

SOFTWARE LEASING - Are You Protected?

- How Safe is Hardware Leasing?
- Software Industry Overview
- Credit Protection
- Legal Protection
- Vendor Protection
- Pragmatic Protection
- Summary



Hardware Leasing Case Study

**Hardware Leasing offers safety because of
the COLLATERAL!**

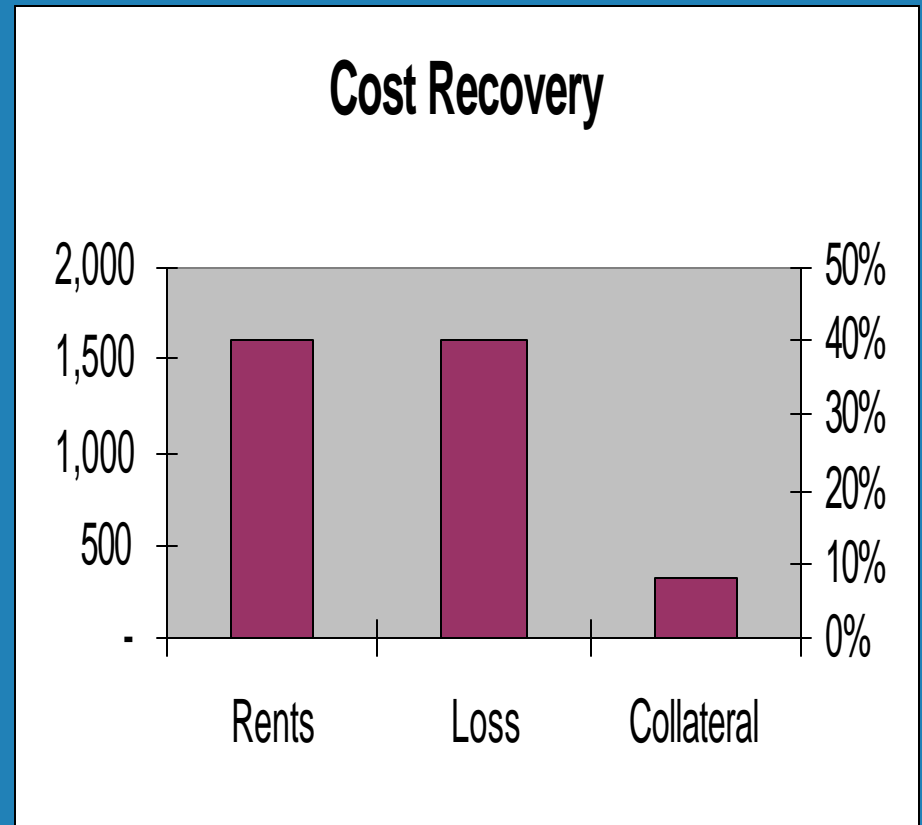
Software Leasing is Unsecured!

Software Leasing is like leasing AIR!

Value of Computer Hardware- Case Study

Assumptions:

- Cost \$ 3,500
- Date : 6/96
- Dell 133Mhz PC
- Term: 36 months
- Rent: \$117
- Default Month: 18
- NBV @ Default: \$1,900
- Net Sale Proceeds:
\$250



Software Industry - Value

“Software is a major portion of overall I.T. costs (typically from 60 - 90%). As hardware continues on its road to becoming a commodity, the software proportion will continue to grow. Moreover, as information technology plays a greater role in organization effectiveness, software costs will grow as a portion of overall business costs. Software, not hardware, is where business value is added.”

But, more important, it is software that enables computers to deliver value. It is becoming the backbone of business. It is the differentiator for competitive advantage.”

Paradigm Shift by Tapscott & Caston

Software Industry - Demographics

<u>Revenues</u>	<u>TOTAL NUMBER OF SOFTWARE COMPANIES</u>			
	<u>Datamation</u>	<u>Soft*Letter</u>	<u>Software Magazine</u>	<u>CorpTech</u>
>\$1 Billion	13	2	5	-
\$500 Million - \$1 Billion	11	3	4	162
\$250 Million - \$500 Million	12	3	8	87
\$100 Million - \$250 Million	14	11	26	182
\$50 Million - \$100 Million	-	14	19	240
\$25 Million - \$50 Million	-	16	38	438
\$10 Million - \$25 Million	-	34	-	905
\$5 Million - \$10 Million	-	17	-	974
<\$5 Million	-	-	-	6376
TOTAL	50	100	100	9364

