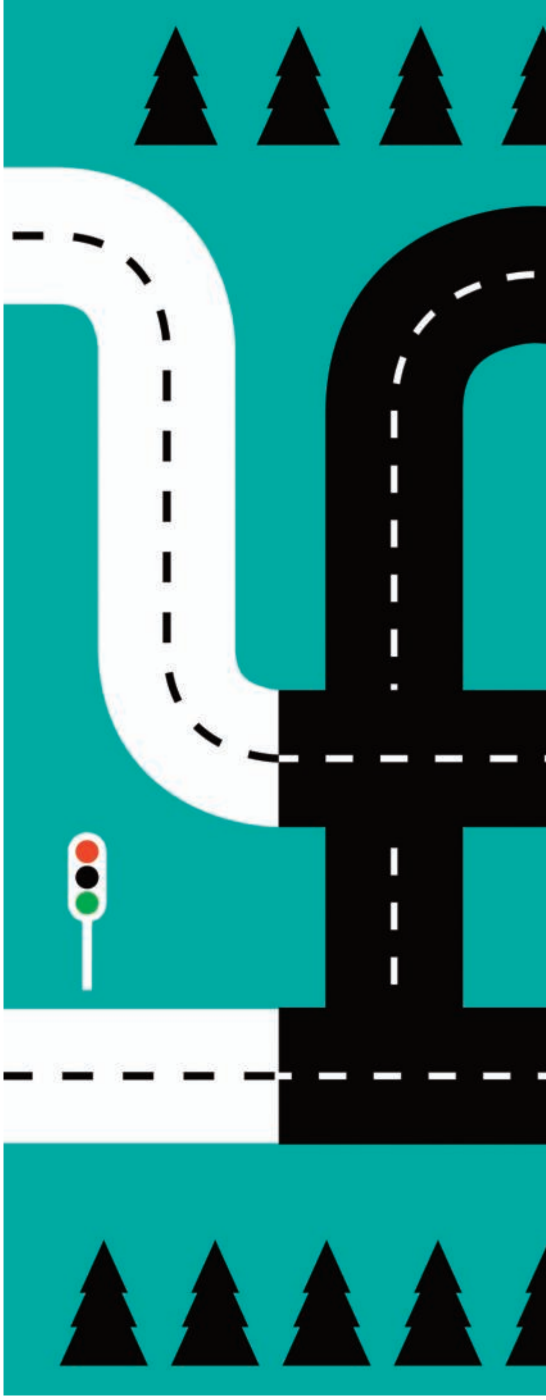


Making your money work HARDER

It's no surprise that many transport operators aren't awash with finance experts but, given our mistrust of the money men, some may be missing out on cost-effective vehicle acquisition. Brian Tinham reports

Nine times out of 10, the least cost-effective method of acquiring new or used commercial vehicles is outright purchase. Most VAT-paying profitable companies are far better off using some sort of lease product. So says vehicle finance specialist Activa Contracts' managing director Ian Hill, echoing the views of the vast majority in his world.

He would, wouldn't he, but why is Hill so emphatic? "One of the biggest factors is the time value of money," he says. "If your new van costs £20,000, that cash is immediately out of your bank so it's not available for more profitable business uses... And you never know what the future holds."

It's all about cash flow and making your money work hardest for you. Hence the generally held aphorism: investing working capital in fixed assets is rarely the best plan, at least in terms of net cost of funding. And there are also the risk issues. If you purchase vehicles, everything is down to you – all the way from interest rate increases on hire purchase (albeit unlikely for the next 12 months) to maintenance, tyres and ultimately, of course, resale values.

