Independents: Banking on the Non-Banks

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Established in 1989, the Equipment Leasing & Finance Foundation is a 501c3 non-profit organization dedicated to inspiring thoughtful innovation and contributing to the betterment of the equipment leasing and finance industry. The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

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Purpose of the Study

This report focuses on the independent equipment finance and leasing sector.

What is an independent? Independents are companies that are neither owned nor majority controlled by a captive or bank. Like those competitors, they provide financing to meet the small, middle, or large ticket needs of private or public companies. Banks benefit from FDIC insurance while captives are usually owned by large corporations that can provide access to capital and funding. In contrast, independents must raise any required capital and funding directly from the financial markets without the governmental or corporate support of their competitors, resulting in a higher cost of funds and the need to differentiate themselves by the value they provide.

This is a particularly fitting time to evaluate the current status and future expectations for independents. Early in the last decade, the recession created great instability. The downturn resulted in a wave of forced company exits due both to funding and credit issues. It also resulted in an acquisition opportunity for banks wanting to build their share in equipment finance and for independents wishing to operate in an environment with lower interest rates and a base of target customers available for cross-selling of their services.

In 2013, FIC Advisors, Inc. (FIC) authored the Equipment Leasing & Finance Foundation report, *Rise of Banks in Equipment Finance*, during a period when the outlook for independents seemed volatile and uncertain. Early in that report, we asked a question that highlighted the unclear future position of independents: "Can independents grow or even survive with the banks making a major push, or are they doomed to become marginalized, fighting over the scraps that banks leave behind?" While some say no question is a bad one, that specific question showed that a lack of appreciation concerning how independents operate and their ability to adapt quickly. As industry participants know well, independents are resilient and quick to manage around roadblocks. One independent interviewee commented: "When something is not working, we change. We go another direction if we need to."

Independents as an industry segment have shown their ability to survive and thrive despite changes in lease accounting, the business cycle, or the competitive environment.

Stability and growth have returned to the equipment finance market and, as virtually all interviewees state, today is a good time to be an independent: funds and capital are readily available, credit performance is strong, and the overall economy provides a rising tide. While banks and captives operate with some significant competitive advantages, they also face constraints related to the type of business they do and the quality of the customer experience they offer. Independents believe limits on its competitors related to risk appetite and structuring flexibility have created a sustainable opportunity for companies able to outmaneuver or avoid banks and the lower-cost debt they offer. Our report provides specific examples of the day-to-day approaches employed by independents to compete effectively.

The report also shows multiple instances of their discipline, ability to quickly take advantage of opportunistic situations, and the commitment to customer service that distinguishes independents. We intend that the report provides industry members with insights into how companies of different size and style have resolved critical management issues.

In developing a problem statement for this report, the Equipment Leasing & Finance Foundation leadership highlighted some of the issues that FIC will address: "What is the domain of the independent financing company today? Do independents provide innovation and benefits to the industry beyond taking credit risks? Do independents provide a better service for the customer-driven by business decisions vs. process decisions? How has this changed since the 2011 Equipment Leasing & Finance Foundation study, *The Place of the Independents*? This report will address how the independents create value and differentiate themselves from often much larger and lower rate competitors. By its nature, this report focuses on those companies that came through the recession relatively unscathed. One interviewee noted that saying, "Just by the fact that we are still standing means we did something right." Another commented: "The downturn made us smarter and stronger."

In addition, the report highlights some of the new entrants, many of which view themselves as disruptors. In recent years equipment finance and leasing have been rediscovered by investors looking for attractive, long-term returns. These newcos' growth is often fueled by private equity, family offices, or insurance investments that see the competitive environment offering a post-downturn profit opportunity. They view themselves as disruptors to traditional financing approaches. While some of the leaders of those companies are millennials, interestingly, others are seasoned veterans, leveraging their decades of experience.

This report provides multiple examples concerning how independents differentiate themselves both from each other and other lending segments. The 2011 report correctly stated, "There is no generic independent." Each independent we interviewed or assessed appears to have been handcrafted by a group of like-minded executives who have evaluated and based their company's fortunes on several critical decisions:

How can we create a sustainable competitive advantage?
How do we continually review what we are doing to avoid emerging risk and explore new opportunities?
How do we avoid concentration risk or being eliminated by an Uber-like event?
How do we anticipate and prepare for the next (inevitable) downturn?
What opportunities exist for us that are of little to no attractiveness for bigger players?
What areas can we focus on with limited competition?

While this report does not provide a roadmap for new entrants or potential investors, it will offer details concerning how successful players identify the key issues that can impact their performance, how they engage their personnel teams in addressing them, and how they make informed decisions, all the time maintaining the flexibility to "pivot" or change their course, if necessary.

"There is no generic independent" may be an even more accurate statement today than when it was written in 2011. The following sections will highlight how independents have built their current success and are preparing for future events.

Charles Wendel
President
FIC Advisors, Inc.

Executive Summary

"There has never been a better time to be an independent than right now." This quote, from one of the 20+ independent company executives we interviewed, summarizes both the attitude and the enthusiasm of the leaders of this segment of the equipment finance and leasing industry. However, managers approach their businesses taking nothing for granted about the future. They may be enthusiastic, but they also operate with a good dose of healthy skepticism about their industry's future. Company executives promote discipline while at the same time looking for new business opportunities that fit into their skill sets and culture. Management also emphasizes the need for a realistic view of the overall environment as well as continued evaluation of current and emerging competitive threats.

This report begins by presenting an economic overview of the recent performance of independents. In recent years, market share numbers for independents show them capturing a stable single-digit share of New Business Volume (NBV). Decades ago, independents dominated the equipment finance business. Decline in market share resulted from factors including the economic downturn and the acquisitive nature of banks with the capital available to enter or expand their presence in the equipment finance space. independents provided suitable acquisition targets for banks, and many remain so today.

While banks have been capturing increased NBV, independent year-to-year growth outpaces both banks and captives. The metrics in the next section quantify the independents strong performance related both to yield and returns on equity and assets. independent metrics portray a segment that may have smaller market share than 20 years ago but generates consistently higher yields and returns than banks or captives.

Higher yields and returns result in part from independents avoiding rate-based "fights" that they cannot win and instead focusing on activities in which they can demonstrate value to their customers. Virtually all of FIC's interviewees stress the need for independents to avoid direct competition with banks, as summarized by one frank comment: "When we see ourselves competing with a bank in a deal, we figure we will lose." But, this view is not defeatist; it expresses a realistic view of the pricing power a bank can bring to a transaction it wants to do. Another executive commented: "If a bank wants to win a deal, they will win the deal."

Multiple interviews with independents (and additional interviews with bankers on a confidential basis) indicate that, while banks can win deals, their focus has narrowed concerning the type of deals they pursue and are willing to fund. A later section discusses this topic in detail, suggesting that the banks' narrow "credit box" will continue to provide ample opportunity for independents. Similarly, captives operate with constraints on the type of equipment they are willing to finance as well as their ability to offer more complex financing structures, particularly if they involve equipment from multiple manufacturers. Again, independents focus on providing structures and a level of customer service that others cannot or will not provide.

Independents often mention service quality as a differentiator. They view banks and captives as concentrating on larger companies, those with higher credit ratings, and/or relatively straightforward financing needs. This is their competitors' "sweet spot." The remaining majority of companies provide a large pool for independents to focus on.

Independents have also come to realize that different customer types define a “quality” experience differently. Some independents distinguish themselves by the level of technology they provide and the extent to which they are embedded into their customers. This seems of particular value in the small ticket and vendor spaces. For other customer segments, technology may play a minor role; in those instances, the ability to structure complex transactions and make a relatively quick decision defines an excellent customer experience. Interviews with industry participants indicate that many companies tend to emphasize one approach over the other, but it is a mistake to consider independents as operating solely at one end of the spectrum of the other.

Figure 1: High Tech versus High Touch Spectrum

Higher Tech vs. Higher Touch

Company Preferences:
- Digital
- Self-service
- Streamlined processes
- Standardized approach
- Millennials

Company Preferences:
- Largely paper-based
- Personal service
- Customized processes
- “Bespoke”
- Business veterans

While management may emphasize high tech over high touch or vice versa (Figure 1), market forces have pushed most to offer a mix of both elements. The startup that is “all in” on technology and that hires mostly millennials also needs to develop relationships with its customers by providing customized reports and other “sticky” services. The company operated by long-term industry veterans who know everyone they need to know to generate business leads needs technology, as well. It leverages technology both for internal efficiencies, sales tracking progress, and customer demands for relationship value that includes data analytics to help customer improve their business operations. While some independents operate on the extremes of the above spectrum more operate in the middle, pushed there by market forces. Relationship-oriented companies apply technology as part of building the value and solidifying relationships; IT-oriented firms bring industry knowledge, as well.

Based on our assessment of this industry, one element that distinguishes independents from their financing competitors centers on the power of specialization. As one interviewee noted, “This is a good time to be an independent. It is not a good time to be a generalist.” Every firm we interviewed emphasized its focus on an industry vertical or financing niche. Importantly, independents operate with a mindset that continually evaluates new niches and, as appropriate, exits those that do are not provide the appropriate risk/return tradeoffs.

Based on our assessment of this industry, one element that distinguishes Independents from their financing competitors centers on the power of specialization.

