2018 Survey of Equipment Finance Activity

ELFA
EQUIPMENT LEASING AND FINANCE ASSOCIATION

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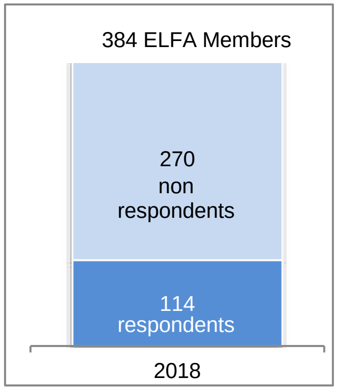
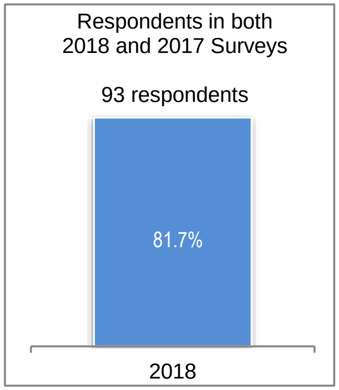
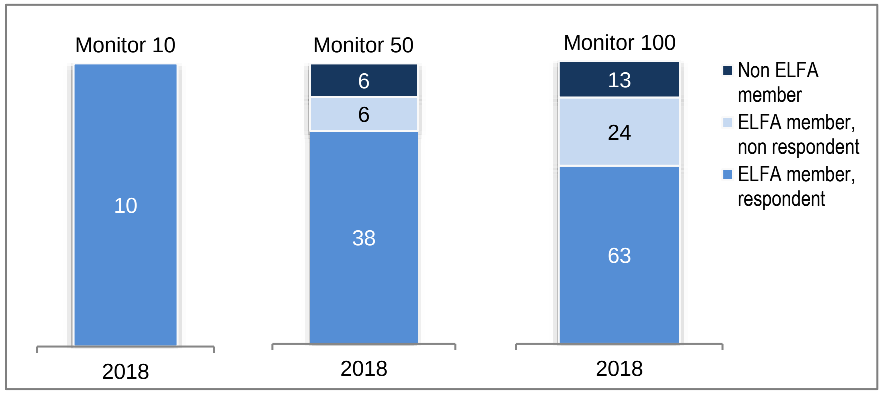
About The ELFA 2018 Survey of Equipment Finance Activity Report

Who Participates in This Survey?

ELFA Members participate in the Survey. Respondents to this survey represent the majority of the 2017 Monitor 100, with 81.9% of the assets reported there. Note that this report has a different scope than the Monitor. Here, we ask respondents to focus on their U.S. equipment leasing and finance business only.







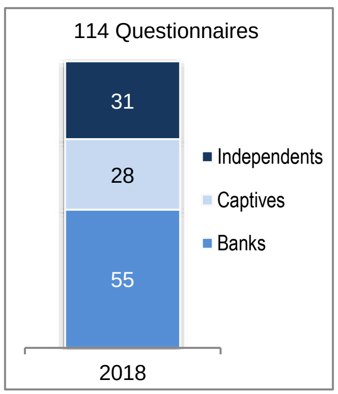
114 questionnaires were used to compile this Survey.

What Information Is Provided in This Survey?

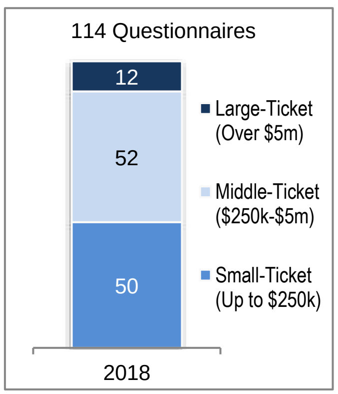
- Financial and Operational Information, covering New Business Volume (NBV), Financial Statements, Collections, Credit, Remarketing, Employee Levels.
- The data represents operations in the **United States** only.
- Respondents are asked to **exclude** dealer floorplan or wholesale financing, real estate leasing and financing, and non equipment finance operations.
- The data is **not audited**, but simply **compiled**. The data is **not extrapolated** to industry-wide projections.
- Respondents provide **two years of data** for almost all data points covered in the Survey.
- Respondents do not necessarily provide data for all 66 questions in the Survey. Note that each table shows the number of respondents included in that table.

