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Agenda for today

Welcome and introduction
Early adopter experience
Coffee break – ca. 11.00
Communicating to the capital markets
Lunch break – ca. 12.30
Impairment testing and valuation
Tax accounting
Coffee break – ca. 15.30
Accounting hot topics
Drinks reception – ca. 17:00
Today’s presenters (2/2)

Impairment testing and valuation

Gijs de Graaff & Sander Mulder

Tax accounting

Arthur Plantfeber

Accounting hot topics

Brian O’Donovan
Polling statements and questions

Ruben Rog

—

27 March 2019
Do you feel energised?

- Yes! One day full about IFRS 16 to come!!: 31 votes
- Yes! The coffee was Great!!: 1 vote
- No, I need more coffee.....: 2 votes
When do you plan to handover responsibility for IFRS 16 lease accounting to the business?

- **No plans to hand over - IFRS 16 will be managed centrally**: 7
- **Already handed over!**: 8
- **After FY 2019**: 3
- **After Q1 reporting 2019**: 15
What do you foresee as the biggest IFRS 16 challenge in 2019?

1. Technical accounting & Judgement
2. Preparing the disclosure
3. Tool implementation
4. Embedding IFRS 16 in day-to-day processes
5. The audit

32
Did your tool calculate the January & February journal entries?

- Yes it did: 10
- No - we plan to only make entries quarterly: 1
- The entries were calculated in a temporary spreadsheet solution: 5
- Yes it did, but it needed some workarounds: 7
- Yes it did, but we are still reviewing the figures: 6
- Yes it did - our tool is a spreadsheet: 0
To what extent is your auditor involved in IFRS 16?

- The audit of the opening balance is complete: 12
- Required processes & controls are agreed: 9
- Transition approach agreed: 23
- Accounting policy agreed: 18
- Not involved yet: 4
How will you account for inter-company leases?

- 7: We do not have any inter-company leases
- 7: We apply local GAAP in statutory accounts and IFRS 16 is not relevant
- 13: We have inter-company leases for which we need to apply IFRS 16 for statutory purposes
- 5: We do not know yet whether we need to apply IFRS 16 to our inter-company leases
IFRS 16: One year further... some observations from KPMG
Preparing your IFRS 16 disclosures

Niels Ebbinkhuijsen

27 March 2019
Disclosure on IFRS 16 in 2018 financial statements - some observations

- 63 Dutch listed companies have issued their 2018 financial statements

- 93% of Dutch listed companies have quantified the expected impact of IFRS 16 in their latest financial statements*

- 9 companies reported that they are planning to apply the full retrospective approach to transition

- Just over half of the companies intend to use both the short-term and low-value exemption options*

*Excluding those who have early-adopted
Some observations of the early adopters

8 listed ‘early adopters’ in the Netherlands:

- Air France – KLM
- ASML
- Kendrion
- Kiadis Pharma
- RELX
- SBM Offshore
- Tom Tom
- WDP
Early adopters - Transition

Transition approach

- Full Retrospective: 4
- Modified Retrospective: 4

Impact on total balance sheet per transition date

- <1%: 1
- 1%-5%: 1
- 10-20%: 1
- >20%: 5
Early adopters - Presentation & disclosure

**Disclosed it applied the expedient to not separate lease and non-lease components**

- Yes: 1
- Not disclosed: 2
- No: 5

**Applies low-value & short-term exemptions**

- Yes: 6
- No: 2
Early adopters - Presentation & disclosure

RoU presentation in the balance sheet

- Separate RoU FSC
- In PP&E

Presentation of lease liability in the balance sheet

- Separate Lease Liability FSC
- In Other Debt
Disclosure requirements

A lessee shall disclose the following amounts for the reporting period:

(a) depreciation charge for right-of-use assets by class of underlying asset;
(b) interest expense on lease liabilities;
(c) the expense relating to short-term leases accounted for applying paragraph 6. This expense need not include the expense relating to leases with a lease term of one month or less;
(d) the expense relating to leases of low-value assets accounted for applying paragraph 6. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 53(c);
(e) the expense relating to variable lease payments not included in the measurement of lease liabilities;
(f) income from subleasing right-of-use assets;
(g) total cash outflow for leases;
(h) additions to right-of-use assets;
(i) gains or losses arising from sale and leaseback transactions; and
(j) the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.