In conversations with banks, we often hear them stating that their market is highly competitive and offers limited opportunity for growth. Further questions uncover that many banks are pursuing similar types of customers with similar credit profiles and financing needs. In effect, many are “fishing in the same pond,” resulting in a more intense competitive environment and a squeeze on margins. Independents actively avoid focusing on areas in which big players are also concentrating. They know they have no choice but to do so. Instead, they pick industry and niche areas that they hope are too arcane or small for large lenders.

And, they do not move in lockstep with each other. Two interviews, conducted within a few days of each other, underscored that point. In one case the interviewee spoke about his industry (a transportation sub-segment) and how his company had decided to buy a specialist provider in that business. Days later, another interviewee, also from a successful company, highlighted that same sub-segment as one his company had looked into and then quickly abandoned because of concerns over its ability to control the collateral, among other reasons.

Who is right? Probably they both are because they manage based upon knowing their company's strengths and weaknesses and risk appetites.

This story also points out both the delight and the difficulty for analysts trying to characterize how independents operate and succeed. The delightful part involves the variety and dynamism of the industry. Our interviews included small startups and large and established firms operating in the U.S. and abroad. Some independents have "gone all in on technology" while others still operate with paper-based systems. Some have sophisticated funding approaches while others may depend upon one or two banks for funding.

The diversity of strategy and even culture differs what one would see at most banks or captives. That diversity and the individual nature of many independents also results in this analyst's difficulty. The challenge for this report is to illustrate the common themes that carry across the industry, whether the independent is large or small and vendor or direct lending focused. Each of the companies we interviewed differed in multiple areas: its size of assets, target ticket focus, the area of specialization, approaches to funding, and other areas. However, cultural strength, customer focus, and building off expertise serve as common traits.

The independents we interviewed and the numbers we evaluated point to an ongoing path for growth and profitability for this group. None of the companies were resting on their past successes. In fact, many express restlessness about the future and see the need to evolve and anticipate the changing environment. The ability to adapt, to meet emerging needs, to manage through crises, typifies the best independents and plays a key part in ensuring their continued relevance and success.

This report also includes case examples that present a topic of interest to independents and the larger industry. While each case features a specific company, the cases include "takeaways" all companies can consider.

Independents: Economic Overview and Market Sizing

Independents continue to be a critical and valued source of equipment finance and advice for businesses across multiple industries. Given many changes in competitive dynamics and market requirements, where and how independents compete today has changed over the past 20 years and will likely continue to change in the future. And while data shows that the independent segment has declined in market share, at the same time it has built a sustainable position with high returns by its ability to provide customized solutions and insights to its customer, the price for risk, maintain strong credit quality, and respond successfully to changing market conditions.

This section provides an economic overview of the independents' recent performance and quantifies the size of some of the major industries on which independents focus. The interviews and case studies, highlighted throughout the remainder of our report, point to the independents' consistent focus on internal management disciple and differentiating themselves by providing clients with value, two elements that are part of the fabric of how independents approach their business.

Recent Performance

FIC analysis includes review of the Equipment Leasing and Finance Association's Survey of Equipment Finance Activity (SEFA), the *2018 Equipment Leasing & Finance Industry Horizon Report ("Horizon Report")*, the *2018* Monitor 100, the *Monitor Daily*, the *Equipment Leasing and Finance Association's MLFI-25*, the Equipment Leasing & Finance Foundation's 2011 report, *The Place of the independent Equipment Leasing and Finance Company*, PayNet, and U.S. Department of Commerce reports, among other reports.

While the various data sources support similar conclusions about the current state of independents, their recent performance, and likely path forward, these reports used different survey-based sources; in one case the report used stretches back 40 years. Therefore, while the numbers point in the same direction, they vary in absolute values and may be open to more than one interpretation.

Later in this section, our analysis of the size and potential growth available from select industries of importance to independents focuses on industry-wide opportunities rather than sub-segments. The volumes those industries generate is large and, in most cases, growing. Typically, independents thrive by finding and serving the sub-segments within a larger industry and exploiting niche opportunities. For example, some independents focus on sub-segments within the overall trucking industry, such as used and specialized vehicles. They avoid vehicles that are easier to evaluate and finance at lower rates, typically, the world of banks and captives. Most independents focus on meeting the needs of a more specialized end-user of equipment finance, differentiating themselves by knowledge, responsiveness, and their ability to structure and service transactions that others cannot or will not do.

> *As this report will show, typically, independents thrive by finding and serving the sub-segments within a larger industry and exploiting niche opportunities. For example, some independents focus on sub-segments within the overall trucking industry, such as used and specialized vehicles.*

Independents also operate successfully despite the high degree of industry market share captured by a relatively small number of players. For example, a recent *Monitor Daily* article quoted an EDA report indicating the extent to which a handful of the largest industry players capture the majority of total New Business

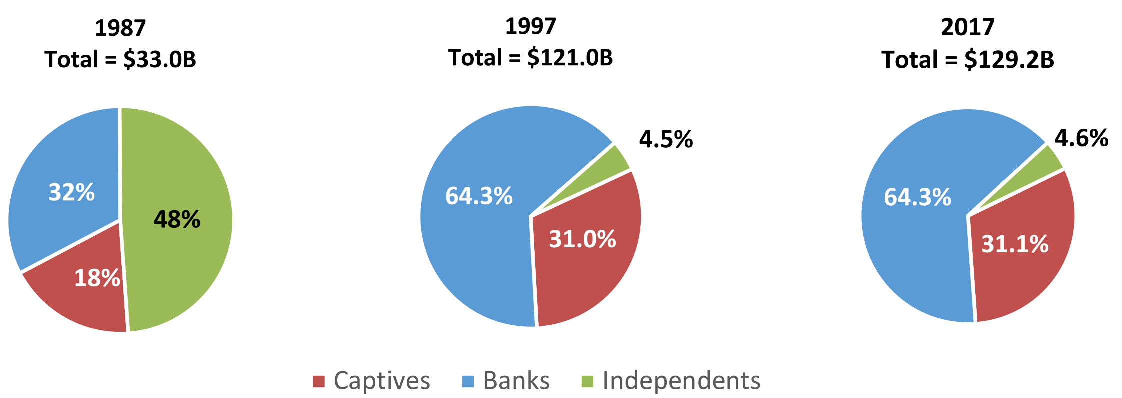
Volume (NBV). In September 2018, the 20 largest bank, captive, and independent equipment lenders (to industries including agriculture, construction, lift trucks, logging equipment, machine tools, office equipment printing, trucking, and woodworking) accounted for 84% of UCC equipment filings for the month. The top five lenders (four captives and U.S. banks) filed for 49% of the total. In June, even higher concentration occurred, with the top five lenders accounting for 70.1% of filings. In some industries the top five concentration is higher; in agriculture, the top five industries (all captives) accounted for over 62% of agriculture-related filings. Of course, the above and other share data should be viewed in the context of the overall market. The Horizon Report quantifies the total equipment financing opportunity at $1.01T; therefore, independents continue to operate within a large revenue pool.

A snapshot of past key performance numbers shows how the overall landscape has changed for independents, resulting in a more competitive operating environment.

Independents dominated equipment finance until 1997 when they achieved their highest share of NBV at close to 70%, up from 48% in 1987. However, the most recent Equipment Leasing and Finance Association data shows independent volumes having stabilized at the single-digit level.

As Figure 2 summarizes, the percentage of total NBV independents now generate is 4.6%.

Figure 2: Percentage Share of Annual New Business Volume (NBV)



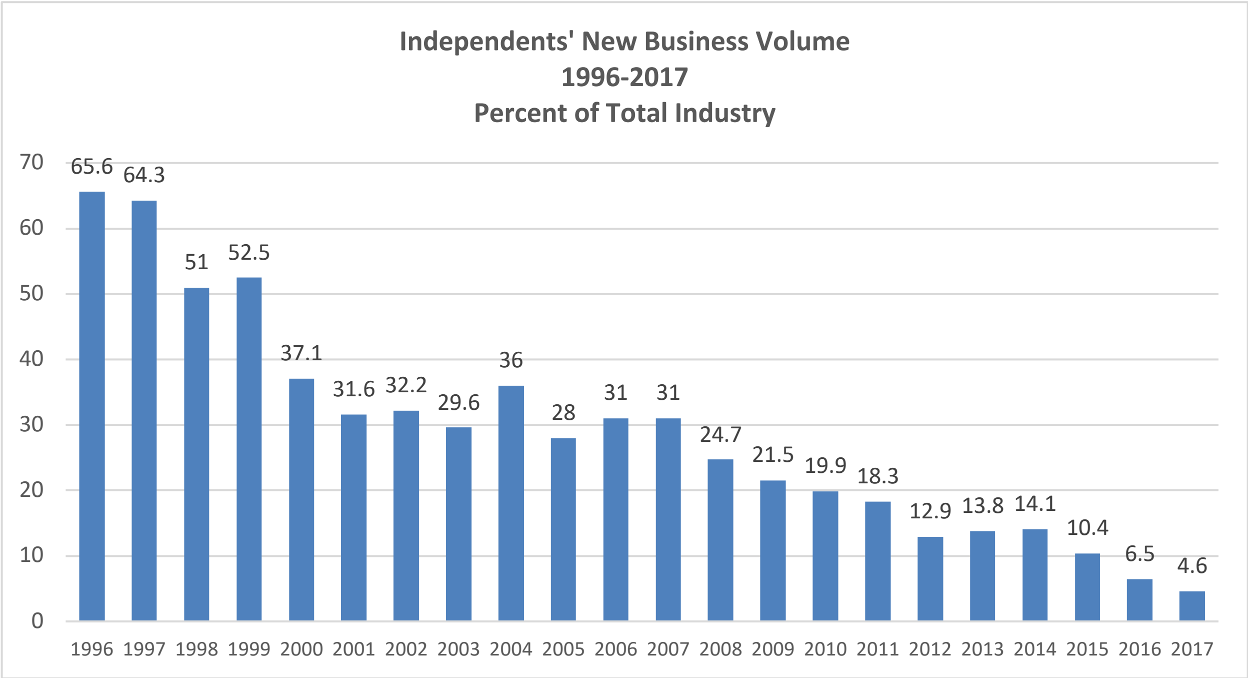
Source: 2018 ELFA Survey of Equipment Finance Activity; 2011 Equipment Leasing & Finance Foundation, *The Place of the Independent Leasing & Finance Company.*

The independents' 4.6 % translates into $5.9B of NBV, up from $5.4B in the prior year.

