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A Calcbench Analysis
**Operating Leases:
What Lies Beneath**

Next Generation Interactive Financial Data



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Introduction

Operating Leases

- Do not appear on the balance sheet today, however under new FASB regulation ASU 2016-02*, companies will now have to include lease liabilities starting December 2018

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 1,500 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)

*http://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



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Comparative Lease Liabilities of Firms with Liabilities >\$0 (USD Billion, 2016)





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Top 10 Firms with Greatest Total Operating Lease Liability (2016)

	Total Lease Liability	Implied Lease years	Total Interest Expense	Ratio (1:5)	Total Liabilities (Balance Sheet)
At&T Inc.	\$23,116,510,542	8.7	\$1,023,299,595	1.7	\$279,711,000,000
Walgreens Boots Alliance, Inc.	\$22,824,318,613	12.3	\$1,056,262,615	1.6	\$42,407,000,000
CVS HEALTH Corp	\$18,163,528,939	12.5	\$841,207,302	1.6	\$57,628,000,000
Verizon Communications Inc	\$14,380,100,502	8.0	\$621,367,217	2.3	\$220,148,000,000
American Airlines Group Inc.	\$10,595,916,853	7.1	\$447,821,675	2.3	\$47,489,000,000
Delta Air Lines Inc /DE/	\$9,549,985,715	10.4	\$429,886,089	2.3	\$38,974,000,000
Bank Of America Corp /DE/	\$8,804,958,811	8.3	\$402,552,482	0.0	\$1,920,862,000,000
Mcdonalds Corp	\$8,622,948,619	11.1	\$393,645,337	1.8	\$33,228,200,000
Jpmorgan Chase & Co	\$8,173,757,009	7.9	\$352,689,273	2.2	\$2,236,782,000,000
Amazon Com Inc	\$7,467,050,933	8.5	\$328,842,920	1.8	\$64,117,000,000



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Top 25 Firms with Implied Liability (2016)

	Total Lease Liability	Implied Lease Years	Implied Liability Increase
Potbelly	\$240,257,814.84	7.4	469.2%
Chipotle Mexican Grill	\$2,290,533,991.21	13.9	367.3%
Yelp	\$253,360,278.09	7.1	324.7%
Tile Shop Holdings	\$282,255,450.46	17.1	223.3%
Fiesta Restaurants	\$350,408,597.78	13.2	197.5%
Zoe's Kitchen	\$165,584,196.87	18.0	194.2%
Vitamin Shoppe	\$545,458,288.50	6.9	185.4%
Granite Falls Energy	\$25,931,593.08	8.5	164.8%
SP Plus	\$826,971,346.08	6.4	162.1%
Crocs	\$264,343,721.53	6.7	158.2%
Tractor Supply Co	\$1,928,288,985.57	9.2	157.8%
Whole Foods Market	\$4,901,460,641.88	17.2	157.2%
Skechers Usa	\$1,078,837,436.49	8.4	152.3%
Shopify	\$113,521,381.18	11.3	141.8%
NOODLES & Co	\$252,452,463.20	7.4	137.5%
Sprouts Farmers Market	\$1,019,713,342.83	11.0	133.0%
Bassett Furniture Industries	\$124,766,580.56	7.0	127.9%
Kite Pharma	\$117,308,157.10	18.7	121.8%
Marketaxess Holdings	\$72,184,826.23	19.0	120.2%
CC Holdings	\$1,281,523,856.46	17.6	109.0%
Strayer Education	\$120,027,982.33	5.6	108.8%
Select Comfort	\$319,709,719.41	7.7	107.7%
Marin Software	\$20,962,325.11	5.6	107.5%
Bravo Brio Restaurants	\$194,848,241.92	8.9	103%
Cheesecake Factory	\$697,751,279.77	11.7	101%



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Data by Economic Sector

	Total Lease Liability (\$MM)	Firm Count	Avg. Total Lease Liability (\$MM)
Consumer Discretionary	\$175,368	378	\$464
Financials	\$135,220	416	\$325
Industrials	\$82,833	276	\$300
Information Technology	\$45,183	154	\$293
Telecommunication Services	\$44,606	22	\$2,028
Consumer Staples	\$34,808	106	\$328
Energy	\$34,384	130	\$264
Healthcare	\$20,376	69	\$295
Materials	\$12,749	97	\$131
Utilities	\$847	2	\$423
TOTAL:	\$586,374	1650	\$4,853

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.



