

**ELEMENT FINANCIAL CORPORATION**  
**Form 51-102F4**  
*Business Acquisition Report*

**Item 1. Identity of the Company**

**1.1 Name and Address of the Company**

Element Financial Corporation (“**Element**” or the “**Company**”)  
161 Bay Street, Suite 4600  
Toronto, Ontario, M5J 2S1

**1.2 Executive Officer**

The following executive officer of the Company is knowledgeable about the significant acquisition and this report:

Michel Beland  
Chief Financial Officer  
Tel: (416) 386-1067

*Certain statements in this business acquisition report (“Report”) constitute forward-looking information (as defined under applicable Canadian securities laws). Readers should refer to the “Cautionary Statement Regarding Forward-Looking Information” that appears at the end of this Report.*

**Item 2. Details of Acquisition**

**2.1 Nature of Business Acquired**

Pursuant to a stock purchase agreement dated June 2, 2014 between the Company and PHH Corporation (“**PHH**”), on July 7, 2014, the Company acquired PHH Arval, PHH’s fleet management services business, which business includes fleet leasing services, fleet management, maintenance services, accident management services, fuel card programs, data warehousing, information management and online systems support and access (collectively, the “**Fleet Business**”) for a purchase price of approximately US\$1.4 billion (the “**Acquisition**”). As part of the Acquisition, the Company also assumed certain financing programs and securitizations of PHH related to the Fleet Business.

The Fleet Business primarily focuses on clients with fleets of greater than 75 vehicles. It provides its clients fleet leasing services and additional services and products including fleet management, maintenance services, accident management services and fuel card programs. Open-end leases represent 98% of the Fleet Business’ lease portfolio, under which its clients bear substantially all of the residual value risk of vehicles under lease.

The Fleet Business differentiates itself from its competitors in the fleet industry through the breadth of its product offering, customer service, and technology. The Fleet Business’ data warehousing, information management and online systems support its clients with their evaluation of overall fleet performance and costs, to allow them to better monitor and manage their corporate fleets.

The Fleet Business funds itself primarily through securitization programs in the U.S. and Canada. Under the U.S securitization program, Chesapeake Funding LLC (“**Chesapeake**”) issues notes to finance the purchase of certain lease assets originated by the Fleet Business in the United States.

As at March 31, 2014, Chesapeake and related entities had approximately US\$3.3 billion of assets and US\$2.9 billion of liabilities. The Canadian securitization program operates through Fleet Leasing Receivables Trust (“**FLRT**”). FLRT issues notes to finance the purchase of certain lease assets originated by the Fleet Business in Canada. As at March 31, 2014, FLRT and related entities had approximately US\$618 million in assets and US\$570 million in liabilities. As part of the Acquisition, Element assumed PHH’s obligations under the Chesapeake and FLRT securitization programs and the outstanding debt under the Chesapeake and FLRT securitization programs remained outstanding.

As part of the Acquisition, Element acquired the employees, systems, intellectual property, operations, offices, agreements and other assets that the Fleet Business employed to service its North American fleet customers.

The Acquisition was financed with a combination of 74,416,500 subscription receipts at \$12.75 per subscription receipt, \$345,000,000 aggregate principal amount of 6.125% extendible convertible unsecured debentures and 5,000,000 cumulative 5-year rate reset preferred shares series E at \$25.00 per preferred share pursuant to a short form prospectus dated June 11, 2014 (the “**Capital Raise**”).

## **2.2 Date of Acquisition**

July 7, 2014.

## **2.3 Consideration**

The aggregate purchase price for the Acquisition was approximately US\$1.4 billion. The Acquisition was financed with the proceeds from the Capital Raise and funds drawn under Element’s Amended and Restated Revolving Credit Agreement (as defined below).

As part of the Acquisition, Element assumed PHH’s obligations under the Chesapeake and FLRT securitization programs and the outstanding debt under the Chesapeake and FLRT securitization programs remained outstanding.

In conjunction with the Acquisition, Element amended and restated its revolving credit agreement for an aggregate commitment of approximately C\$1.5 billion (the “**Amended and Restated Revolving Credit Agreement**”). The borrowing base under the Amended and Restated Revolving Credit Agreement reflected an expansion of the borrowing base under Element’s prior revolving credit facility so as to include Element’s railcar assets and related contract balances. The new facility also provided Element with the ability to request a release of the security upon the satisfaction of certain conditions, such as receipt by Element of an investment grade credit rating. The Amended and Restated Revolving Credit Agreement was entered into by, among others, Element, as borrower, a syndicate of financial institutions as lenders and Bank of Montreal as agent.

## **2.4 Effect on Financial Position**

The Acquisition increased Element’s total assets to \$10 billion and raised the Company’s tangible leverage to 3.2:1 from 1.6:1 as at March 31, 2014 while the expansion and amendment to the revolving credit facility provided balance sheet capacity to fund forecasted growth.

## **2.5 Prior Valuations**

Not applicable.

## 2.6 Parties to Transaction

The transaction was not with an “informed person” (as such term is defined in Section 1.1 of National Instrument 51-102 – *Continuous Disclosure Obligations*), associate or affiliate of Element.

## 2.7 Date of Report

July 29, 2014.

## Item 3. Financial Statements

The following financial statements, attached as Schedule “A” hereto, are included as part of this report:

### *Unaudited Pro Forma Consolidated Financial Statements of Element Financial Corporation*

- (i) *Pro forma* consolidated statement of financial position as at March 31, 2014
- (ii) *Pro forma* consolidated statement of operations for the year ended December 31, 2013 and for the three-month period ended March 31, 2014

### *Audited Combined Financial Statements of the Fleet Business and Subsidiaries of PHH Corporation as of and for the Years Ended December 31, 2013 and 2012*

- (i) Independent Auditor’s Report
- (ii) Combined Statements of Comprehensive Income
- (iii) Combined Balance Sheets
- (iv) Combined Statements of Changes in Parent Equity
- (v) Combined Statements of Cash Flows

### *Unaudited Combined Condensed Financial Statements of the Fleet Business and Subsidiaries of PHH Corporation as of and for the Three Months Ended March 31, 2014 and 2013*

- (i) Condensed Combined Financial Statements

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Report contains certain forward-looking statements and forward-looking information which are based upon Element's current internal expectations, estimates, projections, assumptions and beliefs. In some cases, words such as “expect”, “believe”, “estimate”, “may”, “will”, “potential”, “proposed” and other similar words, or statements that certain events or conditions “may” or “will” occur are intended to identify forward-looking statements and forward-looking information. These statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in the forward-looking statements or information. In addition, this Report may contain forward-looking statements and information attributed to third party industry sources. Undue reliance should not be placed on these forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By its nature, forward-looking information involves numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Such forward-looking statements and information in this Report speak only as of the date of this Report.

Forward-looking statements and information in this Report include, but are not limited to, statements with respect to:

- Element's expectations regarding its revenue, expenses and operations;
- Element's anticipated cash needs and its needs for additional financing;
- Element's anticipated effect of the Acquisition on the financial performance of the company;
- Element's ability to achieve the expected benefits of the Acquisition;
- Element's plans for and timing of expansion of its services;
- Element's anticipated financing costs;
- Element's future growth plans (including growth resulting from acquisitions);
- Element's ability to attract new customers and vendor relationships and develop and maintain relationships with existing customers;
- Element's expectations regarding its origination volumes;
- Element's ability to attract and retain personnel;
- Element's expectation's regarding its reduced reliance on third-party brokers for originations;
- Element's expectations regarding growth in certain verticals in which it operates;
- anticipated trends and challenges in Element's business and the markets in which it operates; and
- Element's anticipated delinquency rates and credit losses.

Although Element believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Element cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither Element nor any other person assumes responsibility for the accuracy or completeness of the forward-looking statements and information. Some of the risks and other factors, some of which are beyond Element's control, which could cause results to differ materially from those expressed in the forward-looking statements and information contained in this Report include, but are not limited to:

- credit risks that may lead to unexpected losses;
- concentration of leases and loans to small and mid-sized companies that may carry more inherent risks;
- the concentration of leases and loans within a particular industry or region that may negatively impact Element's financial condition;
- risks relating to the integration of the business acquired pursuant to the Acquisition;
- Element's provision for credit losses that may prove inadequate;
- the collateral securing a loan or a lease that may not be sufficient;
- lack of funding that may limit Element's ability to originate leases and loans;
- the concentration of debt financing sources that may increase Element's funding risks;
- global financial markets and general economic conditions that may adversely affect Element's results;
- Element's credit facilities and securitization transactions that may limit its operational flexibility;
- changes in interest rates that may adversely affect Element's financial results;
- an unexpected increase in Element's funding costs that may adversely affect its earnings;
- a competitive business environment that may limit the growth of Element's business;
- competition for vendor equipment finance that may affect Element's relationships with vendors;

- loss of key personnel that may significantly harm Element's business;
- inability to realize benefits from growth (including growth related to the Acquisition) that may harm Element's financial condition;
- complications in managing acquisitions that may negatively affect Element's operating results;
- the fact that Element has a brief operating history and Element has incurred losses in the past and may not achieve profitability in future periods;
- the fact that the market for Element's listed securities may be volatile and subject to wide fluctuations in response to numerous factors;
- the fact that Element's quarterly net finance income and results of operations are difficult to forecast and may fluctuate substantially;
- the fact that litigation may negatively impact Element's financial condition; and
- the other factors considered under "Risk Factors" in the Company's short form prospectus dated June 11, 2014 and in the annual information form of Element for the year ended December 31, 2013, under the heading "Risk Factors" available under Element's profile on SEDAR at [www.sedar.com](http://www.sedar.com), which is incorporated by reference herein.

Readers are cautioned that the foregoing list of factors is not exhaustive. The forward-looking statements contained in this Report are expressly qualified by this cautionary statement. Element is not under any duty to update any of the forward-looking statements after the date of this Report to conform such statements to actual results or to changes in Element's expectations except as otherwise required by applicable legislation.

**SCHEDULE A**

*Pro Forma* Consolidated Financial Statements

**Element Financial Corporation**

Unaudited

Statement of Financial Position as at March 31, 2014

Statements of Operations for the year ended December 31, 2013 and  
for the three-month period ended March 31, 2014

Element Financial Corporation

**PRO FORMA CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

[unaudited in millions of Canadian dollars]

As at March 31, 2014

Element	PHH Fleet <sup>(1)</sup>	[a]	[b]	[c]	[d]	[e]	[f]	[g]	<i>Pro forma consolidated</i>
\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
<i>Adjustments [note 2]</i>									
<b>ASSETS</b>									
Cash	42	313	792	121	289	346	(1,548)	—	355
Restricted cash	102	273	—	—	—	—	—	—	375
Finance receivables	2,986	—	—	—	—	—	3,986	—	6,972
Equipment under operating leases	813	4,000	—	—	—	—	(14)	(3,986)	813
Accounts receivable and other assets	36	467	—	—	—	—	(13)	—	490
Notes receivable	36	—	—	—	—	—	—	—	36
Income taxes receivable	—	4	—	—	—	—	—	—	4
Derivative financial instruments	1	—	—	—	—	—	—	—	1
Property, equipment and leasehold improvements	6	30	—	—	—	—	—	—	36
Intangible assets	77	31	—	—	—	—	180	—	288
Deferred tax assets	32	21	—	—	—	—	(19)	—	34
Goodwill	104	28	—	—	—	—	337	—	469
	<b>4,235</b>	<b>5,167</b>	<b>792</b>	<b>121</b>	<b>289</b>	<b>346</b>	<b>(1,077)</b>	<b>—</b>	<b>9,873</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
<b>Liabilities</b>									
Accounts payable and accrued liabilities	113	273	2	1	2	—	—	25	416
Current income taxes payable	1	—	—	—	—	—	—	—	1
Due to affiliates	—	25	—	—	—	—	(25)	—	—
Derivative financial instruments	8	—	—	—	—	—	—	—	8
Secured borrowings	2,467	3,817	—	—	—	346	—	—	6,630
Deferred tax liabilities	36	640	—	—	—	—	(640)	—	36
Convertible debt	—	—	—	—	273	—	—	—	273
<b>Total liabilities</b>	<b>2,625</b>	<b>4,755</b>	<b>2</b>	<b>1</b>	<b>275</b>	<b>346</b>	<b>(665)</b>	<b>25</b>	<b>7,364</b>
Share capital	1,564	—	790	120	14	—	—	—	2,488
Special warrants	—	—	—	—	—	—	—	—	—
Contributed surplus	27	—	—	—	—	—	—	—	27
Net parent investment	—	397	—	—	—	—	(397)	—	—
Retained Earnings (Deficit)	(2)	—	—	—	—	—	—	(25)	(27)
Accumulated other comprehensive income	21	15	—	—	—	—	(15)	—	21
<b>Shareholders' equity</b>	<b>1,610</b>	<b>412</b>	<b>790</b>	<b>120</b>	<b>14</b>	<b>—</b>	<b>(412)</b>	<b>(25)</b>	<b>2,509</b>
	<b>4,235</b>	<b>5,167</b>	<b>792</b>	<b>121</b>	<b>289</b>	<b>346</b>	<b>(1,077)</b>	<b>—</b>	<b>9,873</b>

See accompanying notes

<sup>(1)</sup> Column was derived from the historical consolidated balance sheet as at March 31, 2014 of the Fleet Business and Subsidiaries of PHH Corporation, which was prepared in accordance with U.S. GAAP and in U.S. dollars. The exchange rate used to translate the U.S. dollar amounts is the exchange rate as at March 31, 2014 of U.S. \$0.9046 for Cdn \$1.0000.