Figure 3 tracks changes in the independents; NBV from 1996 onward. Based upon the SEFA numbers, independents dominated the industry in 1996 with a steady decline in share since then. The Equipment Leasing and Finance Association and Keybridge Research LLC (Keybridge) analyses, the 2011 Equipment Leasing & Finance Foundation report on independents, and FIC's recent interviews with a cross-section of industry leaders capture the main factors that resulted in independents now having a reduced NBV share from decades ago:

- During the recent Great Recession, many smaller and weaker independents disappeared due to lack of funding and performance issues.
- Perhaps most significantly, banks have been active acquirers of independents with many of the bank groups of today having been independents a few years ago. Banks have focused on independents as a foundation for asset growth and increased outbound marketing. As one indication, the 2018 SEFA report has 9.1% of independent respondents stating their firms were acquired or merged in the past year (SEFA, Chart 47a). Over the past five years, banks have reemphasized equipment finance to stimulate loan growth and increasingly view this financing area as a differentiator with commercial clients whether as a lead product or a cross-sell tool.
- Also related to banks and contributing to reduced independents' share of NBV, some private equity-owned independents entered sales agreements to cash out on their previously liquid investments.
- Some banks have also commoditized aspects of equipment finance lending, offering rates 200 basis points or more below what independents must offer to meet their profit hurdles. Interviews suggest that over the past year some banks have reduced their discipline on pricing to win share, an approach not possible or attractive to most independents. Lower rates remain an effective tool for banks to attract companies that had been borrowing from independents. Interviews with independents admit that banks are frequently trying to undercut with pricing the value-added and relationship focus they rely on.
- SEFA reports rely on self -classification of respondents. Major reclassifications have also occurred from independents to other segments, for example, CIT to bank from independent; GE Capital to captive from independent; DLL to bank from independent.

Figure 3: Independents' New Business Volume 1996-2017

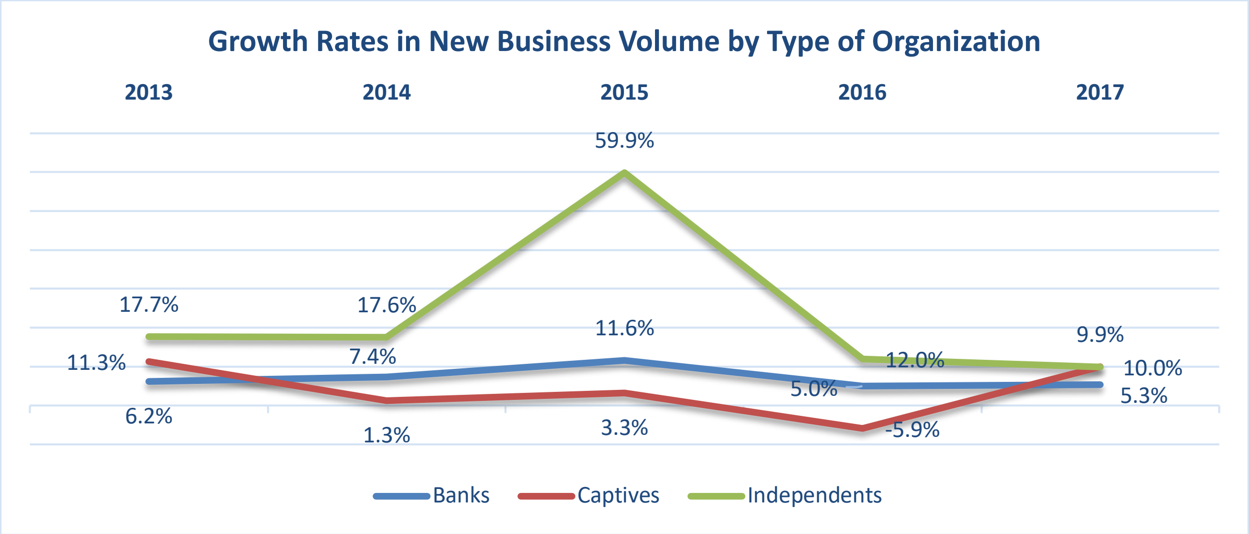


Source: SEFA reports; 2011 Equipment Leasing & Finance Foundation, *The Place of the Independent Leasing & Finance Company.*

While share has declined, Figure 4 shows that over the last year independents achieved the highest growth rate in NBV at about 10% versus 5.3% and 9.9%, respectively, for banks and captives. Independents have also outpaced the NBV growth of competitors in each of the past five years, demonstrating the effectiveness of their ongoing sales emphasis. The unusual jump in 2014-2015 NBV is largely explained by changes in the makeup of that year's survey respondents.

Figure 4: Growth in New Business Volume over Five Years by Type of Organization

Growth in NBV	FY '13/'12		FY '14/'13		FY '15/'14		FY '16/'15		FY '17/'16	
Overall	**9.3%**		**6.7%**		**12.4%**		**2.5%**		**6.9%**	
By Type of Organization:										
Banks	6.2%	48	7.4%	46	11.6%	54	5.0%	55	5.3%	55
Captives	11.3%	24	1.3%	22	3.3%	26	(5.9%)	24	9.9%	28
Independents	17.7%	37	17.6%	32	59.9%	37	12.0%	37	10.0%	31
Number of Respondents		109		100		117		116		114



Source: SEFA 2018, 1e

The SEFA report states that nearly 64.5% of all independents grew NBV on a year-over-year comparison, outpacing competitor groups. Independent performance contrasts favorably with the 54.5% growth rate for banks and the 57.1% growth for captives (SEFA Chart 2a).

Most independent volume results from direct origination at 48%. Independents captured 26.0 % of NBV from vendor programs and an additional 6.0% from captives. The third-party broker channel brings in the remaining 20%. Independents continue to rely more on brokers than others. Banks take 15.5% of deals from third parties, and captives gain just 0.1% of NBV from this source (SEFA Chart 3b).

As for the type of financial product they emphasize, independents fund more tax-oriented leases than banks or captives (Figure 5) while banks focus on non-tax transactions.

Figure 5: New Business Volume by Financial Product Category and by Type of Organization

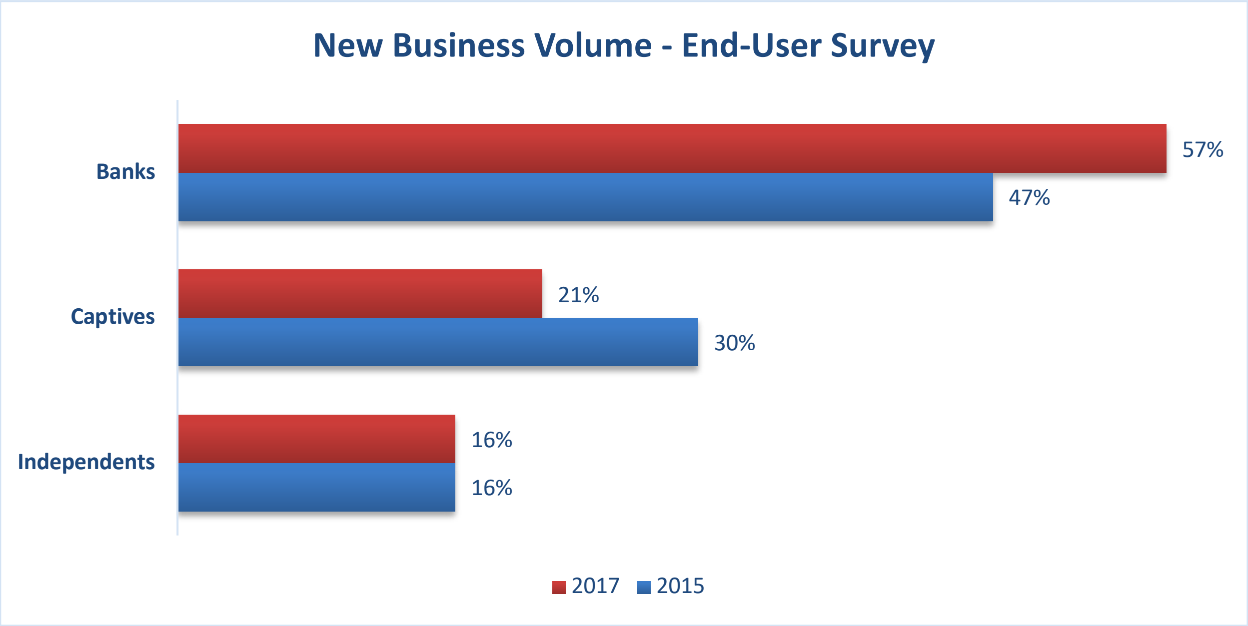
	% of Total					
	banks		captives		independents	
Tax Oriented Leases:						
– Direct Finance	22.5%	29.0%	21.7%	36.0%	34.8%	46.8%
– Operating Leases	6.5%		14.3%		12.0%	
Non Tax Oriented Leases	34.6%	61.1%	30.2%	52.5%	35.5%	48.4%
Term Loans	26.5%		22.3%		12.9%	
Off Balances Sheet		0.9%		0.0%		0.0%
Tax Exempt		6.4%		2.8%		2.3%
Other		2.5%		8.6%		2.6%
Total		**100.0%**		**100%**		**100%**