How Are Respondents Categorized?

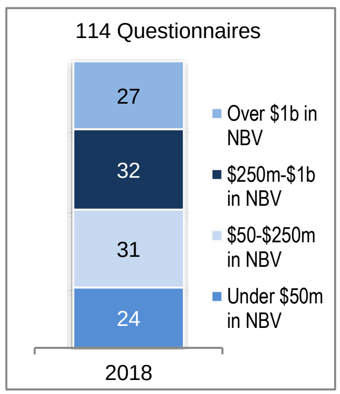
By **Type of Organization**



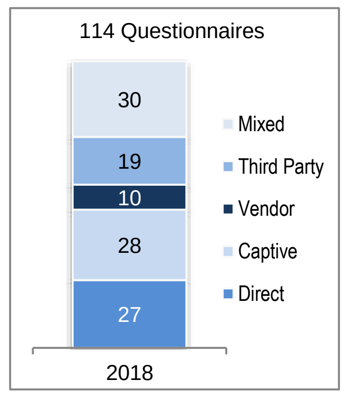
By **Market Segment**



By **Organization Size**



By **Origination Business Model**



For complete definitions of these categories, please see the Glossary in the Appendix to the report.

EXECUTIVE SUMMARY

The Equipment Leasing and Finance Association is pleased to present the 2018 Survey of Equipment Finance Activity. The Survey is the most important source of statistical information available on the $1-trillion equipment finance industry. This survey report covers key statistical, financial and operations information for 114 equipment leasing and finance companies.

If slow but steady growth of the U.S. economy and the equipment-finance industry seemed fortuitous in 2016, both upward trends gained traction in 2017 as a new President took office and business and consumer confidence translated into increased spending. Real GDP grew 2.3%, compared to 1.6% in 2016, and New Business Volume (NBV) for the equipment-finance companies who participated in this survey grew 6.9%, exactly three times the rate of national growth. Industry NBV growth for 2016 was 2.5%, in comparison.

Contributing to the industry's solid results were companies' continued application of technologies and their focused investment in sales and marketing, continuing a trend we noted for 2016 in last year's Survey. Assets under management grew 4% overall in 2017, with the largest increase stemming from growth in off-balance-sheet assets. Return on assets rose from 1.4% in 2016 to 1.7% in 2017, helped mainly by recent corporate tax changes, and return on average equity bounced back to more than 16% after dipping to 11.8% in 2016. Reserves for losses grew in dollar terms but remained steady at less than 1% of total assets, showing stability and strength. Additional findings pertaining to the full industry appear after the following breakdown.

Key Findings by Sector

Banks: NBV for this largest of industry sectors grew at a respectable 5.3% in 2017 to just over $83 billion. Yet the sector's growth was the smallest of the three sectors, likely due to continuing consolidation and larger banks' tightening the reins of growth in their equipment finance businesses. Not surprisingly, though, Banks experienced the lowest delinquency rates in the industry, holding steady with 2016 at 98.9% of portfolio current or under 31 days delinquent. Net full-year losses were similarly miniscule at 0.18% of average receivables—down 10 basis points from 2016. Overall net full-year losses, by comparison, were 0.26%.

But delinquencies by several end-user industries were pronounced, with Railroad Transportation past-dues of over 90 days at more than 4%. Mining/Oil and Gas Extraction, Utilities and Agriculture, Forestry and Fishing also experienced delinquencies above 1% for 2017.

Banks' approved credit applications as a percentage of applications submitted fell 2.5%, but at 68.7% approval, Banks may have lost customers to Independents, Captives and other finance entities with fewer credit restrictions. As in 2016, Banks trailed other sectors in booked and funded credit applications as a percentage of approved applications. Employment levels at Banks increased just 2.4%, compared to 3.4% overall.

Captives: With 9.9% growth in NBV totaling $40 billion, Captives were among the winners of industry sectors in 2017, though slightly edged out by Independents. Their progress is particularly impressive, given three previous, consecutive years of difficulty and the 5.9% decline in NBV experienced by the sector in 2016.