<table>
<thead>
<tr>
<th>Amounts recognised in profit or loss</th>
<th>In thousands of euro</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 16.53(b) Interest on lease liabilities</td>
<td>(1,369)</td>
<td></td>
</tr>
<tr>
<td>IFRS 16.53(e) Variable lease payments not included in the measurement of lease liabilities</td>
<td>(1,700)</td>
<td></td>
</tr>
<tr>
<td>IFRS 16.53(f) Income from sub-leasing right-of-use assets</td>
<td>950</td>
<td></td>
</tr>
<tr>
<td>IFRS 16.53(c) Expenses relating to short-term leases</td>
<td>(1,470)</td>
<td></td>
</tr>
<tr>
<td>IFRS 16.53(d) Expenses relating to leases of low-value assets, excluding short-term leases of low-value assets</td>
<td>(750)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amounts recognised in the statement of cash flows</th>
<th>In thousands of euro</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 16.53(g) Total cash outflow for leases</td>
<td>(11,809)</td>
<td></td>
</tr>
</tbody>
</table>
Disclosure requirements

In addition to the disclosures required in paragraphs 53–58, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 51 (as described in paragraph B48). This additional information may include, but is not limited to, information that helps users of financial statements to assess:

(a) the nature of the lessee’s leasing activities;
(b) future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from:
   (i) variable lease payments (as described in paragraph B49);
   (ii) extension options and termination options (as described in paragraph B50);
   (iii) residual value guarantees (as described in paragraph B51); and
   (iv) leases not yet commenced to which the lessee is committed.

(c) restrictions or covenants imposed by leases; and
(d) sale and leaseback transactions (as described in paragraph B52).

---

Extension options

Some leases of office buildings contain extension options exercisable by the Group up to one year before the end of the non-cancellable contract period. Where practicable, the Group seeks to include extension options in new leases to provide operational flexibility. The extension options held are exercisable only by the Group and not by the lessors. The Group assesses at lease commencement whether it is reasonably certain to exercise the extension options. The Group reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant change in circumstances within its control.

<table>
<thead>
<tr>
<th>In thousands of euro</th>
<th>Lease liabilities recognised (discounted)</th>
<th>Potential future lease payments not included in lease liabilities (discounted)</th>
<th>Historical rate of exercise of extension options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office buildings</td>
<td>1,733</td>
<td>2,915</td>
<td>33%</td>
</tr>
</tbody>
</table>
Publication on disclosures

Our *illustrative disclosures supplement* will help you to navigate the new requirements and enable you to focus on the information that is relevant to users of financial statements.
TOMTOM IFRS ADOPTION
About TOMTOM
Our vision

Our vision is a safe, connected, autonomous world, free of congestion and emissions.
Our mission

We are on a mission to create the most innovative technologies to help shape tomorrow’s mobility ecosystems.
Three focused business units

Previously four business units - sale of Telematics expected to be completed in Q2
Our offices

5000 employees worldwide
Scope of leases

As at year end December 2016, TomTom had the following:

**BUILDINGS**
- 53 buildings over 43 company codes
- Earliest start date 31-09-2007
- Last committed end date 31-10-2025
- Total commitment of €72 million

**CARS**
- Over 400 lease cars in 33 entities
- Average lease duration of 4 years
- Average lease payment of €600

**OTHER**
- lease expense <€100k
About

ADOPTION
Adoption approach

Two key decisions taken early on

1. EARLY ADOPTION

ADVANTAGES
– Restate financial information only once as IFRS 15 adoption also taking place
– One year of additional audit work on restatement

DISADVANTAGES
– Hesitancy from auditors
– Limited practical guidance as a result of lack of early adopters
– Immature tooling

1. FULLY RETROSPECTIVE

ADVANTAGES
– Restate comparative information for ease of comparability
– Enhance understanding of financial statements in transition year

DISADVANTAGES
– Data collection and historical data quality
– Enhanced complexity of including determination of historical discount rates
Practical policy decisions

- No short term leases (<12 months)
- Portfolio approach lease cars
- No separation of lease components (Cars only)
- Disregard low value items
After ADOPTION
Communication

