Fleet Options For Improving Cash Flow

By Fiona Soltes

JON KELLER, DIRECTOR OF Sales, East Region, Merchants Fleet Management, has a habit of asking the chief financial officers he comes across what keeps them up at night. "And I always get the same answer," said Keller. "They say cash flow. It's the thing I think is at the top of the list for most CFOs today."

Those CFOs are not alone. Even though there are a variety of ways to maximize cash flow and minimize exposure on the road to lower total operating costs, it can still be a tricky business. Today's fleet professionals must explore options, know the relevant data, and get help where needed to ensure the best outcome.

Charles Carr, MBA, Senior Contracts Manager, Willbros Group, shared one resourceful tactic: the open-end TRAC (terminal rental adjustment clause) lease, in use at his company. It comes down to an equation at the tail end: net sale proceeds minus reduced book value. With a TRAC lease, the lessee is the one who chooses the depreciation factor, as well as assumes the depreciation risk. The lessee also is the one who determines the service life of the vehicle after a set term. Flexibility is the name of the game.

"It sounds simple, but there are a lot of external forces at play," Carr said. "If you don't pay attention to them, they're going to bite you in the end." Setting a lower depreciation rate will mean lower monthly payments; a higher depreciation rate will mean higher payments. But under- or over-depreciating vehicles can impact cash flow.

"If you over-depreciate a vehicle, a positive rental adjustment will occur at the time of termination," Carr said. "The positive rental adjustment you realize represents capital that could have been used in the organization for another expenditure." Under-depreciate, on the other hand, and the time of termination could include a surprise bill.

Setting the right rate requires data. On the list: mileage; the way the vehicles are being used (such as trucks that often travel up and down the right-of-way on dirt compared to those that largely stay on highways, he said); maintenance and repair costs; and the history of the fleet.

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When that history is readily available, "you'll know the vehicles that are going to be remarketed, the mileage, the condition, what you thought you were going to get for them and what you did get for them," said Carr. "That can help you adjust the depreciation rate so you can get the reduced book value where it needs to be, so when you do the TRAC adjustment at the end, there are no surprises. You break even, and you did a great job. Now your money is not being stockpiled, and (you do not have) to come up with a lot of money because you didn't set the right depreciation rate."

"These are two very important considerations CFOs take into account," said Tod A. Nestor, Chief Financial Officer for Merchants Fleet Management. "One of the reasons is return…speaking in terms of cost. What kind of cost am I incurring here for the risk I'm willing to take? Another factor considered is the size of the cash flow relative to the overall cost structure of the business. Like any finance organization, one of our primary roles is managing risk throughout the company. We're always looking at what can we afford, what kind of risk can we take on at the most optimal cost? It's important to understand the impact of the relative cost of the entire fleet to the cost structure to the business. If it's smaller, you might be willing to take more risk. If it's larger, and it could really impact the cash flow of the business and your business model, then you might want to take a different approach."

Some fleet managers might prefer a closed-end lease, leaving the risk of the residual value with the lessor. They might prefer a full maintenance program with set monthly rates. They might also prefer a fixed interest rate over a variable one if certainty is important. All of these can impact cash flow. The tradeoff for gaining certainty, however, might be higher costs.

"There is no recipe for which way it should be," Nestor said. "There is only a recipe for which way it will be given the culture of your organization and your finance organization, and how they may want to look at this."

"If you're in the fleet business, and you want to be successful, I would really, really encourage you to use your suppliers," said NAFA Associate Member Peter Egan, U.S. and Canadian Partner for FleetVision. "In North America, I think we do that reasonably well, but we could do it better. If you say to your fleet management company or your insurance company or your other providers, 'Hey! I want you to help me be better,' and you give them the data to work with, they'll come back to you with a business plan that you can shop around to the other stakeholders inside the organization. I think that's really a strong suit we have here, and it's very unique."

In Europe, he continued, "they're not going to share their data with anybody because this data that I have is my job security. I'm not going to share it with the guy across the hallway, much less somebody who's an outsider. I just encourage you to be candid and to give your fleet suppliers as much of a head's up as you can on things like acquisitions, divestitures, and major business changes, the things that are coming down the pike, so they can help you get prepared for the various changes that are inevitably going to happen in this wonderful world we call the fleet leasing business." ■