**Element Financial Corporation**

**PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS**

[unaudited in millions of Canadian dollars]

Three-month period ended March 31, 2014

	Element	PHH Fleet <sup>(1)</sup>	[b]	[f]	[h]	[i] Pro forma consolidated	
	\$	\$	\$	\$	\$	\$	\$
<b>NET INTEREST REVENUE</b>							
Interest income - finance receivables	48	—	—	33	—	—	81
Rental revenue, net	10	379	—	(379)	—	—	10
	58	379	—	(346)	—	—	91
Interest expense	21	15	—	—	9	—	45
Net interest income before provision for credit loss	37	364	—	(346)	(9)	—	46
Provision for credit losses	3	—	—	—	—	—	3
Net interest income	34	364	—	(346)	(9)	—	43
Other revenue items	11	70	—	1	—	—	82
Net financial income	45	434	—	(345)	(9)	—	125
<b>OPERATING EXPENSES</b>							
Depreciation on operating leases	—	331	—	(331)	—	—	—
Salaries and benefits	13	21	—	—	—	—	34
General and administrative expenses	6	57	—	(14)	—	—	49
Share-based compensation	4	—	—	—	—	—	4
	23	409	—	(345)	—	—	87
<b>BUSINESS ACQUISITION COSTS</b>							
Amortization of intangible assets	1	1	—	—	—	2	4
Integration costs	—	—	—	—	—	—	—
Income (loss) before income taxes	21	24	—	—	(9)	(2)	34
Provision for (recovery of) income taxes	5	8	—	—	(3)	(1)	9
<b>Net income (loss) for the period</b>	<b>16</b>	<b>16</b>	<b>—</b>	<b>—</b>	<b>(6)</b>	<b>(1)</b>	<b>25</b>
Cumulative dividend on preferred shares	(2)	—	(2)	—	—	—	(4)
<b>Net income available to common shareholders</b>	<b>14</b>	<b>16</b>	<b>(2)</b>	<b>—</b>	<b>(6)</b>	<b>(1)</b>	<b>21</b>
<b>Earnings (loss) per share</b>							
Basic	0.07						0.08
Fully diluted	0.07						0.08
<b>Weighted average shares outstanding</b>							
Basic	189,214,813						253,924,813
Fully diluted	194,113,733						258,823,733

See accompanying notes

<sup>(1)</sup> Column was derived from the unaudited consolidated statement of income for the three-month period ended March 31, 2014 of the Fleet Business and Subsidiaries of PHH Corporation, which was prepared in accordance with U.S. GAAP and in U.S. dollars. The exchange rate used to translate the U.S. dollar amounts is the average exchange rate for the three-month period ended March 31, 2014 of U.S. \$0.906 for Cdn \$1.000.

Element Financial Corporation

**PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS**

[unaudited in millions of Canadian dollars]

Year ended December 31, 2013

Element	PHH Fleet <sup>(1)</sup>	GE Canadian Fleet <sup>(2)</sup>	[b]	[f]	[h]	[i]	[j]	[k] Pro forma consolidated
\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>NET INTEREST REVENUE</b>								
Interest income - finance receivables	136	—	2	—	82	—	12	232
Rental revenue, net	—	1,427	93	—	(1,386)	—	(93)	41
	<u>136</u>	<u>1,427</u>	<u>95</u>	<u>—</u>	<u>(1,304)</u>	<u>—</u>	<u>(81)</u>	<u>273</u>
Interest expense	50	63	—	—	34	—	—	152
Net interest income before provision for credit loss	86	1,364	95	—	(1,304)	(34)	(81)	121
Provision for credit losses	5	—	—	—	—	—	—	5
Net interest income	81	1,364	95	—	(1,304)	(34)	(81)	116
Other revenue items	33	264	6	—	2	—	—	305
Net financial income	<u>114</u>	<u>1,628</u>	<u>101</u>	<u>—</u>	<u>(1,302)</u>	<u>(34)</u>	<u>(81)</u>	<u>(5)</u>
								<u>421</u>
<b>OPERATING EXPENSES</b>								
Depreciation on operating leases	—	1,247	81	—	(1,247)	—	(81)	—
Salaries and benefits	35	71	5	—	—	—	—	111
General and administrative expenses	14	217	4	—	(55)	—	—	180
Share-based compensation	12	—	—	—	—	—	—	12
	<u>61</u>	<u>1,535</u>	<u>90</u>	<u>—</u>	<u>(1,302)</u>	<u>—</u>	<u>(81)</u>	<u>303</u>
<b>BUSINESS ACQUISITION COSTS</b>								
Amortization of intangible assets	2	2	—	—	—	9	—	13
Transaction costs	35	—	—	—	—	—	—	35
Integration costs	11	—	—	—	—	—	—	11
Income (loss) before income taxes	5	91	11	—	—	(34)	(9)	59
Provision for (recovery of) income taxes	6	31	3	—	—	(10)	(2)	27
<b>Net income (loss) for the period</b>	<u>(1)</u>	<u>60</u>	<u>8</u>	<u>—</u>	<u>—</u>	<u>(24)</u>	<u>(7)</u>	<u>32</u>
Cumulative dividend on preferred shares	—	—	—	(8)	—	—	—	(8)
<b>Net income available to common shareholders</b>	<u>(1)</u>	<u>60</u>	<u>8</u>	<u>(8)</u>	<u>—</u>	<u>(24)</u>	<u>(7)</u>	<u>(4)</u>
								<u>24</u>
<b>Earnings (loss) per share</b>								
Basic	(0.01)							0.11
Fully diluted	(0.01)							0.11
<b>Weighted average shares outstanding</b>								
Basic	138,422,653							216,844,290
Fully diluted	138,422,653							220,841,650

See accompanying notes

<sup>(1)</sup> Column was derived from the unaudited consolidated statement of income for the year ended December 31, 2013 of the Fleet Business and Subsidiaries of PHH Corporation, which was prepared in accordance with U.S. GAAP and in U.S. dollars. The exchange rate used to translate the U.S. dollar amounts is the average exchange rate for the year ended December 31, 2013 of U.S. \$0.9710 for Cdn \$1.0000.

<sup>(2)</sup> Column was derived from the unaudited constructed statement of operations of GE Capital's Canadian fleet for the six-month period ended June 28, 2013 prepared in accordance with U.S. GAAP. The results of operations for GE Capital's Canadian fleet for the six-month period ended December 31, 2013 are already reflected in the condensed consolidated financial statements of the Company for the year ended December 31, 2013, based on the actual acquisition date.

## Element Financial Corporation

# NOTES TO *PRO FORMA* CONSOLIDATED FINANCIAL STATEMENTS

[in millions of Canadian dollars unless otherwise noted]

March 31, 2014

Unaudited

## 1. BASIS OF PRESENTATION

On June 2, 2014, Element Financial Corporation ["Element" or the "Corporation"] announced the probable acquisition of the Fleet Business and Subsidiaries of PHH Corporation ["PHH Fleet"] for anticipated cash consideration of approximately U.S.\$1.4 billion. The consideration is expected to be financed through a combination of a subscription receipt issuance, a preferred share issuance, a convertible debenture issuance, amended and restated borrowing facilities and cash on hand [the "PHH Fleet Acquisition"].

On June 28, 2013, the Corporation acquired the Canadian fleet portfolio of GE Capital along with the related operational resources. The Corporation completed the transaction for net cash consideration of \$559. The purchase was satisfied through a combination of \$173 in cash and from short-term borrowings of \$386 [the "GE Canadian Fleet Portfolio Acquisition"].

The unaudited *pro forma* consolidated statement of financial position as at March 31, 2014 gives effect to the PHH Fleet Acquisition as if it had occurred on March 31, 2014 and is based on: [i] the unaudited condensed consolidated financial statements of the Corporation as at and for the three-month period ended March 31, 2014 prepared in accordance with International Financial Reporting Standards ["IFRS"]; [ii] the unaudited combined condensed financial statements of Fleet Business and Subsidiaries of PHH Corporation as at and for the three-month period ended March 31, 2014, prepared in accordance with U.S. generally accepted accounting principles ["U.S. GAAP"].

The *pro forma* consolidated statement of operations for the year ended December 31, 2013 gives effect to the PHH Fleet Acquisition and GE Canadian Fleet Portfolio Acquisition [collectively the "Acquisitions"] as if they had occurred on January 1, 2013 and is based on: [i] the audited consolidated financial statements of the Corporation for the year ended December 31, 2013 prepared in accordance with IFRS; [ii] the audited combined financial statements of Fleet Business and Subsidiaries of PHH Corporation for the year ended December 31, 2013 prepared in accordance with U.S. GAAP; [iii] the unaudited constructed statement of operations of GE Capital Fleet Services Canada Business Unit for the six-month period ended June 30, 2013 prepared in accordance with U.S. GAAP.

The *pro forma* consolidated statement of operations for the three-month period ended March 31, 2014 gives effect to the Acquisitions as if they had occurred on January 1, 2013 and is based on: [i] the unaudited condensed consolidated financial statements of the Corporation for the three-month period ended March 31, 2014 prepared in accordance with IFRS; and [ii] the unaudited combined condensed financial statements of Fleet Business and Subsidiaries of PHH Corporation for the three-month period ended March 31, 2014 prepared in accordance with U.S.

## Element Financial Corporation

# NOTES TO *PRO FORMA* CONSOLIDATED FINANCIAL STATEMENTS

[in millions of Canadian dollars unless otherwise noted]

March 31, 2014

Unaudited

GAAP. The results of operations for the Canadian fleet portfolio of GE Capital for the three-month period ended March 31, 2014 are already reflected in the condensed consolidated financial statements of the Corporation for the three-month period ended March 31, 2014 based on the timing of the GE Canadian Fleet Portfolio Acquisition.

These unaudited *pro forma* consolidated financial statements are not intended to reflect the results of operations or the financial position of the Corporation which would have actually resulted had the Acquisitions been effected on the dates indicated. Any potential synergies that may be realized upon consummation of the Acquisitions have not been reflected in the unaudited *pro forma* consolidated financial statements. Further, the unaudited *pro forma* consolidated financial statements are not necessarily indicative of the results of operations that may be obtained in the future.

## 2. *PRO FORMA* ADJUSTMENTS

The *pro forma* adjustments contained in these unaudited *pro forma* consolidated financial statements reflect on estimates and assumptions by management of the Corporation based on currently available information.

The following *pro forma* adjustments relate to the PHH Fleet Acquisition:

- [a] In advance of the PHH Fleet Acquisition, the Corporation expects to complete an offering of 64,710,000 subscription receipts at a price of \$12.75 per subscription receipt for gross proceeds of \$825. Proceeds expected to be received, net of estimated share issue costs incurred for underwriting services of \$33, are \$792. An additional \$2 of estimated share issue costs are anticipated to be incurred with respect to legal, audit, and other fees, which has been recorded as an increase to accounts payable and other liabilities.
- [b] In advance of the PHH Fleet Acquisition, the Corporation expects to complete an offering of 5,000,000 6.4% cumulative 5-Year Rate Reset Preferred Shares, Series E at a price of \$25.00 per preferred share for gross proceeds of \$125. Proceeds expected to be received, net of estimated share issue costs incurred for underwriting services of \$4, are \$121. An additional \$1 of estimated share issue costs are anticipated to be incurred with respect to legal, audit, and other fees, which has been recorded as an increase to accounts payable and other liabilities. The impact of the cumulative dividend on the anticipated preferred shares for the three-month period ended March 31, 2014 and for the year ended December 31, 2013 is \$2 and \$8, respectively.

## Element Financial Corporation

### NOTES TO *PRO FORMA* CONSOLIDATED FINANCIAL STATEMENTS

[in millions of Canadian dollars unless otherwise noted]

March 31, 2014

Unaudited

- [c] In advance of the PHH Fleet Acquisition, the Corporation expects to complete an offering of 5.125% Extendible Convertible Unsecured Subordinated Debentures for gross proceeds of \$300 [the “Debentures”]. Proceeds expected to be received, net of estimated transaction costs of \$11, are \$289. An additional \$2 of estimated share issue costs are anticipated to be incurred with respect to legal, audit, and other fees, which has been recorded as an increase to accounts payable and other liabilities.

For accounting purposes, the Debentures are compound financial instruments which consist of a debt instrument and equity conversion feature. Within these *pro forma* financial statements, the \$300 principal amount has been allocated between the liability and equity components. The allocation was made by estimating the fair value of the liability component, which is the fair value of a similar liability that does not have an equity conversion feature. A market interest rate of 6.25% was used to estimate the fair value of the liability component, which was determined to be \$285. The initial value of the equity component of \$15 was based on the residual principal amount after deducting the fair value of the liability component. Estimated transaction costs attributable to the issuance of \$13 have been allocated to the liability and equity components on a proportionate basis.

- [d] In advance of the PHH Fleet Acquisition, the Corporation expects to draw \$346 from an amended and restated credit facility to finance the remainder of the anticipated cash consideration.
- [e] The anticipated cash consideration in the PHH Fleet Acquisition of U.S.\$1.4 billion has been translated into Canadian dollars at the exchange rate as at March 31, 2014 of U.S.\$0.9046 for CDN\$1.00. The anticipated cash consideration has been reflected as a reduction to cash of \$1,548.

Adjustments to reflect the preliminary allocation of assets acquired and liabilities assumed include: [i] a decrease of \$14 to equipment under operating leases to reflect the preliminary fair value adjustment; [ii] a decrease of \$13 to accounts receivable and other assets to reflect the preliminary fair value adjustment; [iii] an increase to intangible assets of \$180 to reflect the preliminary estimate of the fair value of customer relationship and software assets acquired; [iv] the reduction of deferred tax assets and deferred tax liabilities of \$19 and \$640, respectively, to reflect the Corporation’s U.S.-tax election to treat a portion of the PHH Fleet Acquisition as an asset purchase for tax compliance purposes, thereby eliminating the existing temporary differences between the financial statement amounts of assets acquired and liabilities assumed and the corresponding tax basis used in the computation of taxable income; [v] the elimination of PHH Fleet’s previously recognized goodwill of \$28 and allocation of the excess purchase consideration over the fair value of net assets acquired of \$365 to

**Element Financial Corporation**

**NOTES TO *PRO FORMA* CONSOLIDATED  
FINANCIAL STATEMENTS**

[in millions of Canadian dollars unless otherwise noted]

March 31, 2014

Unaudited

goodwill; and [vi] the elimination of PHH Fleet's due to affiliates balance and net parent investment of \$25 and \$397, respectively.

- [f] Under U.S. GAAP, the majority of PHH Fleet's fleet portfolio was classified as operating leases. This presentation is the result of a specific quantitative lease classification test, whereby the present value of the minimum lease payments did not exceed 90% of the initial fair value of the lease. Based on a preliminary assessment of the portfolio, the Corporation expects to present the lease contracts as finance leases under IFRS. This preliminary conclusion is based on an overall assessment of the substance of the transaction, whereby historic lessee behavior and contractual residual value guarantees suggest that substantially all of the risks and rewards of ownership have been transferred to the lessee.

A corresponding adjustment has also been made to the *pro forma* consolidated statement of operations to reflect the change in the nature of the related revenue and expenses from operating lease income and amortization of leased assets to interest income.