Communicating the impact of adoption to the market

9 Jan ‘18 - presentation

17 April ‘18 – Q1 ‘18 press release

5 Oct ‘18 – Full details by quarter for ‘17 on IFRS 15/16 impact

6 Feb ‘18 – Q4 ‘17 press release

17 July ‘18 - presentation

6 Feb ’19 – Audited 2018 results under IFRS 15/16
Communication

Figure 19: IFRS 15/16 comments by company

<table>
<thead>
<tr>
<th>Company</th>
<th>IFRS adoption</th>
<th>Impact</th>
<th>P&amp;L (£m)</th>
<th>BS (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 15</td>
<td>Primarily impact the timing of revenue recognition of certain customer contracts and certain revenue hardware sales</td>
<td>Revs &lt;£5m</td>
<td></td>
<td>Assets +£5m/£25m.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gross Profit +£5m to £25m</td>
<td></td>
<td>Liabilities -£5m/£25m</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Net Profit +£5m to £15m</td>
<td></td>
<td>Cash flow - NA</td>
</tr>
<tr>
<td>TomTom</td>
<td>IFRS 16</td>
<td>Recognition of additional lease, tangible fixed assets and their corresponding lease liability on balance sheet</td>
<td>EBIT/Net result: +£5m</td>
<td>Assets &amp; Liabilities</td>
</tr>
<tr>
<td>IFRS 15</td>
<td>No impacts in detail.</td>
<td>The company expects a balance-sheet extension, especially due to recognition of assets and liabilities resulting from operating leasing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFRS 16</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ASML</td>
<td>IFRS 15</td>
<td>Shift in timing of revenue recognition</td>
<td>Increase of total net sales in the range of 0-5% and an increase of net income between 2-10% for 2016</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balance Sheets expect a significant decrease in deferred income</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 16</td>
<td>Expect to recognize a right of use asset and a corresponding liability in respect of these leases.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ericsson</td>
<td>IFRS 15</td>
<td>Impact being determined</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 16</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infineon</td>
<td>IFRS 15</td>
<td>No significant quantitative effect on the consolidated financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 16</td>
<td>Yet to be analysed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ingeneo</td>
<td>IFRS 15</td>
<td>Not expected to have any material impact on the consolidated financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Melexis</td>
<td>IFRS 15</td>
<td>No impact on the Group’s future financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 16</td>
<td>Hasn’t yet evaluated the effect on the financial statement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nokia</td>
<td>IFRS 15</td>
<td>Will have a material impact on revenue but not quantified</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 16</td>
<td>Impact currently being assessed.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IFRS 15</td>
<td>Not expected to have a material impact. The Group expects to be in a position to quantify the impact early in Q1 18</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Word: Yesterday, TOM2 organised a meeting for the new accounting standards are changes in accounting only and have flow impact, for instance, we do not have an impact on the underlying earnings of theGROUP, the nature of the new accounting standards are not well understood by the management and the actual reported near-term performance revenues/profitability trends momentum which imply that the new standards are supportive of the current order book.
After adoption steps

**TRAINING**
- Training to controllers
- Training to financial shared service center (FSSC)

**PROCESS OPTIMISATION**
- Transfer activities from corporate finance to controllers
- Improve process with facilities
- Improvements to be made to tooling

**RESPONSIBILITY**
- Fleet management
- Real estate
- Treasury
- FSSC
- Group Control
- Corporate Accounting
Governance and process outline

Governance Structure

- Fleet Management
- Treasury
- Real Estate
- FSSC Accounting
- SAP Lease Administration by NAKISA
- SAP
- Other ERPS
- Group Control
- Taxation
- Corporate Accounting

FINANCE ACADEMY

GREAT IN FINANCE
Other practical implications

Internal reporting needs to be redefined after the new standard

**DEBT GOVERNANCE**
- Engaging with loan providers to explain impact of adoption on loan covenants
- Possible renegotiation of loan covenants

**IMPACT ON KPI’S**
- Lease payments no longer considered in FCF
- Alternative measures?
- Impact on valuation of business
- Impact on Goodwill impairment assessments
- EBITDA – treatment of lease depreciation and impact on internal KPI’s for performance measurement

**OTHER**
- Definition of capex for internal performance measurement as lease payments are no longer part of opex
Reporting and DISCLOSURES
Half year

- Accounting policy
- Significant estimates
- Presentation of lease balances on balance sheet (part of PPE?)
- Practical expedients applied in adoption
- First time balance sheet of 2017 was “audited”
Annual report

- Presentation of third balance sheet (fully retrospective)
- Lease asset disclosures
- Lease liability disclosures
- Short term leases
- Low value leases expense
- Lease commitments in commitments disclosure
Thank you

Any questions?
Communicating to the capital markets on IFRS 16

John Forbes

27 March 2019
Introduction

Makinson Cowell

- We started in 1989 and were acquired by KPMG UK in 2013
- Our 40-strong team is based in London and New York
- We have strong access and insights into institutional investors
- We help companies communicate to and build direct relationships with these institutions
- We work for many companies on ongoing, multi-year retainers and also do standalone projects

John Forbes

- Has advised Benelux companies on capital markets communications since 2001
- Previously a forensic accountant at Deloitte
- UK Chartered Accountant
The capital markets network