Source: 2018 SEFA 7c

As stated above SEFA data, based on a survey of Equipment Leasing and Finance Association members, showed a 4.6% NBV share. The Horizon Report, prepared by Keybridge on behalf of the Equipment Leasing & Finance Foundation, employs a different methodology, surveying over 400 businesses, of which 255 acquired equipment in 2017.

While the raw numbers differ, the Horizon Report survey, summarized in Figure 6, tells a similar story with banks and captives dominating NBV. The Horizon Report estimates independent NVB at 16%, flat from 2015. Banks continued to gain share, apparently at the expense of captives.

Figure 6: New Business Volume – End-user Survey



Source: *2018 Equipment Leasing & Finance Industry Horizon Report*, page 13.

Yet another data source, the Monitor 100, shows that independents continue to appear on a consistent level among the top players. In the most recent Monitor 100, based upon 2017 net new assets summarized in Figure 7, 25 independents appear, six of them among the Monitor top 50. A similar number of independents have appeared on the list in past years. Going back to 1991 and 2009 independents represented 25 and 26 companies, respectively, of the Monitor 100.

Within the Monitor 100, independents captured about 4.6%, of total NBV with the 100 largest companies and 6.6% of Net Assets (Figure 8), providing a third point of comparison with the 4.6% captured by SEFA and 16% by the Horizon Report.

Figure 7: Monitor 100 Rankings by New Business Volume

2017 Rank	2016 Rank	Company	2017 NBV ($MM)	16-17 Growth %	2016 NBV	
21	24	Air Lease	1,972.00	3	1,914.1	
37	38	Ascentium Capital	1,004.70	11.8	898.5	
38	43	Stonebriar Commercial Finance	970.80	32.6	732.1	
41	40	GreatAmerica	922.00	8.9	847	
47	45	GATX	603.40	-2.8	620.7	
58	61	ENGS Financial	375	18.3	317	
61	75	Willis Lease Finance	345.00	91.7	180	
64	65	Navitas Credit	323.4	17.3	275.7	
67	64	Somerset Capital	256.4	-7	275.7	
70	76	Trans Lease	214.2	22.3	175.1	
72	80	Amur Equipment Finance	210.7	37.3	153.5	
73	83	Pawnee Leasing	201.2	45.9	137.9	
74	71	Kingsbridge Holdings	200.9	0.5	200	
75	72	Crossroads	176.7	-9.8	195.8	
76	85	United Leasing	176	37.5	128	
78	79	VAR Technology Finance	171.7	14.5	150	
79	74	SQN Capital Management	164.2	-10.8	184	
81	82	Northland Capital	144	2.3	140.7	
82	84	Jules and Associates	140.4	7.5	130	
84	81	Lease Corporation of America	125.7	-12.1	125.7	
85	91	Forsythe/McArthur Assoc.	120.8	16	104.1	
87	88	Wallwork Financial	116.3	4.2	111.6	
90	95	CCA Financial	101.5	8.2	93.8	
93		Onset Financial	82.9	-34.7	127	
94		GSG Financial	77.8	21.9	63.8	
98	97	AeroCentury	39.7	-42.5	69	
TOTAL NBV			**9,237.40**		**8350.8**	**10.6% Growth**
Total Industry			**196,686.90**		**180,593.9**	
Percent of Total NBV			**4.70**		**4.6**	

Source: 2018 Monitor 100

Figure 8: Monitor 100 Rankings by Net Assets

Rank	Company	2017 Net Assets ($MM)
11	Air Lease	13,280.30
22	GATX	6,321.80
41	GreatAmerica	1,912.20
43	Stonebriar Commercial Finance	1,614.80
44	Willis Lease Finance	1,603.00
48	Ascentium Capital	1,359.70
59	SQN Capital Management	883.6
65	ENGS Financial	596
67	Somerset Capital	569.9
69	Kingsbridge Holdings	447
70	Trans Lease	443.2
71	Navitas Credit	441.5
73	United Leasing	362
75	Crossroads	321.2
76	Amur Equipment Finance	319.1
78	Pawnee Leasing	314.7
82	Wallwork Financial	275.4
83	Jules and Associates	272.5
86	CCA Financial	221.6
88	AeroCentury	218.7
88	Lease Corporation of America	218.7
90	Northland Capital	212.7
93	Forsythe/McArthur Assoc.	171
97	VAR Technology Finance	137.7
98	GSG Financial	131.7
Total Monitor 100 Net Assets		**497,469.90**
Percent of Total Monitor Net Assets		**6.60%**

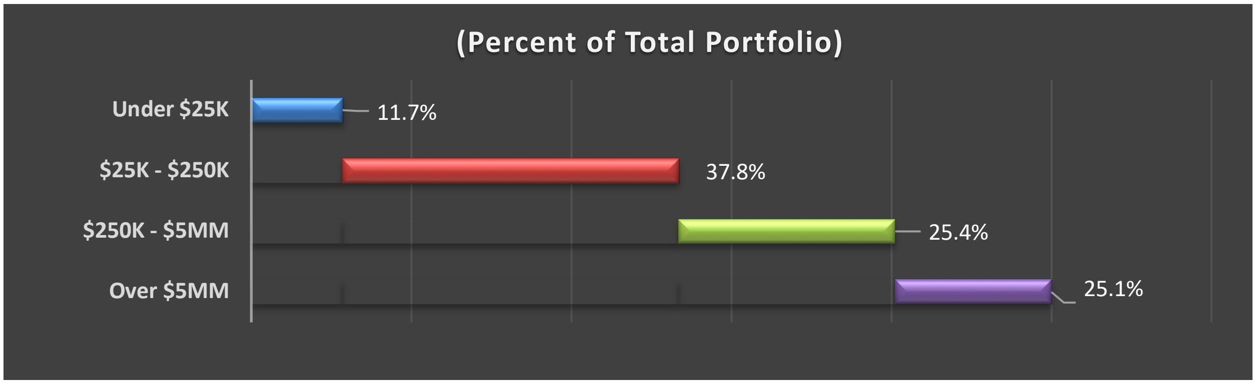
Source: 2018 Monitor 100

Even with single-digit share, independents have a large and growing financing opportunity.

As noted above, the financing market for the total equipment finance industry exceeds $1.01T. Applying the range of 4.6% (Equipment Leasing and Finance Association member survey) and 16% (Keybridge end-user survey) results in a potential financing market for independents of $50.6B-$176B.

As for transaction size, Figure 9 shows that, while some movement to larger transactions may be occurring among independents, most booked deals continue to focus on transactions below $250,000, an area of limited focus for many banks.

Figure 9: Share of Independent Portfolio by Transaction Size



Source: 2018 SEFA, 34b

Many commercial banks lose money on smaller loans due to their cost of origination, monitoring, compliance, capital, and other cost areas as well as a lack of an institutionalized approach to risk-based pricing (Figure 9). Therefore, banks often avoid or ignore this segment, preferring to focus on larger dollar transactions, aimed at the top 10-20% of companies. Unless banks can introduce operating efficiencies in this area, smaller ticket transactions should continue to be an opportunity for independents.

Figure 10: Loan Example

Banks lose money on small loans, making this an attractive arena for an efficient and targeted independent.

$100,000 Loan Example		
Loan origination	$1,000-1,500	
Underwriting	$1,000	
Loan review	$100	
Operations	$250	
Monitoring	$500	
Compliance	$250-500	
Total	$3,100-3,850	
Interest Income (assume 6.25% loan)		$6,250
Loan cost to bank (3%)		$3,000
Total non-interest costs to generate loan		$3,100-3,850
Net Income		**($600) to +$150**

Note: Excludes bank overhead, losses, and capital costs.

Source: FIC analysis.

Operating without the business flow that banks and captives can provide, on a percentage basis, Figure 11 shows that independents need to sift through more deals before funding and also must spend more on sales. Independents generate more expense than competitors versus net adjusted revenues (SEFA, Chart 17a). Total expenses are 61.8% versus 54.0% for banks and 39.4% for captives. Versus banks, independents take a 10.6% provision for bad debts versus 7.0% for banks. Their "Other salary and wages" charge is also much higher at 20.45% versus the banks' 7.6%. They make up for some of the higher personnel costs by avoiding the allocated expenses that banks need to cover. "Other general and administrative expenses" hit 34.1% at banks. That is the banks' highest expense category and one which the equipment finance unit within a bank may have little control over and be unable to reduce. In comparison, G&A for independents is 16.5%, less than half the banks' expense.

