What's Hot, What's Not
in Equipment Leasing for 2011

By Carl Chrappa, M.R.I.C.S., A.S.A., I.F.A.

In January and February 2011, Independent Equipment Company ("IEC"), with the assistance of the Equipment Leasing and Finance Association ("ELFA"), conducted a confidential internet survey of approximately 400 equipment managers and consultants throughout the United States regarding what's hot, what's not in equipment leasing for 2011. A near record total of (155) responses were received, of which 93% were lessors, asset-based lenders, or financial advisors, and 7% were service providers.

COMPOSITION OF RESPONDENTS

Lessors reported that they added the following amounts of equipment to their portfolios in 2010: 8% added up to $10 million; 4% added $10 to $20 million; 8% added $20 to $50 million; 18% added $50 to $100 million; 26% added $100 to $500 million; 11% added $500 million to $1 billion; 13% added $1 to $3 billion; and 12% added over $3 billion. Thus, this survey was heavily influenced by the 61% of lessors who added $100 million or more of equipment to their portfolios in 2010.

SURVEY RESULTS AND FUTURE LEASING BUSINESS VOLUME

The survey consisted of six questions. One of the most important was Question VI(B), which asked for the "Total dollar amount (volume) of business per specific equipment type *expected* to be booked by your firm, (in the future) 2011 compared to 2010?" Respondents were simply asked to "click" on either the "increase," "about the same," or "decrease" box, with the final score (referred to as a Net Rising Index – NRI) representing the net difference between the percentage of increase (+) and decrease (−) for each type. **Chart I** illustrates the 'NRI' results for the 15 equipment types surveyed. **This year's results are much better than last year's. This part of the survey shows a lot of optimism.** For example, medical scored the highest with (+69) compared to (+63) in 2010's survey, and (+64) in 2008's survey; oil/gas/energy (OGE) (+54) compared to (+44) in 2010; machine tools (+49) compared to (+19). Also rounding out the top five were: truck/trailer (+48); followed by a tie between aircraft and construction equipment each at (+47). This year, only one type showed a decline, versus eight types in 2010, and one type in 2008's survey. The only 'loser' was printing (-19) which actually improved from its (-38) score last year. Based on past surveys, a response of +20% or greater indicates a strong preference for *adding* equipment to the portfolio during the coming year, while a response of -20% or greater indicates a strong preference for *not adding* a specific type of equipment to the portfolio during the same period. **Chart I** shows there is a strong preference for adding a stunning eleven types of equipment, compared to eight types in 2010, one type in 2009's survey, and seven types in 2008's survey; while the survey found no types showed a strong preference for ‘not adding’, compared to two types in 2010, five types in 2009's survey, and none in the 2008 survey. **Thus, this year’s survey results are much stronger than 2010's and indicates the industry is returning to pre-recession levels. This also means that the volume of equipment to be leased in 2011 is expected to be greater than in 2010.**

Using the same ‘NRI’ scoring methodology, Question VI (A) asked for "The total (current) amount of business (volume) that was booked by your firm per specific equipment type as of year end 2010 versus 2009?" The responses to this question, illustrated in **Chart II**, indicate that for 2010, the leasing industry had a strong preference (score of 20+) for three equipment types, an increase from 2010's one type, which was a drop from two equipment types in 2009's survey, and a steep drop from seven equipment types in the 2008 survey; little or no preference for 5 types; and a decline from 13 types in 2010 which was the same as the 2009 survey, which itself represented a sharp increase from only four in 2008's survey. **These results are much stronger than 2010's survey, showing that the industry was recovering last year; readying for a sizable expansion in 2011.** This also suggests that volume increased in 2010 after contracting in 2009.

