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A Case Study on Whether a Business Should Own or Lease Its Real Estate

by

Benjamin James Cooper

Advisor: Dr. Gary Peters

**An Honors Thesis in partial fulfillment of the requirements for the degree Bachelor of
Science in Business Administration in Finance and Accounting.**

**Sam M. Walton College of Business
University of Arkansas
Fayetteville, Arkansas**

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INTRODUCTION

Businesses are continually faced with many difficult decisions to make daily that can have a significant impact on their success. Whether it is if they should adopt a new accounting practice, work with a new supplier, or push into a new consumer sector, these decisions will affect their operations and long-term plans. One of these major decisions that a business has to make is whether they should own or lease their real estate.

Depending on the size, type, and scope of a business this decision could be made differently but for certain companies there is definitely a correct answer. Buying and leasing each have their benefits and disadvantages so it is important for an owner to know how each could affect their business. This decision will ultimately affect a business's financial allocation, time management, daily operations, and overall profit. That is why it is so important for it to be taken seriously and to genuinely put in the time to research how owning or leasing will fair with your company.

This thesis is going to approach this question through a case study performed over a local automotive service provider's business. They currently own the operations of their business while they are paying for a lease on the land, building, and furniture, fixtures & equipment (FF&E). They have a proposed deal to purchase the real estate along with the FF&E. I will compile and analyze data from both their current leasing situation and their new proposed situation where they own the real estate. From here I should be able to make a conclusion on which is the better route for their business to take. I understand that this doesn't answer the question for every business as situations may vary, but it provides insight on how a company should approach this decision. Considering this, it is most likely that my answer will include a caveat based on what a business is like.

CASE STUDY

To answer if a business should own or lease their real estate, I am going to look at a real-life business to see how it affects them. This is one of the best ways to approach this question because it will not be subjective. The data analyzed is real and truly impactful on the company, so I know that the conclusion I come to is one that is realistic and truthful.

For some background on this company, they are an automotive service provider that has several locations across the Northwest Arkansas region. This is purposefully vague as they have asked me to not disclose their name since I will be providing so much of their data. They currently own the operations of their business while paying for leases on the real estate and FF&E. Part of the deal for them to have purchased the operations originally included a loan of \$8 million at a seven-year amortization at 6.5%.

Their business plan is centered around purchasing the real estate and FF&E so they no longer have the lease payments and can replace them with payments on principal reduction and interest of a newly worked loan. The new loan they are asking for would be \$40.8 million set at a 20-year amortization at 4%. They then would own the business for another five years before selling the operations, real estate, and FF&E in an arms-length transaction to a third-party.

The real estate and FF&E are projected to be sold at a 7.5% capitalization rate with disposition closing costs coming in at 5%. The value of the operations would also have increased due to increased Net Operating Income from not paying leases. This theoretically results in profits from both ends of operations and real estate. There are also other significant benefits including increased cash flow while paying less taxes and depreciation expense benefits. Let's look at the data from leasing versus owning the real estate to see if these plans are truly accurate.

PRO FORMA CASH FLOW SUMMARY-LEASING SCENARIO

On page four (4) you can observe the company's pro forma cash flow summary. Pro forma means that it is based off of projections and assumptions. These projections are based on current data from their business, the market, and details for their long-term plan. Cash flow may be one of the most important details in this study, so we are going to analyze it significantly. Cash flow can tell the true health of a business and how strong its future looks. Some other accounting points can be misleading as they include intangible values like goodwill or items like accounts receivable which cannot be completely relied on. A business relies on cash and needs to have adequate amounts of it at all times if it is able to continue operating and paying its expenses, loans, taxes, etc. This is why cash flow is so important when dissecting a business and its finances.

This model has columns that show a five-year plan and a total sum of the years starting at "Year 0", the year of purchase. The main item in year zero is closing costs which can contain expenses from lawyers, appraisers, and several fees. The rows show revenues, expenses, and several other metrics like net taxable income and EBITDA (earnings before interest, taxes, depreciation, and amortization). It's important to comprehend the meaning of these metrics as they can show owners and investors a lot about the prospects of the business.

Firstly, there is Net Cash Flow – Annual (NCF) which takes the sum of net operating income, working capital, operations disposition, real estate disposition less closing costs, interest expense, maintenance reserve, principal reduction, and the disposition of the principal reduction. NCF is negative each year besides the year of disposition resulting in a total cash flow of \$4,579,933. As I pointed out before a business cannot sustain itself with consistent negative cash flows, but they are able to do so since they have significant capital backing and the long-term plan is to eventually sell. It's important for investors to pay attention to this final total value as they need to make sure at the end of this plan there is net positive cash flow.