- Listed company
- Advisers
- Media & PR
- Sell-side research analysts
- Buy-side investors
  - Active
  - Passive
  - Sovereign wealth funds
  - Hedge funds
  - Activist
Changing accounting and disclosures

- Sophisticated capital markets audiences are used to dealing with changing financials:
  - IFRS 16 is just the latest in a succession of new accounting standards
  - Companies also adjust their segment disclosures from time to time…
    …and change their accounting policies for existing standards
- Analysts and investors expect open and timely communications from companies with appropriate disclosures for them to update their models
- Companies are also answerable to:
  - Stock exchange and other regulators
  - Their Boards and Audit Committees
Capital markets communications on IFRS 16 so far

Early adopters
- Adopted with IFRS 15
- Full retrospective or modified retrospective methods used

Adopters w.e.f. 1/1/19
- 2018: some indicative statements of expected impact
- 2019: (31 Dec year-ends) IAS 8 statements, 2019 outlook statements

Detailed disclosures separate from results announcements
- Press release with restated numbers
- Teach-in events
What important (discretionary) choices have you made in setting your new accounting policies, and why?

Tell us about the implementation process (time, cost, complexity etc.)
Is this more than “just a change in book-keeping”? Will it lead to changes in your strategy or operations?

— Will it affect how you invest in & manage tangible assets (e.g. lease or buy)?
— If you are a lessor, what are your lessees doing?

Will it affect your financial and capital allocation strategy?
Investor perspective

Financial metrics

Which reporting metrics will it affect and by how much compared to old basis?

— Income statement: EBIT(DA), depreciation, interest, net result/EPS

— Does it lead to any changes for your tax affairs?

— Cash flow statement: line items (classifications) and KPIs

— Balance sheet: line items, net debt and net assets

— Returns on net assets/ equity/ average capital employed

— Different effects per segment
Help us reconcile your pre- and post-adoption numbers in the transition year?
- For example (assuming modified retrospective) Q1 2019 vs. Q1 2018
- Do you run parallel accounting systems during the transition year?

How does it effect your guidance for future financial performance?
- Guidance set post-adoption (e.g. “outlook” in FY 2018 results statement)
- Multi-year guidance set pre-adoption

What does it mean for our long-term financial models?
- Re-set of several years of historic data
- Future trends based on current lease portfolio
- Consequences of potential changes to lease portfolio
Will you have to amend your criteria for variable remuneration?

- Remuneration can be a key focus for shareholder dissent in company AGMs and an area of major sensitivity for Boards.
- Most companies award their executives variable annual and long-term remuneration on top of basic pay.
- The criteria usually include metrics that are affected by IFRS 16 adoption.
- This may also apply to other employees.
How does it affect how we benchmark your performance and assess your valuation compared to other companies?

— The change in accounting policy should not affect the intrinsic value of the company or its total cash flows ... BUT it may change valuation metrics:

- EV/EBIT(DA), P/book, P/earnings - will be affected
- FCF yield - depends on treatment of capex and KPI definitions
- Dividend yield - will not be affected unless dividend is fixed payout %

— There may be important effects on comparisons between companies

- Companies within the same sector and across sectors
- IFRS versus non-IFRS companies
Potentially tricky areas

- Significant accounting policy choices compared to key peers
- Reliance on exemptions
- Choice of discount rate
- Effect on WACC
- Impairments
- Intercompany arrangements
- FX
- Supply contracts
IFRS 16: impact on valuation and impairment testing

Sander Mulder & Gijs de Graaff

—

27 March 2019
IFRS 16 will have an impact on valuations and IAS 36 impairment testing

**Carrying amount**
- Treatment of ROU assets
- Treatment of lease liabilities

**Valuation**
- Cash flow forecast and discounted cash flow models
- Discount rate
- Treatment of lease liabilities

Valuation multiples also impacted
Impact on valuation
Efficient markets (or not?)

Efficient markets immediately reflect new information in prices
- Currently companies disclose minimum operating lease payments
- No major changes for finance leases due to IFRS 16
- Rating agencies consider operating leases in their ratings in the past, no major changes in ratings are expected

No material effects on stock prices after announcement of lease liabilities

For Deutsche Post AG (early adopter), no market-adjusted returns are visible after release of Q3/2017 or FY2017 reports where the first and second announcements of additional lease liabilities due to IFRS 16 were made

IFRS 16 represents only a shift of information from the notes and P&L to the Balance Sheet

### Operating lease obligations by asset class

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and buildings</td>
<td>6,657</td>
<td>9,403</td>
</tr>
<tr>
<td>Aircraft</td>
<td>909</td>
<td>1,138</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>495</td>
<td>611</td>
</tr>
<tr>
<td>Technical equipment and machinery</td>
<td>79</td>
<td>129</td>
</tr>
<tr>
<td>Other equipment, operating and office equipment, miscellaneous</td>
<td>48</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>8,188</td>
<td>11,298</td>
</tr>
</tbody>
</table>

*1 Undiscounted.