CHANGES IN RESIDUAL ASSUMPTIONS
RESIDUALS RISE WITH THE ECONOMY

Finally, Question VI(C) asked for "Change in the amount of residual value assumed this year (increase/decrease) per specific equipment type in comparison to last year." The results found on **Chart III** show that the industry is becoming more aggressive in booking residuals. This reflects a marked improvement in the economy and financial markets. In fact, seven types showed increasing residuals, and eight types showed decreasing residuals; almost a 50/50 split. Last year, for only the third time in the 21 year history of this survey, all equipment types were negative. Overall, on a net basis, 20% to 23% of respondents increased residual values for machine tools, oil/gas/energy, and medical, and 13% to 14% of respondents increased residual values for containers/chassis, and rail. Meanwhile, 24% to 36% of respondents reduced residual values for aircraft, FF&E, and printing. **These residual value results are very encouraging versus the very negative results in the 2010 survey. Thus, it is clear that the industry is becoming more aggressive and responsive to market conditions**. Also, note that historically, positive results (increases) in residual positions, taken together with positive results of 20% or more in the survey's Future Business Volume question, indicate a strong willingness on a lessor's part (or if negative, a lack thereof) to aggressively seek (or avoid) business within certain equipment types. **This year's survey shows ‘very positive’ results for a stunning 11 of the 15 types and ‘very negative’ results for none of the equipment types, a dramatic turnaround and improvement over 2010's survey which showed ‘very negative’ results in 11 of the 15 equipment types.** These results are significant because once again they illustrate that lessors are becoming more responsive to market conditions.

MOST AND LEAST FAVORABLE FUTURE EQUIPMENT LEASING OPPORTUNITIES

For clarification and correlation purposes, additional questions were asked and a weighted approach to scoring the survey was used (*i.e.*, Questions III and IV), versus the previously discussed unweighted approach (*i.e.*, Question VI). Questions III and IV asked respondents to pick only the *three* best and worst future equipment leasing opportunities (in order, 1 through 3) by specific equipment type.

The results for each equipment type were weighted by assigning a numerical weighting (multiplier) to each 'place' selected, whether positive or negative. For example, a first place vote was assigned five (5) points, a second place vote three (3) points, and a third place vote one (1) point. A weighted score was tabulated for each equipment category by multiplying the actual number of votes for each place by their respective multipliers (+ or –), then summing the total. A final weighted equipment score (net weighted score) was determined by calculating the difference between each equipment type's total positive and negative weighted scores. Note, the weighted results, (see **Chart IV**), show a good correlation with the unweighted results (see **Chart I**), in that the general order of equipment types – best to worst – is very similar in both approaches (weighted/unweighted). This lends support to the survey's findings. However, the enormity of this year's most positive and negative scores indicates for the third year in a row that the industry is much more focused on certain equipment types.

The weighted scoring approach indicates the level of preference (strong or weak) for a specific type of equipment – whether positive or negative. This year's results show that respondents felt that very strong (positive) future equipment leasing opportunities would exist in medical (+252), oil/gas/energy (+133), hi-tech/computer (+102), truck/trailer (+63), and machine tools (+47), while being greatly diminished in plastic (-49), automobiles (-76), construction (-83), FF&E (-102), and printing - falling to a new record low of (-229). **It is interesting to note that this year's top and bottom scores, medical (+252), and printing (-229) are almost exact opposites, clearly showing preference within the industry.** Also, as previously mentioned, this year printing broke the 21 year all-time low set by automobiles (-181) in the 2009 survey. Overall, survey respondents rated six (6) equipment types very highly (+20 or greater), and six (6) equipment types very low; a slight improvement over last year. Thus, **these results indicate that leasing companies continue to be very selective about which equipment types to focus on.**

FINAL OVERALL RANKING

Finally, a combined overall score was tabulated by adding each equipment type's place (rank) for survey Question VI(B) – the amount of future leasing volume - unweighted, and Questions III and IV – the best and worst future equipment leasing opportunities - weighted. The combined results, shown on **Chart V**, indicate for the sixth year in a row there is a very strong preference for medical, oil/gas/energy, high-tech/computer, while truck/trailer finally broke into the top tier. Also scoring in the top six were container/chassis, and telecom. Marine/intercoastal and rail slipped out of the top tier. Meanwhile, automobiles, plastic, FF&E, and printing had poor showings. The lower the overall numeric score, the better the ranking. For instance, oil/gas/energy, which has a combined overall score of 4, theoretically (and in this case, *actually*) indicates an average of second place in the two future leasing business opportunity questions (weighted, and unweighted), while printing's score of 30 indicates an average of 15th place (the worst possible out of 15 possible) for the same two questions.