Net Taxable Income (NTI) is the next important item to observe. While taxes are necessary, they can be one of the heaviest burdens on a company which is why many businesses put lots of effort into reducing this cost as much as possible. There are a few items that make this different from net cash flow. Here it is calculated by taking the sum of net operating income, operations disposition, and real estate disposition less closing costs, interest expense, depreciation expense, and basis reduction. Similarly, to NCF, NTI is negative each year besides the year of disposition resulting in a total sum of \$1,821,985. One of the few positives to having a negative NTI is not having to pay taxes and being able to take advantage of tax reductions on future positive NTI's due to the carry forward rule.

The next important item to note is depreciation expense. Depreciation is a very important item since it is included in calculating taxable income and it is included on both the income statement and balance sheet as depreciation expense and accumulated depreciation. Currently the only item they are depreciating is goodwill on a 15-year straight line schedule. They own some FF&E at only certain locations which would be depreciated but they were able to write it fully off using the section 179 tax rule in 2019.

One of the most important values to pay attention to is EBITDA. This metric is important for companies for a few reasons including showing the true efficiency of a company's operations. By removing finance and accounting activities like depreciation and amortization an investor is able to see the actual earnings from operations. Removing the tax expense from the equation is important since due to a company's country, state, or industry it can have different tax rates from another company. Along with different tax rates, companies also make different

PRO FORMA CASH FLOW SUMMARY-LEASING SCENARIO

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	SSOP LLC TOTAL
Revenue	4000	-	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50	37,548,877.50
Vehicles Per Day		296,000	296,000	296,000	296,000	296,000	1,480,000
Vehicle Capture Rate		0.61%	0.61%	0.61%	0.61%	0.61%	0.61%
Daily Car Count		1,811	1,811	1,811	1,811	1,811	9,055
Monthly Car Count		54,330	54,330	54,330	54,330	54,330	271,650
Annual Car Count		651,960	651,960	651,960	651,960	651,960	3,259,800
Avg. Ticket Price		11.52	11.52	11.52	11.52	11.52	11.52
Total Operating Expenses	-	6,164,138.18	6,205,202.23	6,246,882.24	6,289,187.44	6,332,127.23	31,237,537.32
Net Operating Income	-	1,345,637.32	1,304,573.27	1,262,893.26	1,220,588.06	1,177,648.27	6,311,340.18
Other Cash Flows	(216,231.43)	(2,433,494.98)	(2,433,494.98)	(2,433,494.98)	(2,433,494.98)	4,755,038.96	(5,195,172.38)
Working Capital	9999	-					-
Closing Costs	6010	216,231.43					216,231.43
Operations Disposition	4027					9,162,692.37	9,162,692.37
Real Estate Disposition	4027						-
Interest Expense	9700	742,529.19	680,043.34	613,372.68	542,236.98	466,337.18	3,044,519.37
Maintenance Reserve	6500	65,196.00	65,196.00	65,196.00	65,196.00	65,196.00	325,980.00
Principal Reduction	2100	933,016.71	995,502.57	1,062,173.22	1,133,308.92	1,209,208.72	5,333,210.14
Principal Reduction - Disposition	2100					1,974,158.43	1,974,158.43
Basis Reduction						6,927,530.76	6,927,530.76
Depreciation Expense	9900	692,753.08	692,753.08	692,753.08	692,753.08	692,753.08	3,463,765.38
Net Cash Flow - Annual	(216,231.43)	(395,104.58)	(436,168.63)	(477,848.64)	(520,153.85)	6,625,440.31	4,579,933.18
Net Cash Flow - Cumulative	-	(395,104.58)	(831,273.22)	(1,309,121.85)	(1,829,275.70)	4,796,164.61	
Net Taxable Income	(216,231.43)	(89,644.95)	(68,223.14)	(43,232.50)	(14,402.00)	2,253,719.63	1,821,985.61
EBITDA	(216,231.43)	1,345,637.32	1,304,573.27	1,262,893.26	1,220,588.06	10,340,340.64	15,257,801.12
EBITDAR	(216,231.43)	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	13,245,932.77	29,362,662.93
Capital Balances	7,307,369	6,374,352	5,378,849	4,316,676	3,183,367	1,974,158	-
Senior Debt	7,307,369	6,374,352	5,378,849	4,316,676	3,183,367	1,974,158	
Equity Distributions	(3,600,000)	(158,042)	(174,467)	(191,139)	(208,062)	5,527,875	1,196,165
Investor IRR	3.4%						
Investor Split Before Payback	33.33%	(52,681)	(58,156)	(63,713)	(69,354)	1,443,903	1,200,000
Investor Split After Payback	20.00%	-	-	-	-	239,233	239,233
Investor Equity Balance & Payback	(1,200,000)	(1,252,681)	(1,310,836)	(1,374,550)	(1,443,903)	239,233	1,439,233
Sponsor IRR**	6.4%						
Sponsor Split Before Payback	66.67%	(105,361)	(116,312)	(127,426)	(138,708)	2,887,807	2,400,000
Sponsor Split After Payback	80.00%	-	-	-	-	956,932	956,932
Sponsor Equity Balance & Payback	(2,400,000)	(2,505,361)	(2,621,673)	(2,749,099)	(2,887,807)	956,932	3,356,932
Ending Cash Balance	-	(237,063)	(498,764)	(785,473)	(1,097,565)	-	
Metrics & Ratios							
Debt Service Coverage Ratio (Pre-Distribution)		2.44	2.44	2.44	2.44	NA	3.50
Debt Service Coverage Ratio (Post-Distribution)		2.53	2.54	2.55	2.56	NA	3.36
Lease Coverage Ratio		1.49	1.47	1.45	1.43	4.56	2.08