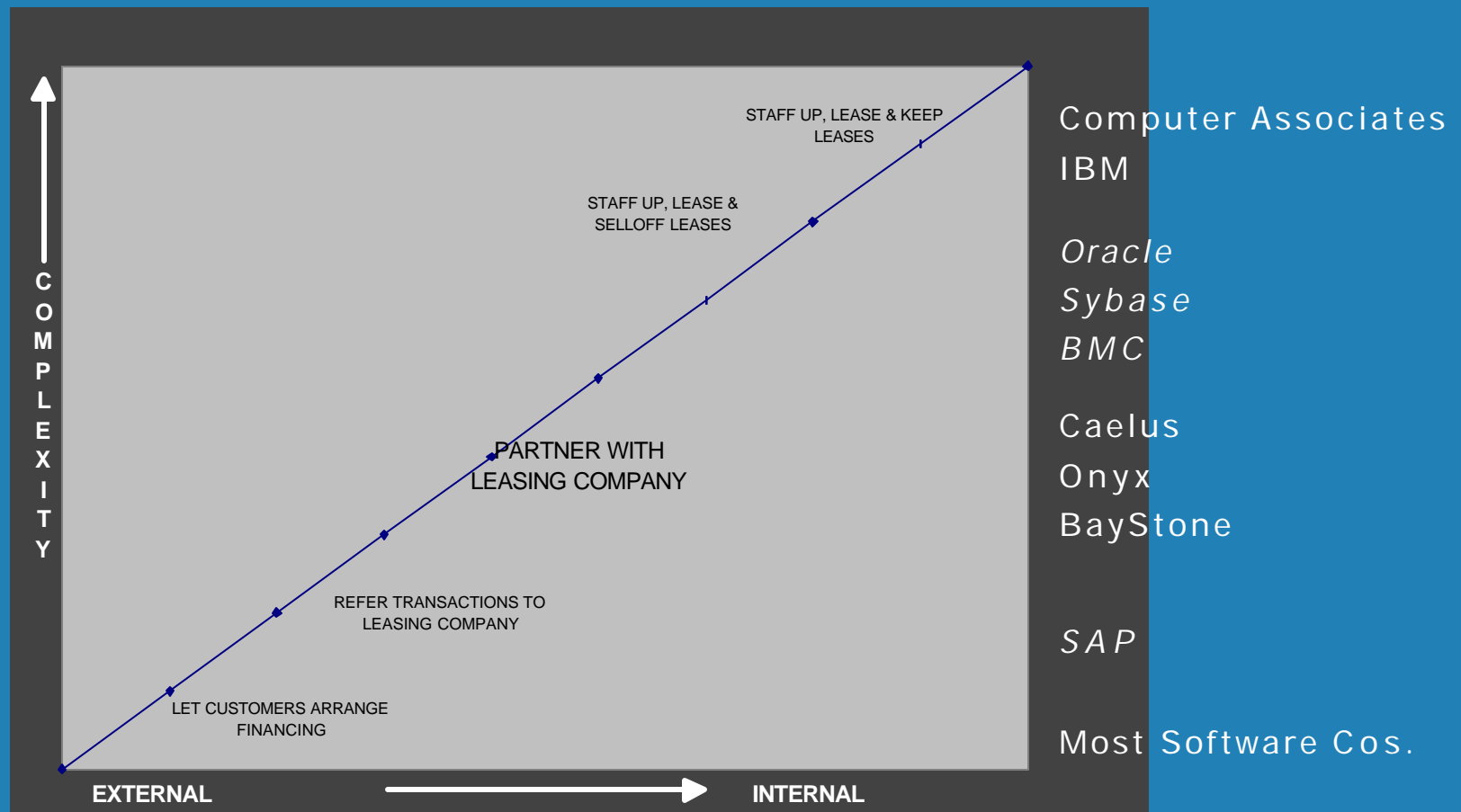
Software Industry - Demographics

TOTAL REVENUES (IN MILLIONS) OF SOFTWARE COMPANIES				
<u>Revenues</u>	<u>Datamation</u>	<u>Soft*Letter</u>	<u>Software Magazine</u>	<u>CorpTech</u>
	(A)	(B)	(C)	(D)
>\$1 Billion	42,686	9,320	16,275	-
\$500 Million - \$1 Billion	7,380	1,798	2,618	121,500
\$250 Million - \$500 Million	4,491	1,107	2,901	32,265
\$100 Million - \$250 Million	3,110	1,730	4,042	31,850
\$50 Million - \$100 Million	-	1,006	1,396	18,000
\$25 Million - \$50 Million	-	621	942	16,425
\$10 Million - \$25 Million	-	575	-	15,837
\$5 Million - \$10 Million	-	128	-	7,305
<\$5 Million	-	-	-	9,823
TOTAL	57,667	16,285	28,174	253,366