Source: Deutsche Post Annual Report 2017, p. 60.
Impact of IFRS 16 on cash flows and cost of capital

The value drivers of a company are ...

1. Cash flow
2. Cost of capital

1. Impact on cash flows

Assumption
- ‘Actual’ cash flows will **not** change
- Cash flow to equity will **not** change

But,
- Operating cash flows and financing cash flows change

2. Impact on cost of capital

Assuming IFRS 16 does not reveal new information and ignoring possible tax impact:
- Share price will **not** change
- Levered beta in the cost of equity will **not** change
- Equity value will **not** change

But,
- Weighting of debt in total capital would increase if additional lease liabilities are included in debt
- As a result, Weighted Average Cost of Capital (WACC) would decrease
Impact on cash flows

**IAS 17**
- Free cash flow to the firm
- Financing cash flow
- Cash flow to equity

**IFRS 16**
- Free cash flow to the firm
- Financing cash flow
- Cash flow to equity

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>EBITDA (excl. lease payments)</td>
</tr>
<tr>
<td>2</td>
<td>Capital expenditure</td>
</tr>
<tr>
<td>3</td>
<td>Free cash flow to the firm</td>
</tr>
<tr>
<td>4</td>
<td>Financing cash flow (incl. interest and redemption of lease liability)</td>
</tr>
<tr>
<td>5</td>
<td>Cash flow to equity</td>
</tr>
</tbody>
</table>
Cash flow to equity vs. cash flow to the firm

Cash flow to equity valuation

1. Cash flow to equity
2. Cost of equity

Cash flow to firm valuation

1. Cash flow to the firm
2. Cost of capital

Typical recoverable amount calculation approach
Calculation of the weighted average cost of capital (WACC)

\[
\text{Cost of debt} \times \text{Debt} + \text{Cost of equity} \times \text{Equity} = \text{WACC}
\]

- Market risk premium
- (Re) Levered Beta
- Risk free rate
- Debt spread
- Marginal tax rate
- Corporate risk premium
- Additional risk premium
- Cost of debt (pre-tax)
- Cost of debt (after-tax)

\[
\text{WACC} = \text{Cost of equity} \times \text{Equity} + \text{Cost of debt} \times \text{Debt}
\]
Impact on cost of capital (WACC) (1/2)

<table>
<thead>
<tr>
<th>Change in capital structure</th>
<th>31-12-2018</th>
<th>31-12-2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Currency</td>
<td>IAS17</td>
</tr>
<tr>
<td>Net debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lufthansa</td>
<td>EURm</td>
<td>5,185</td>
</tr>
<tr>
<td>Wizz Air</td>
<td>EURm</td>
<td>(947)</td>
</tr>
<tr>
<td>Ryan Air</td>
<td>EURm</td>
<td>2,448</td>
</tr>
<tr>
<td>International Airlines Group</td>
<td>EURm</td>
<td>3,672</td>
</tr>
<tr>
<td>Easy Jet</td>
<td>GBPm</td>
<td>(48)</td>
</tr>
<tr>
<td>Market value of equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lufthansa</td>
<td>EURm</td>
<td>9,307</td>
</tr>
<tr>
<td>Wizz Air</td>
<td>EURm</td>
<td>2,269</td>
</tr>
<tr>
<td>Ryan Air</td>
<td>EURm</td>
<td>12,184</td>
</tr>
<tr>
<td>International Airlines Group</td>
<td>EURm</td>
<td>13,644</td>
</tr>
<tr>
<td>Easy Jet</td>
<td>GBPm</td>
<td>4,864</td>
</tr>
<tr>
<td>Enterprise value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lufthansa</td>
<td>EURm</td>
<td>14,492</td>
</tr>
<tr>
<td>Wizz Air</td>
<td>EURm</td>
<td>1,322</td>
</tr>
<tr>
<td>Ryan Air</td>
<td>EURm</td>
<td>14,632</td>
</tr>
<tr>
<td>International Airlines Group</td>
<td>EURm</td>
<td>17,316</td>
</tr>
<tr>
<td>Easy Jet</td>
<td>GBPm</td>
<td>4,816</td>
</tr>
<tr>
<td>Debt / Total Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lufthansa</td>
<td></td>
<td>35.8%</td>
</tr>
<tr>
<td>Wizz Air</td>
<td></td>
<td>-71.7%</td>
</tr>
<tr>
<td>Ryan Air</td>
<td></td>
<td>16.7%</td>
</tr>
<tr>
<td>International Airlines Group</td>
<td></td>
<td>21.2%</td>
</tr>
<tr>
<td>Easy Jet</td>
<td></td>
<td>-1.0%</td>
</tr>
<tr>
<td>Median Debt / Total Capital</td>
<td></td>
<td>16.7%</td>
</tr>
<tr>
<td>Median Equity / Total Capital</td>
<td></td>
<td>83.3%</td>
</tr>
<tr>
<td>Median Debt / Equity</td>
<td></td>
<td>20.1%</td>
</tr>
</tbody>
</table>