There are no other adjustments required to convert PHH Fleet's statement of operations from U.S. GAAP to IFRS.

- [g] The adjustment to record an accrual for the estimated costs associated with the PHH Fleet Acquisition of \$25. These costs have not been reflected in the *pro forma* statements of operations because they are not reflective of the recurring operations of the combined entities.
- [h] The adjustment to recognize interest expense on the anticipated issuance of the Debentures and anticipated draw on the amended and restated credit facility associated with the PHH Fleet Acquisition. The interest expense on the anticipated issuance of Debentures is based on an effective interest rate of 6.98%, which reflects: [i] the effective interest rate that is applicable to the liability component of the compound instrument, which incorporates the difference between actual cash interest payments and interest expense accreted to the liability component; and [ii] the adjustment to record the amortization of related transaction costs. The estimated interest expense on the amended and restated credit facility is the U.S. base rate plus 1% per annum.
- [i] The adjustment to record amortization expense on the customer relationship and software-based intangible assets recognized as part of the PHH Fleet Acquisition.

## Element Financial Corporation

# NOTES TO *PRO FORMA* CONSOLIDATED FINANCIAL STATEMENTS

[in millions of Canadian dollars unless otherwise noted]

March 31, 2014

Unaudited

The following *pro forma* adjustments relate to the GE Canadian Fleet Portfolio Acquisition:

[j] Under U.S. GAAP, the majority of GE's Canadian fleet portfolio was classified as operating leases. This presentation is the result of a specific quantitative lease classification test, whereby the present value of the minimum lease payments did not exceed 90% of the initial fair value of the lease. Based on an assessment of the portfolio, the Corporation has presented the lease contracts as finance leases under IFRS. This conclusion is based on an overall assessment of the substance of the transaction, whereby historic lessee behavior and contractual residual value guarantees suggest that substantially all of the risks and rewards of ownership have been transferred to the lessee. An adjustment has been made to the *pro forma* consolidated statement of operations to reflect the change in the nature of the related revenue and expenses from operating lease income and amortization of leased assets to interest income.

There are no other adjustments required to convert GE Capital Fleet Services Canada Business Unit's statement of operations from U.S. GAAP to IFRS.

[k] The adjustment to recognize interest expense and deferred financing costs on the Corporation's secured borrowings associated with the new securitization arrangement relating to the GE Canadian Fleet Portfolio Acquisition. The interest expense reflects: [i] the interest rate on the Corporation's secured borrowing arrangements and [ii] the percentage of finance receivables funded by way of debt. The amortization recorded is based on an estimate of the required effective yield adjustment on the related financing.

### 3. EARNINGS (LOSS) PER SHARE

The weighted average number of common shares for all *pro forma* earnings per share calculations assumes that the 64,710,000 subscription receipts expected to be issued in conjunction with the PHH Fleet Acquisition and the 29,462,500 Special Warrants issued in conjunction with the GE Canadian Fleet Portfolio Acquisition, were converted into common shares as of January 1, 2013. This is consistent with the key assumption underlying the *pro forma* consolidated statements of operations which gives effect to the PHH Fleet Acquisition and GE Canadian Fleet Portfolio Acquisition as if each had occurred on January 1, 2013.

**Fleet Business and Subsidiaries of  
PHH Corporation**

**Combined Financial Statements as of and for  
the Years Ended December 31, 2013 and 2012  
(With Independent Auditors' Report Thereon)**

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## Table of Contents

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### Combined Financial Statements as of and for the years ended December 31, 2013 and 2012:

	<b>Page</b>
Independent Auditors' Report.....	1
Combined Statements of Comprehensive Income .....	3
Combined Balance Sheets.....	4
Combined Statements of Changes in Parent Equity.....	6
Combined Statements of Cash Flows.....	7
Notes to Combined Financial Statements:	
1. Description of Business and Basis of Presentation .....	8
2. Summary of Significant Accounting Policies .....	9
3. Vehicle Leasing Activities.....	14
4. Goodwill and Other Intangible Assets .....	16
5. Financial Instruments.....	17
6. Debt .....	18
7. Due from/to Affiliates and Related Party Transactions .....	20
8. Income Taxes.....	22
9. Commitments and Contingencies .....	24
10. Retirement Plans and Stock Based Compensation.....	25
11. Variable Interest Entities.....	26
12. Subsequent Events .....	28



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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
PHH Corporation  
Mount Laurel, New Jersey

We have audited the accompanying combined financial statements of PHH Vehicle Management Services Group LLC and its subsidiaries (VMS), PHH Sub 1 Inc. (Sub 1), and PHH Sub 2 Inc. (Sub 2) (collectively the "Company"), all of which are under common ownership and common management, which comprise the combined balance sheet as of December 31, 2013 and 2012, and the related combined statements of comprehensive income, changes in parent equity, and cash flows for the years then ended, and the related notes to the combined financial statements.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the companies' preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the companies' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Other Matter

The accompanying combined financial statements have been prepared from the separate records maintained by VMS, Sub 1, and Sub 2, and may not necessarily be indicative of the conditions that would have existed or the results of operations if the Company had been operated as an unaffiliated company. Portions of certain income and expenses and assets and liabilities represent allocations made from home-office items applicable to the company as a whole.

## Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of PHH Vehicle Management Services Group LLC, PHH Sub 1 Inc., and PHH Sub 2 Inc. as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte + Touche LLP*

May 29, 2014

**FLEET BUSINESS AND SUBSIDIARIES OF PHH CORPORATION**  
**COMBINED STATEMENTS OF COMPREHENSIVE INCOME**  
(In millions)

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>REVENUES</b>		
Fleet lease income .....	\$ 1,386	\$ 1,364
Fleet management fees .....	175	180
Other income .....	81	73
<b>Total revenues</b> .....	<b>1,642</b>	<b>1,617</b>
<b>EXPENSES</b>		
Depreciation on operating leases .....	1,211	1,212
Cost of goods sold .....	122	94
Interest expense .....	61	76
Salaries and related expenses .....	69	62
Allocated expenses (Note 7) .....	53	50
Other depreciation and amortization .....	10	10
Other operating expenses .....	28	33
<b>Total expenses</b> .....	<b>1,554</b>	<b>1,537</b>
<b>Income before income taxes</b> .....	<b>88</b>	<b>80</b>
Income tax expense .....	30	22
<b>Net income</b> .....	<b>\$ 58</b>	<b>\$ 58</b>
Other comprehensive (loss) income, net of tax:		
Currency translation adjustment .....	(14)	5
<b>Total other comprehensive (loss) income, net of tax</b> .....	<b>(14)</b>	<b>5</b>
<b>Total comprehensive income</b> .....	<b>\$ 44</b>	<b>\$ 63</b>

See accompanying Notes to Combined Financial Statements.

## COMBINED BALANCE SHEETS

(In millions)

	December 31,	
	2013	2012
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents .....	\$ 278	\$ 230
Accounts receivable, net .....	348	409
Net investment in fleet leases .....	45	49
Income tax receivable .....	—	1
Deferred taxes .....	25	33
Other assets .....	28	20
<b>Total current assets</b> .....	<b>724</b>	<b>742</b>
<b>Noncurrent Assets</b>		
Restricted cash .....	207	256
Net investment in fleet leases .....	3,608	3,606
Due from affiliates (Note 7) .....	22	—
Property and equipment, net .....	27	26
Goodwill .....	25	25
Intangible assets .....	29	31
Other assets .....	21	25
<b>Total noncurrent assets</b> .....	<b>3,939</b>	<b>3,969</b>
<b>Total assets</b> <sup>(1)</sup> .....	<b>\$ 4,663</b>	<b>\$ 4,711</b>
<b>LIABILITIES AND PARENT EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued expenses .....	\$ 220	\$ 253
Debt .....	1,023	841
Other liabilities .....	8	7
<b>Total current liabilities</b> .....	<b>1,251</b>	<b>1,101</b>
<b>Noncurrent Liabilities</b>		
Debt .....	2,458	2,616
Deferred taxes .....	578	553
Due to affiliates (Note 7) .....	—	131
Other liabilities .....	9	16
<b>Total noncurrent liabilities</b> .....	<b>3,045</b>	<b>3,316</b>
<b>Total liabilities</b> <sup>(1)</sup> .....	<b>4,296</b>	<b>4,417</b>
Commitments and contingencies (Note 9) .....	—	—
<b>PARENT EQUITY</b>		
Net parent investment .....	345	258
Accumulated other comprehensive income .....	22	36
<b>Total parent equity</b> .....	<b>367</b>	<b>294</b>
<b>Total liabilities and parent equity</b> .....	<b>\$ 4,663</b>	<b>\$ 4,711</b>

See accompanying Notes to Combined Financial Statements.

Continued.

**COMBINED BALANCE SHEETS—(Continued)**

(In millions)

<sup>(1)</sup> The Combined Balance Sheets include assets of variable interest entities which can be used only to settle their obligations and liabilities of variable interest entities which creditors or beneficial interest holders do not have recourse to the Group (as defined within Note 1, "Description of Business and Basis of Presentation") as follows:

	December 31,	
	2013	2012
<b>ASSETS</b>		
Cash and cash equivalents .....	\$ 5	\$ 2
Restricted cash .....	203	245
Accounts receivable, net .....	46	73
Net investment in leases .....	3,581	3,531
Other assets .....	18	19
<b>Total assets</b> .....	<b>\$ 3,853</b>	<b>\$ 3,870</b>
<b>LIABILITIES</b>		
Accounts payable and accrued expenses .....	\$ 7	\$ 10
Debt .....	3,464	3,433
<b>Total liabilities</b> .....	<b>\$ 3,471</b>	<b>\$ 3,443</b>

See accompanying Notes to Combined Financial Statements.

**COMBINED STATEMENTS OF CHANGES IN PARENT EQUITY**  
(In millions)

	Net Parent Investment	Accumulated Other Comprehensive Income (Loss)	Total Equity
<b>Beginning Balance, January 1, 2012</b> .....	\$ 213	\$ 31	\$ 244
Net income .....	58	—	58
Currency translation adjustment .....	—	5	5
Recapitalization to parent (Note 7) .....	(13)	—	(13)
<b>Balance at December 31, 2012</b> .....	<b>\$ 258</b>	<b>\$ 36</b>	<b>\$ 294</b>
Net income .....	58	—	58
Currency translation adjustment .....	—	(14)	(14)
Net transfers from affiliates (Note 7) .....	7	—	7
Recapitalization from parent (Note 7) .....	22	—	22
<b>Balance at December 31, 2013</b> .....	<b>\$ 345</b>	<b>\$ 22</b>	<b>\$ 367</b>

See accompanying Notes to Combined Financial Statements.

**COMBINED STATEMENTS OF CASH FLOWS**  
(In millions)

	Year Ended December 31,	
	2013	2012
<b>Cash flows from operating activities:</b>		
Net income .....	\$ 58	\$ 58
Adjustments to reconcile Net income to net cash provided by operating activities:		
Depreciation on operating leases .....	1,211	1,212
Other depreciation and amortization .....	10	10
Amortization of debt issuance costs .....	11	10
Deferred income tax expense .....	19	17
Changes in other assets and liabilities:		
Accounts receivable, net .....	93	—
Accounts payable and accrued expenses .....	(26)	9
Other, net .....	(8)	33
<b>Net cash provided by operating activities</b> .....	<b>1,368</b>	<b>1,349</b>
<b>Cash flows from investing activities:</b>		
Investment in vehicles .....	(1,703)	(1,721)
Proceeds on sale of investment vehicles .....	409	345
Purchases of property and equipment .....	(11)	(8)
Decrease in restricted cash .....	35	68
Other .....	1	1
<b>Net cash used in investing activities</b> .....	<b>(1,269)</b>	<b>(1,315)</b>
<b>Cash flows from financing activities:</b>		
Net transfers to affiliates .....	(103)	(129)
Proceeds from secured borrowings .....	2,781	3,111
Principal payments on secured borrowings .....	(2,716)	(2,792)
Cash paid for debt issuance costs .....	(9)	(16)
<b>Net cash (used in) provided by financing activities</b> .....	<b>(47)</b>	<b>174</b>
<b>Effect of changes in exchange rates on Cash and cash equivalents</b> .....	<b>(4)</b>	<b>—</b>
Net increase in Cash and cash equivalents .....	48	208
Cash and cash equivalents at beginning of period .....	230	22
<b>Cash and cash equivalents at end of period</b> .....	<b>\$ 278</b>	<b>\$ 230</b>
<b>Supplemental Disclosure of Cash Flows Information</b>		
Interest payments .....	\$ 47	\$ 56
Income tax payments, net .....	11	8
<b>Significant Non-Cash Transactions</b>		
Recapitalization (from) to parent (Note 7) .....	\$ (22)	\$ 13

See accompanying Notes to Combined Financial Statements.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### 1. Description of Business and Basis of Presentation

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#### *Description of Business*

PHH Corporation (“PHH”) maintains a fleet management services business comprised of various legal subsidiaries. The Combined carve-out Financial Statements of the Fleet Business and Subsidiaries of PHH are comprised of PHH Vehicle Management Services Group LLC and its subsidiaries (“VMS”), PHH Sub 1 Inc. (“Sub 1”) and PHH Sub 2 Inc. (“Sub 2”) (collectively the “Group”).

- VMS provides commercial fleet management services to corporate clients, including financial institutions and government agencies, throughout the United States and Canada. The fleet management services include leasing services and additional products and services including fleet management, maintenance services, accident management services, fuel card programs, data warehousing, information management and online systems support and access.
- Sub 1 is a holding company which owns the preferred interest in Chesapeake Finance Holdings LLC (“Chesapeake Finance”), which facilitates the acquisition of vehicles for VMS pursuant to its vehicle leasing operations. Chesapeake Finance is a wholly-owned subsidiary of VMS.
- Sub 2 is a holding company which owns all of the interest in Chesapeake Funding LLC which issues asset-backed securities used to support the acquisition of vehicles by Chesapeake Finance for the U.S. leasing operations.

The Combined Financial Statements include the accounts and transactions of the Group and its subsidiaries, as well as entities in which the Group directly or indirectly has a controlling financial interest and variable interest entities of which the Group is the primary beneficiary. Total assets attributable to foreign operations (Canada) were 19% and 21% as of December 31, 2013 and 2012, respectively. Total revenues attributable to foreign operations were 19% and 20% for the years ended December 31, 2013 and 2012, respectively.