**Sponsor guarantees all leases & liabilities to the extent that is required by lienholders

decisions on depreciation and amortization policies, so in this way EBITDA also allows companies in different industries and countries to be more comparable to each other. This comparability is a huge factor for investors and is why many pay so much attention to this metric. EBITDAR is the exact same metric but also excludes rent. This value will be important when comparing their current scenario versus post acquisition of the real estate since they would no longer be needing to pay rent.

Lastly, we will analyze the internal rate of return or IRR. IRR is a calculation that can be used to project the profitability of an investment so generally the higher the IRR the better for an investor. Investors are able to compare an IRR of a project to other projects or to the general average to decide whether it is smart to invest or not. In this way, IRR can sometimes be the end all decision-making factor for investors, so it is very important. Here you can see an IRR calculated for the investors and for the sponsor. The sponsor is the company that manages the project and in turn receives this IRR for their compensation.

DISCOUNTED CASH FLOW VALUATION-LEASING SCENARIO

The discounted cash flow valuation that can be found on page six is similar to the pro forma cash flow summary but has a few differences that are helpful for us to look at. Similarly, the columns are made up of years 0-5 with another column dedicated to the total sum of the years. The rows are again made up of the revenues and expenses with a few less metrics than the summary but with the addition of a very important metric, the present value of future cash flows.

Due to time value of money cash doesn't currently have the same value that it will have in the future. Time value of money basically breaks down that money today is worth more than the same amount of money in the future. It's important for us to recognize this so that we can see a business's true value from a cash standpoint. Discounting cash flows decreases the value of the company's future cash flows so that they can be seen at a present value. If the total present value of the cash flows is greater than the price of the investment it is deemed profitable and a strong investment.

These specific values are based on EBITDA, so that it ignores financing decisions of the company and focuses more on operations, and the calculated present value factors. The sum of the present value of future cash flows is \$8,849,187 in this scenario. This value will be very important when we compare it to its counterpart in the scenario of the acquisition of the real estate.