- Net debt increases due to the classification of operational leases as debt
### Impact on cost of capital (WACC) (2/2)

<table>
<thead>
<tr>
<th>Weighted Average Cost of Capital</th>
<th>31-12-2018</th>
<th>31-12-2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IAS17</td>
<td>IFRS16</td>
</tr>
<tr>
<td>Risk-free rate</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Unlevered beta</td>
<td>0.687</td>
<td>0.592</td>
</tr>
<tr>
<td>Debt/Equity ratio</td>
<td>20.1%</td>
<td>39.5%</td>
</tr>
<tr>
<td>Relevered beta</td>
<td>0.825</td>
<td>0.825</td>
</tr>
<tr>
<td>Market risk premium</td>
<td>6.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td><strong>Cost of Equity</strong></td>
<td><strong>6.0%</strong></td>
<td><strong>6.0%</strong></td>
</tr>
<tr>
<td>Risk-free rate</td>
<td>1.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Debt spread</td>
<td>1.7%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Pre-tax cost of debt</td>
<td>2.7%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Marginal tax rate</td>
<td>20.5%</td>
<td>20.5%</td>
</tr>
<tr>
<td><strong>Cost of Debt</strong></td>
<td><strong>2.1%</strong></td>
<td><strong>2.1%</strong></td>
</tr>
<tr>
<td>Debt/ Total Capital</td>
<td>16.7%</td>
<td>28.3%</td>
</tr>
<tr>
<td>Equity/ Total Capital</td>
<td>83.3%</td>
<td>71.7%</td>
</tr>
<tr>
<td><strong>WACC</strong></td>
<td><strong>5.3%</strong></td>
<td><strong>4.9%</strong></td>
</tr>
</tbody>
</table>

Please note that the above WACC calculations are for illustrative purposes. The above example does not take into account unlevered betas as at a pre-IFRS 16 date and a post-IFRS 16 date. The unlevered betas have been recalculated based on the hypothesis that levered betas remain unchanged as IFRS 16 should not provide new information to the market. Typically, the unlevered beta is derived based on the regression analysis of listed companies, which is not the case above.

- Hypothesis - Levered betas remain unchanged as IFRS 16 should not provide new information to the market
- Debt spread remains unchanged as cost of financial leverage should not be affected as IFRS 16 should not provide new information to the lenders
- Net debt increases due to the classification of operational leases as debt
- As a result, Cost of capital (WACC) would decrease
Impact on valuation: DCF approach

How to reconcile the DCF valuation under IFRS 16 to the DCF valuation under IAS 17?
Was the DCF valuation under IAS 17 right in the first place?

IAS 17

Enterprise value

Net debt

Equity value

IFRS 16 (indefinite lease tenor)

Enterprise value

Net debt incl. lease liability

Equity value

IFRS 16 (finite lease tenor)

Enterprise value

Net debt incl. lease liability

Equity value

6 Free cash flow to firm (impact on Enterprise value)

7 WACC (impact on Enterprise value)
Impact on valuation: DCF approach

You have two options

**OPTION I: Decrease of enterprise value**

In order to account for the continuity of the use of asset, an additional cash outflow could be captured in the enterprise value calculation.