#### *Basis of Presentation*

The Combined carve-out Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States (GAAP), based upon financial information derived from PHH’s consolidated financial statements and accounting records. The Combined Financial Statements include corporate costs incurred by PHH that are provided to or on behalf of the Group and consist of both direct and allocated costs.

As the Group was combined for purposes of these financial statements, Net parent investment is shown in lieu of Shareholders’ Equity. The Net parent investment equity balance on the Combined Balance Sheets represents PHH’s historical investment in the Group and the accumulated earnings of the business. Intercompany transactions with PHH or its affiliates are reflected in the Combined Statements of Cash Flows within Net transfers to affiliates in financing activities, and in the Combined Balance Sheets within Due to or from affiliates.

The Combined Financial Statements require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. All significant intercompany balances and intercompany transactions have been eliminated.

Unless otherwise noted, dollar amounts presented within these Notes to Combined Financial Statements are in millions.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### *Methods of Allocation*

The Combined Financial Statements include the assets, liabilities, revenue, and expenses solely attributable to the Group, as well as certain allocations described below. Management believes these allocation methods are reasonable and the allocations were applied consistently for all periods presented. The historical results of operations and financial position of the Group included in the Combined Financial Statements may not be indicative of what would have been recorded if the Group had been a stand-alone entity, or if each entity in the Group had been operating as a separate, stand-alone entity.

**Revenues and Expenses.** PHH allocates direct costs that can be specifically identified to the Group based upon the business activity or dedicated employee function. For costs that cannot be specifically identified, the Group is allocated costs that are intended to represent the costs of providing these shared services. The methods for allocating corporate costs to the Group are based on allocation factors including revenues, expenses, headcount and usage. See Note 7, “Due from/to Affiliates and Related Party Transactions” for more information. There were no allocations with respect to Revenues for the periods presented.

**Assets and Liabilities.** Certain assets and liabilities that were historically carried at PHH have been included in the Combined Financial Statements to the extent that they are separately identifiable to the Group or allocated based upon an allocation methodology. Allocations from PHH include amounts related to Cash and cash equivalents, Property and equipment, Other assets and Other liabilities. See Note 7, “Due from/to Affiliates and Related Party Transactions” for more information.

**Income Taxes.** The results of operations of the Group, excluding any Canadian subsidiaries, have historically been included in the consolidated federal income tax returns of PHH and its combined and separate state income tax returns. The income tax amounts reflected in the accompanying Combined Financial Statements have been allocated based on taxable income directly attributable to the Group. See Note 2, “Summary of Significant Accounting Policies” for more information on tax amounts.

## **2. Summary of Significant Accounting Policies**

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### *Principles of Combination*

The accompanying Combined Financial Statements have been prepared on a stand-alone basis to present the combined financial position, results of operations, changes in parent equity and cash flows of the Group. All significant intracompany transactions and accounts within the Group’s combined businesses have been eliminated. All significant intercompany transactions between PHH Corporation and its subsidiaries and the Group have been included in the Combined Financial Statements, and additional amounts were allocated to the Group from PHH Corporation as described in Note 1, “Description of Business and Basis of Presentation”.

### *Revenue Recognition*

Revenues are comprised of Fleet lease income, Fleet management fees and Other income. Fleet lease income consists of leasing revenue related to operating and direct financing leases as well as the gross sales proceeds associated with operating lease syndications. Fleet management fees consists of revenue related to principal fee- and asset-based products and services. Other income primarily consists of gross sales proceeds from owned vehicle dealerships, the net gain or loss on the sale of used vehicles and other ancillary revenues.

Vehicles are leased primarily to corporate customers under open-end operating and direct financing lease arrangements where the client bears substantially all of the vehicle’s residual value risk. The lease term under the open-end lease agreements provides for a minimum lease term of 12 months. After the minimum term, the leases may be continued at the lessees’ election for successive monthly renewals. In limited circumstances, vehicles are leased under closed-end leases where the Group bears all of the vehicle’s residual value risk. Gains or losses on the sales of vehicles under closed-end leases are recorded in Other income in the period of sale.

## NOTES TO COMBINED FINANCIAL STATEMENTS

Lease revenues for operating leases, which contain a depreciation component, an interest component and a management fee component, are recognized over the lease term of the vehicle, which encompasses the minimum lease term and the month-to-month renewals. Lease revenues for direct financing leases contain an interest component and a management fee component. The interest component is recognized using the effective interest method over the lease term of the vehicle, which encompasses the minimum lease term and the month-to-month renewals. Direct financing leases are placed on non-accrual status when it is determined that the value of past due lease receivables will not be recoverable.

The interest component of lease revenue is determined in accordance with the pricing supplement to the respective lease agreement. The interest component of lease revenue is generally calculated on a variable-rate basis that fluctuates in accordance with changes in the variable-rate index; however, in certain circumstances, the lease may be calculated on a fixed rate basis that would remain constant for the life of the lease. The depreciation component of lease revenue is based on the straight-line depreciation of the vehicle over its expected term. The management fee component of lease revenue is recognized on a straight-line basis over the life of the lease.

Revenue for other fleet management services is recognized as earned when the services are provided to the lessee. These services include fuel cards, accident management services, maintenance services and driver safety training services. Revenue for these services is based on a negotiated percentage of the purchase price for the underlying products or services provided by certain third-party suppliers, or is outlined on a fee basis.

Certain truck and equipment leases are originated with the intention of syndicating to third parties. When operating leases are sold, the underlying assets are transferred and any rights to the leases and their future leasing revenues are assigned to the third parties. Upon the transfer and assignment of the rights associated with the operating leases, the proceeds from the sale are recorded as revenue in Fleet lease income and an expense for the undepreciated cost of the assets sold is recognized in Cost of goods sold in the Combined Statements of Comprehensive Income. Upon the sale or transfer of rights to direct financing leases, the net gain or loss is recorded in Other income. Under certain of these sales agreements, a portion of residual risk in connection with the fair value of the asset at lease termination is retained and a liability is recorded for the retention of this risk.

### *Income Taxes*

The Group, excluding any Canadian subsidiaries, is included in the consolidated federal income tax return of PHH. Current income taxes payable or receivable are presented as Income tax payable and receivable in the Combined Balance Sheets. In addition, the Group files unitary and consolidated state income tax returns in jurisdictions where required. Income tax expense or benefit is computed as if federal and state income tax returns are filed on a stand-alone basis. Certain state income tax returns are filed on a stand-alone basis. The Canadian subsidiaries file Canadian and provincial income tax returns at the entity level.

Income tax expense or benefit consists of two components: current and deferred. Current tax expense or benefit represents the amount of taxes currently payable to or receivable from a taxing authority plus amounts accrued for income tax contingencies (including tax, penalty and interest). Deferred tax expense or benefit generally represents the net change in the deferred tax asset or liability balance during the year plus any change in the valuation allowance. Interest and penalties related to income tax contingencies are recognized in Income tax expense in the Combined Statements of Comprehensive Income.

Deferred income taxes are determined using the balance sheet method. This method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities for book and tax purposes. Deferred tax assets and liabilities are regularly reviewed to assess their potential realization and to establish a valuation allowance when it is "more likely than not" that some portion will not be realized.

The Group must presume that an uncertain income tax position will be examined by the relevant taxing authority and must determine whether it is more likely than not that the position will be sustained upon examination based on its technical merit. An uncertain income tax position that meets the "more likely than not" recognition threshold is then measured to determine the amount of the benefit to recognize in the financial statements. A liability is recorded for the amount of the unrecognized income tax benefit included in: (i) previously filed income tax returns and (ii) financial results expected to be included in income tax returns to be filed for periods through the date of the Combined Financial Statements.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### *Cash and Cash Equivalents*

Marketable securities with original maturities of three months or less are included in Cash and cash equivalents.

### *Restricted Cash*

Restricted cash primarily relates to amounts specifically designated to purchase assets, repay debt, support letters of credit and/or provide over-collateralization within asset-backed debt arrangements.

### *Net Investment in Fleet Leases and Accounts Receivable*

Net investment in fleet leases includes vehicles under operating leases and direct financing lease receivables, as well as vehicles that are in transit awaiting delivery to clients or sale. Vehicles under operating leases are stated at cost, net of accumulated depreciation. The initial cost of the vehicles is recorded net of incentives and allowances from vehicle manufacturers. Leased vehicles are depreciated on a straight-line basis over a term that generally ranges from 3 to 6 years. Direct financing leases are stated at the net present value of future expected cash flows.

An allowance for uncollectible lease receivables is recorded as a reduction to Accounts receivable when it is determined that the past due lease receivables will not be recoverable upon sale of the underlying asset. The exposure to losses typically arises from clients that file for bankruptcy protection, as pre-petition receivables are fully reserved and post-petition balances are reserved if the leases are rejected from the bankruptcy petition or if the client enters into liquidation. Charge-offs are recorded after the leased vehicles have been disposed and final shortfall has been determined.

### *Property and Equipment*

Property and equipment (including leasehold improvements) are recorded at cost, net of accumulated depreciation and amortization. Depreciation, recorded as a component of Other depreciation and amortization in the Combined Statements of Comprehensive Income, is computed utilizing the straight-line method over the estimated useful lives of the related assets. Amortization of leasehold improvements and capital leases is computed utilizing the straight-line method over the estimated benefit period of the related assets or the lease term, if shorter. Estimated useful lives are 30 years for buildings, 50 months for automobiles, lesser of the remaining lease term or 20 years for leasehold improvements, lesser of the remaining lease term or 5 years for capital leases and range from 3 to 5 years for capitalized software and 3 to 7 years for furniture, fixtures and equipment.

Internal software development costs are capitalized during the application development stage. The costs capitalized relate to external direct costs of materials and services and employee costs related to the time spent on the project during the capitalization period. Capitalized software is evaluated for impairment annually or when changing circumstances indicate that amounts capitalized may be impaired. Impaired items are written down to their estimated fair values at the date of evaluation.

### *Goodwill and Other Intangible Assets*

The carrying value of Goodwill and indefinite-lived intangible assets is assessed for impairment annually or more frequently if circumstances indicate impairment may have occurred. Goodwill is assessed for impairment by first performing a qualitative assessment before calculating the fair value of the reporting unit. If it is determined, based upon the qualitative factors, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, the fair value of the reporting unit will be estimated and compared to the carrying amount. The fair value of reporting unit may be determined using an income approach, using discounted cash flows, or a combination of an income approach and a market approach, wherein comparative market multiples are used.

Indefinite-lived intangible assets are comprised entirely of trademarks for all periods presented. Fair value of trademarks is determined by discounting cash flows determined from applying a hypothetical royalty rate to projected revenues associated with these trademarks.

Intangible assets subject to amortization are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Amortizable intangible assets included on the Combined Balance Sheets consist primarily of customer lists that are amortized on a straight-line basis over a 20-year period.

Costs to renew or extend recognized intangible assets are expensed as the costs are incurred.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### *Derivative Instruments*

Derivative instruments are used as part of the overall strategy to manage exposure to market risks primarily associated with fluctuations in interest rates. As a matter of policy, derivatives are not used for speculative purposes. Derivative instruments are measured at fair value on a recurring basis and are included in Other assets or Other liabilities in the Combined Balance Sheets. The Group does not have any derivative instruments designated as hedging instruments.

### *Foreign currency*

Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at rates prevailing on the balance sheet date; income and expenses are translated at the average rate for the month in which the transactions are recorded. Foreign currency translation adjustments are recorded as a component of Total parent equity. Foreign currency transaction gains or losses are recorded in the Combined Statements of Comprehensive Income and primarily relate to our foreign exchange contracts. See Note 7, "Due from/to Affiliates and Related Party Transactions".

Accumulated other comprehensive income was \$22 million and \$36 million as of December 31, 2013 and 2012, respectively and consists only of accumulated foreign currency translation adjustments. Currency translation adjustments exclude income taxes on undistributed earnings of foreign subsidiaries, which are considered to be indefinitely invested. During the year ended December 31, 2013, there were no reclassifications out of Accumulated other comprehensive income.

### *Debt*

Asset-backed notes are initially recorded at cost (which approximates fair value to the Group) and are subsequently measured at amortized cost. Interest expense is recorded on an accrual basis using the effective interest method. Deferred financing fees are costs incurred in connection with issuing debt and are amortized using the effective interest method based upon the estimated life of the notes.

### *Fair Value*

A three-level valuation hierarchy is used to classify inputs into the measurement of assets and liabilities at fair value. The valuation hierarchy is based upon the relative reliability and availability to market participants of inputs for the valuation of an asset or liability as of the measurement date. When the valuation technique used in determining fair value of an asset or liability utilizes inputs from different levels of the hierarchy, the level within which the measurement in its entirety is categorized is based upon the lowest level input that is significant to the measurement in its entirety. The valuation hierarchy consists of the following levels:

**Level One.** Level One inputs are unadjusted, quoted prices in active markets for identical assets or liabilities which the Group has the ability to access at the measurement date.

**Level Two.** Level Two inputs are observable for that asset or liability, either directly or indirectly, and include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, observable inputs for the asset or liability other than quoted prices and inputs derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified contractual term, the inputs must be observable for substantially the full term of the asset or liability.

**Level Three.** Level Three inputs are unobservable inputs for the asset or liability that reflect the Group's assessment of the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, and are developed based on the best information available.

Fair value is based on quoted market prices, where available. If quoted prices are not available, fair value is estimated based upon other observable inputs. Unobservable inputs are used when observable inputs are not available and are based upon judgments and assumptions, which are the Group's assessment of the assumptions market participants would use in pricing the asset or liability. These inputs may include assumptions about risk,

## NOTES TO COMBINED FINANCIAL STATEMENTS

counterparty credit quality, the Group's creditworthiness and liquidity and are developed based on the best information available.

When a determination is made to classify an asset or liability within Level Three of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement of the asset or liability. The fair value of assets and liabilities classified within Level Three of the valuation hierarchy also typically includes observable factors and the realized or unrealized gain or loss recorded from the valuation of these instruments would also include amounts determined by observable factors.

Changes in the availability of observable inputs may result in the reclassification of certain assets or liabilities. Such reclassifications are reported as transfers in or out of Level Three as of the beginning of the period that the change occurs.

### *Stock-based Compensation*

The Group's employees have historically participated in PHH's stock-based compensation plans. Compensation cost for stock and cash awards is generally recognized over the requisite service period, net of estimated forfeitures. The weighted-average grant-date fair value was estimated using the Black-Scholes option valuation model for stock options and using a Monte Carlo simulation valuation model for market-based Restricted Stock Units.