CHANGES IN PREFERENCE

Table I shows a comparison between the overall results of the 2011 and 2010 surveys, in order to determine trends (preferences) in leasing towards ("+"), or away from ("–") certain types of equipment over the past year. Once again, the overall combined scores taken from the final rankings for each of the two years were used. The lower the score the better, and the larger the year-over-year difference the greater the trend towards ("+") or away ("–") from a given type. In comparing the two surveys, the equipment leasing industry's perception of trucks/trailers improved considerably for the second year in a row (+9) over last year, as did aircraft (+9). Also, containers/chassis improved moderately (+3). On the other hand, lessors' preference for marine/intercoastal (-7), and hi-tech/computers (-6) fell considerably, (although hi-tech/computers managed to place fifth in this year's survey). Additionally, FF&E (-5), rail (-4) and telecom (-4) showed moderate declines in popularity. **Thus, the best year-over-year *improvement* came from truck/trailer, which for the second year in a row, had its overall preference score increase by (+9); this represents a huge move in popularity.** It also registered an increase (+7) in residual value assumptions. Thus, one could view this equipment sector as rapidly moving into lessors' preferred class of equipment after the underlying economics in this market greatly improved. Aircraft also showed great improvement at (+9) over last year's survey. However, it ranked near the bottom in change in residual positions (third from the last). Thus one can conclude although the aircraft equipment segment is coming back into favor, related values within that sector are still quite weak. Probably the most meaningful year-over-year changes occurred in medical (+0) and oil/gas/energy (+2). Medical equipment's preference could not have improved because it was rated the best for the *sixth year in a row*, while oil/gas/energy improved to a solid second place in both "future" questions with a combined score of 4, an improvement of (+2) over last year's survey. Overall, for 2011, it appears that equipment managers have more preference for five types, no change in preference for three types, and less preference for seven types. This approximates last year's preference ratings.

EQUIPMENT OUTLOOK FORECAST

Based on the 2011 survey results, equipment managers and leasing companies remain optimistic in some of their equipment outlooks, yet decidedly pessimistic in others.

1. Specifically, **medical equipment was the clear winner in this year's survey, finishing in first place for a record sixth year in a row. In addition, this sector also showed the greatest increase in residual values (+23) of all equipment types**. This very strong finish is believed to highlight the medical industry's preference for leased equipment, which continues unabated, driven by demographics linked to the 'baby-boomer' generation. This flies in the face of the potential negative impact that healthcare "reform" could have on the sector, along with various potential DRA reimbursement cuts, rules, etc., aimed at the industry, potentially making used equipment more desirable.

2. **Oil/gas/energy** finished in second place this year, after finishing in third place in the last survey. This sector showed a slight improvement in preference (+2) and also finished just behind medical with the second largest increase in residual value position (+22). This finish continues to reflect optimism by some over opportunities in 'clean energy' technology and equipment. In addition, a drilling boom has developed in the natural gas/oil segment which has caused solid increases in drilling rig values.

3. **Machine tools** finished in third place with a minor increase (+1) in preference over last year. This ranking is believed to be linked to the dramatic turnaround in the domestic and the global manufacturing sector which caused sales in the primary market to increase by over 85%. This ranking is also believed to be linked to financing choices relative to smaller ticket size opportunities related to one-off deals, or large vendor product line financings, or entire manufacturing plant fundings. Furthermore, the secondary market for machine tools has also improved dramatically over the past year.

4. **Truck/trailer** finished in fourth place with a sharp increase of (+9) in preference; the same increase as in last year's survey. There is significant renewed optimism in this equipment type as sales of both new and used truck/trailers increased smartly along with prices. In addition, the freight tonnage index has been steadily improving every month.

5. **Hi-tech/computers** rounded out the top five showing a moderate decline in preference (-6) from last year's score. This industry continues to operate on very low margins yet has a very large secondary market base. Thus, volume is important. Over the past year, hi-tech/computer market has been status quo.

6. **Aircraft** finished in sixth place showing a significant improvement in preference (+9) over last year's survey. However, it ranked third from the bottom in change of residual position. This indicates that respondents view this equipment market as being in a turnaround position with improvement showing in the commercial sector, and optimism rising in the beleaguered business jet segment. However, the rising price of fuel could negatively impact profits in this industry.

7. Meanwhile, **rail** finished in seventh place with a moderate decline in preference (-4). This is believed to be linked to improving, but still somewhat soft conditions within this industry caused by a significant number (300,000+) of rail cars in storage. It is believed that once this problem has been resolved, the stage will be set for a strong turnaround within this market segment.