Our interviews underscore the willingness of independents to pay for performance with a high emphasis on commissions and bonuses, sometimes outside the parameters followed by banks. This may allow independents to attract and retain sales personnel who rely significantly on NBV growth for their income.

Figure 11: Independents: Efficiency and Effectiveness

Thousands of Dollars or Percent	Industry	Banks	Captives	Independents
Booked & Funded/Sold as a Percent of Approved (based on number of applications)	73.9%	63.3%	90.3%	64.3%
New Business Volume per Sales Full Time Equivalent	$18,334	$19,736	$22,468	$6,765
Percentage of Full-Time Equivalents (FTE) in Sales/Origination	23.5%	25.3%	16.9%	32.5%
Sales and Marketing Expense as a Percent of Revenue	6.0%	5.4%	5.3%	14.4%

Source: 2018 SEFA, 21a,31b,28c, 17a

Employee performance numbers show the banks' productivity power over independents. Many banks focus on cross-selling equipment finance to current customers, dramatically reducing their origination costs and increasing the likelihood of an application becoming a funded transaction. Their market size and ability to depend heavily on current customers enhance productivity, as seen in Figure 12 below. Banks outperform independents across virtually all sales efficiency metrics, leveraging one of their competitive advantages.

Figure 12: Comparative Sales Efficiency

Comparative Ratios – Average ($000s)	FY 2017 Average ($000s)			
	Industry	Banks	Captives	Independents
New Business Volume per Full-Time Equivalent (FTE)	$4,318	$4,995	$3,788	$2,198
Net Earning Assets per FTE	$9,244	$12,124	$5,672	$3,798
Total Assets Under Management per FTE	$12,023	$14,918	$9,223	$4,397
Loan & Lease Revenue per FTE	$701	$780	$662	$397
Sales, Gen & Admin Expense per FTE	$180	$214	$127	$145
Net Income per FTE	$217	$209	$265	$129
New Bus. Vol per Sales FTE	$18,334	$19,736	$22,468	$6,765
New Bus. Vol. per Sales/Mktg/Syndic. FTE	$16,097	$18,101	$17,262	$6,101

Source: 2018 SEFA, 31b

Figure 13 points to another competitive advantage other players have versus independents. Independents face higher funding costs versus banks and captives. Importantly, this chart also shows the higher yields and spreads available to independents, resulting in their superior ROA and ROE versus banks and captives. While the volume generated by independents has declined over the past decades, independents have consistently generated superior net margins and returns.

However, using average ROA and ROE may mask the varied range of performance among individual independents. While the weighted average ROA for independents reaches an impressive 3.0% and the median remains at a strong 1.6%, ROA drops to 0.8% for companies in the 25th percentile. The 1.6% and 0.8% ROAs compare to 1.2% and 0.7%, respectively, for banks. While 25th percentile ROEs for banks and independents are similar (4.0% versus 4.7%), the median ROE for independents is only 9.7% (versus an average of 21.2% below) while the banks' median is 15.2%, well above independent levels. Banks appear to be operating with greater consistency in returns versus what independents achieve. Readers may wish to review the Equipment Leasing & Finance Foundation's report on inflation and interest rates: *On the Rise; How Inflationary Pressures and Rising Interest Rates Could Impact the Equipment Finance Industry*.

Figure 13: Funding Costs

Percent	Industry	Banks	Captives	Independents
Median Cost of Funds	2.31%	1.99%	2.89%	4.40%
Median Pre-Tax Yield	5.70%	4.52%	5.84%	8.81%
Median Pre-Tax Spread	3.00%	2.50%	2.90%	4.62%

Source: 2018 SEFA 10c

Pricing is where independents make up for operating inefficiencies and finding costs. Resulting from a higher interest rate environment, yields increased for independents from 8.38% to 8.81% or 50 basis points. The median cost of funds also increased by 72 basis points. However, the median negative net impact on pre-tax spread was only three basis points from 4.65% to 4.62%. Using medians for comparison, banks pre-tax spread declined 13 basis points, and captives declined five basis points. Interviews suggest that spreads continue to be under pressure across the industry.

Figure 14: Performance Returns

Percent (average)	Industry	Banks	Captives	Independents
Return on Total Average Assets (ROA)	1.7%	1.5%	2.4	3.0%
Return on Average Equity (ROE)	16.7%	15.7%	20.0%	21.2%

Source: 2018 SEFA 18a,18d

As should be expected given the parents of bank units and captives, Figure 14 shows that independents must operate with significantly less leverage. Total liabilities to net worth for independents was 5.8 versus 21.0 and 9.1 for banks and captives, respectively (SEFA, Chart 18d).

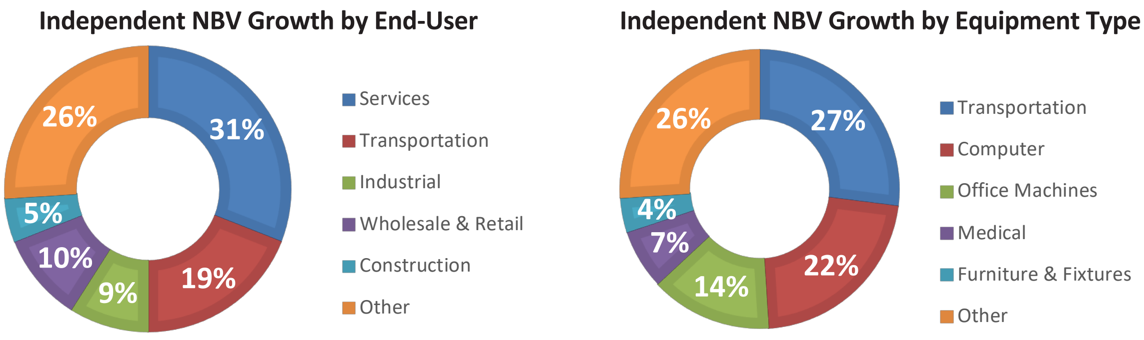
Portfolio quality remains strong for the entire industry, including independents. Delinquencies over 30 days were 1.5% versus 2,1% for the industry overall, driven higher by captives (SEFA, Chart 18c). Net losses for independents stood at 63 basis points, low but slightly from 61 basis points in the prior year (SEFA, Chart 20c).

As for industry and segmentation focus, while overlap exists, to some extent independents sell to different industry end-users than banks or captives. This is particularly true related to sub-segments within the larger industry group. As our interviews show, independents work to avoid direct competition with banks or captives, given the rate and other advantages banks and captives have.

With captives, little apparent direct end-user overlap exists in major industry groups. The most recent SEFA report shows that captives generated 61% of NBV from agriculture, construction and telecommunications (SEFA, Chart 33c). The only significant overlap with independents occurs in construction, accounting for just 5% of independent NBV, based on the SEFA survey. Given their broad focus, banks operate with substantially greater overlap; services, industrial, wholesale & retail, and transportation total about 54% of 2017 NBV (SEFA, Chart 32c) versus 69% for independents.

Figure 15 shows that most independent NBV depends on six broad end-user segments. Regarding equipment type, medical and furniture fixtures, with 11% and 5% of NBV, respectively, are equipment types that do not appear among the top five-volume areas for banks or captives in the SEFA report.