EXECUTIVE SUMMARY *... continued ...*

Captive companies set the stage for their comeback by making significant changes in product offerings and marketing strategies. Executives spoke last year of offering more total solutions for customers and finding ways to differentiate the captive finance product through those solutions. They also talked about steps being taken to remove obstacles to becoming customers' provider of choice for managed solutions. Captives' monitoring of operating efficiencies and reduction of costs while expanding product range contributed to 2017 growth as well.

IT Equipment, including Software, Mainframes and Servers, composed much of the new business as customers added to their technology stacks with digital platforms, artificial intelligence capabilities and new tools designed to prevent cyber-crime. Nonetheless, Construction and Agricultural equipment continued as the lead generators of new business volume, although the percentage of total annual NBV for both equipment types shrank slightly from that of 2016.

Interestingly, Captives also experienced the highest rate of delinquency, with 94.6% of portfolio current or under 30 days delinquent, compared to an overall survey average of 98% of portfolio in current status. Delinquencies also inched up for the segment year over year and were pronounced in the Railroad industry, where total delinquencies reached 19.1%. Rail freight volumes had ticked up in late 2016 and demand for railcars had improved, generating optimism. But the trend was short-lived. Said one industry observer, "There are just too many cars available in too many fleet segments."

An examination of net full-year losses saw Captives almost unchanged, with just 0.42% of total portfolios charged off in 2017, compared with 0.43% the previous year. But the segment experienced a healthy increase in the percentage of credit applications approved, at 77.6% in 2017 compared to 70.6% in 2016. The increase was likely a driving factor in the segment's strong growth, since more approved deals led to a rise in volume.

Captives also led the industry in the percentage of booked and funded applications at nearly 70%, compared to the overall industry percentage of approved applications at 63.5%. Captives grew their employment levels moderately, at 3%, just under the overall industry rate of 3.4% growth.

Independents: Edging out Captives for the top growth rate, Independents grew their NBV by 10% to $6 billion in 2017. Nearly 65% of companies experienced growth, likely helped by the sector's 31% increase in sales/origination headcount. Direct originations accounted for 48% of total NBV, vendor programs produced 26%, and captive programs brought in 6%. Services-Other, which include data-processing services, administrative support services and repair services, led end-user industries in Independents' NBV at 15%. Following were Air Transportation, Health Services, Wholesale/Retail and Truck transportation. Office Equipment, along with Trucks and Trailers, led NBV by equipment type.

Independents also ranked second in delinquencies, with an almost imperceptible increase in the percentage of accounts current or under 30 days delinquent, to 98.5% in 2017, compared to 98.6% in 2016. Yet the sector jumped well ahead of Captives and Banks in net full-year losses as a percentage of average receivables. Independents reported 0.63% for the category, compared to 0.26% for the industry overall. But any level below 1% is considered very low.

Credit approvals as a percentage of applications submitted fell noticeably for Independents, to 60.4% in 2017 from nearly 69% in 2016. Yet, booked and funded credit applications as a percentage of approved applications rose more than 6% for Independents, easily leading Captives and Banks.

EXECUTIVE SUMMARY *... continued ...*

Interestingly, Captives and Independents employed opposite strategies, but both produced good results. Captives relaxed credit criteria, approved more applications, and dramatically increased their NBV. Independents restricted credit approvals, but clearly targeted the best fits as more applications were converted into sales.

Overall Trends

As in 2016, Middle-Ticket volume led segment growth, this time with a nearly 10% increase. Growth leaders by equipment type in Middle-Ticket were Construction, Trucks and Trailers and IT. Small-Ticket NBV grew just over 4%, with Agricultural, Office Equipment and Construction dominating equipment types. Large-Ticket NBV trailed with 2.8% growth, but the growth was particularly welcome given the segment's nearly 2% decline in NBV in 2016. Large-ticket leaders by equipment type were Trucks and Trailers, Railroad and Fresh and Saltwater Transportation.

Almost 60% of Survey respondents reported growth in NBV. But this percentage shrank slightly for the fourth consecutive year, possibly reflecting continued consolidation in the bank sector and new competition from banks and other finance companies entering or increasing their presence in the industry.