8. **Containers/chassis** finished in eighth place with an improvement in preference of (+3) over last year's survey. This market's segment is experiencing a tremendous comeback over a cataclysmic 2009 wherein current production volume has increased by some 10 times and day rates have nearly doubled. Conditions in this segment are very strong and look to remain so into the near future.

9. **Construction** finished in ninth place, the same place as last year with a slight decline in preference (-2). The market conditions for this segment are still somewhat soft although resellers are experiencing shortages in certain types of used equipment. This seems to be the result of the drastic declines in new equipment sales over the past two years. Market conditions for this segment are expected to remain soft for at least the next two years. This could present an opportunity to buy low and sell high in the near term.

10. **Telecom** finished in tenth place with a moderate decline in preference (-4) over last year's survey. This equipment segment seems to be turning the corner in demand with major capex expansions being undertaken in order to significantly increase broadband capacity related to video and data transfer. In addition, the industry is also ramping up LTE (Long Term Evolution) to accommodate 4G mobile phones. Sales in the primary market and secondary market are expected to increase for the foreseeable future. Also, sales of IP PBX systems remain strong.

11. **Marine/Intercoastal** finished in eleventh place with a sizeable decrease in preference (-7). This preference decline is believed to be related to the supply and demand problems in the container shipping segment wherein deliveries of new container ships are rapidly outpacing shipping demand. Also, used marine vessel prices have improved only slightly over the past year. In addition, the offshore vessel market for the GOM has been adversely impacted by the drilling moratorium; however, intercoastal market conditions are quite good.

12. **Automobiles** finished in twelfth place with no net improvement in preference from last year. This equipment type has experienced increased sales in both the primary and secondary markets. New equipment sales are expected to increase for the third year in a row, and late model used car prices have increased so much they are impinging on new car prices. Also, the leasing penetration rate has increased in this sector.

13. **Plastic** finished in thirteenth place from last year's eleventh place, showing a moderate decrease in preference of (-4). Currently, this market segment is experiencing a turnaround in almost all categories, with the sales of new injection molding equipment actually increasing after years of steady decline, and used prices increasing by 20% to 30+% year-over-year. Thus, the stage has been set for a comeback in this equipment segment.

14. Next, **FF&E** finished in second to last position, after finishing fourth to last in the 2010 survey and also showed a moderate decline in preference of (-5). Even though sales in the primary market are forecast to increase this year, conditions in this secondary market remain bloated and are expected to remain so for at least another year or two. Also, some are skeptical of the industry's forecast showing improvements in sales, considering the high unemployment rate and somewhat muted outlook for job creation, both having adverse impacts on office space. However, the outlook for bankruptcies shows improvement thus a potential flood of more used equipment on the market should be averted if the domestic economy stays on track.

15. Finally, **printing** equipment finished in last place, for the second year in a row with a decline in preference of (-2). This equipment type also had the steepest decline in assumed residual values of all equipment types; a dismal showing. The economics surrounding this industry are not healthy, as more and more publications, flyers, newspapers, etc. move away from print media to digital. Nonetheless, the industry appears to have bottomed during 2010 and is undergoing a slow and deliberate turnaround albeit working with a smaller end user

base. Thus, price declines are slowing and discounts related to new equipment sales are falling. Market participants generally have a feeling of 'cautious optimism'.

Based on the results of the 2011 survey, it is felt that lessors have become more aggressive and selective in their approach to equipment leasing as illustrated by the results of the Weighted Future Opportunities question, which carried very high and record low scores. This bifurcation in scoring seems to indicate increased competition for leasing of certain types of equipment, as a consensus of opinion regarding desirable equipment markets has developed among equipment managers and leasing companies towards, or away from specific types.

FINAL COMMENTS

This year marks the first year of positive survey results after two straight years of very negative findings. However, the results of the survey have improved annually from 2009's bottom. Thus, it is apparent that most, if not all equipment types – hit inflection points around December of 2009 with steady improvements following. In spite of this, knowledgeable operating lessors with solid marketing experience, may take a contrarian view to parts of this survey, and consider a sharp drop in popularity for a given equipment type to be an opportunity for future business success.

