\$ Million)	Total Lease Liability to Total Liabilities (Currently on Balance Sheet) Ratio
Consumer Discretionary	\$327,447	780	\$420	6.5%
Consumer Staples	\$43,736	188	\$233	3.3%
Energy	\$34,079	258	\$132	1.7%
Financials	\$117,231	772	\$152	0.3%
Healthcare	\$29,006	117	\$248	6.5%
Industrials	\$123,138	496	\$248	5.7%
Information Technology	\$64,712	276	\$234	4.2%
Materials	\$15,553	167	\$93	3.0%
Telecommunication Services	\$47,444	46	\$1,031	5.6%
Utilities	\$584	2	\$292	1.9%

Consumer discretionary has the largest sum of total lease liability. What does this mean for individual firms that fall into that category? We decided to take a closer look.

If you want to look for yourself, here's a segment of Chipotle's 10-K filing for 2017* (taken directly off the [Calcbench website](#))

8. Leases

Large number of years for ground leases

Our restaurants are generally operated in leased premises. Lease terms for traditional shopping center or building leases generally include combined initial and option terms of 20-25 years. Ground leases generally include combined initial and option terms of 30-40 years. The option terms in each of these leases are typically in five-year increments. Typically, the lease includes rent escalation terms every five years including fixed rent escalations, escalations based on inflation indexes, and fair market value adjustments. Certain leases contain contingent rental provisions that include a fixed base rent plus an additional percentage of the restaurant's sales in excess of stipulated amounts. Our leases generally provide for the payment of common area maintenance, property taxes, insurance and various other use and occupancy costs. In addition, we are the lessee under non-cancelable leases covering certain offices.

Contractually required future minimum cash lease payments under existing operating leases as of December 31, 2017 are as follows:

2018	\$	281,461
2019		285,264
2020		283,934
2021		279,816
2022		278,615
Thereafter		2,497,163
Total minimum lease payments	\$	3,906,253

Minimum lease payments have not been reduced by minimum sublease rentals of \$7,359 due in the future under non-cancelable subleases.

Rental expense consists of the following:

Large minimum lease payments connected with the lease years

	Year ended December 31,		
	2017	2016	2015
Minimum rentals	\$ 278,812	\$ 255,955	\$ 227,602
Contingent rentals	\$ 2,317	\$ 1,811	\$ 4,542
Sublease rental income	\$ (2,214)	\$ (2,074)	\$ (1,879)

We have six sales and leaseback transactions. These transactions do not qualify for sale leaseback accounting because of our deemed continuing involvement with the buyer-lessor due to fixed price renewal options, which results in the transaction being recorded under the financing method. Under the financing method, the assets remain on the consolidated balance sheet and the proceeds from the transactions are recorded as a financing liability. A portion of lease payments are applied as payments of deemed principal and imputed interest. The deemed landlord financing liability was \$2,630 and \$2,854 as of December 31, 2017, and 2016, respectively, with the current portion of the liability included in accrued liabilities, and the remaining portion included in other liabilities in the consolidated balance sheet.

*Period ending 12/31/2017 (from 10-K filed on 2/8/2018)

Takeaways

- **\$860 Billion*** in debt through operating leases that firms are not required to put onto their balance sheets until December 15, 2018
- By our account, 85 firms will have under-reported their leasing liabilities by over 100% (refer to slide 5 to see the top 25)
- FASB regulation ASU 2016-02 will have a large impact on firms' balance sheets
 - This is especially true for S&P500 companies due to their large amounts of lease liabilities
- *Consumer discretionary* is the biggest total lessee, while *Telecommunication Services* is the biggest average lessee.
- **Calcbench** can get you this information faster than anyone else

About the Authors



Pranav Ghai

CEO & CO-FOUNDER

Pranav is an analytics professional whose career has been based in financial services, with time spent at Morgan Stanley and ITG. He is also a new addition to the board of directors at XBRL-US. Pranav graduated with a BS from Bates College and an MS in Applied Mathematics from the Courant Institute at New York University.



Jeff Kahle

INTERN

Jeff is a student at Bates College, scheduled to graduate in 2019, who matriculated from Choate Rosemary Hall in Wallingford, CT. He works as the Business Manager of the *Bates Student*, and he is active in the Investment Club, where he serves as the Director of Equity Research. Jeff also likes to spend time as a DJ on WRBC Bates College Radio.

Try Calcbench Today!