### *Recently Issued Accounting Pronouncements*

**Comprehensive Income.** In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income". This update to the comprehensive income guidance requires additional disclosure about the amounts reclassified out of Accumulated other comprehensive income, including disclosing the amounts that impact each line item in the Statement of Comprehensive Income within a reporting period. This update enhances the disclosure requirements for amounts reclassified out of Accumulated other comprehensive income but will not impact the Group's financial position, results of operations or cash flows. The Group adopted the new accounting guidance prospectively effective January 1, 2013. The updated disclosures are included above under "*Foreign Currency*".

**Intangibles.** In July 2012, the FASB issued ASU 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment". This update amends the current guidance on testing indefinite-lived intangibles for impairment and allows for the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangibles are impaired. If it is more likely than not that the indefinite-lived intangibles are impaired, the entity is required to determine the fair value of the indefinite-lived intangibles and perform the quantitative impairment test by comparing the fair value with the carrying amount. The Group adopted the new accounting guidance effective January 1, 2013 and applied it prospectively. The adoption of this update did not have an impact on the Group's financial statements.

**Offsetting Assets and Liabilities.** In December 2011, the FASB issued ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities". This update requires disclosure of both gross and net information about instruments and transactions in the scope of these pronouncements. Subsequently in January 2013, the FASB issued ASU 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" which limited the disclosures to derivatives including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in accordance with current derivative and netting guidance, or subject to a master netting arrangement or similar agreement. The Group adopted the new accounting guidance retrospectively effective January 1, 2013. The adoption of this update did not have an impact on the Group's financial statements.

**Income Taxes.** In July 2013, the FASB issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". This update to the income tax guidance clarifies the diversity in practice in the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This update requires the unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset or as a liability to the extent the entity cannot or does not intend to use the deferred tax asset for such purpose. The new accounting guidance is effective beginning January 1, 2014 and should be applied prospectively to all unrecognized

## NOTES TO COMBINED FINANCIAL STATEMENTS

tax benefits that exist at the effective date and retrospective application is permitted. The Group does not expect the adoption of ASU 2013-11 to have a material impact on its financial statements.

### *Subsequent Events*

The Group evaluated subsequent events with respect to the Combined Financial Statements through the date of issuance which was May 29, 2014.

### **3. Vehicle Leasing Activities**

The following table summarizes the components of Net investment in fleet leases:

	December 31,	
	2013	2012
	(In millions)	
<i>Operating Leases:</i>		
Vehicles under open-end operating leases .....	\$ 7,974	\$ 8,174
Vehicles under closed-end operating leases .....	137	154
Vehicles under operating leases .....	8,111	8,328
Less: Accumulated depreciation .....	(4,777)	(4,959)
Net investment in operating leases .....	3,334	3,369
<i>Direct Financing Leases:</i>		
Lease payments receivable .....	100	91
Less: Unearned income .....	(2)	—
Net investment in direct financing leases .....	98	91
<i>Off-Lease Vehicles:</i>		
Vehicles not yet subject to a lease .....	217	188
Vehicles held for sale .....	10	15
Less: Accumulated depreciation .....	(6)	(8)
Net investment in off-lease vehicles .....	221	195
Total .....	\$ 3,653	\$ 3,655
	December 31,	
	2013	2012
Vehicles under open-end leases .....	98 %	98 %
Vehicles under closed-end leases .....	2 %	2 %
Vehicles under variable-rate leases .....	80 %	82 %
Vehicles under fixed-rate leases .....	20 %	18 %

## NOTES TO COMBINED FINANCIAL STATEMENTS

The following table presents the future minimum lease payments to be received as of December 31, 2013. Amounts presented include the monthly payments for the unexpired portion of the minimum lease term, which is 12 months under open-end lease agreements, and the residual value guaranteed by the lessee during the minimum lease term. The interest component included in future minimum payments is based on the rate in effect at the inception of each lease.

	<b>Future Minimum Lease Payments</b>	
	<b>Operating Leases</b>	<b>Direct Financing Leases</b>
	(In millions)	
2014 .....	\$ 1,069	\$ 45
2015 .....	29	1
2016 .....	18	1
2017 .....	12	1
2018 .....	6	—
Thereafter .....	9	—
Total .....	\$ 1,143	\$ 48

Contingent rentals include amounts for excess mileage, wear and tear, early termination fees, and, for variable-rate leases, changes in interest rates subsequent to lease inception. Contingent rentals are recorded in Fleet lease income in the Combined Statements of Comprehensive Income. Contingent rentals from both operating and direct financing leases were not significant for the years ended December 31, 2013 and 2012.

### ***Credit Risk***

Accounts receivable are primarily related to trade accounts receivable from fleet management and leasing services. An allowance for uncollectible receivables is recorded when it becomes probable, based on the age of outstanding receivables, that the receivables will not be collected. As of December 31, 2013 the allowance was not significant and as of December 31, 2012 was \$1 million.

The Group is exposed to commercial credit risk for its clients under vehicle lease and fleet management service agreements. Such risk is managed through an evaluation of the financial position and creditworthiness of the client, which is performed on at least an annual basis. As of December 31, 2013 and 2012, there were no significant client concentrations related to vehicle leases. Lease agreements generally allow VMS to refuse any additional orders upon the occurrence of certain credit events; however, the obligation remains for all leased vehicle units under contract at that time. The fleet management service agreements can generally be terminated upon 30 days written notice. Receivables are charged-off after leased vehicles have been disposed and final shortfall has been determined. Historical credit losses for receivables related to vehicle leasing and fleet management services have not been significant.

Vehicle leases are primarily classified as operating leases; however, certain leases are classified as direct financing leases at inception, based on the extent to which the risks and rewards incidental to ownership of the leased vehicle are transferred to the lessee. Direct financing leases represent financing receivables in which the Group bears the credit risk of the underlying leases, but does not retain the residual risk on the related assets. The amount recognized in Net investment in fleet leases for direct financing leases represents the sum of the undiscounted minimum lease payments, including the guaranteed residual.

## NOTES TO COMBINED FINANCIAL STATEMENTS

The following table summarizes the aging of direct financing leases, based upon the most aged monthly lease billing of each lessee:

	December 31,	
	2013	2012
	(In millions)	
Current amount .....	\$ 87	\$ 73
30-59 days .....	11	12
60-89 days .....	—	1
Greater than 90 days <sup>(1)</sup> .....	—	5
Direct financing lease receivables, gross <sup>(2)</sup> .....	98	91
Allowance for credit losses .....	—	—
Direct financing lease receivables, net .....	<u>\$ 98</u>	<u>\$ 91</u>

<sup>(1)</sup> As of December 31, 2012, there were \$5 million of leases that were still accruing interest.

<sup>(2)</sup> There were no direct financing leases on non-accrual status as of December 31, 2013 and 2012, respectively.

During the years ended December 31, 2013 and 2012, the amount of direct financing leases sold were \$41 million and \$58 million, respectively.

#### 4. Goodwill and Other Intangible Assets

Goodwill and intangible assets are recorded within a single reporting unit and consisted of:

	December 31, 2013			December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In millions)					
<i>Amortized intangible assets:</i>						
Other Assets:						
Customer lists .....	\$ 40	\$ 26	\$ 14	\$ 40	\$ 24	\$ 16
Other .....	13	13	—	13	13	—
Total .....	<u>\$ 53</u>	<u>\$ 39</u>	<u>\$ 14</u>	<u>\$ 53</u>	<u>\$ 37</u>	<u>\$ 16</u>
<i>Unamortized intangible assets:</i>						
Goodwill .....	\$ 25			\$ 25		
Other Assets:						
Trademarks .....	15			15		
Total .....	<u>\$ 40</u>			<u>\$ 40</u>		

Amortization expense included within Other depreciation and amortization relating to intangible assets was as follows:

	Year Ended December 31,	
	2013	2012
	(In millions)	
Customer lists .....	\$ 2	\$ 1
Other .....	—	1
Total .....	<u>\$ 2</u>	<u>\$ 2</u>

Based on the amortizable intangible assets as of December 31, 2013, estimated future amortization expense is expected to approximate \$2 million for each of the next five fiscal years.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### 5. Financial Instruments

The following is a description of the fair value measurement of financial instruments and the Group's risk management policies related to interest rate and foreign exchange risks.

#### *Interest Rate Contracts*

The Group has exposure to interest rate risk from fluctuations in LIBOR due to its impact on changes in variable-rate leases that may be funded by fixed-rate or variable-rate debt. From time to time, various financial instruments are used to manage and reduce this risk by utilizing various hedging strategies and derivative financial instruments to create a desired mix of fixed- and variable-rate assets and liabilities. To the extent that the Group enters into fixed-rate lease contracts, derivative instruments are utilized in order to offset gains and losses related to the interest rate exposure. Derivative instruments used in these hedging strategies may include swaps and interest rate contracts. To more closely match the characteristics of the related assets, including the net investment in variable-rate lease assets, either variable-rate debt or fixed-rate debt is issued, which may be swapped to variable LIBOR-based rates.

Interest rate contracts are classified within Level Two of the valuation hierarchy. The fair value of interest rate contracts is based upon projected short term interest rates and a market-based volatility.

#### *Foreign Exchange Contracts*

The Group has exposure to foreign exchange risk through its investment in Canadian operations and any foreign exchange forward contracts that may be executed. Currency swap agreements are used to manage such risk. The fair value of foreign exchange contracts is determined using current exchange rates. The Group does not hold any foreign exchange-related derivatives as of December 31, 2013 and 2012, however such contracts were held during the respective years. See Note 7, "Due from/to Affiliates and Related Party Transactions" for more information.

The following table presents balances and results of derivative activity as of and for the year ended December 31:

	Interest Rate Contracts		Foreign Exchange Contracts	
	2013	2012	2013	2012
	(In millions)			
Fair value recorded in Other assets .....	\$ 2	\$ 1	\$ —	\$ —
Notional amount .....	710	614	—	—
Loss recorded in Interest expense .....	(1)	(1)	—	(1)

#### *Fair Value of Other Financial Instruments*

As of December 31, 2013 and 2012, all financial instruments were either recorded at fair value or the carrying value approximated fair value, with the exception of Debt. For financial instruments that were not recorded at fair value, such as Cash and cash equivalents and Restricted cash, the carrying value approximates fair value due to the short-term nature of such instruments. These financial instruments are classified within Level One of the valuation hierarchy.

**Debt.** As of both December 31, 2013 and 2012, the total fair value of Debt was \$3.5 billion and substantially all of the debt is measured using Level Two inputs. As of December 31, 2013, the fair value of Level Two Debt was estimated using the following valuation techniques: (i) \$2.2 billion was measured using a market based approach, considering the current market pricing of recent trades for similar instruments or the current expected ask price for the Group's debt instruments and (ii) \$1.3 billion was measured using a discounted cash flow model incorporating assumptions based on current market information available for similar debt instruments.

**NOTES TO COMBINED FINANCIAL STATEMENTS**

**6. Debt**

The following table summarize the components of Debt:

	December 31, 2013				December 31, 2012
	Balance	Wt. Avg-Interest Rate <sup>(1)</sup>	Maximum Capacity	Available Capacity <sup>(2)</sup>	Balance
	(In millions)				
Term notes, in amortization .....	\$ 1,406	1.0 %	\$ 1,406	n/a	\$ 424
Term notes, in revolving period .....	700	0.7 %	700	\$ —	1,593
Variable-funding notes .....	1,358	1.4 %	2,069	711	1,415
Other .....	17	5.0 %	17	n/a	25
Asset-backed debt .....	<u>3,481</u>		<u>4,192</u>	<u>711</u>	<u>3,457</u>
Secured Canadian credit facility .....	—	—%	118	19	—
Total .....	<u>\$ 3,481</u>		<u>\$ 4,310</u>	<u>\$ 730</u>	<u>\$ 3,457</u>

<sup>(1)</sup> Represents the weighted-average stated interest rate of the variable-rate facilities as of the respective date.

<sup>(2)</sup> Capacity is dependent upon maintaining compliance with the terms, conditions, and covenants of the respective agreements and may be further limited by asset eligibility requirements. Available capacity for the Secured Canadian credit facility is limited by the borrowing base calculation as of December 31, 2013.

The following table presents maturities of asset-backed notes, a portion of which are amortizing in accordance with their terms as of December 31, 2013. The maturities represent estimated payments based on the expected cash inflows related to the securitized vehicle leases and related assets.

	Asset-Backed Debt
	(In millions)
Within one year .....	\$ 1,023
Between one and two years .....	1,076
Between two and three years .....	790
Between three and four years .....	441
Between four and five years .....	141
Thereafter .....	10
	<u>\$ 3,481</u>

Assets held as collateral that are not available to pay the Group's general obligations as of December 31, 2013 included Restricted cash of \$203 million, Accounts receivable of \$46 million and Net investment in fleet leases of \$3,603 million.

See Note 5, "Financial Instruments" for a discussion of the fair value of Debt.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### **Asset-Backed Debt**

Asset-backed debt primarily represents variable-rate debt issued by a wholly owned subsidiary, Chesapeake Funding LLC (“Chesapeake”), to support the acquisition of vehicles by the U.S. leasing operations and variable-rate debt issued by the consolidated special purpose trust, Fleet Leasing Receivables Trust (“FLRT”), the Canadian special purpose trust, used to finance leases originated by the Canadian fleet operation. These asset-backed debt structures may provide creditors an interest in: (i) a pool of master leases or a pool of specific leases; (ii) the related vehicles under lease; and/or (iii) in the case of Chesapeake, the related receivables billed to clients for the monthly collection of lease payments and ancillary service revenues (such as fuel and maintenance services). This interest is generally granted to a specific series of note holders either on a pro-rata basis relative to their share of the total outstanding debt issued through the program or through a direct interest in a specific pool of leases. Repayment of the obligations of the facilities is non-recourse and is sourced from the monthly cash flow generated by lease payments and ancillary service payments made under the terms of the related master lease contracts.

Asset-backed debt includes Term notes and Variable-funding notes. **Term notes** provide a fixed funding amount at the time of issuance, and may be classified as:

**Term notes, in amortization:** the monthly collection of lease payments allocable to the series is used in repayment of principal until the notes are paid in full. The amortization period will continue through the earlier of: (i) 125 months following the commencement of the amortization period; or (ii) when the respective series of notes are paid in full.