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Example of Whole Food's 10K Filing for 2016*

Leases

The Company is committed under certain capital leases for rental of certain buildings, land and equipment, and certain operating leases for rental of facilities and equipment. These leases expire or become subject to renewal clauses at various dates from 2016 to 2054. The Company had capital lease obligations totaling approximately \$58 million and \$65 million at September 25, 2016 and September 27, 2015, respectively.

Rental expense charged to operations under operating leases for fiscal years 2016, 2015 and 2014 totaled approximately \$477 million, \$441 million and \$407 million, respectively, which included contingent rentals totaling approximately \$12 million, \$14 million and \$13 million during those same periods. Sublease rental income was not material during fiscal year 2016, 2015 or 2014. Prepaid rent is included in the "Other current assets" line item on the Consolidated Balance Sheets and totaled approximately \$44 million and \$38 million at September 25, 2016 and September 27, 2015, respectively.

Minimum rental commitments and sublease rental income required by all noncancelable leases are approximately as follows (in millions):

	Capital	Operating	Sublease
Fiscal year 2017	\$ 6	\$ 433	\$ 8
Fiscal year 2018	5	522	7
Fiscal year 2019	4	557	5
Fiscal year 2020	5	568	5
Fiscal year 2021	5	569	3
Future fiscal years	65	6,485	4
	90	\$ 9,134	\$ 32
Less amounts representing interest	32		
Net present value of capital lease obligations	\$ 58		

The present values of future minimum obligations for capital leases shown above are calculated based on interest rates determined at the inception of the lease, or upon acquisition of the original lease. The future minimum obligations for operating leases shown above include locations in development.

*Period Ending: 9/25/2016 (from 10-K reported on 11/18/2016)



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Example of Chipotle's 10K Filing for 2016*

8. Leases

The Company generally operates its restaurants 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. The leases generally provide for the payment of common area maintenance, property taxes, insurance and various other use and occupancy costs by the Company. In addition, the Company is the lessee under non-cancelable leases covering certain offices.

Contractually required future minimum cash lease payments under existing operating leases as of December 31, 2016 are as follows:

2017	\$	<u>264,911</u>
2018		<u>268,862</u>
2019		<u>269,133</u>
2020		<u>263,732</u>
2021		<u>257,400</u>
Thereafter		<u>2,358,941</u>
Total minimum lease payments	\$	<u>3,682,979</u>

Minimum lease payments have not been reduced by minimum sublease rentals of \$5,342 due in the future under non-cancelable subleases.

Rental expense consists of the following:

	Year ended December 31,		
	2016	2015	2014
Minimum rentals	\$ <u>255,955</u>	\$ <u>227,602</u>	\$ <u>200,575</u>
Contingent rentals	\$ <u>1,811</u>	\$ <u>4,542</u>	\$ <u>4,616</u>
Sublease rental income	\$ <u>(2,074)</u>	\$ <u>(1,879)</u>	\$ <u>(1,838)</u>

The Company has six sales and leaseback transactions. These transactions do not qualify for sale leaseback accounting because of the Company's 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 \$2,854 and \$3,060 as of December 31, 2016, and 2015, 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: 12/31/2016 (from 10-K reported on 2/7/2017)



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Takeaways

- **\$586 Billion** in debt through operating leases that firms are not required to put onto their balance sheets until December 2018
- By our account, over 25 firms will have under-reported their leasing liabilities by over 100% (refer to slide)
- 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 outstanding amount of lease liabilities
- *Consumer discretionary* is the biggest lessee, meaning this sector will be most effected by the new FASB regulation
- **Calcbench** can get you this information faster than anyone else



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About the Authors



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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.



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Danielle is a student at Bates College, scheduled to graduate in 2019, and matriculated from the Ethical Culture Fieldston School in New York City. She works as the Economics department research assistant, is a manager of The Ronj coffee shop on campus and actively participates in the Investment Club.



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The screenshot displays the Calcbench web application interface. At the top, there is a navigation bar with options like 'COMPARE TO PEER GROUP', 'DETAILED ANALYTICS', and 'COMBILATED BALANCE SHEETS'. The main content area shows a financial comparison tool for the 'Foods - Well Known' sector. The interface includes a search bar, a table of companies, and a sidebar with 'Query Footnotes'. The table lists companies such as BIG HEART PET BRANDS, BOSTON BEER CO, and CAMPBELL SOUP CO, along with their financial metrics like Revenue, Operating Income, and Operating Cash Flow. The sidebar on the right contains 'Query Footnotes' for the selected company, providing detailed financial information and analysis.