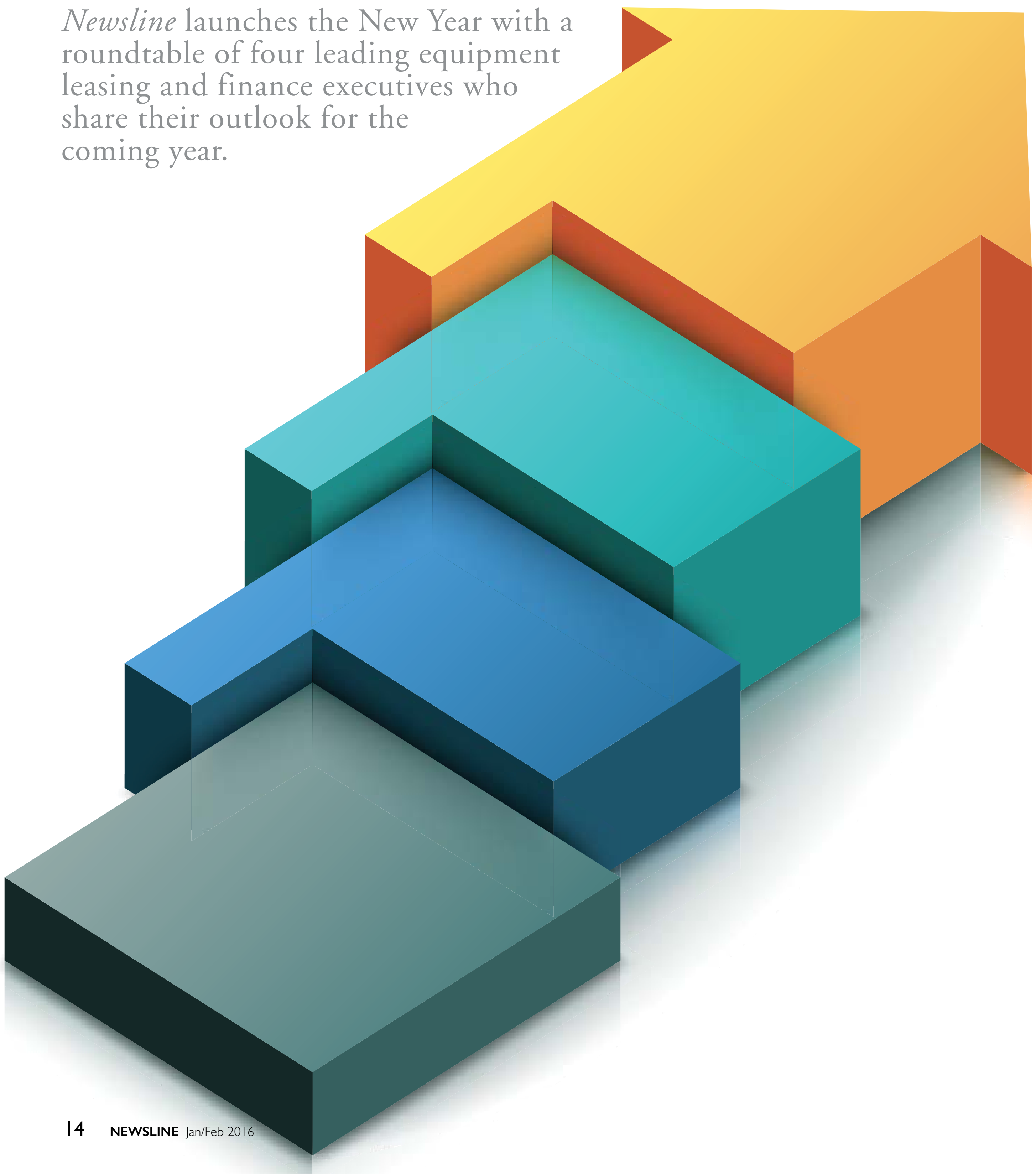
2016 INDUSTRY OUTLOOK

Newsline launches the New Year with a roundtable of four leading equipment leasing and finance executives who share their outlook for the coming year.



Newsline: Please share your overall expectations for the equipment leasing and finance industry for 2016. What are you expecting in terms of new business activity? Will 2016 look much like 2015 or will conditions improve or worsen to a noticeable degree?

