



# The Alta Group<sup>SM</sup>

## Decision Points...Brief

### Global Experience Provides Direction for Equipment Leasing and Asset Finance

*Through collective knowledge and experience, The Alta Group provides value for its clients in the global equipment leasing and finance industry in outcomes that increase revenue, control expenditures and improve productivity and profitability.*

January 2009



## Leasing in '09 and Beyond - What's Next?

**A roundtable discussion with The Alta Group provides current insights on a number of critical issues - bailouts, stimulation, opportunities and challenges.**

With the liquidity crunch and struggling economy playing havoc with many lessors over the past several months, what will 2009 - 2010 bring? Will market conditions improve, or will a prolonged recession grip the country? What impact will Obama's plans and stimulus packages have this year and beyond? Will the industry show resiliency during these troubling times, as it has in the past?

Alta Group principals and long-time industry veterans John Deane, Michael Fleming and Paul Bent convened recently to address these questions and others. They agreed there will be a number of structural changes that unfold within the equipment finance and leasing industry. Natural economic cycles also will come into play. In addition, some anticipated policy changes could alter the general economic landscape. The bottom line is that while the U.S. President and Congress will affect the industry's future, market forces will play an even greater role.

**What impact will anticipated regulatory and legislative actions in Washington have on the**



Malcolm Ogle

**Malcolm Ogle Succeeds Derek Soper in Alta EMEA Region**

Earlier this month, The Alta Group announced Malcolm Ogle is succeeding Derek Soper as chairman of the firm's EMEA Region (Europe, Middle East and Africa). Ogle, a veteran of the leasing and asset finance industry for more than 30 years, has been an Alta Group principal and director since 2001. He is a former joint managing director of Lombard Corporate Finance and held other senior management positions with leading asset finance companies, including Rolls-Royce & Partners

*"Lessors will maintain their creativity in regard to flexible / optional terms and conditions, customer service, channel efficiency and additional features. In summary, there will be more emphasis on customers than on products."*

Michael Fleming

## equipment finance and leasing industry?

### *Fleming:*

Let's make a few assumptions first. We are in a serious recession driven largely by a capital markets crisis. By itself, this affects demand and portfolio performance. We must also assume that a stimulus package approaching \$1 trillion will have serious consequences for equipment finance companies and their customers. Finally, given everything that has materialized over the past several months, there's going to be more regulation (primarily on banks) and tougher oversight resulting in capital requirements, tougher reporting requirements and enforcement actions not seen before. Equipment leasing and finance companies, however, will be less affected by the regulatory changes than commercial banks, with the exception of new accounting standards. Capitalization is coming. There will be several tax provisions designed to incent investment in targeted ways.

### *Bent:*

The equipment leasing industry has never been regulated as heavily as the banking business. I expect this to continue to be the case, resulting in a potential competitive advantage for lessors - giving them an opportunity to differentiate themselves from other capital sources, especially if certain tax incentives come into play. For instance, there's recently been talk of a renewed business investment tax credit and more highly accelerated depreciation deductions, both of which benefit lessors. We can compete strongly with banks by making capital available, leveraging income tax benefits and providing an attractive cost of funds.

### *Fleming:*

Most, but not all, of the tax changes will be an opportunity for the overall equipment leasing and finance industry. But, depending on individual circumstances, they may not be good for some companies. First, tax incentives cannot be equally useful in all lease products. Second, a lessor has to have taxable income to use incentives. So, who will have both a capital and tax appetite? There is a shrinking list.

However, the lessors with capital and tax appetite can use the new realities to solidify their position of enhancing capital allocation efficiency through the use of tax incentives, competitive cost of capital pricing, sober credit underwriting, asset

and PSA Finance PLC. Soper remains with The Alta Group as an associate, specifically focusing on M&A, captive finance and senior management advisory activities.

### **Alta M&A Advisory Division is Busy**

Kropschot Financial Services, a unit of The Alta Group, recently worked with SWC Credit Leasing LP of San Antonio, Texas, to complete the sales of its equipment lease portfolio to Kapok Investment Group, LLC. Kropschot Financial Services initiated the transaction and served as the exclusive financial advisor to SWC Credit Leasing. In related news, Bruce Kropschot, managing principal of Alta's M&A advisory division, said there remains plenty of interest in acquisitions throughout the industry, despite the current difficulties in the financial markets. The firm also initiated the sale of 50 percent ownership interest in a small-ticket equipment leasing company to a private investor, as well as secured new financing relationships for three clients.

management, cash management and meeting lessee / borrower hard asset needs. All of this benefits lessees and the economy, as well as finance companies.

*Bent:*

In terms of liquidity, risk management concerns in banking and other competing areas of commercial finance will help innovative lessors who have access to liquidity. They will emerge from under the radar and help businesses tap into lesser-known funding resources, including the huge amount of equity capital in the current market. Those resources with strong equity funding will want to put that money to work, which provides opportunities for creativity that the modern leasing industry has used to distinguish itself since its beginning in the 1950s. This will also help fuel the trend away from thinking of leasing as simply another part of the bank's product mix and, instead, help companies think of leasing (once again) as a separate source of capital in the market.

*Deane:*

From a macro-economic perspective, if there is no funding for equipment, the economy is dead in the water. We need to emphasize that leasing is a core part of America's economy, since we provide substantial liquidity to businesses - to the tune of \$300 billion annually, which is quite impressive. This fact needs to be front and center among the policy makers as they make important decisions moving forward.

