JOINT VENTURES
2004 Lease Accountants Conference

- Business Dynamics
- U.S. GAAP Issues
- Income Tax Issues
- International GAAP
Joint Ventures

Business Dynamics

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What is a JV?

- Webster’s Dictionary implies that venturing involves going into “risky business” and joint venturing involves “not going it alone”

- **Venture:** An undertaking involving chance, risk or danger

- **Joint Venture:** A united activity of two or more in an undertaking involving chance, risk or danger
What is a JV? Take 2

- Commercial law describes the general characteristics
  - An association of persons engaged in a joint undertaking
  - Generally involves temporary conduct of a separate activity
  - Parties contribute money, property, and/or expertise
  - Parties have a community of interest with an equal right of control in policy-making and management
  - Parties share in the profit, risks and losses
What is a JV? Take 3

- **True (equity) joint ventures**
  - Jointly owned and managed “newco”
  - Formal means of combining complementary strengths
  - Entity-based sharing of risks and rewards

- **Virtual (rights and obligations) joint venture**
  - Contractual-based arrangement
  - Transaction-level sharing
  - Sharing without creating an identifiable common business
How significant are JVs?

- Used extensively by “fast-growing” companies
  - 1/3rd use joint ventures & alliances
    - Approximately 40% for service companies
    - Approximately 20% of business assets
    - Approximately 25% of business growth
  - Average 5 strategic alliances

- Averages approximately 20% of a firm’s market value
Why enter into a JV?

- Improve innovation and new product development
- Extend the business without major acquisition bet
- Enter new markets without a painful learning curve
- Mitigate financial or technological risk taking
- Leapfrog regulatory barriers
- Reduce operating costs
- Exit a business activity with a softer landing
What is the value proposition?

- Quicker way to ramp up revenues and profits
- Lower risk than full-blown M&A strategy
- Greater flexibility in changed circumstances
- More cost efficient way to access specialized skills
What are the drawbacks and challenges?

- Cost of giving up equity participation
- Costs of collaborating / integrating
- Looser operational integration
- Identity / relationship issues
- Tax planning complexity
Why do JVs succeed?

- Sound, well articulated business strategy
- Strong governance and performance measures
- “We” mindset
- Balanced / complementary “skin-in-the-game”
- Trust
Leasing JVs

- Complement existing business activities
- Support key business relationships
- Serve as a vehicle to strategically exit or expand business
- (Re)optimize allocation of pre-tax cash flows and tax benefits
- Reduce operating costs
GATX CORPORATION’s JVs

- Complements its existing business activities
  - “Big Ticket” transportation leasing
  - Residual value guarantees

- Partnering objectives
  - improve scale
  - broaden diversification
  - enter new markets
GATX’s JVs (contd)

- Significant business activity
  - Investments exceed $100MM
  - Thirty-three joint ventures
  - Forty-five partners

- Assets
  - Aircraft
  - Facilities
  - Marine
  - Rail
  - Real estate
GATX’s JVs (contd)

- GATX partners include:
  - Pitney Bowes Financial Services (diversified)
  - EMD, a division of General Motors (locomotives)
  - Commonwealth Bank of Australia (RVGs)
  - Rolls-Royce PLC (aircraft engines and aircraft)
  - I.M. Skaugen (marine)
  - CB Richard Ellis (real estate)
  - Credit Lyonnais (aircraft)
  - Air Liquide (facility)
CIT GROUP’s JVs

- Supports key vendor relationships
  - Dell Computer Corporation
  - Snap-On Incorporated

- Supports asset-back lending in Canada
  - Canadian Imperial Bank of Commerce (CIBC)
CIT GROUP’s JVs (contd)

- Dell Financial Services L.P. (“DFS”)
  - Provides Dell with financing and leasing capabilities
  - Provides CIT with a steady source of new financings
  - Disproportionate ownership with Dell as majority owner
  - CIT bears first risk of credit losses and priority recovery rights
  - Board of Directors voting representation evenly split among CIT, Dell, and an independent third party