End-user industries with the most growth in NBV included Wholesale/Retail, up 24% year-over-year to end at nearly 12% of total annual volume in 2017. Retail-industry analysts noted that even department stores experienced positive results for the 2017 holiday season. Other Services, which include data processing, administrative support and repair services, also grew overall from 9% of NBV in 2016 to 9.5% in 2017, and Construction surpassed its 8.1% of 2016 NBV to reach 8.3% in 2017. News reports of record spending in construction were plentiful last year.

At the other end of the spectrum, end-user industries with the greatest declines in 2017 NBV were Water Transportation, Telecommunications and Health Services. Telecommunications garnered the most headlines last year with stories and studies detailing antiquated processes, industry disruption, ailing revenues and falling profits. In Water Transportation, stagnant freight volumes and natural disasters, along with sluggish oil prices were issues that reduced demand. In Health Services, hospitals were challenged by the ongoing struggle over healthcare reform and choices between value-based care and fee-for-service, making future revenues uncertain.

Equipment types experiencing the largest overall declines in NBV for 2017 were Railroad Transportation, Agriculture and Telecommunications.

Despite healthy growth in all industry sectors and segments in 2017, expenses continued to rise and spreads tightened further. Pre-tax yields increased by 48 basis points over their 2016 rate but didn't keep pace with the cost of funds, which increased 52 basis points overall in a reflection of interest-rate increases by the Federal Reserve. A 4-basis-point decrease occurred in pre-tax spreads, marking the fifth straight year of narrowing. Sales and marketing expenses also rose 9.4% in 2017 after a 21.6% increase in 2016. Yet Captives held these expenses in check with no appreciable change from 2016. Even so, rising sales costs, combined with shrinking margins, will eventually erode the overall industry's future profitability if unchecked—and if not countered by continued strides in efficiency and customer service.

EXECUTIVE SUMMARY *... continued ...*

Participants

A total of 114 questionnaires were submitted by ELFA member companies for the 2018 Survey. Participants represent the majority of firms listed in the 2017 Monitor 100 and just under 82% of the assets reported there. For the purposes of the SEFA, however, respondents were asked to focus exclusively on their U.S. equipment leasing and finance business. Ninety-four of the 114 respondents, or 81.7% also participated in last year's survey.

Of this year's participants, 48% categorize themselves as Banks, while 27% define themselves as Independents and 25% classify themselves as Captives. By market segment, 44% specialize in small-ticket transactions (up to $250,000), while 46% focus on middle-ticket transactions ($250,000 to $5 million). Just 10% work principally in the large-ticket segment (over $5 million).

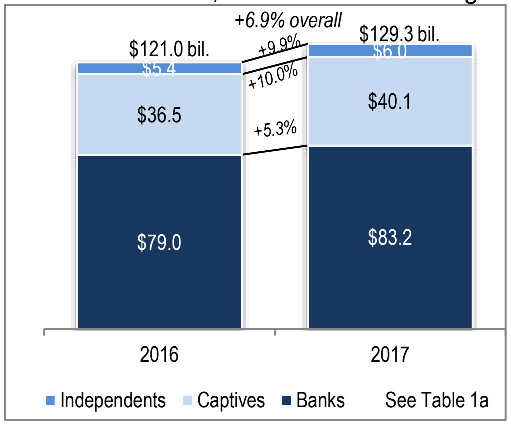
In terms of new business volume, 27 participating companies reported doing over $1 billion in 2017, while 32 participants reported NBV of $250 million to $1 billion. Another 31 respondents reported doing $50 million to $250 million, while 24 participants reported under $50 million in NBV. Classifying participants by origination business model, 27 companies reported doing business directly, while 28 said they use a captive model. Another 30 companies reported using mixed origination models, while 10 said they use the vendor model and 19 said they acquire new business volume primarily through third parties. For complete definitions of all categories, please see the Glossary in the Appendix of this report.