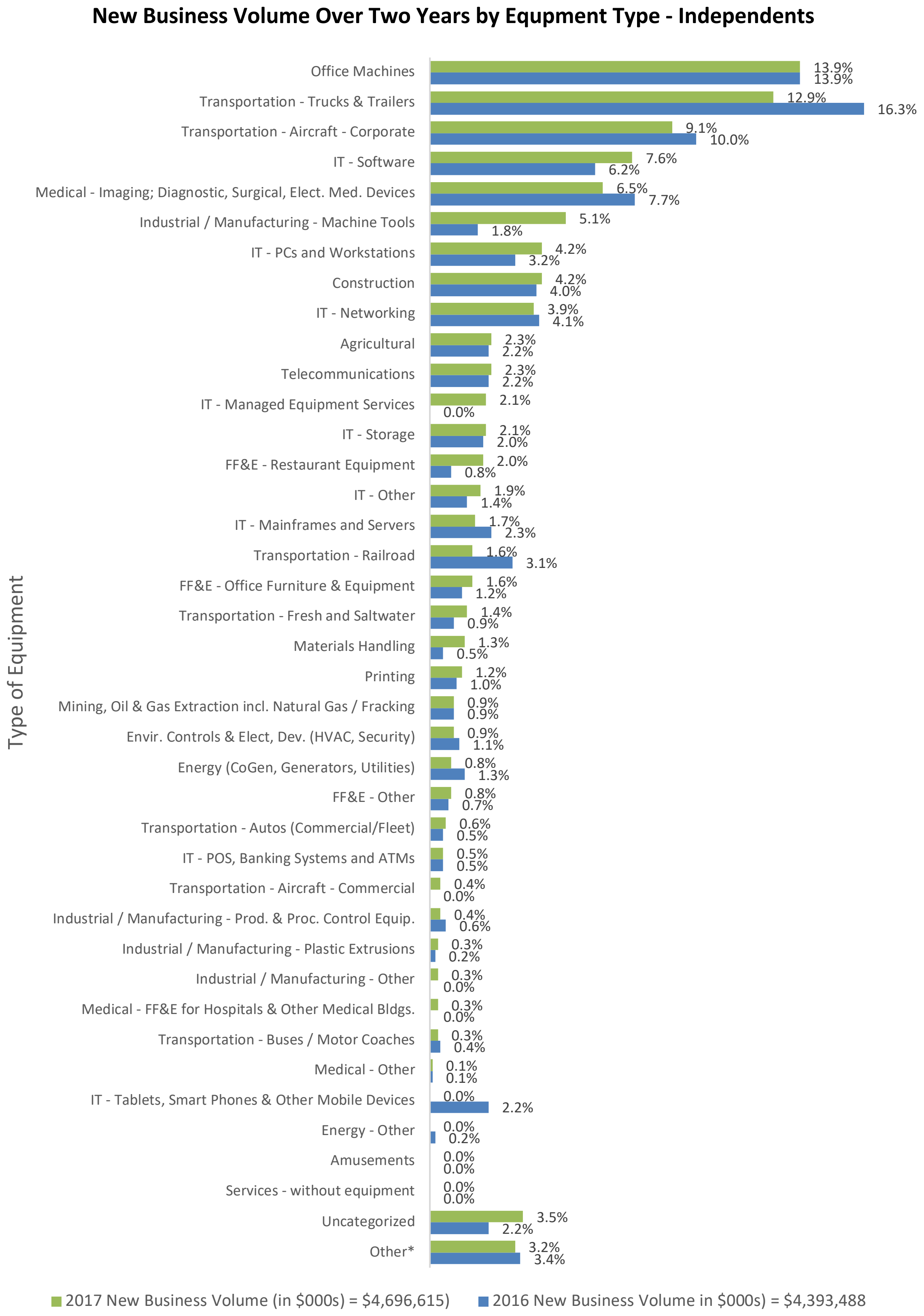
Figure 15: Independent NBV Growth



Source: 2018 SEFA 34d, 34f

Independents do not focus on overall industries but rather segments within those industries. Successful companies will even differ on the attractiveness of certain sub-segments, some avoiding a segment than another company will aggressively pursue. Figure 16 underscores the sub-segment emphasis that differentiates independents.

Figure 16: New Business Volume Over Two Years by Equipment Type – Independents



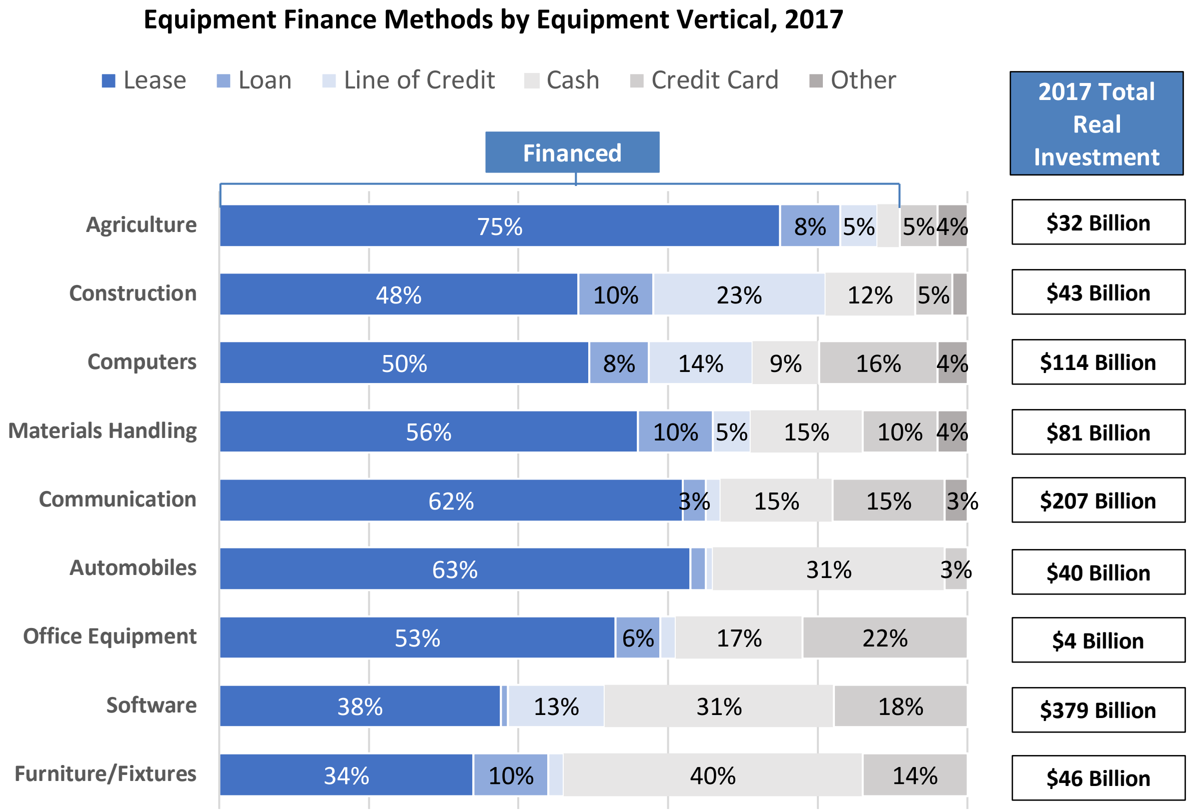
*Other includes miscellaneous equipment types such as consumer goods, laundry/garment care equipment, fitness, and auto repair.

Source: SEFA, 34e

Market and Industry Sizing – The Independents' Opportunity

The Equipment Leasing & Finance Foundation's Horizon Report estimates the potential dollars for financing by the equipment finance industry and its competitors. Figure 17 quantifies both total investment and the amount financed within nine vertical segments. The percentage of equipment financed ranges from a high of 88% for agriculture to a low percentage of about 35% for furniture/fixtures.

Figure 17: Equipment Finance Methods by Equipment Vertical, 2017



Source: 2018 Equipment Leasing & Finance Foundation end-user survey
Note: Equipment verticals not shown did not receive a sufficient number of responses to produce statistically viable results.
Shares 2% or less are not labeled.

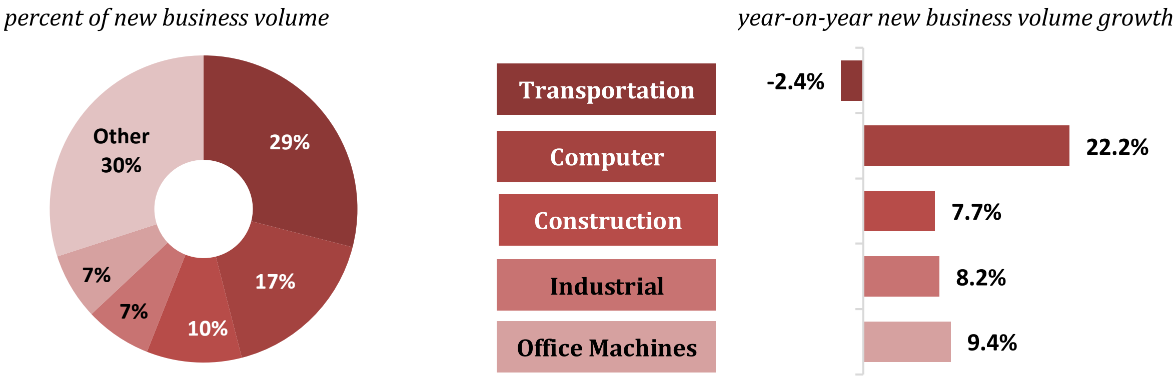
Source: *2018 Equipment Leasing & Finance Industry Horizon Report,* Figure 4

Software, communications equipment, computers, and furniture/fixtures are the four biggest investment areas resulting in financing opportunities for all financial Institutions. While the software vertical finances only about 51% of its purchases, it represents a potential financing opportunity of over $190B, more than other verticals.

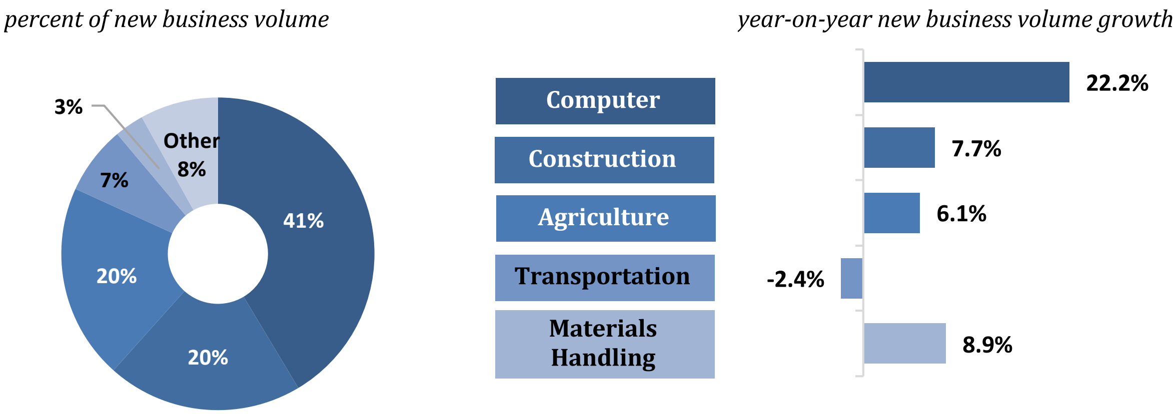
The Horizon Report also estimates the independents' share of these key areas with, depending upon the area, independents capturing 7-37% of the available financing opportunity. Software and computers, materials handling, and construction show the largest shares for independents. Apples-to-apples comparisons are difficult due both to different survey sources and different categorization of verticals. For example, software in the Horizon Report includes all software acquisitions by equipment end-user, regardless of their industry.