DCF VALUATION-LEASING SCENARIO

		SSOP LLC TOTAL	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	4000	37,548,877.50	-	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50
Vehicles Per Day		1,480,000		296,000	296,000	296,000	296,000	296,000
Vehicle Capture Rate		0.61%		0.61%	0.61%	0.61%	0.61%	0.61%
Daily Car Count		9,055		1,811	1,811	1,811	1,811	1,811
Monthly Car Count		271,650		54,330	54,330	54,330	54,330	54,330
Annual Car Count		3,259,800		651,960	651,960	651,960	651,960	651,960
Avg. Ticket Price		11.52		11.52	11.52	11.52	11.52	11.52
Total Operating Expenses		31,237,537.32	-	6,164,138.18	6,205,202.23	6,246,882.24	6,289,187.44	6,332,127.23
Net Operating Income		6,311,340.18	-	1,345,637.32	1,304,573.27	1,262,893.26	1,220,588.06	1,177,648.27
Other Cash Flows		(5,195,172.38)	(216,231.43)	(2,433,494.98)	(2,433,494.98)	(2,433,494.98)	(2,433,494.98)	4,755,038.96
Working Capital	9999	-	-	-	-	-	-	-
Closing Costs	6010	216,231.43	216,231.43	-	-	-	-	-
Operations Disposition	4027	9,162,692.37	-	-	-	-	-	9,162,692.37
Real Estate Disposition	4027	-	-	-	-	-	-	-
Interest Expense	9700	3,044,519.37	-	742,529.19	680,043.34	613,372.68	542,236.98	466,337.18
Maintenance Reserve	6500	325,980.00	-	65,196.00	65,196.00	65,196.00	65,196.00	65,196.00
Principal Reduction	2100	5,333,210.14	-	933,016.71	995,502.57	1,062,173.22	1,133,308.92	1,209,208.72
Principal Reduction - Disposition	2100	1,974,158.43	-	-	-	-	-	1,974,158.43
Basis Reduction		6,927,530.76	-	-	-	-	-	6,927,530.76
Depreciation Expense	9900	3,463,765.38	-	692,753.08	692,753.08	692,753.08	692,753.08	692,753.08
Net Cash Flow - Annual		4,579,933.18	(216,231.43)	(395,104.58)	(436,168.63)	(477,848.64)	(520,153.85)	6,625,440.31
Net Taxable Income		1,821,985.61	(216,231.43)	(89,644.95)	(68,223.14)	(43,232.50)	(14,402.00)	2,253,719.63
EBITDA		15,257,801.12	(216,231.43)	1,345,637.32	1,304,573.27	1,262,893.26	1,220,588.06	10,340,340.64
Average Cost of Equity				16.49%	16.49%	16.49%	16.49%	16.49%
Present Value Factors (B)			1.00	0.47	0.86	0.74	0.63	0.54
Present Value of Future Cash Flows (A) x (B)		8,849,187.27	(216,231.43)	627,313.73	1,119,901.51	930,656.37	772,152.67	5,615,394.41

PRO FORMA CASH FLOW SUMMARY-OWNING SCENARIO

On page eight is the pro forma cash flow summary for the scenario in which the business has made the acquisition of the real estate and FF&E. The format of this model is exactly the same format as of the model in the leasing scenario. I'd like to point out the same important metrics including the "Net Cash Flow-Annual", "Net Taxable Income", "Depreciation Expense", "EBITDA and EBITDAR", and the "Investor and Sponsor IRR".

"Net Cash Flow-Annual" during year 0 is still negative due to the closing costs which are still valued at \$216,231. Every other year though NCF is now positive with a total sum of \$42,940,218 after year 5. This positive cash flow is obviously beneficial and allows the business to be more self-sustaining and less reliant on more capital backing. These positive values can also make this deal appear more attractive to investors.

"Net Taxable Income" is also \$216,231 in year 0 and is again negative in years 1-4 like in the leasing scenario. Year 5 has a positive NTI due to the dispositions of operations, real estate, and principal reduction leading to a net positive NTI in total of \$36,448,017. One thing to note is that during years 1-4 the negative NTI is much larger and this is due to an increased depreciation expense. Due to the acquisition there are more materials for them to depreciate which decreases their NTI. They are now depreciating goodwill at 15 years straight line, the newly acquired FF&E at 5 years straight line, buildings at 39 years straight line, site improvements at 5 years straight line, and soft costs at 5 years straight line.

The next items to observe are the EBITDA and EBITDAR. For years 0-4, EBITDAR is actually the exact same as in the leasing scenario with year 5 just having a larger disposition. The main part to pay attention to is now how EBITDA is actually the exact same value as EBITDAR throughout the whole period. This is here mostly to point out how now in this situation they are no longer paying any rent since they own all of the property.

The last metrics to note here are the investor and sponsor IRR's. They are calculated the exact same as in the leasing scenario but note that they are now much higher. Remember that IRR stands for the internal rate of return and that it can signal how profitable an investment is.

DISCOUNTED CASH FLOW VALUATION-OWNING SCENARIO

We have also created another model for discounted cash flows for the owning scenario that can be seen on page nine. Similar to the cash flow summary it is in the exact same format as the model for the leasing scenario. The main item in the model is the "Present Value of Future Cash Flows" and this has a similar trend as the leasing scenario but with increased values resulting in a total sum of \$51,737,288.