Peter Bullen: I expect customer demand for equipment financing to show modest growth in 2016 and be reflective of GDP. I believe the market is at a crossroads. Sharply lower energy prices have increased consumer disposable income, which will help propel the economy; however capital expenditures have come to a complete halt for businesses directly tied to the oil patch. The trickle down impact is significant, as I am seeing a slowing of general manufacturing activity here in the Great Lakes region where I live due to ties to the energy sector, but this is also reflective of weak global demand. That being said, a number of industries such as airlines, automotive, chemicals, trucking, and others greatly benefit from low energy prices and will expand accordingly.

Tony Golobic: One of characteristics of the Great Recession recovery has been some uncertainty in its durability felt by many business leaders. This in turn has resulted in constrained equipment investment and therefore tepid new business activity in our industry. I expect this to continue in 2016.

Daryn Lecy: It is our anticipation that equipment demand in 2016 will be similar to 2015 under current conditions. Competition in the marketplace will remain fierce at what will still be highly competitive pricing, but should hopefully slow down the booming entry into the marketplace by many new comers with access to cheap money while wielding aggressive credit appetites. After months of uncertainty surrounding what has become a landmark decision by the Federal Reserve, a rate bump may actually stabilize the markets. Stabilized markets will increase demand for new equipment purchases.

Gary Silverhardt: While the equipment finance industry experienced significant growth in 2013 and 2014, business began to level off in 2015. Overall, I'm optimistic about the coming year, but I'll temper my optimism with a touch of caution. Absent any major market disruptions, I expect demand in 2016 will continue to level off somewhat but remain healthy throughout the year. Potential disruptions are always out there, of course – a large increase in fuel prices, interest rates rising more than 75 basis points, a spike in unemployment or even an escalation in terrorist activities – and any of these could dampen demand. Interest rates are particularly important. While North Mill and other independent equipment finance companies have enjoyed a low cost of funds in recent years and have passed some of the savings on to customers, an increase in interest rates by the Fed could have a negative impact on demand. As always, competition for customers with strong credit will remain brisk. So, to find additional growth opportunities and volume, I see the equipment finance industry developing new products to serve those customers whose credit scores are below the top tiers.

Newsline: What would you say matters most these days to your customers, brokers and vendor partners?

Bullen: Pricing certainly is important, but relationships are what matter the most. Companies are increasingly looking to partner with finance providers who know their business, understand their industry and who can bring unique ideas on how to finance their capital expenditures. Savvy customers understand that there is a plethora of capital chasing deals, but will typically choose to work with equipment finance providers who can provide value outside of competitive rates.

Golobic: At GreatAmerica we have never focused on price. Those who offer lowest prices usually don't have much else to offer. You can never build lasting market leadership based on lowest prices; there is always going to be someone else who'll be willing to undercut you. Our mission at GreatAmerica is to help our customers be more successful and that is much more important than the lowest rates. This has been our strategy for the past 23 years of uninterrupted growth, with each year more successful than the previous.