Figure 18: Equipment Finance Market Segmentation by Equipment Vertical, 2017

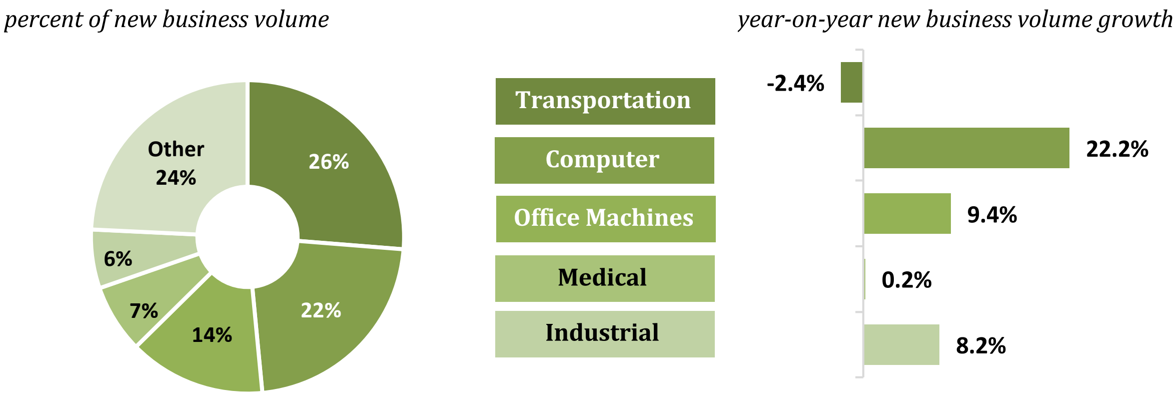
Banks



Captives



Independents

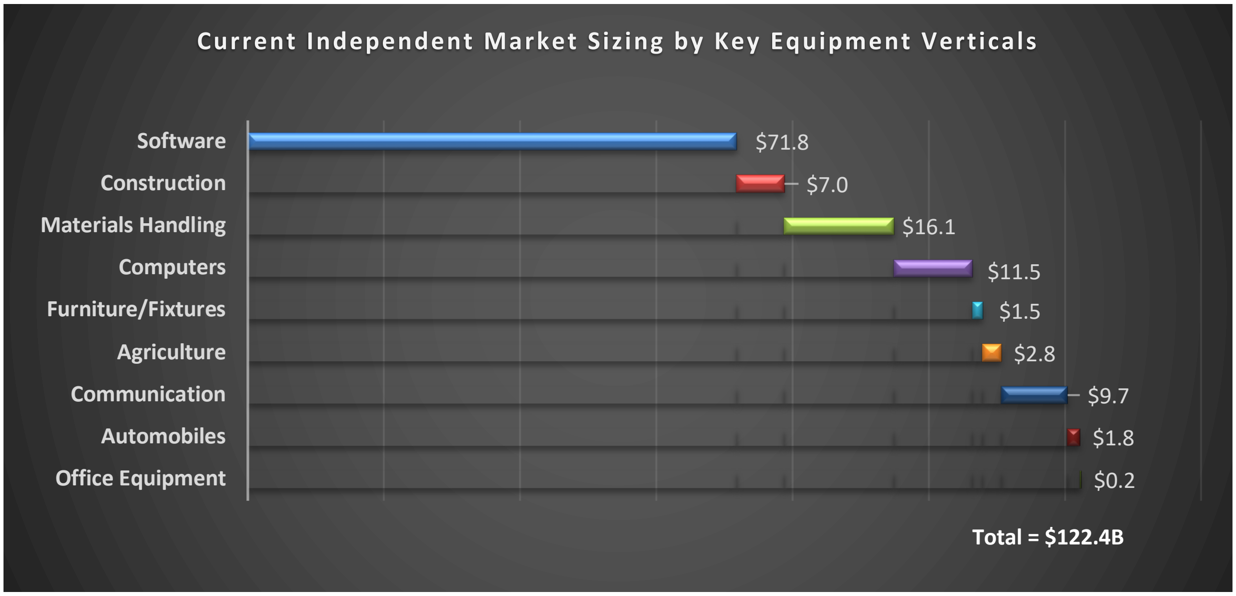


Note: Due to rounding, percentages may not sum to 100%

Source: *2018 Equipment Leasing & Finance Industry Horizon Report,* Figure 13, 2018 SEFA, Keybridge

Figure 19 quantifies the independents' opportunity, based upon the above Horizon Report data.

Figure 19: Current Independent Market Sizing by Key Equipment Verticals



Source: 2018 Equipment Leasing & Finance Industry Horizon Report, Figures 4 and 7

Two additional data sources provide valuable perspectives on several key industries for independents. Selected PayNet data shows some recent financing growth trends for key industries and reaffirms that these are attractive areas for independents. In Figure 20, the base index is set at 100, as of January 2006.

Figure 20: US Small Business Lending Index

	1/06	1/10	1/15	1/16	1/17	1/18	9/18
Agriculture	100.0	104.2	149.8	122.0	109.9	113.3	116.9
Construction	100.0	43.2	71.7	79.3	83.8	89.3	91.9
Transportation	100.0	36.6	114.4	122.2	105.7	110.1	126.4

Source: PayNet

Figure 20 indicates the cyclical nature of each vertical. While all verticals are impacted by macroeconomic factors, even these three industries do not move in lockstep in their overall performance with even some variance in month-to-month trends. (Specifically related to Construction, U.S. Census Bureau also shows growth. Its data puts overall construction spending at $1.3B, a 7.2% increase over the same month in 2017. Year-to-date spending is 5.5% above 2017.) PayNet data suggests that growth is not linear nor steady and, therefore, lenders need to continually track and evaluate their industries, the segments within them, and avoid concentration risks. That is precisely the approach followed by the best independents.

Economics Overview Summary

The available financing market for independents remains large and, at least in many segments, growing. Further, as our interviews indicate, more share erosion is unlikely (other than due to continued acquisitions), given internal bank risk management issues and regulatory concerns.

In short, the overall market is large, and independents have a continuing opportunity for growth.

The next section focuses how independent manage themselves, discusses the key issues they face, and their diverse approaches to sustaining quality assets and building market position.

The Current Status of Independents

"For those of us who survived, the economy is a lot better."

"Independents used to be looked down upon us. No longer."

"Independents perpetuate the art of leasing."

"There could not be a better time to be an independent than now."

These comments, along with many similar ones, portray the general view of the leaders of independents toward their sector. Executives are well aware of the competitive environment in which they operate: "We are working harder to make the same amount of dollars from vendors...banks are pushing more." And, in some cases, the value that independents provide cannot overcome a lower interest rate: "Independents are creative and tenacious, but the lending business has become more of a commodity than ever before."

Independents know the hurdles they need to meet versus lower cost competitors. Without exception, however, they believe that if they provide creative solutions, offer excellent responsiveness to their clients, and strongly maintain internal risk disciples they will continue to play a critical and sustainable role in equipment financing.

In our interviewees, four areas were consistently mentioned in response to why today is a good time for the independents. Each will be discussed in greater detail later in this report.

Financing. One interviewee summarized the availability of both long-term capital and bank funding: "Now is a good time. There is a lot of idle money out there. It is a good time to grow." Ready funding encourages growth and new entrants. However, comments later in this report show industry veterans expressing caution both about growing too fast and the type of funding partner to work with. The last recession proved the need for funding diversity and most independents are taking advantage of the strong environment to increase the diversity of their funding sources.

Competitive environment. Independents respect banks for their balance sheet strength, low funding costs, and large customer base. They know that if a bank wants to do a specific deal, they can usually win it based upon lower rates and fees versus independents: "Banks have a commodity, not a lot else." At the same time, banks operate within a limited credit box and are widely viewed as slow-moving and offering a mediocre customer experience to all but the largest companies. Independents believe that banks are locked into their current approach, have been successful at it, and are unlikely to focus on the sub-segments and credit niches on which independents focus. Similarly, captives are tough competition in financing their major equipment types, but open up the opportunity to when customers require used, highly specialized, and/or multi-company equipment. The competitive framework appears to provide significant growth path for independents.

Niche focus. Most independents have generated their growth by avoiding direct competition with their bigger and lower cost to customer rivals: "Great time to be an independent. Great time to be an entrepreneur.

Not a great time to be vanilla." One common theme is: "We play where others do not." Banks and captives have either abandoned or do not wish to focus on many of the industry and credit areas that independents focus on: "We have done well in part because small niches do not attract large banks."