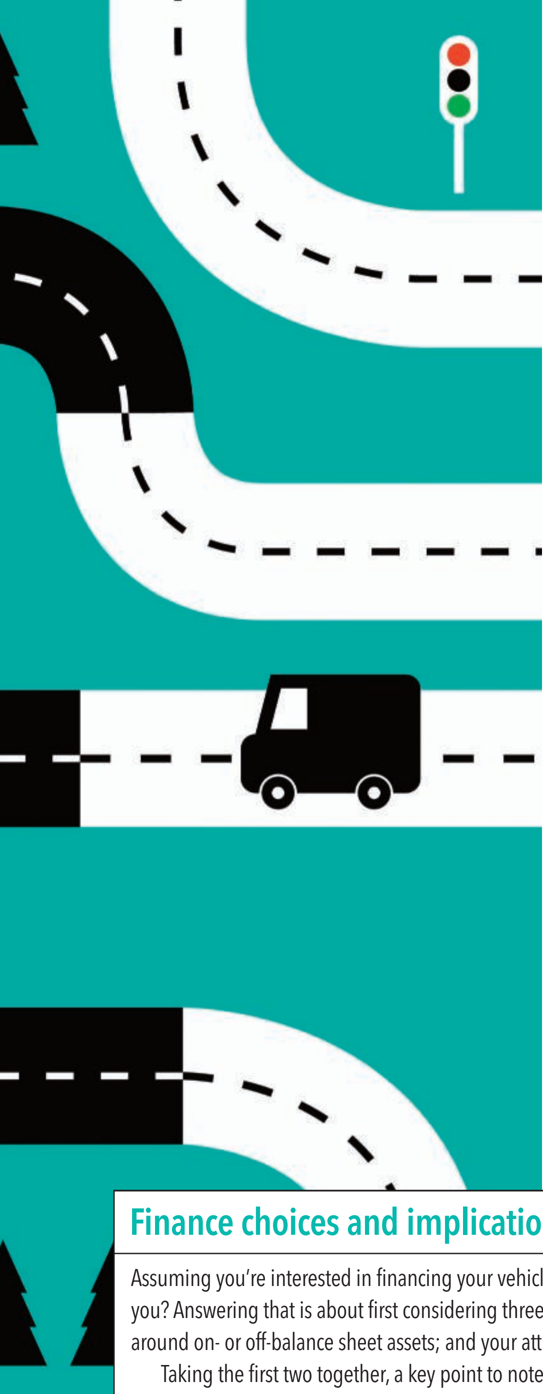
Not that funding vehicles through any of the alternative financial instruments – purchase or lease – is automatically risk free. You might worry, for example, about exceeding contract vehicle mileage terms or unpredictable costs of repairs beyond reasonable wear and tear, particularly where municipal and construction vehicles are concerned.

CHOOSE CAREFULLY

But all that depends on your choice of finance method, the detailed terms – and the provider. Most offer mechanisms that assume some or all of these risks under contract. If you plump for a contract hire (lease) product, for example, all operational responsibility – including vehicle management and R&M – is part of the package. So you're left with nothing more than fixed monthly payments. That said, many finance providers will also help you to outsource as much or as little risk as you like – particularly those with a vehicle manufacturer affiliation.

For that matter, some also offer consultancy services not only in terms of selecting finance packages (with the caveat that they can't advise on tax), but also the types of vehicles best suited to your applications.

Some of the independents take that even further, with staff fleet engineers



advising on which brands and even models fare best in terms of whole life costs and discounts. Suddenly, finance and leasing companies sound rather more attractive, don't they?

So who should you talk to? A lot depends on what you're after and your attitude to risk. Looking at the independents, Activa, for example, finances cars and vans up to 3.5 tonnes, and has a fleet of around 45,000 funded vehicles. Lex Autolease – the undisputed giant, with more than 300,000 on its fleet – increases that vehicle range to include panel vans, dropsides and tippers up to 6.5 tonnes. Meanwhile, Five Arrows Vehicle Finance (currently being acquired by Paragon Bank) has some 2,500 on its books but claims to consider "anything on wheels, from £5,000 upwards". And then there are the OEMs' finance arms.

CONSULTANCY TOO

They're all different. Five Arrows, for example – which coincidentally has particular interests in recovery vehicles and road sweepers – offers everything from hire purchase to finance lease, sale and lease back, and hire purchase and back (see panels). But sales director Greg Viviers says operators should also know his company offers advice on vehicle specifications through its own consultants and has "quite a bit of sway" over vehicle discounts.