**Term notes, in revolving period:** contain provisions that allow the outstanding debt to revolve for a specified period of time. During the revolving period, the monthly collection of lease payments allocable to each outstanding series creates availability to fund the acquisition of vehicles and/or equipment to be leased to customers. Upon expiration of the revolving period, notes begin amortizing.

**Variable-funding notes** provide a committed capacity which may be drawn upon as needed during a commitment period, which is primarily 364 days in duration, but may extend to a two-year duration for some facilities. Similar to revolving term notes, the monthly collection of lease payments creates availability to fund the acquisition of vehicles and/or equipment to be leased to customers. Available committed capacity under Variable-funding notes may be used to fund growth in Net investment in fleet leases or pay down amortizing notes during the term of the commitment.

### ***Term Notes***

As of December 31, 2013, Term notes outstanding that are revolving in accordance with their terms are the Chesapeake Series 2013-1. The expiration date of the revolving period is May 22, 2014.

As of December 31, 2013, Term notes outstanding that are amortizing in accordance with their terms are the Chesapeake Series 2009-3, 2011-2, 2012-1, and 2012-2. Final repayment dates of Term notes in amortization range from September 7, 2014 to April 7, 2017.

On June 13, 2013, Chesapeake issued \$700 million of Series 2013-1 Term notes. Proceeds from the notes were used to repay a portion of the Series 2010-1 notes and Series 2011-1 notes.

On August 15, 2013, Chesapeake fully repaid the Series 2009-2 Term notes with available cash.

### ***Variable-funding Notes***

As of December 31, 2013, Variable-funding notes outstanding are the FLRT Series 2010-2 and the Chesapeake Series 2013-2 and 2013-3. Expiration dates of the revolving periods range from July 9, 2014 to July 10, 2015.

On July 10, 2013, Chesapeake issued Series 2013-2 and Series 2013-3 Variable-funding notes with available commitments of \$780 million and \$520 million, respectively. Proceeds of the issuance were used to fully repay Chesapeake Series 2010-1 and Series 2011-1 Variable-funding notes.

On August 30, 2013, the FLRT 2010-2 Series was amended to extend the maturity date to August 30, 2014.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### Secured Canadian Credit Facility

PHH Vehicle Management Services Inc. (“VMS Canada”), a wholly-owned subsidiary, has a secured revolving credit facility with a group of lenders providing up to C\$125 million (\$118 million USD as of December 31, 2013) of committed revolving borrowing capacity. See Note 12, “Subsequent Events” for a discussion of the decrease in committed capacity in March 2014.

Borrowings under the facility bear interest at a variable-rate, and the facility fee and interest rate margin are dependent on PHH’s senior unsecured long-term debt ratings issued by certain credit rating agencies. The facility is scheduled to expire on August 2, 2015.

Available borrowing capacity under the facility is based on a borrowing base calculation which considers eligible unencumbered vehicle leases, vehicles not yet subject to lease, and accounts receivable for ancillary services. VMS Canada’s obligations under the facility are guaranteed by PHH Corporation and are secured by a first-priority lien on all of VMS Canada’s present and future assets and property (and corresponding security in any jurisdiction), subject to certain eligibility exceptions.

### Debt Covenants

Certain debt arrangements require that the Group, its subsidiaries and/or PHH maintain minimum net worth and maximum indebtedness to tangible net worth ratios and contain other affirmative and negative covenants, including but not limited to, material adverse change, liquidity maintenance, profitability and restrictions on the indebtedness of the Group, PHH and other material subsidiaries of PHH.

**Covenants—PHH Corporation:** Among other covenants, the Secured Canadian Revolving Credit Facility and vehicle asset backed debt facilities require that PHH maintain: (i) on the last day of each fiscal quarter, net worth of at least \$1.0 billion; (ii) a ratio of indebtedness to tangible net worth no greater than 5.75 to 1; and (iii) require subsidiaries of PHH Corporation to maintain a minimum of \$750 million in committed third party fleet vehicle lease financing capacity.

**Covenants—The Group:** The Chesapeake vehicle asset backed debt facilities requires that Chesapeake Finance Holdings maintain a minimum net worth equal to at least 4% of the aggregate lease balance and contain certain required levels towards the Group’s aggregate investment in Chesapeake Finance Holdings.

These covenants represent the most restrictive net worth and debt to equity covenants; however, certain other outstanding debt agreements contain debt to equity covenants that are less restrictive.

As of December 31, 2013, the Group and PHH Corporation were in compliance with all of their financial covenants related to the Group’s debt arrangements.

### 7. Due from/to Affiliates and Related Party Transactions

Due from (to) affiliates, net consisted of the following:

	December 31,	
	2013	2012
	(In millions)	
Due from PHH Corporation .....	\$ 58	\$ 62
Due from other PHH affiliates .....	10	12
Unsecured intercompany line of credit .....	(19)	(180)
Interest payable on Unsecured intercompany line of credit .....	(27)	(25)
Total .....	\$ 22	\$ (131)

## NOTES TO COMBINED FINANCIAL STATEMENTS

Amounts due to or from PHH Corporation and its affiliates that arise in the normal course of operations are non-interest bearing and payable or receivable on demand.

An unsecured intercompany line of credit exists between Sub 2 and PHH which bears interest at a variable rate based on LIBOR. This arrangement exists to fund working capital needs and debt issuance costs of the Chesapeake facility. For the years ended December 31, 2013 and 2012, interest charges related to this facility were \$2 million and \$8 million, respectively and are included in Interest expense in the Combined Statements of Comprehensive Income.

### *Corporate Overhead Allocation*

PHH utilizes a centralized corporate platform to provide shared services for general and administrative functions to the Group and other affiliates of PHH. These shared services include, but are not limited to, support associated with information technology, enterprise risk management, internal audit, human resources, accounting and finance and communications. The Group is also allocated expenses for insurance, bank fees, external audit fees and for costs to manage the overall corporate function of PHH. Corporate overhead allocations and allocated expenses from PHH are recorded in Allocated expenses in the Combined Statements of Comprehensive Income.

The corporate overhead expenses allocated from PHH to the Group relate to the following costs:

	December 31,	
	2013	2012
	(In millions)	
Salaries and related expenses .....	\$ 24	\$ 29
Occupancy and other office expenses .....	1	1
Other depreciation and amortization .....	2	2
Other operating expenses .....	26	18
Total .....	\$ 53	\$ 50

### *Other Allocations*

**Interest charges.** Historically, the Group's working capital needs were managed in the normal course of business with other affiliates of PHH. For certain years, the Group was allocated a share of interest expense and facility fees related to an unsecured line of credit that was maintained by PHH to fund working capital needs and to supplement asset-backed debt. During the fourth quarter of 2012, the Group entered into the Secured Canadian credit facility and no longer needed access to PHH's unsecured line of credit. As a result, the Group was not allocated any interest costs during the year ended December 31, 2013.

During the year ended December 31, 2012, the Group was allocated \$2 million of interest costs for its proportionate share of available commitments under the unsecured line of credit. Interest charges were recorded in Interest expense in the Combined Statements of Comprehensive Income.

**Foreign exchange contracts.** PHH periodically enters into foreign exchange contracts to mitigate the exchange risk associated with Canadian dollar denominated lease assets collateralizing U.S. dollar denominated borrowings. Any gains or losses associated with these foreign exchange contracts are allocated to the Group and recorded in Interest expense in the Combined Statements of Comprehensive Income. During the year ended December 31, 2013 the amount was not significant and during the year ended December 31, 2012, the Group recorded a loss of \$1 million.

**Retirement plans and Stock-based compensation.** PHH maintains retirement benefit plans and stock-based compensation programs at a corporate level. The Group's employees participate in these plans and the financial statements reflect an allocation for a portion of the costs associated with these programs; however, the Combined Balance Sheets do not include any net benefit obligation or outstanding equity balances related to these programs. See Note 10, "Retirement Plans and Stock Based Compensation" for a further description of these plans.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### *Other Related Party Transactions*

**Cash Management and Treasury.** PHH uses a centralized approach to cash management and financing its operations. Cash transferred to and from PHH has historically been recorded as an intercompany receivable or payable in the Combined Balance Sheets. On a daily basis, PHH's corporate treasury function determines the minimum cash balance the Group needs to fund the following day's accounts payable disbursements and any cash in excess of that amount is swept to PHH. The Combined Financial Statements as of both December 31, 2013 and 2012 include an allocation of \$159 million to increase Cash and cash equivalents on the Combined Balance Sheets for the amount of cash related to the Group that was held at the PHH Corporate level at the Balance Sheet dates.

**Noncash Recapitalization.** On an annual basis, PHH evaluates several data sources, including rating agency leverage benchmarks, industry comparables and asset-backed securities market subordination levels to establish the appropriate equity levels in each of its segments. During 2013, the Group received a \$22 million contribution from PHH and during 2012, the Group distributed \$13 million to PHH. The recapitalization is recorded through Net parent investment in the Combined Statements of Changes in Parent Equity.

**Demand Note.** VMS has a demand note from PHH whereby PHH has a commitment to pay \$345 million, due and payable upon the demand of VMS, which will then contribute the amounts to Chesapeake Finance Holdings LLC. See also Note 11, "Variable Interest Entities", for more information about Chesapeake Finance Holdings LLC.

**Tax Sharing Agreement.** The results of operations of the Group, excluding the Canadian subsidiaries, have historically been included in the consolidated federal income tax returns of PHH and its combined and separate state income tax returns. The Group, excluding the Canadian subsidiaries, has entered into a tax sharing agreement between PHH and its subsidiaries whereby the net operating losses of other entities are available for use to offset taxable income of the Group. As of December 31, 2013, the Group has a \$32 million obligation to PHH for the utilization of other members' tax losses pursuant to the tax sharing agreement, which has been reflected as an increase to the Group's deferred tax liabilities in Note 8, "Income Taxes", as presented on a separate income tax return basis.

### **8. Income Taxes**

The following table summarizes Income tax expense (benefit):

	<u>Year Ended December 31,</u>	
	<u>2013</u>	<u>2012</u>
	(In millions)	
<i>Current:</i>		
Federal .....	\$ —	\$ —
State .....	3	—
Foreign .....	8	5
Total current income tax expense (benefit) .....	<u>11</u>	<u>5</u>
<i>Deferred:</i>		
Federal .....	25	22
State .....	(5)	(6)
Foreign .....	(1)	1
Total deferred income tax expense (benefit) .....	<u>19</u>	<u>17</u>
Income tax expense .....	<u>\$ 30</u>	<u>\$ 22</u>

## NOTES TO COMBINED FINANCIAL STATEMENTS

The following table summarizes Income before income taxes:

	Year Ended December 31,	
	2013	2012
	(In millions)	
Domestic operations .....	\$ 64	\$ 54
Foreign operations .....	24	26
Income before income taxes .....	<u>88</u>	<u>80</u>

No provision has been made for federal deferred taxes on \$150 million of accumulated and undistributed earnings of foreign subsidiaries as of December 31, 2013 since it is the present intention of management to reinvest the undistributed earnings indefinitely in those foreign operations. The determination of the amount of unrecognized federal deferred tax liability for unremitted earnings is not practicable.

Deferred tax assets and liabilities represent the basis differences between assets and liabilities measured for financial reporting versus for income-tax return purposes. The following table summarizes the significant components of deferred tax assets and liabilities:

	December 31,	
	2013	2012
	(In millions)	
<i>Deferred tax assets:</i>		
Federal loss carryforwards and credits .....	\$ 205	\$ 253
State loss carryforwards and credits .....	15	16
Alternative minimum tax credit carryforward .....	23	23
Other .....	4	4
Gross deferred tax assets .....	<u>247</u>	<u>296</u>
Valuation allowance .....	<u>(5)</u>	<u>(5)</u>
Deferred tax assets, net of valuation allowance .....	<u>242</u>	<u>291</u>
<i>Deferred tax liabilities:</i>		
Depreciation and amortization .....	<u>795</u>	<u>811</u>
Deferred tax liabilities .....	<u>795</u>	<u>811</u>
Total current and noncurrent net deferred tax liability .....	<u>553</u>	<u>520</u>
Less: current deferred tax asset .....	<u>(25)</u>	<u>(33)</u>
Noncurrent deferred tax liability .....	<u>\$ 578</u>	<u>\$ 553</u>

The deferred tax assets valuation allowance primarily relates to state loss carryforwards. The federal and state loss carryforwards will expire from 2027 to 2032 and from 2015 to 2034, respectively.

The total alternative minimum tax credit is not subject to limitations, and consists of credits that are available to the Group. As of December 31, 2013, it has been determined that all alternative minimum tax carryforwards can be utilized in future years; therefore, no reserve or valuation allowance has been recorded.

The deferred tax liabilities related to depreciation and amortization result primarily from differences in the net book value and tax basis of vehicles subject to lease due to differences in depreciation methods.

## NOTES TO COMBINED FINANCIAL STATEMENTS

Total income taxes differ from the amount that would be computed by applying the U.S. federal statutory rate as follows:

	Year Ended December 31,	
	2013	2012
	(In millions)	
Income before income taxes .....	\$ 88	\$ 80
Statutory federal income taxes.....	(35)%	(35)%
Income taxes computed at statutory federal rate.....	\$ 31	\$ 28
State and local income taxes, net of federal tax benefits .....	3	1
Changes in rate and apportionment factors.....	(1)	(5)
Other .....	(3)	(2)
Income tax expense .....	\$ 30	\$ 22
Effective tax rate.....	34.1 %	27.5 %

**State and local income taxes, net of federal tax benefits.** Represents the impact to the effective tax rate from the pre-tax income or loss as well as the mix of income and loss from the operations by entity and state income tax jurisdiction. The effective state tax rate was higher for the year ended December 31, 2013 as compared to 2012.

**Changes in rate and apportionment factors.** Represents the impact to the effective tax rate from deferred tax items for changes in apportionment factors and tax rate. For the years ended December 31, 2013 and 2012, the amounts represent the impact of applying statutory changes to apportionment weight, apportionment sourcing and corporate income tax rates that were enacted by various states.

**Other.** Represents the impact to effective tax rate from miscellaneous items, primarily due to taxes on foreign operations at a rate different than the U.S. federal income tax rate.

The Group's liability for unrecognized income tax benefit, including interest and penalties, was immaterial as of both December 31, 2013 and 2012. The Group does not expect the change in the unrecognized income tax benefit in the next 12 months to be significant.