- Snap-On Incorporated
  - Similar business purpose and model to DFS
  - 50/50 ownership, board representation, and profit/loss sharing
Bank of America Leasing’s JVs

- **Strategic exit/acquisition**
  - Ford Motor Credit Company
    - Partnership formed in the disposition of U.S. Leasing
    - Disproportionate ownership with joint control over major decisions
    - Disproportionate sharing of pre-tax risks and rewards
    - Retention of pre-contribution tax attributes

- **Strategic expansion**
  - Oshkosh/McNeilus Financial Services Partnership
    - 50/50 Joint Venture
    - Offers truck lease financing (principally TRACs)
    - Utilize existing staff resources
De Lage Landen JV

- Complementary strategic expansion

  - AGCO Finance LLC (“AF”) provides retail and wholesale dealer financing in North America on behalf of AGCO Corporation (“AC”), world’s 3rd largest AG equipment manufacturer
  - AF owned 51% by De Lage Landen and 49% by AC
  - Rabobank and its affiliates provide financing to the JV
  - AC repurchases repossessed inventory at market rates, subject to an annual limitation
  - AC periodically subsidizes rates to end users
Japanese Leasing Company Alliance

- Remarketing Alliance
  - Auction website jointly maintained by Japan’s SMBC Leasing, IBJ Leasing, Diamond Lease, and Fuyo General Lease
    - Simplifies process of finding buyers
    - Reduces disposal costs
  - Combined annual sales expected to top $91MM by 2006
Lessor X enters into a residual assurance agreement with Lessor Y to expand its leasing business.

- Lessor X accepts risk of loss for shortfall in residual proceeds.
- Lessor Y agrees to pay Lessor X a cash fee plus share in the proceeds realized above a defined amount.
- Lessor Y makes Lessor X whole for credit-related defaults.
- Settlement may be deal-by-deal or on a pooled basis.
Tax-advantaged JV partnerships

- Leasing is ideal for JV partnerships in which tax benefits are not available to one or more of the JV partners.

- This may be (i) because of the way in which the JV is structured, or (ii) because of the tax situation of one or more of the JV partners.

- The lessor may utilize the tax benefits, which would otherwise be lost, and pass those benefits to the JV in the form of lower lease payments.
Future Wave: Public-Private JVs

- ENERGY WASTE WATER OPTIMIZATION
- PUBLIC SECTOR
  - POLITICAL SOCIAL INFRASTRUCTURE
- PRIVATE SECTOR
  - TECHNOLOGY MANAGEMENT FINANCE
- JV PARTNERSHIP
  - OWNERSHIP OR COMMITMENT
  - PROJECT DEVELOPMENT ENTITY
  - COMMITMENT OR OWNERSHIP
JOINT VENTURES

International Developments
IASB – JV Timeline

- 01/01/05 – Effective date of IAS 31, *Interests in Joint Ventures* (Revised); issued 12/18/03
- 04/2003 – IASB asks Australian Accounting Standards Board (AASB) to take responsibility for broad long-term research project on joint venture arrangements
- 01/01/01 – Effective date of IAS 39 (Financial Instrument) revisions to IAS 31; issued 12/1998
- Oct 1999 – Special Report, *Reporting Interests in Joint Ventures and Similar Arrangements*, issued by GIV+1
- 01/01/92 – Effective date of IAS 31; issued 12/1990
AASB - JV Project Leader

- **7/28/04** - JV Questionnaire due
  - Identify and analyze distinguishing characteristics
  - Assist in follow-on field testing

- **April 2004** - IASB divides project into two parts:
  - Short-term: seek to converge accounting for jointly controlled entities by removing IAS 31 option to use either proportionate consolidation or the equity method
  - Longer-term: research on fundamental issues, commencing with JV Questionnaire.