Perhaps the industry's perception can best be summed up in some of the following comments received about the greatest threats to the secondary market:

- the cost of financing for small/medium businesses which buy used equipment;
- slower economic growth than expected, rising interest rates;
- more bank foreclosures resulting in government attempts to manage bank lease portfolios, lacking the general knowledge and resources necessary to maximize portfolio values;
- access to capital to finance used equipment purchases;
- continued weak recovery, compared to past recoveries, with GDP growth rate weak and unemployment high;
- potential double dip recession negatively affecting Capex budgets;
- lack of liquidity;
- double dip recession;
- global economic recession, trade war, high interest rates, and continued regulations that obsolete equipment too quickly;
- poor economy and record high government debt;
- software re-licensing fees and OEM support;
- the overall economy;
- struggling economy, unemployment, housing (lack of new starts);
- slowing economy;
- $4.00+ gasoline; and
- downturn in the economy.

It is clear from the comments received that the biggest concern seems to be the health of the domestic and global economy, along with access to capital.

Since it appears that most equipment markets bottomed in late 2009, and 2010 was the start of a recovery, 2011 looks to be a very good year for most equipment markets and equipment lessors alike.

I hope the information provided in this article will help you as you chart your course to a successful 2011.

BIOGRAPHY
CARL C. CHRAPPA, M.R.I.C.S., A.S.A., I.F.A.
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Carl C. Chrappa is President and CEO of Independent Equipment Company, the nation's oldest equipment management outsourcing firm, headquartered in Clearwater, Florida. He is a registered auctioneer, and nationally (A.S.A.) as well as internationally (M.R.I.C.S.) tested and accredited senior equipment appraiser with over 35 years of experience.

Mr. Chrappa is uniquely qualified for this presentation, since he actively trades in equipment markets, and provides appraisals and equipment consulting services to companies throughout the world. He is also a member of the *National Association for Business Economics (NABE)*, and is Chair of the Association's Industrial/ Manufacturing Roundtable. Mr. Chrappa also serves as a panelist on the Federal Reserve Bank of Philadelphia's – 'Livingston Survey,' which twice a year forecasts macroeconomic moves in the U.S. economy.

He is a current and founding member of *The Equipment Leasing and Finance Association's* Equipment Management Committee, also serves on the Board of Directors of the *Commercial Finance Association,* and is a past Director of *ELFA Business Services, Inc.* He was also elected and currently serves on the ELFA's Service Providers Steering Committee, and is a past national technical director of the *American Association of Cost Engineers*. Mr. Chrappa received the ELFA's Distinguished Service Award in 2010. In addition, he co-authored a book entitled A Leasing Company's Guide to Equipment Management and is the author of several columns devoted to equipment management as well as being a regular content provider to the ELFA's web-based ELFAonline.org. He has given numerous presentations at professional and trade association meetings and seminars throughout the United States and Europe, and has been interviewed and quoted by such news media as The Wall Street Journal, the L.A. Business Times, TheStreet.com, CNBC MoneyLine, and NPR radio. Mr. Chrappa is a graduate of the University of Massachusetts at Amherst.