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Stearns Bank

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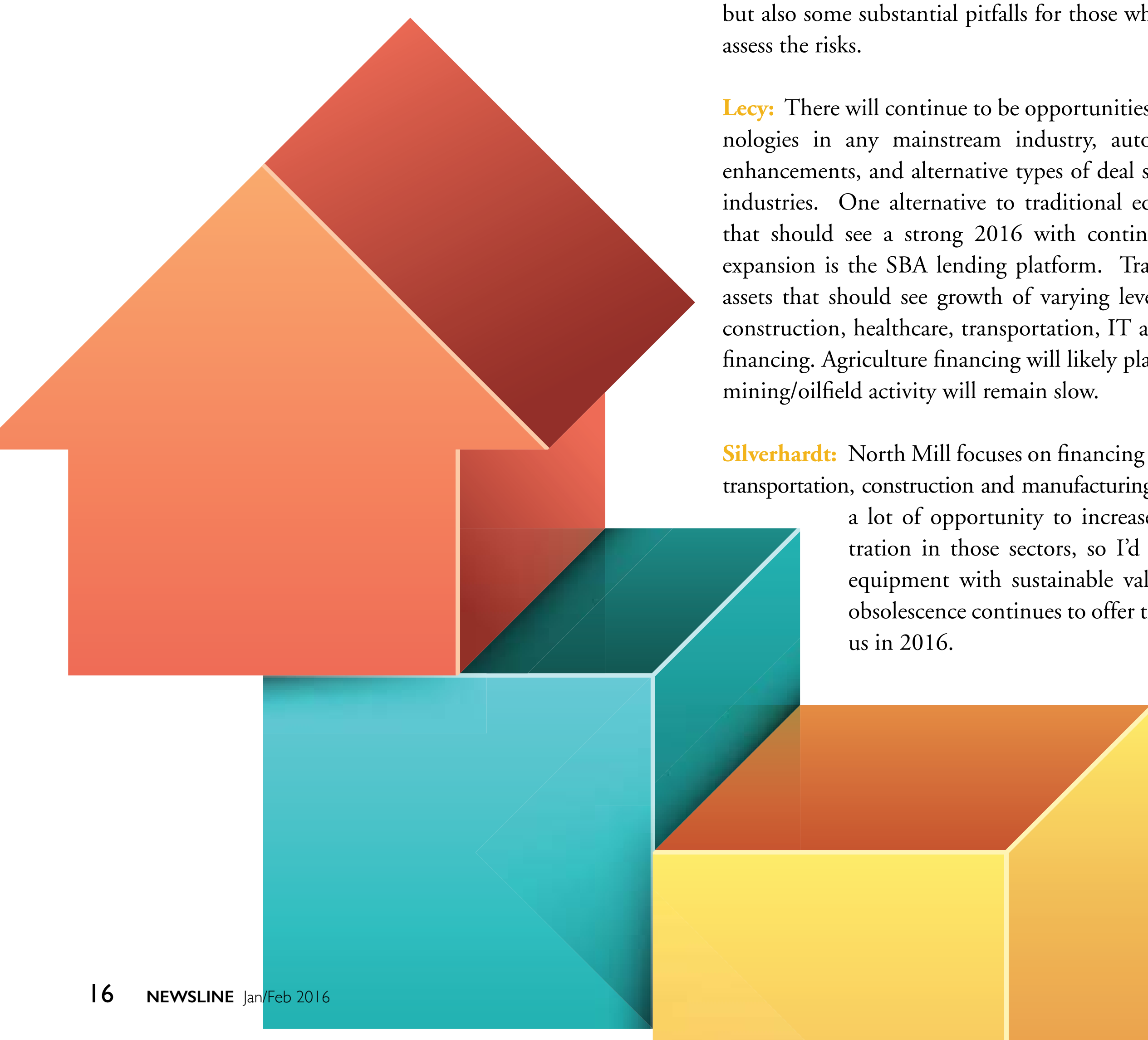
North Mill Equipment Finance

Lecy: Pricing is still the primary concern with most, but that has given way some to the ability to consistently execute transactions for them. Fast turnaround and diligent follow up are next in line and those are important for all channels: direct, vendor and third party. We want nothing more than to exceed our direct customer's expectations or to help one of our partners impress their customer by getting the job done for them. We look at relationships with vendors and third-parties as a true partnership and the term partner carries heavy weight for us. We communicate with our partners frequently to understand how we can do better and how we can earn more of their business. We try to be creative to find solutions in the best interest of both parties. We also expect if and when the time arises that our partner is there to help us out.

Silverhardt: What matters most to everyone – in addition to competitive rates, which are always important – is service. That's why it's job number one at North Mill to listen to what our customers (and for us, that's mostly third-party referral agents) have to say. Their feedback tells us what's happening in the market and what kinds of products and services are in demand. Also, having the appropriate technology to provide quick turnaround on credit applications is critical. Responding in a timely manner helps keep the customer from moving on to another source. As for long-standing business relationships, maintaining strong relationships with referral agents is a critical success factor in our business, but you can't achieve that without providing competitive service and realistic rates.



Newsline: Which equipment sectors do you anticipate to lead the way in terms of financing opportunities for the equipment finance industry?

Bullen: Industries benefiting from low energy prices or increased consumer disposal income (e.g. transportation, retail, restaurants, and chemicals) certainly will be actively replacing equipment and/or expanding their business. Green industries such as solar should get a boost in 2016 as companies try to take advantage of expiring tax credits. Finally, firms tied to oil and gas exploration will be trying to manage their cash and will be unlikely candidates for significant equipment acquisition.

Golobic: I think our industry will find itself at a major inflection point over the coming decade. Not only will a lot of what we finance change, but also how we finance it. Technology will have a huge impact in the way we deliver our products, and in some markets value-add services will become a major focus. All this will present some wonderful opportunities for those who will adapt, but also some substantial pitfalls for those who will not properly assess the risks.