The Group and its subsidiaries remain subject to examination by the IRS for the tax years ended December 31, 2010 through 2013. As of December 31, 2013, foreign and state income tax filings were subject to examination for periods including and subsequent to 2006, dependent upon jurisdiction.

### 9. Commitments and Contingencies

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#### *Legal Contingencies*

The Group is party to various claims and legal proceedings from time to time related to contract disputes and other commercial, employment and tax matters. The Group is not aware of any pending legal proceedings that it believes could have, individually or in the aggregate, a material impact on its business, financial position, results of operations or cash flows.

#### *Lease and Purchase Commitments*

The Group is committed to making rental payments under noncancelable operating leases related to various facilities and equipment. In addition, during the normal course of business, the Group enters into purchase commitments for vehicles to be leased and other commitments are made to purchase goods or services from specific suppliers.

## NOTES TO COMBINED FINANCIAL STATEMENTS

The following table summarizes the Group's commitments as of December 31, 2013:

	<b>Future Minimum Operating Lease Payments</b>	<b>Purchase Commitments</b>
	(In millions)	
2014 .....	\$ 5	\$ 89
2015 .....	5	—
2016 .....	5	—
2017 .....	4	—
2018 .....	4	—
Thereafter .....	23	—
Total .....	\$ 46	\$ 89

During the years ended December 31, 2013 and 2012, rental expense of \$7 million and \$6 million, respectively, was recorded in Other operating expenses in the Combined Statements of Comprehensive Income.

### ***Guarantees***

In the normal course of operations, the Group enters into agreements that contain standard guarantees and indemnities to third parties in transactions such as sales of assets and the performance of services. The nature of substantially all of the indemnification undertakings prevents the Group from making a reasonable estimate of the maximum potential amount the Group could be required to pay third parties and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, the Group has not made significant payments nor do they expect to make significant payments under such indemnification agreements.

VMS guarantees the obligations of PHH under its unsecured Revolving Credit Facility. The Revolving Credit Facility consists of a \$250 million revolving credit tranche (Tranche A) that will expire on August 2, 2015. As of December 31, 2013, PHH had no balance outstanding under the Revolving Credit Facility.

## **10. Retirement Plans and Stock Based Compensation**

PHH offers various retirement benefits to its eligible employees, including employees of the Group and various equity compensation arrangements, which provide employees with restricted stock units ("RSUs") or stock options to purchase stock in PHH. Because PHH provides these benefits to eligible employees and retirees of the Group, the costs to participating employees are included in the Combined Statements of Comprehensive Income while the related assets and liabilities are retained by PHH.

**U.S. Retirement Plans.** PHH sponsors a defined contribution savings plan that provides certain eligible employees an opportunity to accumulate funds for retirement. Certain eligible employees of the Group are participants in the plan. Contributions of participating employees are matched on the basis specified by these plans. The costs for contributions to these plans are included in Salaries and related expenses in the Combined Statements of Comprehensive Income and were \$1 million for both years ended December 31, 2013 and 2012.

PHH also sponsors a defined benefit pension plan and an other post employment benefits plan, which cover certain eligible employees of the Group. Both the defined benefit pension plan and the other post employment benefits plan are frozen, wherein the plans only accrue benefits for a very limited number of employees. Benefits are based on an employee's years of credited service and a percentage of final average compensation, or as otherwise described by the plan. The amount of net periodic benefit costs allocated to the Group from PHH in the overhead allocation was not significant for both years ended December 31, 2013 and 2012.

## NOTES TO COMBINED FINANCIAL STATEMENTS

**Foreign Retirement Plans.** PHH also sponsors a defined contribution plan in Canada that provides certain eligible employees an opportunity to accumulate funds for retirement. This plan has been designed in accordance with the federal regulations contained in the Income Tax Act (Canada), allowing it to function as a Registered Retirement Saving Plan. Employees can contribute up to a certain percentage of pre-tax earnings. The Company may match the employee's pre-tax contribution, up to a certain percentage, on an annual basis. The costs for contributions to these plans are included in Salaries and related expenses in the Combined Statements of Comprehensive Income and were not significant for both years ended December 31, 2013 and 2012.

**Stock Based Compensation.** Share-based payment expense for the awards granted to the Group's employees has been reflected in Allocated expenses in the Combined Statements of Comprehensive Income. The expense recognized for these programs was \$1 million for the year ended December 31, 2013 and was not significant for the year ended December 31, 2012.

### 11. Variable Interest Entities

The Group determines whether an entity is a variable interest entity ("VIE") and whether it is the primary beneficiary at the date of initial involvement with the entity. The Group reassesses whether it is the primary beneficiary of a VIE upon certain events that affect the VIE's equity investment at risk and upon certain changes in the VIE's activities. The purposes and activities of the VIE are considered in determining whether the Group is the primary beneficiary, including the variability and related risks the VIE incurs and transfers to other entities and their related parties. Based on these factors, a qualitative assessment is made and, if inconclusive, a quantitative assessment of whether it would absorb a majority of the VIE's expected losses or receive a majority of the VIE's expected residual returns. If the Group determines that it is the primary beneficiary of the VIE, the VIE is consolidated within the Combined Financial Statements.

The Group's involvement in variable interest entities primarily relate to fleet vehicle financing activities. The activities of significant variable interest entities are more fully described below.

Assets and liabilities of significant consolidated variable interest entities are included in the Combined Balance Sheets as follows:

	<u>December 31, 2013</u>		<u>December 31, 2012</u>	
	<u>Chesapeake and D.L. Peterson Trust</u>	<u>FLRT and PHH Lease Receivables LP</u>	<u>Chesapeake and D.L. Peterson Trust</u>	<u>FLRT and PHH Lease Receivables LP</u>
	(In millions)			
<b>ASSETS</b>				
Cash .....	\$ 5	\$ —	\$ 2	\$ —
Restricted cash <sup>(1)</sup> .....	157	46	186	59
Accounts receivable, net .....	46	—	73	—
Net investment in fleet leases .....	2,982	599	2,856	675
Other assets .....	12	6	12	7
<b>Total assets</b> .....	<u>\$ 3,202</u>	<u>\$ 651</u>	<u>\$ 3,129</u>	<u>\$ 741</u>
Assets held as collateral <sup>(2)</sup> .....	\$ 3,185	\$ 645	\$ 3,114	\$ 731
<b>LIABILITIES</b>				
Accounts payable and accrued expenses .....	\$ 2	\$ 5	\$ 2	\$ 8
Debt .....	2,866	598	2,771	662
<b>Total liabilities</b> <sup>(3)</sup> .....	<u>\$ 2,868</u>	<u>\$ 603</u>	<u>\$ 2,773</u>	<u>\$ 670</u>

<sup>(1)</sup> Represents amounts specifically designated to purchase assets, repay debt and/or provide over-collateralization related to asset-backed debt arrangements.

<sup>(2)</sup> Represents amounts not available to pay general obligations. See Note 6, "Debt" for further information.

<sup>(3)</sup> Excludes intercompany payables.

## NOTES TO COMBINED FINANCIAL STATEMENTS

In addition to the assets and liabilities of significant variable interest entities that were consolidated as outlined above, the Group had the following involvement with these entities as of and for the year ended December 31:

	Net income (loss) <sup>(1)</sup>		VMS Investment <sup>(2)</sup>		Intercompany payable <sup>(2)</sup>	
	2013	2012	2013	2012	2013	2012
	(In millions)					
Chesapeake and D.L. Peterson Trust .....	\$ 64	\$ 58	\$ 613	\$ 766	\$ (273)	\$ (238)
FLRT and PHH Lease Receivables LP .....	12	11	23	81	(9)	(36)

<sup>(1)</sup> Includes adjustments for the elimination of intercompany transactions.

<sup>(2)</sup> Amounts are eliminated in the Combined Balance Sheets.

### ***Chesapeake and D.L. Peterson Trust***

**Purpose and Structure.** Vehicle acquisitions in the U.S. for the Fleet Management services segment are primarily financed through the issuance of asset-backed variable funding notes issued by Chesapeake Funding LLC. D.L. Peterson Trust (“DLPT”), a bankruptcy remote statutory trust, holds the title to all vehicles that collateralize the debt issued by Chesapeake Funding. DLPT also acts as a lessor under both operating and direct financing lease agreements. Chesapeake Funding’s assets primarily consist of a loan made to Chesapeake Finance Holdings LLC, a subsidiary of the Group. Chesapeake Finance owns all of the special units of beneficial interest in the leased vehicles and eligible leases and certain other assets issued by DLPT, representing all interests in DLPT.

The Group determined that each of Chesapeake Funding, Chesapeake Finance and DLPT are VIEs and that it is the primary beneficiary due to insufficient equity investment at risk. The determination was made on a qualitative basis, considering the nature and purpose of each of the entities and how risk transfers to interest holders through their variable interests. The Group holds the significant variable interests, which include equity interests, ownership of certain amounts of asset-backed debt issued by Chesapeake and interests in DLPT. There are no significant variable interests that would absorb losses prior to the Group or that hold variable interests that exceed those of the Group.

In accordance with the Amended and Restated Servicer Agreement, the Group acts as a servicer for Chesapeake Finance and DLPT and in accordance with the Administrative Agreement, the Group acts as an administrator of the entities. The Group received related fees from Chesapeake of \$6 million during each of the years ended December 31, 2013, and 2012.

**Contributions and Distributions.** Certain capital transactions are executed between the Group and Chesapeake whereby the Group makes contributions to Chesapeake for increased escrow requirements, debt issuance costs and additional paydown of outstanding notes of Chesapeake. During both years ended December 31, 2013 and 2012 these contributions were \$5 million. Chesapeake may also distribute capital to the Group from the release of overcollateralization from asset-backed debt arrangements, leveraging existing series of asset-backed notes or from issuance of new note series. Distributions received from Chesapeake were \$158 million and \$30 million during the years December 31, 2013 and 2012, respectively.

**Other Support.** The Chesapeake Finance LLC agreement requires the Group to contribute additional capital to Chesapeake Finance as needed in order to maintain certain required capitalization levels. In addition, a separate Demand Note agreement requires PHH to contribute up to \$345 million of additional capital to Chesapeake Finance, upon the demand of Chesapeake Finance. During 2013 and 2012, no demands were made under this agreement.

## NOTES TO COMBINED FINANCIAL STATEMENTS

### *Fleet Leasing Receivables Trust*

**Purpose and Structure.** Fleet Leasing Receivables Trust (“FLRT”) is a Canadian special purpose trust and its primary business activities include the acquisition, disposition and administration of purchased or acquired lease assets from our other Canadian subsidiaries and the borrowing of funds or the issuance of securities to finance such acquisitions. PHH Fleet Lease Receivables LP is a bankruptcy remote special purpose entity that holds the beneficial ownership of lease assets transferred from Canadian subsidiaries.

The Group determined that FLRT and PHH Fleet Lease Receivables LP are VIEs based on a qualitative basis after considering the nature and purpose of the entities and how the risk is transferred to interest holders through their variable interests.

The Group acts as initial servicer, collections agent and financial services agent of FLRT and PHH Fleet Lease Receivables LP. Related fees of \$1 million were paid to the Group by FLRT during each of the years ended December 31, 2013 and 2012.

**Contributions and Distributions.** Certain FLRT debt transactions are structured whereby subsidiaries of the Group contribute the beneficial ownership in vehicles under lease to PHH Fleet Lease Receivables LP, and receive distributions upon the issuance of the debt by FLRT. During the years ended December 31, 2013 and 2012, the Group and its subsidiaries contributed \$275 million and \$380 million of vehicles to PHH Fleet Lease Receivables LP, respectively, and received distributions of \$333 million and \$381 million, respectively.

### **12. Subsequent Events**

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On March 11, 2014, Chesapeake Funding LLC issued \$800 million of Series 2014-1 Term notes. Proceeds from the notes were used to repay a portion of the Series 2013-2 variable-funding notes. On March 20, 2014, the total commitments under the Series 2013-2 and 2013-3 notes were reduced from \$1.3 billion to \$1.1 billion.

On March 21, 2014, the Secured Canadian credit facility was amended to decrease the committed revolving capacity from \$118 million (C\$125 million) to \$23 million (C\$25 million).

**Fleet Business and Subsidiaries of  
PHH Corporation**

**Combined Condensed Financial Statements as of and for  
the Three Months Ended March 31, 2014 and 2013**  
(Unaudited)

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## **Table of Contents**

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### **Interim Financial Statements**

**as of and for the three months ended March 31, 2014 and 2013 (unaudited):**

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Condensed Combined Financial Statements .....	1
Notes to Condensed Combined Financial Statements.....	6

**FLEET BUSINESS AND SUBSIDIARIES OF PHH CORPORATION**  
**CONDENSED COMBINED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)**  
(In millions)

	Three Months Ended March 31,	
	2014	2013
<b>REVENUES</b>		
Fleet lease income .....	\$ 343	\$ 332
Fleet management fees .....	44	43
Other income .....	19	19
<b>Total revenues</b> .....	406	394
<b>EXPENSES</b>		
Depreciation on operating leases .....	300	302
Cost of goods sold .....	30	16
Interest expense .....	14	17
Salaries and related expenses .....	19	18
Allocated expenses (Note IV) .....	13	12
Other depreciation and amortization .....	2	2
Other operating expenses .....	7	7
<b>Total expenses</b> .....	385	374
<b>Income before income taxes</b> .....	21	20
Income tax expense .....	7	6
<b>Net income</b> .....	\$ 14	\$ 14
Other comprehensive loss, net of tax:		
Currency translation adjustment .....	(8)	(5)
<b>Total other comprehensive loss, net of tax</b> .....	(8)	(5)
<b>Total comprehensive income</b> .....	\$ 6	\$ 9

See accompanying Notes to Condensed Combined Financial Statements.