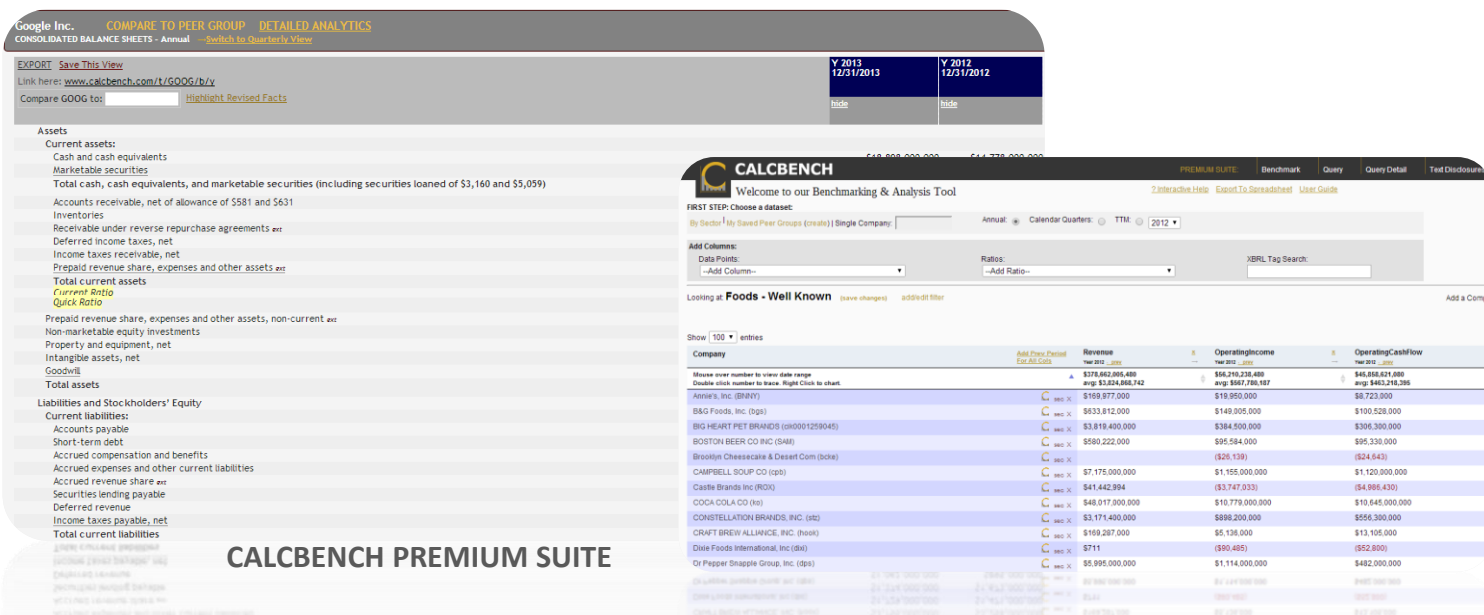
ABOUT THIS REPORT: This report was created using data analyzed via Calcbench's Premium Suite, an online interactive platform that helps finance leaders access and analyze financial data thoroughly and efficiently.

Our accessible and intuitive platform can aid in better understanding competitor financials, identifying potential risk areas, analyzing trends across industry sectors, or conducting more effective due diligence.

Sign up for a 2 week free trial at

www.calcbench.com/trial

or contact us at us@calcbench.com or via www.calcbench.com



The screenshot displays the Calcbench Premium Suite interface. On the left, there is a navigation menu for Google Inc. with sections for Assets, Liabilities and Stockholders' Equity, and Current liabilities. The main area shows a comparison of financial data for Y 2013 (12/31/2013) and Y 2012 (12/31/2012). Below this, there is a table of companies in the 'Foods - Well Known' sector, with columns for Revenue, Operating Income, and Operating Cash Flow.

Company	Revenue Year-end 2012	Operating Income Year-end 2012	Operating CashFlow Year-end 2012
AT&T Intellectual Property (int)	\$375,662,005,480	\$66,210,235,480	\$46,656,621,680
AT&T INTEL (int)	avg \$3,204,696,742	avg \$567,780,167	avg \$452,740,395
AT&T INTEL (int)	\$168,977,000	\$18,950,000	\$8,723,000
B&G Foods, Inc. (dps)	\$833,812,000	\$149,005,000	\$190,528,000
BIG HEART PET BRANDS (cik0001259045)	\$3,819,400,000	\$384,500,000	\$306,300,000
BOSTON BEER CO INC (SAM)	\$580,222,000	\$95,584,000	\$95,330,000
Brooklyn Cheese&ale & Desert Com (dps)		(\$26,139)	(\$24,643)
CAMPBELL SOUP CO (ops)	\$7,175,000,000	\$1,155,000,000	\$1,120,000,000
Castle Brands Inc (ROK)	\$41,642,994	(\$3,747,033)	(\$4,986,430)
COCA COLA CO (ds)	\$48,017,000,000	\$10,779,000,000	\$10,645,000,000
CONSTELLATION BRANDS, INC (stc)	\$3,171,400,000	\$899,200,000	\$556,300,000
CRAFT BREW ALLIANCE, INC (psok)	\$169,287,000	\$5,136,000	\$13,105,000
Dixie Foods International, Inc (dix)	\$711	(\$90,485)	(\$52,800)
Or Pepper Shingle Group, Inc. (dps)	\$5,995,000,000	\$1,114,000,000	\$482,000,000