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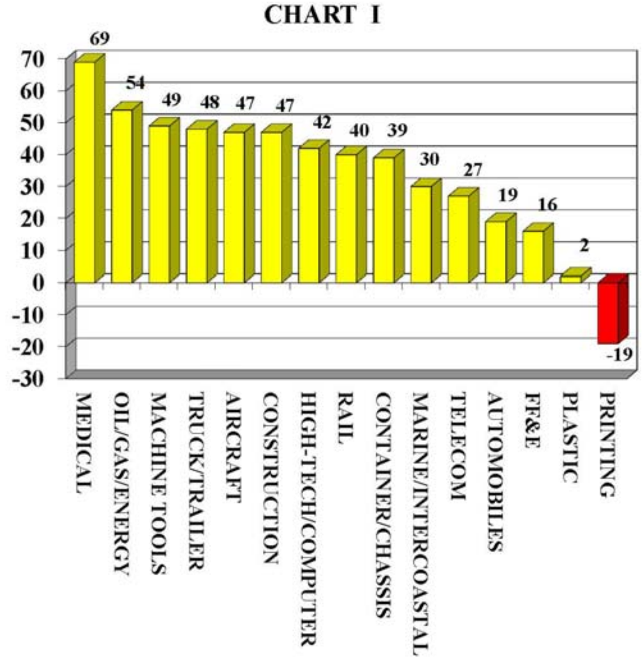
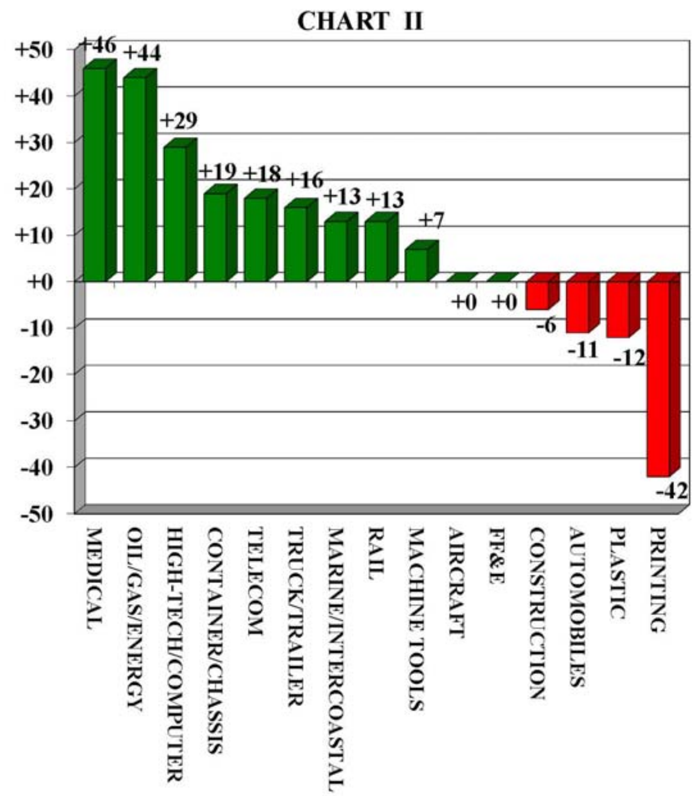
FUTURE LEASING BUSINESS VOLUME BY EQUIPMENT TYPE (Unweighted)

CHART I



Source: IEC Research

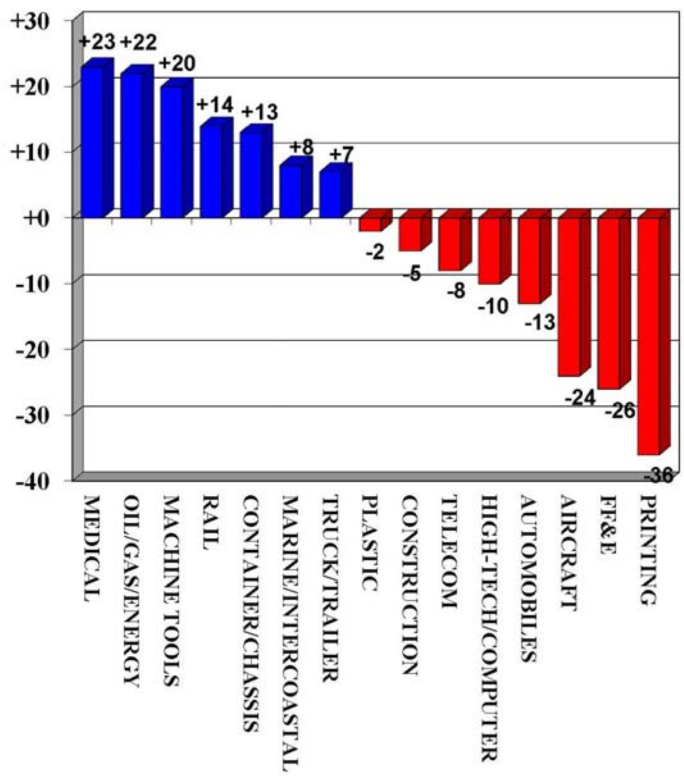
2010 LEASING BUSINESS VOLUMES v. 2009
BY EQUIPMENT TYPE (Unweighted)



Source: IEC Research

CHANGES IN RESIDUAL POSITIONS
BY EQUIPMENT TYPE (+ increase / - decrease)