PRO FORMA CASH FLOW SUMMARY-OWNING SCENARIO

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	SSOP LLC TOTAL
Revenue	4000	-	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50	37,548,877.50
Vehicles Per Day		296,000	296,000	296,000	296,000	296,000	1,480,000
Vehicle Capture Rate		0.61%	0.61%	0.61%	0.61%	0.61%	0.61%
Daily Car Count		1,811	1,811	1,811	1,811	1,811	9,055
Monthly Car Count		54,330	54,330	54,330	54,330	54,330	271,650
Annual Car Count		651,960	651,960	651,960	651,960	651,960	3,259,800
Avg. Ticket Price		11.52	11.52	11.52	11.52	11.52	11.52
Total Operating Expenses	-	3,426,535.10	3,426,535.10	3,426,535.10	3,426,535.10	3,426,535.10	17,132,675.51
Net Operating Income	-	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	20,416,201.99
Other Cash Flows	(216,231.43)	(6,091,645.55)	(6,091,645.55)	(6,091,645.55)	(6,091,645.55)	31,808,981.01	7,226,167.37
Working Capital	9999	-					-
Closing Costs	6010	216,231.43					216,231.43
Operations Disposition	4027					31,769,651.91	31,769,651.91
Real Estate Disposition	4027					39,558,395.90	39,558,395.90
Interest Expense	9700	1,607,253.24	1,554,377.83	1,494,209.87	1,434,211.03	1,371,767.74	7,461,819.70
Maintenance Reserve	6500	65,196.00	65,196.00	65,196.00	65,196.00	65,196.00	325,980.00
Principal Reduction	2100	1,359,626.46	1,412,501.86	1,472,669.82	1,532,668.66	1,595,111.95	7,372,578.76
Principal Reduction - Disposition	2100					33,427,421.24	33,427,421.24
Basis Reduction						32,320,331.54	32,320,331.54
Depreciation Expense	9900	3,059,569.86	3,059,569.86	3,059,569.86	3,059,569.86	3,059,569.86	15,297,849.31
Net Cash Flow - Annual	(216,231.43)	1,051,164.71	1,051,164.71	1,051,164.71	1,051,164.71	38,951,791.27	42,940,218.66
Net Cash Flow - Cumulative	-	1,051,164.71	2,102,329.41	3,153,494.12	4,204,658.82	43,156,450.09	
Net Taxable Income	(216,231.43)	(583,582.70)	(530,707.30)	(470,539.33)	(410,540.49)	38,659,619.06	36,448,017.81
EBITDA	(216,231.43)	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	75,411,288.21	91,528,018.37
EBITDAR	(216,231.43)	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	75,411,288.21	91,528,018.37
Capital Balances	40,800,000	39,440,374	38,027,872	36,555,202	35,022,533	33,427,421	33,427,421
Senior Debt	40,800,000	39,440,374	38,027,872	36,555,202	35,022,533	33,427,421	33,427,421
Equity Distributions	(7,200,000)	420,466	420,466	420,466	420,466	41,474,587	35,956,450
Investor IRR	33.7%						
Investor Split Before Payback	25.00%	105,116	105,116	105,116	105,116	1,379,534	1,800,000
Investor Split After Payback	15.00%	-	-	-	-	5,393,468	5,393,468
Investor Equity Balance & Payback	(1,800,000)	(1,694,884)	(1,589,767)	(1,484,651)	(1,379,534)	5,393,468	7,193,468
Sponsor IRR**	48.0%						
Sponsor Split Before Payback	75.00%	315,349	315,349	315,349	315,349	4,138,602	5,400,000
Sponsor Split After Payback	85.00%	-	-	-	-	30,562,983	30,562,983
Sponsor Equity Balance & Payback	(5,400,000)	(5,084,651)	(4,769,301)	(4,453,952)	(4,138,602)	30,562,983	35,962,983
Ending Cash Balance	-	630,699	1,261,398	1,892,096	2,522,795	-	
Metrics & Ratios							
Debt Service Coverage Ratio (Pre-Distribution)		1.38	1.38	1.38	1.38	NA	6.17
Debt Service Coverage Ratio (Post-Distribution)		1.23	1.23	1.23	1.23	NA	3.75
Lease Coverage Ratio		NA	NA	NA	NA	NA	NA