Software Industry Market Data

- ❁ **\$95 to \$100 billion in worldwide revenue in 1996.**
- ❁ **U.S. computer software companies grew five times the economy in the seven years 1987 - 1994 and employment of such companies grew at seven times the economy.**
- ❁ **Industry is young. 14% were formed in the 1990's; 54% in the 1980's; 24% in the 1970's; and 8% prior.**

Software Leasing Implementation



4/25/98

Presented by Lawrence N. Bazrod LPI Software Funding Group

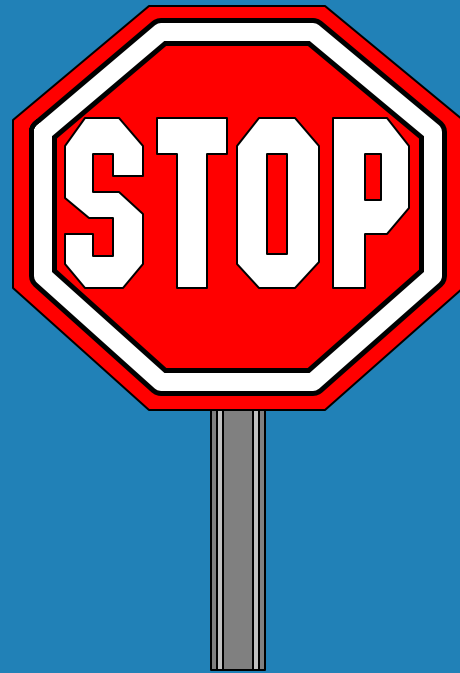
Credit Protection

- Consider the Value of the Software to the Lessee
- Read the License
 - Is it transferable?
 - Is it exclusive?
 - Will the Vendor allow transfer upon default?
- Will the Vendor provide any form of Remarketing?

Credit Protection

- Continue “Standard” credit underwriting process, but be mindful of special credit issues surrounding technology
 - Purchased R&D
 - R&D Expenses

Legal Protection



WARNING: This material may be
hazardous to your alertness

SOFTWARE LEASING IS SECURED LENDING!

• The Copyright Act:

- Governs transfers of Copyrights
- Granting a security interest in a Copyright is a transfer [See section 101]
- Copyright and license are not the same
- Exclusive license is governed by Copyright
- Non-exclusive license is not!

SOFTWARE LEASING IS SECURED LENDING!

• The Analysis

- Is the license exclusive or non-exclusive
 - Shrink-wrap clearly non-exclusive
 - 100% Custom clearly exclusive
 - Others look to language of license
- If non-exclusive then follow UCC-9 just like equipment ; license is classified as a general intangible under UCC-9

SOFTWARE LEASING IS SECURED LENDING!

• The Analysis - Continued

- If exclusive, then in order to prevail in bankruptcy you need to file with the Copyright Office.

• References:

- In Re Peregrine
- In Re Dabney
- Everex Case

Legal Protection

⊙ Practical Implications

- Always file UCC-1 against the License
- Avoid full custom software unless you involve special counsel on copyright and file with copyright office
- Hybrid situations: get protection from UCC filing against the shrink-wrap kernel.

Legal Protection

- Special Documents for Software
 - Upgrades & new versions
 - Additional remedies - prevent use
 - What if Software Licensor goes bankrupt?
- Bankruptcy
 - Secured v. Unsecured
 - Chapter 11 v. Chapter 7
 - Value : Rash Case

UCC ARTICLE 2B

- Addresses licensing of intangibles
- March, 1998 Draft
 - Definition of “Financier”. Section 2B-102(a)(20)
 - Transfer of Rights. Section 2B-501-508
 - Sanctions Security Interest in Non-Exclusive License. Section 2B-504 [Issue: Resale]
- Web Sites-www.law.uh.edu/ucc2b or www.softwareindustry.org/issues/guide

Vendor Protections

• Possible Vendor Commitments

- Remarketing
- Resell Assistance
- Right to Transfer
- Maintenance Rebate
- Credit Enhancement
- Copyright Indemnity

VENDOR PROTECTION - REVENUE RECOGNITION

- **Statement of Position No. 97-2**
- **Revision to 97-2 License - Recognize revenue when delivered and no obligations of developer**
- **Post-Contract Support(Maintenance) - Recognize revenue over period of service**
- **Details extremely complex**
- **Accountants “burned” in past. High level of scrutiny**

Pragmatic Protections

- Essential nature of software + lessor ability to prevent use = LEVERAGE
 - Better collection
 - Greater likelihood of continued payment in Bankruptcy

Summary

- **Software industry is a key industry of U.S.**
- **Software industry has above average growth**
- **Hardware does not offer much protection.**
- **Software leasing is secured lending and UCC 2B and new UCC9 will settle any questions.**
- **Negative leverage of lessor almost insures lease repayment**
- **Software leasing is an attractive market for leasing companies and brokers**



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