**CONDENSED COMBINED BALANCE SHEETS (unaudited)**

(In millions)

	<u>March 31, 2014</u>	<u>December 31, 2013</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents .....	\$ 282	\$ 278
Accounts receivable, net .....	373	348
Net investment in fleet leases .....	45	45
Income tax receivable .....	4	—
Deferred taxes .....	19	25
Other assets .....	25	28
<b>Total current assets</b> .....	<u>748</u>	<u>724</u>
<b>Noncurrent Assets</b>		
Restricted cash .....	247	207
Net investment in fleet leases .....	3,574	3,608
Due from affiliates (Note IV) .....	—	22
Property and equipment, net .....	27	27
Goodwill .....	25	25
Intangible assets .....	28	29
Other assets .....	24	21
<b>Total noncurrent assets</b> .....	<u>3,925</u>	<u>3,939</u>
<b>Total assets</b> <sup>(1)</sup> .....	<u>\$ 4,673</u>	<u>\$ 4,663</u>
<b>LIABILITIES AND PARENT EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued expenses .....	\$ 230	\$ 220
Debt .....	959	1,023
Other liabilities .....	10	8
<b>Total current liabilities</b> .....	<u>1,199</u>	<u>1,251</u>
<b>Noncurrent Liabilities</b>		
Debt .....	2,493	2,458
Deferred taxes .....	579	578
Due to affiliates (Note IV) .....	23	—
Other liabilities .....	6	9
<b>Total noncurrent liabilities</b> <sup>(1)</sup> .....	<u>3,101</u>	<u>3,045</u>
<b>Total liabilities</b> .....	<u>4,300</u>	<u>4,296</u>
Commitments and contingencies .....	—	—
<b>PARENT EQUITY</b>		
Net parent investment .....	359	345
Accumulated other comprehensive income .....	14	22
<b>Total parent equity</b> .....	<u>373</u>	<u>367</u>
<b>Total liabilities and parent equity</b> .....	<u>\$ 4,673</u>	<u>\$ 4,663</u>

See accompanying Notes to Condensed Combined Financial Statements.

**Continued.**

**CONDENSED COMBINED BALANCE SHEETS (unaudited)—(Continued)**

**(In millions)**

(1) The Condensed Combined Balance Sheets include assets of variable interest entities which can be used only to settle their obligations and liabilities of variable interest entities which creditors or beneficial interest holders do not have recourse to the Group (as defined in Note 1, "Basis of Presentation and Summary of Significant Accounting Policies") as follows:

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
Cash and cash equivalents .....	\$ 10	\$ 5
Restricted cash .....	243	203
Accounts receivable, net .....	45	46
Net investment in leases .....	3,556	3,581
Other assets .....	21	18
<b>Total assets</b> .....	<b>\$ 3,875</b>	<b>\$ 3,853</b>
<b>LIABILITIES</b>		
Accounts payable and accrued expenses .....	\$ 8	\$ 7
Debt .....	3,437	3,464
<b>Total liabilities</b> .....	<b>\$ 3,445</b>	<b>\$ 3,471</b>

See accompanying Notes to Condensed Combined Financial Statements.

**CONDENSED COMBINED STATEMENTS OF CHANGES IN PARENT EQUITY (unaudited)**

(In millions)

	<u>Net Parent Investment</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Equity</u>
<b><u>Three Months Ended March 31, 2014</u></b>			
<b>Beginning Balance, January 1, 2014</b> .....	\$ 345	\$ 22	\$ 367
Net income .....	14	—	14
Currency translation adjustment .....	—	(8)	(8)
<b>Balance at March 31, 2014</b> .....	<u>\$ 359</u>	<u>\$ 14</u>	<u>\$ 373</u>
 <b><u>Three Months Ended March 31, 2013</u></b>			
<b>Beginning Balance, January 1, 2013</b> .....	\$ 258	\$ 36	\$ 294
Net income .....	14	—	14
Currency translation adjustment .....	—	(5)	(5)
Recapitalization from parent .....	22	—	22
<b>Balance at March 31, 2013</b> .....	<u>\$ 294</u>	<u>\$ 31</u>	<u>\$ 325</u>

See accompanying Notes to Condensed Combined Financial Statements.

**CONDENSED COMBINED STATEMENTS OF CASH FLOWS (unaudited)**

(In millions)

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income .....	\$ 14	\$ 14
Adjustments to reconcile Net income to net cash provided by operating activities:		
Depreciation on operating leases .....	300	302
Other depreciation and amortization .....	2	2
Amortization of debt issuance costs .....	4	3
Deferred income tax expense .....	7	5
Changes in other assets and liabilities:		
Accounts receivable, net .....	(19)	52
Accounts payable and accrued expenses .....	20	(8)
Other, net .....	(4)	(9)
<b>Net cash provided by operating activities</b> .....	<b>324</b>	<b>361</b>
<b>Cash flows from investing activities:</b>		
Investment in vehicles .....	(409)	(428)
Proceeds on sale of investment vehicles .....	103	77
Purchases of property and equipment .....	(2)	(2)
(Increase) decrease in restricted cash .....	(42)	10
<b>Net cash used in investing activities</b> .....	<b>(350)</b>	<b>(343)</b>
<b>Cash flows from financing activities:</b>		
Net transfers from (to) affiliates .....	45	(7)
Proceeds from secured borrowings .....	992	491
Principal payments on secured borrowings .....	(998)	(469)
Cash paid for debt issuance costs .....	(5)	—
<b>Net cash provided by financing activities</b> .....	<b>34</b>	<b>15</b>
<b>Effect of changes in exchange rates on Cash and cash equivalents</b> .....	<b>(4)</b>	<b>—</b>
Net increase in Cash and cash equivalents .....	4	33
Cash and cash equivalents at beginning of period .....	278	230
<b>Cash and cash equivalents at end of period</b> .....	<b>\$ 282</b>	<b>\$ 263</b>
<b>Significant Non-Cash Transactions</b>		
Recapitalization from parent .....	\$ —	\$ (22)

See accompanying Notes to Condensed Combined Financial Statements.

## NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS

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### **I. Basis of Presentation and Summary of Significant Accounting Policies**

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PHH Corporation (“PHH”) maintains a fleet management services business comprised of various legal subsidiaries. The Condensed Combined carve-out statements of the Fleet Business and Subsidiaries of PHH are comprised of PHH Vehicle Management Services Group LLC and its subsidiaries (“VMS”), PHH Sub 1 Inc. (“Sub 1”) and PHH Sub 2 Inc. (“Sub 2”), collectively (the “Group”).

The Condensed Combined Financial Statements include the accounts and transactions of the combined Group and its subsidiaries, as well as entities in which the Group directly or indirectly has a controlling financial interest and variable interest entities of which the Group is the primary beneficiary.

#### ***Basis of Presentation***

The Condensed Combined carve-out Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States (GAAP), for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. In management’s opinion, the unaudited Condensed Combined Financial Statements contain all adjustments, which include normal and recurring adjustments necessary for a fair presentation of the financial position and results of operations for the interim period presented. The results of operations reported for the interim period are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. These unaudited Condensed Combined Financial Statements should be read in conjunction with the Combined Financial Statements as of and for the year ended December 31, 2013.

The Condensed Combined carve-out financial statements have been prepared based upon financial information derived from PHH’s Condensed Consolidated financial statements and accounting records. The Condensed Combined Financial Statements include corporate costs incurred by PHH that are provided to or on behalf of the Group and consist of both direct and allocated costs.

As the Group was combined for purposes of these financial statements, Net parent investment is shown in lieu of Shareholders’ Equity. The Net parent investment equity balance on the Condensed Combined Balance Sheets represents PHH’s historical investment in the Group and the accumulated earnings of the business. Intercompany transactions with PHH or its affiliates are reflected in the Condensed Combined Statements of Cash Flows within Net transfers from/to affiliates in financing activities, and in the Condensed Combined Balance Sheets within Due to or from affiliates.

The Condensed Combined Financial Statements include the assets, liabilities, revenue, and expenses solely attributable to the Group, as well as certain allocations from PHH. Management believes these allocation methods are reasonable and the allocations were applied consistently for all periods presented, and were consistent with the allocations in the Combined Financial Statements for the year ended December 31, 2013. The historical results of operations and financial position of the Group included in the Condensed Combined Financial Statements may not be indicative of what would have been recorded if the Group had been a stand-alone entity, or if each entity in the Group had been operating as a separate, stand-alone entity.

Unless otherwise noted, dollar amounts presented within these Notes to Condensed Combined Financial Statements are in millions.

#### ***Changes in Accounting Policies***

**Income Taxes.** In July 2013, the FASB issued ASU 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists”. This update to the income tax guidance clarifies the diversity in practice in the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This update requires the unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset or as a liability to the extent the entity cannot or does not intend to use the deferred tax asset for such purpose. The Group adopted the accounting guidance effective January 1, 2014 and applied the guidance prospectively to all

**NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS**

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unrecognized tax benefits that exist at the effective date. The adoption of the guidance did not have a material impact on the Group's financial statements.

***Interim Income Tax Expense or Benefit***

Interim income tax benefit or expense is recorded by applying a projected full-year effective income tax rate to the quarterly Income before income taxes for results that are deemed to be reliably estimable.

***Subsequent Events***

The Group evaluated subsequent events with respect to the Condensed Combined Financial Statements through the date of issuance which was May 29, 2014.

**II. Vehicle Leasing Activities**

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The following table summarizes the components of Net investment in fleet leases:

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>(In millions)</b>		
<i>Operating Leases:</i>		
Vehicles under open-end operating leases .....	\$ 7,948	\$ 7,974
Vehicles under closed-end operating leases .....	128	137
Vehicles under operating leases.....	8,076	8,111
Less: Accumulated depreciation.....	(4,790)	(4,777)
Net investment in operating leases .....	<u>3,286</u>	<u>3,334</u>
<i>Direct Financing Leases:</i>		
Lease payments receivable .....	102	100
Less: Unearned income .....	(6)	(2)
Net investment in direct financing leases .....	<u>96</u>	<u>98</u>
<i>Off-Lease Vehicles:</i>		
Vehicles not yet subject to a lease .....	233	217
Vehicles held for sale .....	11	10
Less: Accumulated depreciation.....	(7)	(6)
Net investment in off-lease vehicles .....	<u>237</u>	<u>221</u>
Total.....	<u>\$ 3,619</u>	<u>\$ 3,653</u>

## NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS

### III. Debt

The following table summarize the components of Debt:

	March 31, 2014			December 31, 2013	
	Balance	Wt. Avg- Interest Rate <sup>(1)</sup>	Maximum Capacity	Available Capacity <sup>(2)</sup>	Balance
(In millions)					
Term notes, in amortization .....	\$ 1,237	1.0 %	\$ 1,237	n/a	\$ 1,406
Term notes, in revolving period .....	1,500	0.7 %	1,500	\$ —	700
Variable-funding notes .....	700	2.1 %	1,839	1,139	1,358
Other .....	15	5.1 %	15	n/a	17
Asset-backed debt .....	<u>3,452</u>		<u>4,591</u>	<u>1,139</u>	<u>3,481</u>
Secured Canadian credit facility .....	—	—%	23	19	—
Total .....	<u>\$ 3,452</u>		<u>\$ 4,614</u>	<u>\$ 1,158</u>	<u>\$ 3,481</u>

<sup>(1)</sup> Represents the weighted-average stated interest rate of the variable-rate facilities as of the respective date.

<sup>(2)</sup> Capacity is dependent upon maintaining compliance with the terms, conditions, and covenants of the respective agreements and may be further limited by asset eligibility requirements. Available capacity for the Secured Canadian credit facility is limited by the borrowing base calculation as of March 31, 2014.

Assets held as collateral that are not available to pay the Group's general obligations as of March 31, 2014 included Restricted cash of \$243 million, Accounts receivable of \$45 million and Net investment in fleet leases of \$3,574 million.

On March 11, 2014, Chesapeake Funding LLC issued \$800 million of Series 2014-1 Term notes. Proceeds from the notes were used to repay a portion of the Series 2013-2 variable-funding notes. On March 20, 2014, the total commitments under the Series 2013-2 and 2013-3 notes were reduced from \$1.3 billion to \$1.1 billion.

On March 21, 2014, the Secured Canadian credit facility was amended to decrease the committed revolving capacity from \$118 million (C\$125 million) to \$23 million (C\$25 million).

There were no significant amendments to the terms of debt covenants during the three months ended March 31, 2014. As of March 31, 2014, the Group and PHH Corporation were in compliance with all of their financial covenants related to the Group's debt arrangements.

### IV. Due from/to Affiliates and Related Party Transactions

Due from (to) affiliates, net consisted of the following:

	March 31, 2014	December 31, 2013
	(In millions)	
Due from PHH Corporation .....	\$ 15	\$ 58
Due from other PHH affiliates .....	10	10
Unsecured intercompany line of credit .....	(21)	(19)
Interest payable on Unsecured intercompany line of credit .....	(27)	(27)
Total .....	<u>\$ (23)</u>	<u>\$ 22</u>

**NOTES TO CONDENSED COMBINED FINANCIAL STATEMENTS**

The corporate overhead expenses allocated from PHH to the Group included in Allocated expenses in the Condensed Combined Statements of Comprehensive Income relate to the following costs:

	Three Months Ended	
	March 31,	
	2014	2013
	(In millions)	
Salaries and related expenses .....	\$ 6	\$ 6
Other depreciation and amortization .....	1	1
Other operating expenses .....	6	5
Total .....	\$ 13	\$ 12

**V. Variable Interest Entities**

Assets and liabilities of significant consolidated variable interest entities are included in the Condensed Combined Balance Sheets as follows:

	March 31, 2014		December 31, 2013	
	Chesapeake and D.L. Peterson Trust	FLRT and PHH Lease Receivables LP	Chesapeake and D.L. Peterson Trust	FLRT and PHH Lease Receivables LP
	(In millions)			
<b>ASSETS</b>				
Cash .....	\$ 10	\$ —	\$ 5	\$ —
Restricted cash <sup>(1)</sup> .....	196	47	157	46
Accounts receivable, net .....	45	—	46	—
Net investment in fleet leases .....	2,991	565	2,982	599
Other assets .....	15	6	12	6
<b>Total assets</b> .....	<b>\$ 3,257</b>	<b>\$ 618</b>	<b>\$ 3,202</b>	<b>\$ 651</b>
Assets held as collateral <sup>(2)</sup> .....	\$ 3,232	\$ 612	\$ 3,185	\$ 645
<b>LIABILITIES</b>				
Accounts payable and accrued expenses .....	\$ 2	\$ 6	\$ 2	\$ 5
Debt .....	2,873	564	2,866	598
<b>Total liabilities</b> <sup>(3)</sup> .....	<b>\$ 2,875</b>	<b>\$ 570</b>	<b>\$ 2,868</b>	<b>\$ 603</b>

<sup>(1)</sup> Represents amounts specifically designated to purchase assets, repay debt and/or provide over-collateralization related to asset-backed debt arrangements.

<sup>(2)</sup> Represents amounts not available to pay general obligations. See Note III, "Debt" for further information.

<sup>(3)</sup> Excludes intercompany payables.