- **February 2004** - JV Project Team meets
AASB-IASB Improvements Project

- July 2004 - AASB 131, *Interest in Joint Ventures*
  - Effective 1/01/05; supercedes AASB 1006
  - Board decides against verbatim adoption of IAS 31
  - Optional treatment not permitted; equity method only
  - Simultaneous compliance achieved

- June 2004 - Abstract 113, Jointly Controlled Entities - Non-Monetary Contributions by Venturers
  - Effective 1/01/05; supercedes Abstract 36
  - Simultaneous compliance achieved
Appendix: Summary of IAS 31

IAS 31(R), *Interests in Joint Ventures*
IAS 31(R) - Background

- Revised as part of IASB’s Improvements Project

- Updated for extensive changes to other IAS GAAP
  - IAS 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*
  - IAS 28, *Accounting for Investments in Associates*

- Does not reconsider fundamental approach to accounting, notable optional reporting of a venturer’s interest in a joint controlled entities (JCE).
IAS 31(R) - Main Changes

- Modified scope by providing exclusions and exemptions
  - Excludes certain investments in JCEs within the scope of IAS 39.
  - Exempts certain interests from proportionate consolidation or equity method
    - Certain parents not otherwise required to prepare consolidated financials
    - Interests acquired and held for disposal “within twelve months”
    - Certain investments made by a privately held venturer

- Incorporates IAS 27 by reference as applicable for an investor’s separate financial statements

- Requires disclosure by a venturer in a JCE of the method used to recognize its investment, i.e., equity method or proportionate consolidation
IAS 31(R) - Key Definitions

- **Joint control** as “the contractually agreed sharing of control over an economic activity such that no contracting party has control.”

- **Joint venture** as “a contractual arrangements whereby two or more parties undertake an economic activity subject to joint control.”

- **Venturer** as “a party to a joint venture and has joint control over that joint venture.”
IAS 31(R) - 3 Broad Types of JVs

- Jointly controlled operations, which involves separate use of assets and other resources to accomplish a common goal, e.g., manufacture and sale of an airplane.

- Jointly controlled assets, which involves joint control, joint sharing of risks and rewards, and often joint ownership of dedicated assets, e.g., control & operation of an oil pipeline.

- Jointly controlled entities, which involves establishment of a separate legal entity to carry out the venture, e.g., a for-profit entity commencing a business in a foreign country with a governmental agency.
IAS 31(R) - Optional Reporting

- Allows optional reporting of an investment in a JCE
  - Proportionate consolidation, a method of accounting whereby a venturer share of each of the assets, liabilities, income and expenses of a JCE is combined line by line with similar items in the venturer’s financial statements or reported as separate line items therein
  - Equity method, a method of accounting whereby an interest in a JCE is initially recorded at cost and adjusted thereafter for the post-acquisition changes in the venturer’s share of net assets of the JCE. The P&L of the venturer include its share of the P&L of the JCE.
IAS 31(R) - Transactions Between

- Sale of assets to jointly controlled entity where the venturer has transferred significant risks and rewards of ownership
  - Gain: Recognize portion attributable to interests of other venturers
  - Loss: Recognize full amount indicative of a reduction in net realizable value of current assets or an impairment loss

- Non-monetary contributions
  - General rule: See sale treatment above
  - Exception #1: Gain or loss cannot be measured
  - Exception #2: Other venturers contribute similar assets
IAS 31(R) - Transactions Between

- Purchase of assets from a JV
  - Gain: No recognition of its share of profits until resold
  - Loss: Same as gain treatment, except immediate, full recognition of losses that represent a reduction in net realizable value of current assets or an impairment loss
IAS 31(R) - Disclosures

- Contingent liabilities relating to its interests in the JV where the risk of loss is more than remote jointly incurred
- Capital commitments
- A listing and description of interest in significant JVs and the proportion of ownership interest held in JCEs
- Method used to recognize interest in JCE