**Have we seen the end of the complex financial structures and products that have proliferated the market for such a long time?**

*Deane:*

Capital creation structures like securitizations and highly leveraged equity and hedge fund models are gone for the foreseeable future. In fact, we're now looking at a "back to the future" set of circumstances in arranging capital for leasing companies . . .

The funding mechanisms for companies will become much more transparent. This is a good thing for a couple of reasons: First, it's easy to structure funding for a company when people are comfortable with that structure; second, there's no need for highly leveraged structures because pricing in the market is better.

*Bent:*

Yield calculating methodologies and results in the market today are much more rational than in the past. With greater competition from banks and other more "traditional" sources of funding, lessors are motivated to find opportunities and calculate yields in more traditional ways, without being overly clever in seeking every basis point of return. Even if there are new income tax incentives, this approach will continue. The new generation of industry leaders was not in leadership positions during the craziness of the 1990s and I think that is good for the industry. There will continue to be more rationality and more focus on proven financial principles, customer service and the basics that have always sustained the industry.

*Fleming:*

Not the end of these products, but less complexity and opaqueness. There will be less creativity on the structural side of transactions, due primarily to anticipated accounting and tax policy changes. Lessors, however, will maintain their creativity in regard to flexible / optional terms and conditions, customer service, channel efficiency and additional features. In summary, there will be more emphasis on customers than on products.

**What impact will the expected Obama stimulus package have on the economy and equipment finance industry, in particular?**

*Fleming:*

Historically, the Democrats have used the tax code to spur economic growth. That's going to happen again. I expect increased depreciation and targeted tax credits, which will be favorable to many leasing companies. There will probably be some rate reductions, but that is not advantageous to equipment leasing.

*Bent:*

If the stimulus package focuses solely on federal handouts to create jobs, then it will be a loser and the economy will continue to struggle. You can always create jobs by handing people federal money just to keep busy, but that's simply an indirect tax. Others in the economy have to pay for those jobs if they aren't producing real value in the marketplace. On the other hand, if the stimulus involves an overall tax rate reduction or targeted income tax benefits, the economy will improve sooner. They will allow companies and individuals to retain a larger share of their profits or earnings for reinvestment in their organizations or for

spending on other goods and services.

*Deane:*

I don't think lower interest rates will have much impact on stimulating the economy if nobody is lending to start with. This has to be addressed. I do think government legislation - whether it is good, bad or indifferent economic policy - will absolutely have an impact on our industry. Leasing could make a big difference over the next several years. We are seeing the beginnings of this already, with construction equipment. Probably with alternative energy companies and healthcare, too, with some sort of tax incentives.

*Fleming:*

The stimulus package will focus on policy decisions being made to address cyclical challenges and real structure needs, particularly in energy and transportation. Unemployment and low demand are cyclical issues. It may make sense to launch a variety of infrastructure programs using stimulus resources. This could create a lot of jobs and fuel our industry. The key is to make sure these projects have real, economic long-term value. Structurally, the regulatory environment will change. In addition, actions designed to intervene with select industries, such as the auto industry, will come with real structural change demands.

The price of a huge Fed and Treasury rescue effort is tighter control and standards. Structurally there is going to be less available capital and it will be from fewer sources because of bank consolidation and much tighter regulation of banks. Capital markets have been dramatically deleveraged and new capital will have to eventually be created by economic growth.

More and more equipment leasing companies are going to play a broker-like role because they will neither have the capital to hold portfolio nor securitization available to them. There is going to be the loss of a significant number of companies and it will change the structure of the industry. However, strong non bank companies can play a great role in providing capital from institutions such as banks, and providing it to end users through the special knowledge and capabilities that they possess. Their specialized underwriting and portfolio management capabilities will make them play a successful role.

**There is increasingly more talk about the**

**impact of deflation on the overall economy.  
How will this affect lessors?**

*Deane:*

This is a real concern for many at this point. There are some interesting theories floating around regarding how the government may have to institute changes for all of the economic yard markers to compensate for deflation. In our industry, collateral values used to extend credit would be affected, as well as the ability to structure residual values into transactions. It could also impact the availability of capital.

*Bent:*

The concept of loaning money is based on the idea of achieving a modest rate of growth of capital. If this goes away for an extended period of time, it will change the whole equation. In some ways, deflation is better for borrowers because they don't have to pay the cost for the growth in capital to a lender. Conversely, there's little incentive to be a lender or a leasing company if there is no marginal increase in the value of the resources being put to work.

**Will the challenging economic environment here and abroad have a negative effect on the ongoing globalization activities of lessors?**

*Deane:*

You can't put the genie back in the bottle. There will certainly be an impact, since a number of emerging economies are showing signs of slowing down and becoming more volatile. There is no doubt, however, these countries will continue to provide major opportunities for the equipment finance industry.

*Fleming:*

Yes, globalization will be affected for at least the next few years. Many companies will have all they can handle in North America. Furthermore, market conditions in foreign markets will not be as attractive. However, this will be a good time for certain companies to build their infrastructure for going abroad when the time is right. Eventually, manufacturers are going to have to continue looking abroad for growth. Since lessors' customers are going overseas, they have to go with them.

*Deane:*

Foreign manufacturers are developing operations

here, too, but some are struggling because they can't get the necessary financing. So, they are looking to establish vendor finance programs with lessors here to finance their products. This may produce incremental opportunities, or simply be a redistribution of opportunity.

Editor's Note: Decision Points Brief is a free, quarterly newsletter published by The Alta Group. The Alta Group is a consultancy in the global equipment leasing and finance industry.

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