**OPTION II: Increase of net debt**

In order to account for the continuity of the use of asset, calculate the present value of all renewed leases and include that ‘notional’ amount as ‘net debt’.
Impact on valuation: market approach - equity value multiples

Equity value multiples should remain the same………

But could be impacted due to the front loading effect of interest on net income
Impact on valuation: market approach - enterprise value multiples

Enterprise value multiples is uncertain

Make sure you are comparing apples to apples
- Consistency between peer group and object of valuation
  - EBITDA (with or without lease payments)
  - Enterprise value (assumptions therein e.g. with or without additional cash outflow)
  - Net debt (with or without extension of lease liability)
Impairment testing
Carrying vs. recoverable amount

Net present value

- Cash flows including operating lease payments
- WACC: operating leases not part of leverage
Carrying vs. recoverable amount

Net present value

**Approach 1 (ViU/FVLCD)**

- "The converted"
- Cash Flows excluding lease payments
- WACC: leases part of leverage
- Deduct lease liability

**Approach 2 (FVLCD)**

- "Quasi IAS 17"
- Cash Flows including lease payments
- WACC: leases not part of leverage

[Link to KPMG article on how changes in lease accounting will impact your impairment testing process]
Recommendations
Valuation approaches

<table>
<thead>
<tr>
<th>Approach 1: “The converted”</th>
<th>Approach 2 “Quasi IAS 17” - FVLCD only</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treatment of Cash Flows</td>
<td>Treatment of Lease Liability</td>
</tr>
<tr>
<td>As IFRS 16</td>
<td>Subtract from EV</td>
</tr>
<tr>
<td>Model replacement capex</td>
<td></td>
</tr>
<tr>
<td>ROU assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The adjustments would be made for all lease payments, since IFRS 16 no longer differentiates operating or finance lease for lessees

IFRS 16 impacts the mechanics of DCF valuations and IAS 36 carrying amounts

Cost of capital and multiples pre IFRS 16 cannot be used for post IFRS 16 valuations
IFRS 16
tax accounting

Arthur Plantfeber

27 March 2019
Can IFRS 16 also be applied for Dutch tax purposes?

— Dutch tax accounting governed by sound business principle: ‘goedkoopmansgebruik’
— Main rules: as long as the accounting standard is in line with rules of business economics (bedrijfseconomische beginselen) and not contrary to general tax principles or specific tax rules
— Thus, can IFRS16 be considered as:
  i. in line with rules of business economics; and
  ii. not contrary to tax rules and principles
— No changes expected or announced “Leasebesluit” continues to be in place
— New rules on interest deductions – 15b Wet op de Vennootschapsbelasting 1969
Transition to IFRS 16

### Transition to IFRS

**Full retrospective approach**
- Apply provisions of IFRS 16 retrospectively conform IAS 8
  - Comparative financial information is restated
- Adjustment to equity at the beginning of earliest period presented
  - Determine right-of-use (ROU) asset as if IFRS 16 always been applied

**Modified retrospective approach**
- Provision of IAS 8 are not applied in full
  - Comparative financial information is not restated
- Adjustment to equity at the start of year of first application
  - Option 1: ROU asset based on lease liability
  - Option 2: Determine ROU asset as if IFRS 16 had always been applied
Modified retrospective - option 1 - ROU asset = lease liability

<table>
<thead>
<tr>
<th>Balance Sheet – Accounting</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased Asset (“right of use”)</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance Sheet – Tax purposes</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased Asset (“right of use”)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

Book-to-tax difference of 100 (temporary difference) for asset and liability

Application of initial recognition exemption?
Initial recognition of an asset or liability: general

IAS 12.15 and IAS 12.24: do not recognise deferred tax assets or liabilities arising from the initial recognition of an asset / liability in a transaction that:

- is not a business combination and;
- at the time of the transaction, affects neither accounting nor taxable profit

If applicable

No DTAs / DTLs upfront or subsequently
Initial recognition of an asset or liability: IFRS 16

01 Assess temporary differences on a net basis
No DTA or DTL at inception

02 Assess temporary differences on a gross basis
DTA and DTL at inception
Guidance

<table>
<thead>
<tr>
<th>IFRS Staff paper June 2018</th>
<th>Preliminary view: initial recognition exemption not applicable</th>
<th>Assess deferred tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Preliminary view: analysis per temporary difference</td>
<td>Recognise both deferred tax asset / deferred tax liability</td>
</tr>
</tbody>
</table>
Modified retrospective - option 1 - ROU asset = lease liability

<table>
<thead>
<tr>
<th>Balance Sheet – Accounting</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased Asset (&quot;right of use&quot;)</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance Sheet – Tax purposes</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased Asset (&quot;right of use&quot;)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asset</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>DTL</td>
<td>25</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liability</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>DTA</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>25</td>
<td></td>
</tr>
</tbody>
</table>

Note: *Tax rate 25%.