He's also proud of the company's old-fashioned approach to banking, based on face-to-face engagement and flexibility over terms. "For example, we can offer sale and lease back on used vehicles if operators need to raise cash. We typically advance 80% loan to value, so if we assess a haulier's fleet as worth £200,000, we could offer a £160,000 cash injection, which they might use to expand the fleet with new trucks, improve facilities, whatever. We

"If your new van costs £20,000, that cash is immediately out of your bank so it's not available for more profitable business uses… And you never know what the future holds"

Ian Hill

Finance choices and implications

Assuming you're interested in financing your vehicle acquisitions, which mechanism is likely to be best for you? Answering that is about first considering three issues: your cash flow situation; your preferences around on- or off-balance sheet assets; and your attitude to risk.

Taking the first two together, a key point to note is that, in the eyes of HMRC, there are only two ways of accounting for tax on vehicle acquisition – purchase (on balance sheet and written down over a period of years) or operating lease (currently off balance sheet but due to be brought back on under new lease accounting rules in 2019). Another point, however, is that first year capital allowances are currently £500,000 (reducing to £200,000 next year), meaning there can be tax advantages in purchasing. That said, if you're worried about gearing ratios (an important measure of financial fitness), operating leases hold the trump card for now. So how you fund your assets at this fundamental level affects your balance sheet, gearing, tax and hence also your cash flow.

Meanwhile, your choice of product from either camp also impacts net cost. Hire purchase and contract purchase, for example, are treated identically for tax purposes, with all VAT charged and recovered upfront. Remaining monthly instalments are thus VAT free, which can be attractive for cash flow. However, contract purchase puts an explicit (potentially flexible) residual value on your purchased vehicles, so reducing monthly payments, with the choice over returning, refinancing or paying for the assets deferred to the end of the term.

As for the matter of risk, Activa Contracts' managing director Ian Hill advises: "If you go for basic funding in the form of a finance lease or hire purchase, you remove any interest issues, but you're still exposed to operating cost and resale risks. However, if you choose lower risk options, such as contract hire, which fix the resale value, then you're effectively only paying for depreciation, not the entire vehicle lifecycle cost. And you can overlay these with fixed or variable cost maintenance, depending on your appetite for that aspect of risk."

would then fix repayments, with or without a balloon, over whatever period we agree makes sense."

Lex Autolease is the big player, so, as you might expect, offers most finance options (contract purchase, contract hire, finance lease and 'Flexilease'), albeit only on new vans and cars. That said, principal consultant Paul Lippitt says the firm also offers sale and lease back options on existing fleets, provided vehicles aren't too old and mileages are acceptable.

VEHICLE SPECIFICATION

"We can also recommend best manufacturers for any van types that customers might want, and we can discuss discounts – although, as with all leasing companies, OEMs treat us only as a conduit to the end user," explains Lippitt. That said, he suggests that among Lex Autolease's particular strengths is its independent consultancy.

"We employ professional accountants and others able to advise, for example, on duty of care and procurement – including the individual who used to run HMRC's fleet."

As for Activa, Hill says his company is increasingly called upon to be involved in the specification process. "We can look at options in terms of whole life cost using our own database, which covers net capital cost, resale values, maintenance budgets, tyre budgets, etc. But we also have professional fleet engineers able to help with identifying the right vehicles for the job based on operational factors, such as the types of payload and the relevant duty cycles."

So much for the independent leasing companies: what about OEMs' finance arms? Clearly, you sacrifice that manufacturer independence, but there are plus points. As MAN Financial Services head of sales and marketing David Parkin puts it: "Because of our deep relationship with MAN, not only do we understand the assets customers acquire, but it's also in our interests to

Finance deal drives brighter future

Wellingborough-based transport operator Finedon Bulk Haulage recently managed its own rescue from likely closure by securing an essential funding injection. Director Karl Donaldson explains that the family firm got into difficulties after one of the brothers repeatedly ignored notices of tax arrears from HMRC.

By the time he found out about the problem, HMRC had already escalated matters and court proceedings were no longer avoidable. "When I discovered that [my brother] had been ignoring notices from HMRC, I decided to buy him out and see what could be done to secure our financial future," he says.