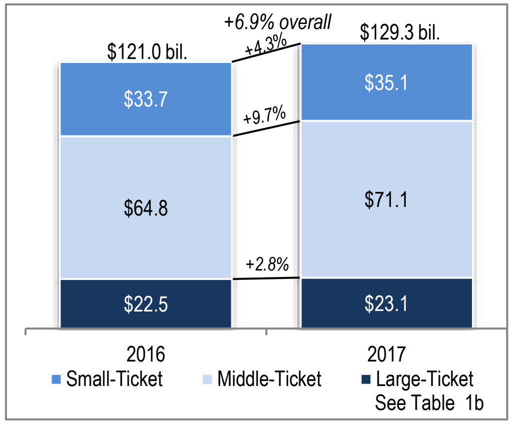
About the Survey

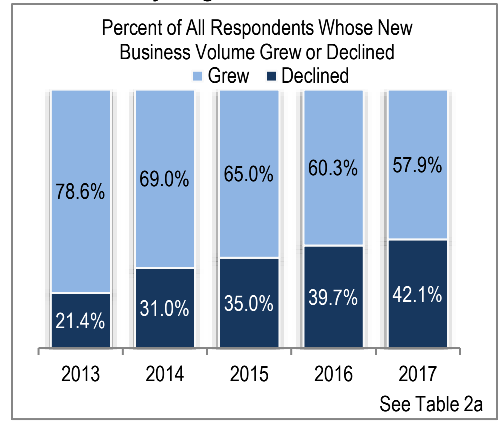
Participation in the Survey of Equipment Finance Activity is a benefit of membership in ELFA. Member-respondents receive a complimentary copy of the survey report, as well as confidential individual company data sheets, which show the individual company's statistics ranked against a peer group.
For more information about the report, please visit www.elfaonline.org/SEFA.

MAJOR FINDINGS

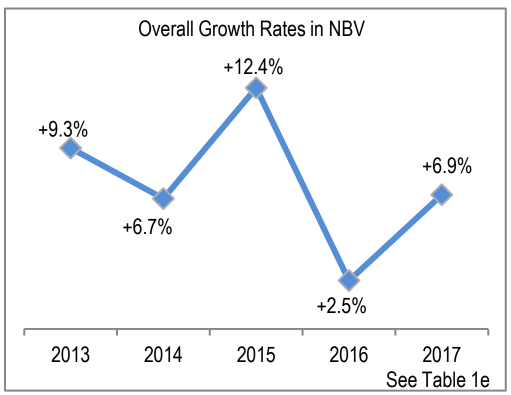
New Business Volume (NBV) **grew by 6.9%** in 2017. Captives grew the most by percentage, at 10.0%, followed by Independents at 9.9%. Growth by the Banks was at 5.3%, closer to the overall growth rate for the Survey. The Middle-Ticket segment led the industry in growth at 9.7% increase in NBV.







Most respondents' volume grew, with just under 58% of respondents experiencing growth in 2017.



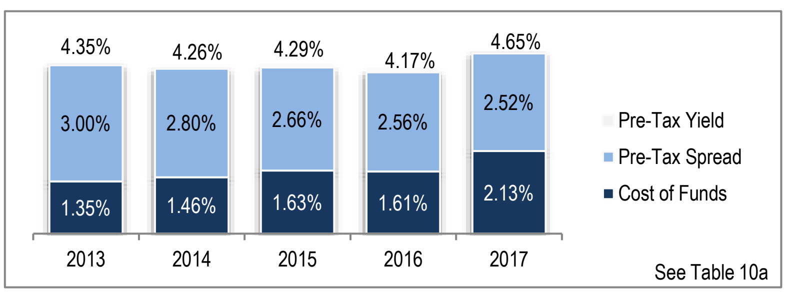
End-User Industries with Most Growth in NBV:
- Wholesale / Retail
- Other Services
- Construction

End-User Industries with Greatest Decline in NBV:
- Water Transportation
- Telecommunications
- Health Services

Equipment Types with Most Growth in NBV:
- Other IT and Related Technology Services
- Mainframes & Servers
- Software

Equipment Types with Greatest Decline in NBV:
- Railroad Transportation
- Agriculture
- Telecommunications

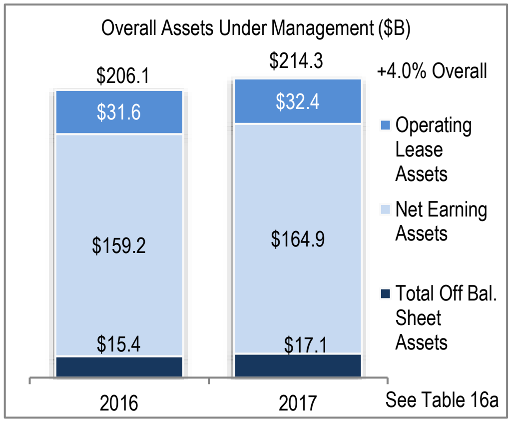
Note that these lists reflect growth and decline rates of respondents who provided two years of data.