Netting of deferred taxes in presentation (possible if conditions are met)
Modified retrospective - option 2 - as if IFRS 16 is always applied for right of use asset

### Balance Sheet – accounting

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Leased Asset (“right of use”)</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

### Balance Sheet – tax purposes

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased Asset (“right of use”)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Lease Liability</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

### Application of initial recognition exemption?

#### Net approach

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>DTA</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>

Note: *Tax rate 25%.

Book-to-tax difference of :
- 80 (taxable temporary difference) for asset
- 100 (deductible temporary difference) for liability
Modified retrospective - option 2 - as if IFRS 16 is always applied for right of use asset

### Asset

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>20</td>
</tr>
<tr>
<td>DTL</td>
<td>20</td>
</tr>
</tbody>
</table>

Note: *Tax rate 25%.

### Liability

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>DTA</td>
<td>25</td>
</tr>
<tr>
<td>Equity</td>
<td>25</td>
</tr>
</tbody>
</table>

Netting of deferred taxes in presentation (possible if conditions are met)
IFRS 16 accounting hot topics

Brian O’Donovan

27 March 2019
Five discussion points

1. Will there be changes to IFRS 16?
2. Is it a lease?
3. How do I determine the incremental borrowing rate?
4. How should I manage my intercompany leases?
5. What should I put in my financial statements?
Question #1
Will there be changes to IFRS 16?
### Changes to IFRS 16
- Annual improvement to amend Example 13
  - Lease incentives

### Current IFRIC items
- Cloud computing arrangements
- Leases in joint arrangements
- Subsurface rights

### Potential IFRIC submissions
- ???
Question #2
Is it a lease?
Lease definition

Identified asset?

Yes

Lessee obtains substantially all of the economic benefits?

No

Yes

Lessee directs the use?

No

Yes

Contract is or contains a lease

Contract does not contain a lease
Example: space on a telecom tower

- The dish only occupies part of the tower
- The agreement doesn't specify the space
- The supplier can move dishes to increase revenue
- The supplier operates and maintains the tower
Some current talking points

- Substitution rights
- Unit of account for sub-leases
- Small cell arrangements
- Company cars
- Easements
- Other assets provided to employees
Question #3
How do I determine the incremental borrowing rate?
Lessee - incremental borrowing rate

“The 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.”
Determining the IBR

Reference borrowing + Adjustments = Incremental borrowing rate
Some current talking points

- Term of reference borrowing
- “Notching”
- Security
- Listed debt and liquidity
- Other asset-related adjustments
- Is there a GAAP difference?
When is the discount rate determined?

Does the lessor determine the discount rate on inception or commencement?

Does the lessee determine the discount rate on inception or commencement?

Brexit

Inception → Commencement → End of lease term
Issue #4
How should I manage my intercompany leases?
Intercompany leases

- **Generally straightforward under IAS 17…**
  - Symmetrical accounting
  - Lease term often not a concern
  - ‘Automatic’ elimination on consolidation

- **Could be a real problem under IFRS 16…**
  - Asymmetrical accounting
  - Lease term a key estimate for lessees
  - Will not eliminate on consolidation
Intercompany leases under IFRS 16

Introduce more usage-based lease payments?

Document lease term assessments for lessees

Continue to apply IAS 17 for group reporting purposes?
Internal PropCo - IAS 17

Head lease: 10-year lease of store

Sub lease: 10-year lease of store

PropCo (intermediate lessor)

Operating subsidiary (sub-lessee)

Head lessor

Operating lease
— Recognise straight line expense

Operating lease
— Recognise straight line income
Internal PropCo - IFRS 16

Head lease: 10-year lease of store

PropCo (intermediate lessor)

Sub lease: 10-year lease of store

Operating Subsidiary (sub-lessee)

Head lessor

ROU model
- Dr ROU asset
- Cr Lease liability

Finance lease
- Dr Lease receivable
- Cr ROU asset
Question #5
What should I put in my financial statements?
Some key focus areas

How best to explain the change

How much detail to include in the interim financial statements

Separate presentation vs disclosure of ROU assets and lease liabilities

How to present / explain movements in KPIs
Impact on financial ratios

Profit/loss
EBITDA
EPS (in early years)
Balance sheet
Total assets
Net assets
Ratios
Gearing
Interest cover
Asset turnover
Which actions will maximise your EBITDA?

1. Renegotiate leases to include more lease payments based on sales?

2. Renegotiate leases to include more break clauses?

3. Maximise use of the short-term lease exemption?

4. Maximise use of the low value exemption?

5. Use the practical expedient to combine lease and non-lease elements?

Which actions will maximise your EBITDA?
Recommended publication

IFRS 16 Leases Supplement: Guide to financial statements
What Questions Do You Have?
Wrap-up
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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