Donaldson explains that the company's accountants Cottons Chartered next called in insolvency and recovery firm BRI, with a goal of finding a solution to the haulier's tax liability and attempting to secure its future. BRI started by agreeing a Company Voluntary Arrangement (CVA) with HMRC, enabling Finedon to pay off the tax as a £100,000 lump sum followed by payments of £1,000 per month for five years.

"We still needed cash to fulfil the lump sum aspect of the CVA, so Cottons introduced us to Praetura Asset Finance," continues Donaldson. Praetura valued his vehicles and agreed a sale and hire purchase-back deal. That released £125,000 from the value of his 44-tonne trucks, effectively enabling the haulier to continue trading.

"Given the extent of the company's HMRC arrears, it had the option to pre-pack [liquidate] the business, but Karl's desire to continue trading and honour its debts prevailed," comments Dan Heald, Praetura's business development manager. "By applying an asset-based approach to the underwrite and given the established nature of the business, Praetura was able to take a strategic view ... and provide the funding required to ensure the family business continued to thrive."

"Customers wanting finance terms for used vehicles won't be turned away. Because we understand the assets we're funding, we can put residual values on used trucks, too"
Steve Clement

help them throughout the contract period so they come back for more. If you like, we have real skin in the game, and that's good for customers."

Hard to argue with that. And Mercedes-Benz Financial Services general manager for CVs Steve Clement adds another point. Customers wanting finance terms for used vehicles won't be turned away. "Because we understand the assets we're funding, we can put residual values on used trucks, too," he says. "So we're able to offer our range of finance products – for example, contract hire or the business equivalent of PCP [personal contract hire] – on new and used vehicles."

USED TRUCK FINANCE

Indeed, Clement argues that Mercedes actively seeks to work with operators, helping them to manage their finance portfolios in step with changing fleet requirements. "Our used business has doubled in the last three years. So, if necessary, we're very happy to look at our customers' financed vehicles before contract end, and, where they still have equity, get them on to new contracts. It's good for them and from our point of view it generates new and used truck sales opportunities."

Clearly, such flexibility is easier to come by with tractor units and heavy rigids that have been well looked after than it is for tippers and the like that are bound to take some knocks. However, Clement insists that the firm's Agility contract purchase product has been used to good effect on tougher duty trucks. "We're not frightened of looking at used Mercedes tippers... Our Agility contract offers operators a good option, not least because, at the end of the contract they can hand it back, or keep it. In which case they don't have to worry about damage, excess mileage charges etc, or use any equity towards a deposit on a new vehicle."

No one pretends that any one finance solution or provider is automatically better than another. Inevitably, it's horses for courses. Larger fleet operators are more likely to tolerate risk, not least because it's spread over many more vehicles, they will have professional vehicle management services and possibly also their own workshops. The converse is the case for most SMEs. Best advice: talk to finance providers and your auditors – and go in with your eyes wide open. TE

Common products

Hire purchase: purchase product with the operator funding the full balance over chosen period of time. At contract end, the user owns the vehicle.
Verdict: Simple but expensive: user retains all risk; useful where residuals are likely to be low.

Contract purchase: purchase product, similar to hire purchase, but with reduced monthly instalments afforded by guaranteed residual value. At contract end, vehicle is returned, retained on payment of balloon, refinanced, or, in some cases, sold by operator on behalf of finance company with profit retained. User can also usually return vehicle before contract end: Ts&Cs apply.
Verdict: More cash friendly; only operating risks retained.

Contract hire: lease product involving fixed (but flexible) period and protected residual values with full R&M bundled in – meaning reduced monthly payments, followed by vehicle return. Ts&Cs on mileage and vehicle condition. Lends itself to fully outsourced service, including fleet management.
Verdict: Cash-friendly funding for the risk averse operator that wants to focus solely on operations with regularly renewed trucks.

Finance lease: lease product, similar to contract hire. Options include: estimated residual value (balloon) and no explicit mileage or damage conditions, which defers disposal method decision to period end; and full payout lease – more costly monthly payments but guaranteed rebate on eventual sale price, again without vehicle condition contract penalties.
Verdict: Potentially better for operators with lease preference but poor visibility of vehicle usage.