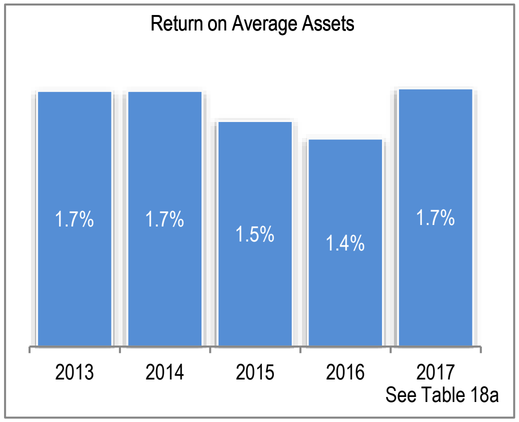


Overall, **Pre-Tax Yields increased** by **48 basis points** in 2017 compared to the previous year. This is driven by a sharp increase in **Cost of Funds.** Despite the **increase in yields,** there was a **4 basis point decrease** in **Pre-Tax Spreads**.

MAJOR FINDINGS *… continued …*

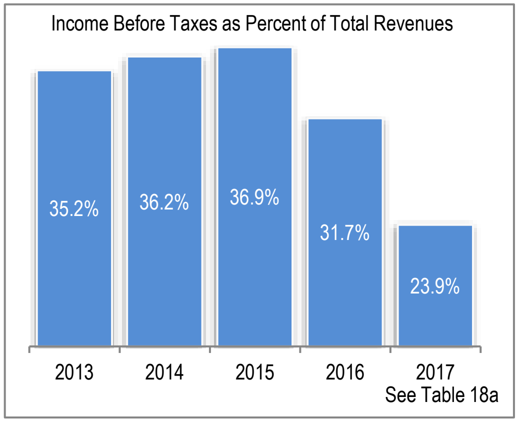
Assets Under Management grew between 2016 and 2017. **Return on Assets** increased in 2017 to 1.7% from 1.4% in 2016, reaching levels last seen in 2013 and 2014, aided primarily by the recent corporate tax changes. Balance Sheet strength increased modestly. Total assets under management grew by 4%, with off-balance-sheet assets driving that increase. Reserves for losses grew in dollar terms, but remained steady at 0.8% of total assets, an indicator of stability and strength.

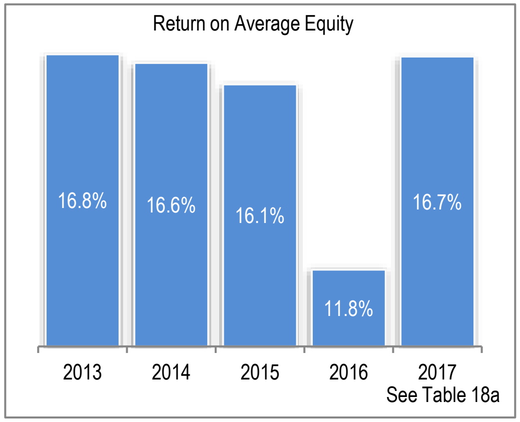




Return on Average Equity increased year-over-year, returning to levels seen between 2013 and 2015, driven at least partly by the recent corporate tax changes. Net lease and loan revenues inched up by 1.3%, but pre-tax expenses grew by 3%. Despite this, net income rose sharply in 2017, by over 50% due to the change in corporate tax policy. Changes to net income came from changes in the provisions for income taxes, not from pre-tax revenues and expenses.

It is noteworthy that sales expenses grew more rapidly than SG&A expenses overall. Coupled with the tightening of margins, rising sales costs will chip away at future profitability if the trend continues.