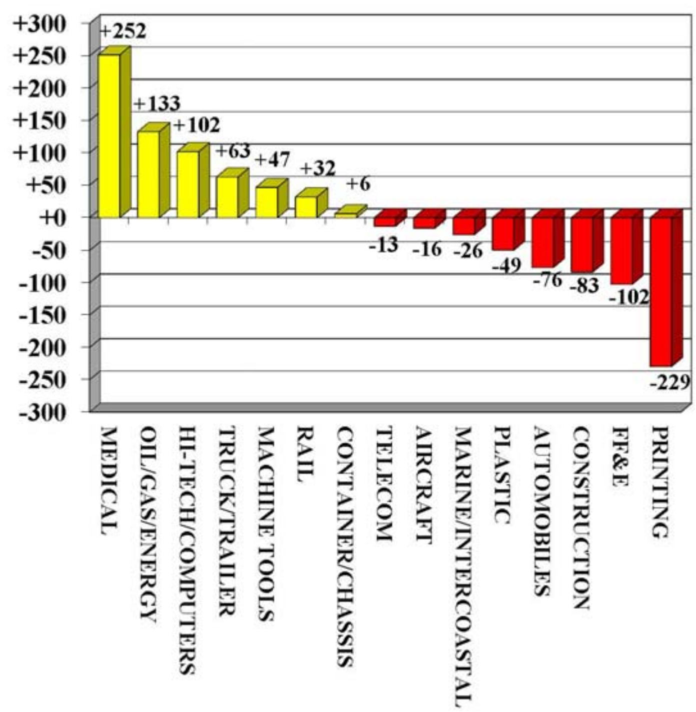
CHART III



Source: IEC Research

WEIGHTED FUTURE OPPORTUNITIES RANKINGS
BASED ON QUESTIONS III AND IV
3 BEST (+) AND 3 WORST (-) BY EQUIPMENT TYPE

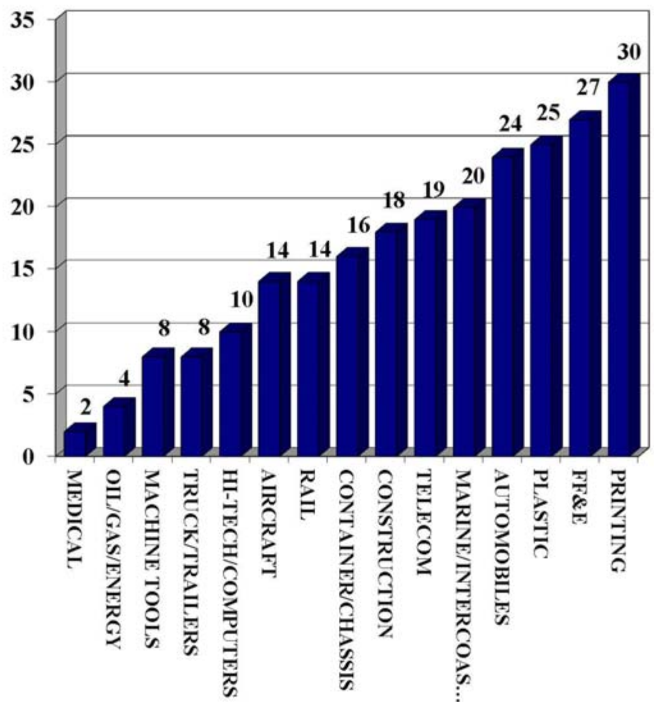
CHART IV



Source: IEC Research

FINAL OVERALL SCORE AND RANKING
LOWEST SCORE BEING THE BEST

CHART V



Source: IEC Research

EQUIPMENT SURVEY RESULTS
2011 vs. 2010
OVERALL RANKING SCORES

TABLE 1

Equipment Type	2011 Score	2010 Score	Difference
MEDICAL	2	2	+0
OIL/GAS/ENERGY	4	6	+2
MACHINE TOOLS	8	9	+1
TRUCK/TRAILERS	8	17	+9
HI-TECH/COMPUTERS	10	4	-6
AIRCRAFT	14	23	+9
RAIL	14	10	-4
CONTAINER/CHASSIS	16	19	+3
CONSTRUCTION	18	16	-2
TELECOM	19	15	-4
MARINE/INTERCOASTAL	20	13	-7
AUTOMOBILES	24	24	+0
PLASTIC	25	21	-4
FF&E	27	22	-5
PRINTING	30	28	-2