**Sponsor guarantees all leases & liabilities to the extent that is required by lienholders

DCF VALUATION-OWNING SCENARIO

		SSOP LLC TOTAL	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	4000	37,548,877.50	-	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50	7,509,775.50
Vehicles Per Day		1,480,000		296,000	296,000	296,000	296,000	296,000
Vehicle Capture Rate		0.61%		0.61%	0.61%	0.61%	0.61%	0.61%
Daily Car Count		9,055		1,811	1,811	1,811	1,811	1,811
Monthly Car Count		271,650		54,330	54,330	54,330	54,330	54,330
Annual Car Count		3,259,800		651,960	651,960	651,960	651,960	651,960
Avg. Ticket Price		11.52		11.52	11.52	11.52	11.52	11.52
Total Operating Expenses		17,132,675.51	-	3,426,535.10	3,426,535.10	3,426,535.10	3,426,535.10	3,426,535.10
Net Operating Income		20,416,201.99	-	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40
Other Cash Flows		7,226,167.37	(216,231.43)	(6,091,645.55)	(6,091,645.55)	(6,091,645.55)	(6,091,645.55)	31,808,981.01
Working Capital	9999	-						
Closing Costs	6010	216,231.43	216,231.43					
Operations Disposition	4027	31,769,651.91						31,769,651.91
Real Estate Disposition	4027	39,558,395.90						39,558,395.90
Interest Expense	9700	7,461,819.70		1,607,253.24	1,554,377.83	1,494,209.87	1,434,211.03	1,371,767.74
Maintenance Reserve	6500	325,980.00		65,196.00	65,196.00	65,196.00	65,196.00	65,196.00
Principal Reduction	2100	7,372,578.76		1,359,626.46	1,412,501.86	1,472,669.82	1,532,668.66	1,595,111.95
Principal Reduction - Disposition	2100	33,427,421.24						33,427,421.24
Basis Reduction		32,320,331.54						32,320,331.54
Depreciation Expense	9900	15,297,849.31		3,059,569.86	3,059,569.86	3,059,569.86	3,059,569.86	3,059,569.86
Net Cash Flow - Annual		42,940,218.66	(216,231.43)	1,051,164.71	1,051,164.71	1,051,164.71	1,051,164.71	38,951,791.27
Net Taxable Income		36,448,017.81	(216,231.43)	(583,582.70)	(530,707.30)	(470,539.33)	(410,540.49)	38,659,619.06
EBITDA		91,528,018.37	(216,231.43)	4,083,240.40	4,083,240.40	4,083,240.40	4,083,240.40	75,411,288.21
Average Cost of Equity				16.49%	16.49%	16.49%	16.49%	16.49%
Present Value Factors (B)			1.00	0.47	0.86	0.74	0.63	0.54
Present Value of Future Cash Flows (A) x (B)		51,737,288.57	(216,231.43)	1,903,538.75	3,505,228.26	3,009,037.91	2,583,086.88	40,952,628.21

COMPARISON

Now that we have looked at a significant amount of data for each scenario, we can compare values to determine if this proposition to acquire the real estate and FF&E would be a strong move for their business. I'd like to outline this comparison in a similar way as the analysis before with first looking at the important metrics from the pro forma cash flow summaries and then the discounted cash flow valuation. The reason I pointed out those items before is because of how much they can tell about the health of a business and an investment so by comparing them between each scenario we can decide which one is stronger.

PRO FORMA CASH FLOW SUMMARY-COMPARISON

Looking at the pro forma cash flow models for each scenario they tend to have similar trends of which values are positive versus negative or when certain values tend to increase versus decrease. The main difference with each metric is that when they acquire the real estate most of the values become significantly larger.

Firstly, looking at the "Net Cash Flow-Annual" we can see that the two different scenarios actually differed in a trend. While in the leasing scenario where the amounts in years 1-4 are negative, in the owning scenario these amounts are actually positive. Remember that cash flow is important to a business because they need cash to be able to pay operating expenses, taxes, fees, etc. Having a positive cash flow is significant to every company to make sure that they stay viable and do not go bankrupt. Some of this cash flow variance can be seen by the differences between payments to principal, interest, and rent. See the chart below for a breakdown between these variances.

