

## RESIDUAL SHARING

By Loni Lowder, President

When I first got into this business, more than 20 year ago, I had just left IBM. At IBM in the 70's, we didn't *sell* anything. We leased. IBM had rental and lease programs for everything from electric typewriters to their largest, most sophisticated computers (which didn't do as much as desktop PCs today). It was at IBM that I first saw companies that were satisfied, even happy, with just the use of the equipment, not ownership of the equipment.

I started a small lease brokerage firm with one of my graduate classmates. I was driven by the dream of making money in my sleep – collecting lease extension payments and residuals. I soon found out that collecting residuals for IBM was much easier than collecting residual income as a lease broker. Most of the funding sources that we brokered to in those early days did not allow us to share in the residuals. Our little brokerage firm focused on small-ticket leasing with big deals up to \$250,000. Most lessees in “Mom and Pop” businesses that we focused on did not want anything to do with Fair Market Value residuals. They wanted to know what they were going to pay at the end of the term. Thus, most of our transactions turned out to be \$1.00 out or 10% PUT.

It wasn't until we provided both tax and operating leases that we were able to build a significant amount of residual. That residual

sharing came in pretty handy later on when, first, I went through my middle age crazies and didn't work for a year, and second, I joined Amembal Halladay as a partner and put my leasing company in dormancy for over four years. While I was teaching and consulting, the residuals continued to pour in. This residual income created a nest egg that allowed me to start up the leasing company again. When I determined that I wanted to put what I was teaching into actual practice, that nest egg provided the “re-start” capital for what is now Amembal Capital Corporation.

How profitable is sharing in the residual proceeds? For example, let's say that we write a transaction for 48 months to 10% or Fair Market Value, whichever is greater. We also give the lessee an early termination option to put it off balance sheet. The lessee is a regional restaurant chain and the lease is for FF&E totaling \$500,000. To many lessees, the benefits of off balance sheet financing are worth future potential residual cost. At the end of the initial lease term, if the lessee doesn't notify the lessor that it wants to purchase the equipment, the lease continues at the initial rents for another twelve months, at which time the lessee still has to pay Fair Market Value. Even if the lessee does give notification, a 16% or 17% residual is very possible, even on soft restaurant equipment

collateral. At a minimum, that is still 6% or 7% of equipment cost, or \$30,000 to \$35,000 of residual that is available to split between the lessor and the broker. If the notice is not given, residual and rental proceeds can jump to somewhere between \$120,000 to \$150,000 (remember the 10% FMV Put).

You fear that this kind of residual income may alienate the lessee and they will never do business with you again. I believe you can use the strategy to strengthen your relationship and make money in your sleep. Here is an example of how it works in the real world in middle market companies:

As a broker, you have developed rapport with the CFO of a regional company that has \$100,000,000 in sales and capital expenditures of \$5,000,000 to \$10,000,000 per year. With ACC's help, you were able to structure Fair Market Value leases, or leases with Fair Market Value potential. You do business with this company for three or four year and fund \$2,000,000 to \$3,000,000 in leases a year. Suddenly, your buddy, the CFO leaves; enter the new CFO whose brother-in-law is a lessor and suddenly you have lost your customer. Another scenario might be that the company is acquired by another larger company that concentrates all financial activities at the parent's headquarters where you don't know a soul and they aren't a

lease candidate. You've had a good repeat customer, but now you are out in the cold. But you now have a share in somewhere between \$200,000 and \$2,000,000 in residual income. Let's say you have negotiated with ACC for 25% of residual income. That means your share is between \$50,000 and \$500,000. Not so cold out in the cold after all, is it?

That's wonderful, but what happens if the company hasn't been sold, and your buddy, the CFO, is still there when the residuals come due. At ACC, we want to help you preserve your customer relationship. We'll help you negotiate a lower residual with the customer in return for an exclusive first right of refusal on, say, the next two to four years of equipment leasing opportunities that the company has coming up. That's not a bad trade off, at least some residual income and locked in future business. Who says you can't have your cake and eat it too. The truth is things change. Customers come and go. Get yourself in a position to make money in your sleep. Contact your ACC intermediary representative today.