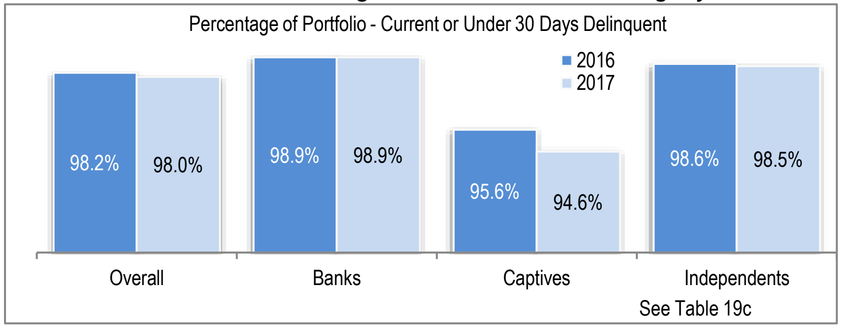


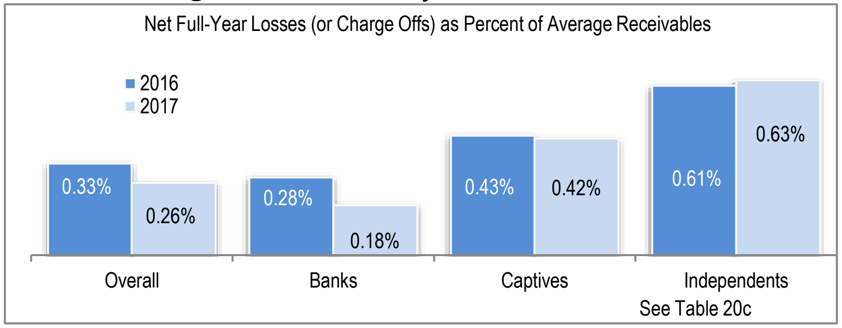


MAJOR FINDINGS *… continued …*

Overall, **Delinquencies increased slightly in** 2017 compared to 2016, with 2.0% of receivables over 31 days past due compared to 1.8% the previous year. While delinquencies are still very low, they have been on the rise since 2013 when only 1.2% of receivables was over 31 day past due.

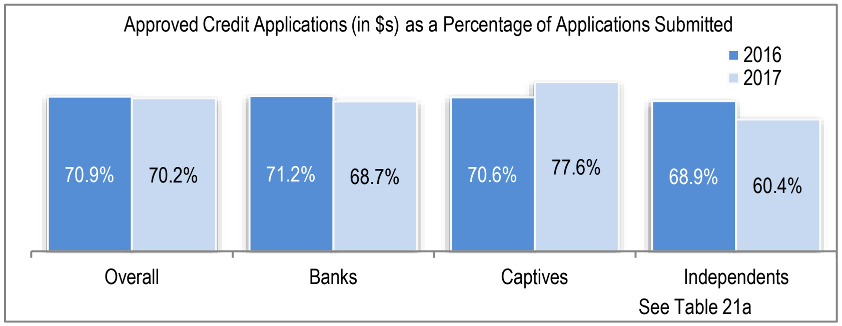
Net Full-Year Losses or Charge-Offs also increased slightly but remain at **0.33% of average receivables**; any level lower than 1% is considered very low.

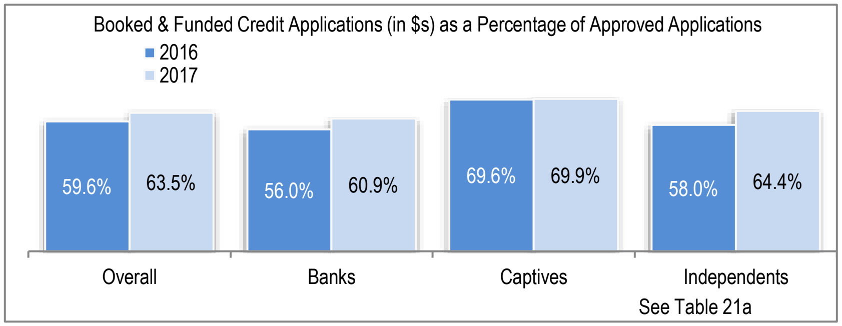




Delinquencies do remain an issue for certain industries, especially Mining / Oil & Gas Extraction; Railroad Transportation; and Agriculture, Forestry & Fishing.

Credit Approvals decreased slightly while the percentage of those approved applications being booked and funded increased.





Employment Levels grew moderately by 3.4%, with Independents growing the strongest at 10.4%, though from a lower base.