	CURRENT LEASING	NEW RE PURCHASE
P & I	1,675,546	2,966,880
RENT	2,642,603	-
TOTAL ANNUAL	4,318,149	2,966,880
ANNUAL VARIANCE	1,351,269	1,351,269
MONTHLY VARIANCE	112,606	112,606

As you can see from the chart, because of the differences between these payments there is a yearly difference in cash flow of \$1,351,269 and a monthly difference of \$112,606. This is a very impactful difference and is all because they would no longer have to pay rent and instead increase their principal and interest payments but to a favorable amount. As many financial professionals say, cash is king, and with this new business plan they are making notable improvements to their cash flow.

The next item to compare is the "Net Taxable Income". Between the two scenarios the NTI follows the same pattern of having negative values years 0-4 and then a large positive value in the year of disposition. The total sums are \$1,821,985 in the current leasing situation versus

\$36,448,017. A larger sum of income coming in is beneficial for obvious reasons, but it does mean paying more taxes. That's why as I pointed out before having a negative NTI isn't necessarily a bad thing because this means paying less taxes. The disposition for the proposed plan has increased significantly but so has the annual negative amounts in years 1-4. This means that there is a larger amount of losses that they can carry forward to reduce their future tax payment.

One of the biggest reasons for the annual negative NTI increasing so much is due to a very large increase in depreciation expense. While depreciation does not affect cash flow, it is included in your NTI calculation. As I described in the analysis of the cash flow summary for the owning scenario this increase is due to the addition of building, FF&E, site improvements, and soft cost depreciation. The yearly depreciation expense has now increased from \$692,753 to \$3,059,569. These tax benefits that result from the new depreciation expenses are some of the most significant advantages to this new deal.

As discussed before, EBITDA is important so that analysts can more truly see the efficiency of a company's operations and are able to more clearly compare companies across different industries and regions. Firstly, due to the increased disposition EBITDA and EBITDAR have increased significantly in sum and more earnings is always positive. But what is really important to note is the differences in EBITDA yearly due to no rent being paid after the proposed acquisition. In the new model EBITDA and EBITDAR are now actually the exact same thing because they no longer have to pay any rent since they own the real estate. In years 1-4 the annual EBITDA has increased around three million due to this reason. These same values are shown in the "Net Operating Income" metric. This makes the operations appear much more profitable and increases the overall value of operations when they sell. You can see this from the difference in the operations disposition of \$9,162,692 versus \$31,769,651. This increase in operations value is part of why this new deal becomes so lucrative.

Now, let's compare the values of the investor and sponsor IRR's. As noted in the analysis of the cash flow summary in the current scenario, IRR is a very important tool for an investor and sometimes used as an end-all decision making metric. It can show how profitable an investment is likely to be based off of the net present value of cash flows. Generally, the higher the IRR the better and in this comparison the acquisition scenario is dominant. The investor and sponsor IRR's in the leasing scenario are 3.4% and 6.4% versus 33.7% and 48% in the proposed plan. This is such a significant increase in an IRR that it is undisputable that the proposed plan is a stronger investment.

DISCOUNTED CASH FLOW VALUATION-COMPARISON

The last item to compare are the discounted cash flows. We know that due to the theory of time value of money that the value of cash changes over time and our future cash flows need to be discounted to see their true present value. Like our net cash flow this item can show how healthy and strong a business is, but the discounted cash flow is a truer value. Comparing the two we can see that the current total DCF is \$8,849,187 versus \$51,737,288 in the new plan. This significant increase tells investors that this new deal can be much more lucrative and profitable than the current one.

CONCLUSION

Through our comparison of the data for the leasing scenario versus the owning of the real estate and FF&E we can make a definitive decision that the proposed plan is a much more

lucrative investment and is the correct decision for this business to make. While significantly increasing their cash flows, they are also able to reduce the amount in taxes that they have to pay. They show stronger internal rate of returns that clearly show this is a more profitable investment. Since they no longer have to pay their leases, they are increasing their NOI and EBITDA which makes the value of their operations much higher. On top of all of this, by owning the real estate they will also have more control over their business and will not have to report to a landlord which can make many things easier.

It's important to note that this situation is very specific to this business and does not mean owning the real estate is the right decision for every business. What it does show though is how important it is for a business to consider this question and to make sure they do a deep analysis on it. While this plan would have continued to be profitable under leasing the real estate, they would have lost out on so much value had they not drawn up this new plan. That is why when starting a business, you need to look at decisions from every angle and consider all situations because there is always a chance that you can make your business stronger.