Lecy: There will continue to be opportunities in alternative technologies in any mainstream industry, automation/technology enhancements, and alternative types of deal structure to existing industries. One alternative to traditional equipment financing that should see a strong 2016 with continued small business expansion is the SBA lending platform. Traditional industries/assets that should see growth of varying levels in 2016 include construction, healthcare, transportation, IT assets and municipal financing. Agriculture financing will likely plateau or weaken and mining/oilfield activity will remain slow.

Silverhardt: North Mill focuses on financing hard assets – mostly transportation, construction and manufacturing equipment. There's a lot of opportunity to increase our market penetration in those sectors, so I'd say that traditional equipment with sustainable value and low risk of obsolescence continues to offer the most promise for us in 2016.

I see three benefits to serving the market we know best. First, we've spent years developing and maintaining a robust infrastructure to service our core market sectors. Second, we don't have to pay the cost – in research, time and personnel – to acquire the knowledge needed to reach a new market; I'd rather spend those resources on enhancing our existing capability. And finally, we don't risk diluting our focus on serving those who already have given us a record of success.

Of course, the allure of exploring new business sectors is worth the inherent risk if the potential rewards are significant. For us, however, that would likely mean an area related to what we already know well. As an example, we finance a lot of trucks; with manufacturers beginning to explore hybrid and all-electric engines, especially for medium-duty trucks, I could see us considering that segment of the market on a limited basis.

Newsline: What's the number one concern you think the equipment finance industry as a whole will encounter in 2016? How is your institution poised to deal with these challenges as well as any opportunities that you expect the New Year to present?

Bullen: There continues to be a supply/demand imbalance in that there is an abundant supply of capital chasing a static amount of equipment finance opportunities. Numerous banks and non-banks have entered the industry during the last 18 months, but the supply of opportunities has not kept pace. As a result, yields continue to drop and I am beginning to see some institutions lower their credit standards in an effort to book earning assets. At Key Equipment Finance, we are well positioned to find continued success in 2016 due to the diversity of our business and the strength of our relationships. We expect to see continued growth in our vendor and lender finance businesses, while our direct originations channel will be expanding with the anticipated addition of First Niagara to our platform. 2016 will be exciting!

Golobic: One of the strong attributes of our industry is that it is very competitive. This is at the same time both positive and negative. On the positive side, intense competition makes us more innovative and efficient. On the negative side, pursuit of volume at any cost encourages much of our industry to behave irrationally. I think the last couple of years have seen a good example of this. It seems like the Great Recession has been forgotten; again we're seeing aggressively lower credit standards and very thin spreads by some of our competitors. I think this will not bode well for our industry.

At GreatAmerica, we continue to build foundations for lasting success by charging fair pricing, employing prudent credit policies, being innovative and at the same time working hard to build our vision of reaching levels of excellence in everything we do, so high that we will indisputably stand apart from our competition.

Lecy: There will be continued competitive pressure on all surrounding pricing. There will be pressure from companies that chose to lag behind in rate increases and by the new players that will likely still enter the market. Rates have been the forefront of discussions between customers and partners more than ever before in our industry and it will be tough to sway from that in 2016 even as rates likely will increase some. Service and execution will remain the ways we compete against rate and as rates come up those tactics will become even more influential. We are cautiously optimistic that there can be a far-reaching change from "it's all about rate" to "it is not always about rate."

Silverhardt: There are new proposed accounting standards for equipment leases in 2016, and their implementation could pose both regulatory and accounting issues for the industry as a whole. Fortunately, the new regulations are unlikely to affect most of our customers.

The major concern for the coming year is the economy. As always, we'll be monitoring key economic indicators in an effort to be prepared. For example, if the dollar becomes too strong versus other currencies, manufacturers may encounter difficulty selling their products overseas, which in turn, could curtail their purchase and financing of new equipment. The housing industry is another indicator to watch. New housing production hasn't rebounded as well as the rest of the economy, and if it turns down again significantly, that would also have a negative impact on related manufacturers, which in turn could mean that truckers will have fewer products to haul. Also, the cost of oil is always a concern for the transportation industry.

In addition, we'll pay close attention to the capital markets. The last quarter has been a volatile, and if this trend continues into the New Year and results in a higher cost of funds, equipment finance companies could see tighter profit margins. If our cost of funds increases significantly, it will be difficult to pass all of those costs on to our borrowers without sacrificing market share to the larger institutions that have access to cheaper capital. If the environment turns unfavorable, independent equipment finance companies like us will need to be more nimble.

The preceding Q&A is part of a continuing series of roundtable discussions.
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