People. This report discusses the role of overall company culture and the increasing importance of millennials in staffing. Many of the executives of independents have worked at larger firms with some designing their organizations to be substantially different in areas such as communications and transparency than their prior employees. Compensation is usually performance-based without the caps that banks often impose. Our interviewees frequently mentioned that it was "fun" to work at their firms because of the collegiality, focus on the customer, and relative lack of internal politics.

The current situation for independents is strong, and the outlook is positive.

At the same time, independents themselves expect a shakeout, based upon some players failing to develop or maintain credit discipline in an era of easy funding. Those independents that manage funding, successfully execute in their niches, and maintain strong staff have set the foundation to thrive even in uncertain times.

Building and Sustaining an Independent: Three Legs to the Stool

The management of independents, whether large companies or small, operates with three factors that mold and sustain their operation: *Culture* helps to define how a company is run and how employees interact with customers. *Strong practices in personnel* selection and management follow from the culture and are critical to business sustainability. The third element follows from a company's flexibility and entrepreneurialism. At first, *strategic opportunism* may appear in conflict with the discipline and niche focus that are the hallmarks of in the best independents. Being selectively opportunistic allows independents to outmaneuver bigger competitors and establish more channels for growth.

The Role of a Strong Culture

Few business topics have received greater focus than the development, care, and feeding of corporate culture. Our interviewees talked extensively about the culture of their companies, each viewing culture a bit differently but all articulating the critical importance of a positive culture, one that reflects its people, their ethics, and the company's focus on its customers. They view culture, like industry verticals or technology, as a critical differentiator, one that can result in a sustainable competitive advantage.

The case example featuring GreatAmerica depicts a leader who has been setting the formation of his company's culture for decades, but certainly with the active input of various levels of the organization. Similarly, the heads of companies with much shorter operating histories than GreatAmerica, as well as startups, also emphasize the need for a common culture that sets a tone and differentiates their companies.

Multiple interviewees suggested the culture they were building was in sharp contrast to what they had experienced at prior employers, often much larger firms with long histories. Interviewees frequently repeated the sentiment expressed by one comment: "I worked for a company that said all the right things, but it was not authentic." Another recounted the required classes he had attended regarding company culture and said, "It was a joke. It allowed people to check a box." Culture is no joking matter for the independents FIC interviewed.

Some companies operate with a preponderance of experienced leasing vets while others have mostly younger employees. These companies know that the best culture is not one size fits all and reflects that in how they define their culture. The currency capital case example discusses the specific needs of millennials and the working atmosphere critical to them. In contrast, one company composed of business veterans, many of whom worked together previously said, "We built our company with friends" while the head of a company with a similar approach commented, "We think we have the best of both worlds. We are disciplined and not a bunch of cowboys, at the same time we are entrepreneurs."

Based on our interviews the culture of the independents includes a focus on nine key areas that receive different attention and weight depending upon the company's stage of life cycle and other needs, listed in Figure 21.

Figure 21: Inputs to Building a Culture

Accountability. Employees are held accountable for their assignments: "There is no place to hide here," said one executive. Another stated that each employee was given a clear role: "Ours is a culture of accountability. We tell our employees what we expect of them, and we evaluate them against that criteria. New hires like the clarity of our culture."

Responsibility. Companies try to give the employees the tools and authority to fill their roles: "People here know they can get things done."

Constant communication. "If anything, we overcommunicate our vision." Interviewees also mentioned their transparency concerning individual and corporate performance.

Employee training. "We have a culture of growth, innovation, and continual training. We have implemented Six Sigma."

Internal "muscle building. "One company of about 100 employees said, "We provide and show leadership paths to our staff. We will move people from one group to another to develop them." This concept, termed "muscle building" by one CEO is intended "to broaden the knowledge base of an employee and provide them with more career options even in a relatively small company." Several mentioned this approach as of particular importance to millennials.

Adaptability. Major lease accounting rules changes, economic downturns, fierce deep-pocketed competitors. These are just three changes independents have had to adapt to over the past 20 years. Independents have managed through these past changes and expect to face new challenges in the future. The best are already preparing for a world with increased customer delinquencies and a more volatile business environment.

Focus on continual innovation. Several companies stressed they want their employees to look outside their industry for opportunities and new approaches: "We try to think like Amazon and not like the equipment finance company down the street. We want to be disruptive in our chosen areas, and the business is ripe for that approach." Interviewees, some relatively new and others well established, mentioned the desire to be disruptive and their view that many equipment finance companies were unprepared for major change.

Balance. Positive cultures are difficult to establish and delicate to maintain. Most independents highlight the need to be actively aware of the critical factors required to maintain a good culture and the steps required to maintain it: "We are a fast growing company, but we have a single and strong positive culture. We try to balance informality in communications and style with a strong structure in our approach to transactions."

Restlessness. None of our 20+ interviewees expressed self-satisfaction or contentment with the current status of their company. Each sees competitive threats and the need for their companies to anticipate evolving customer needs whether that entails technology, new services, or other areas. Given the dramatic changes that independents have experienced over the past 40 years or more and their common trait of adaptability, restlessness is to be expected.

Strong Practices in Personnel Management

The importance of culture and how companies design it differently carries over to the type of person they want to attract and how they need to manage them. The case example on millennials discusses their specific requirements, but each independent we interviewed highlighted the need to find employees with the best fit for their company. Many recounted hiring failures either because they had not developed an internal checklist of characteristics or because they ignored it. A successful employee at one company may fail at another if the circumstances are not right.

Several companies concentrate on hiring locally. One Midwest company mentioned that a number of geographic transplants had failed: "We have had little success in bringing in outsiders."

Several want to build their staff from entry level, investing in required training and molding the new hires:

- "Our best employees are homegrown. We recruit from local universities and want long tenure."
- We prefer people without a finance background. We like to train our own people and prefer to find young people with good sales potential.
- We hire interns from a local university. They get some business experience, and we get to test their abilities.

One company that focuses on leveraging IT wants employees who are similarly driven: "We want to attract nerdy tech people who want to find the coolest technology to apply without spending a lot of dollars."

In contrast, one relatively recent startup has focused on hiring experienced lenders, many of whom they knew from previous jobs. They view those types of hires as critical to its success: "We need people who can hit the ground running. This is a great place for experienced people, not so good if you are new to the industry."

In today's environment salespeople receive greater attention and compensation: "Our salespeople can make a lot of money. It is more attractive than working for a bank; banks will cap compensation." Many independents look at banks as a good staffing source: "When we hire people from banks, we empower them." Companies also mentioned it is harder to find and hire good salespeople, given competition both in equipment finance and from other industries: "It is harder to hire salespeople now; there is a shortage. Software companies offer a guarantee, and it can take five years for a new salesperson to build a profitable portfolio."

Finally, several companies mentioned that loyalty was both important and a two-way street, if they expect the staff to remain loyal: "We are loyal to employees; we did not lay off people during the recession. They remember that."

While many independents have a head of human resources, hiring decisions are made by the business line leaders who define its style and culture.

Strategic Opportunism

The section below, The Power of Verticals and Niches, shows the targeted and disciplined approach most independents follow. The best players focus on areas in which they can demonstrate expertise and where they can "pick their competitors" meaning they avoid outsized players and try to operate in lines of business with limited competition. They review their areas of focus regularly and may exit business lines that no longer appear attractive.

The next section also provides some examples of "lightning striking," that is, unexpected new business opportunities that independents can jump on quickly given their flat management structure and quick decision making. In one case, a transportation specialist learned of a small company for sale in a related space. In another, the leader of a niche business at an independent approached the leaders of a company which he thought could better structure and close transaction. The ability of the experienced teams at the top of these companies allowed them to conduct quick due diligence on the people and their businesses. Their access to capital and depth of funding options allowed them to close these deals quickly.

At many independents, discipline complements the ability to take advantage of opportunistic events.

Growth Paths: How Independents Differentiate Themselves

The Power of Verticals and Niche

Showing differentiation and demonstrating value that cannot be obtained from other providers drive much of an independents' marketing effectiveness. Management have long needed to operate in a world in which bank competitors can provide lower rates, and captive competitors have a point-of-sale advantage. Both these and other advantages require that independents offer a non-cost-based benefit to vendors and end customers. Independents lever strong industry verticals and other niches as well as the use of technology (to be discussed in a later section) to provide value and the necessary differentiation.

Virtually every company we interviewed focused on a vertical ("Everything we do is industry focused. We know the industry, the equipment, and its value.") and/or a financing niche strategy to differentiate themselves. As might be expected with this group of leaders from diverse industries and backgrounds, some independents focus on segments that others specifically avoid. They all try to bring a depth of knowledge to their sub-segment that others cannot replicate. Comment: "I have been focusing on the same verticals for over 30 years since I was at GE." Another interviewee confirms this approach: "We find niches and work to know those niches better than anyone else."

Sub-segment focus. Independents do not focus on "transportation" or on "agriculture." Their lifeblood centers on sub-segments within those larger groups. For example, the Equipment Leasing & Finance Foundation's end-user survey shows that banks and captives dominate agriculture, but significant opportunity still exists. One agriculture-focused company commented:

> *"I don't go up against the big players. We focus on used farm equipment that most others avoid. We also have specialized knowledge of some fairly unusual equipment. Big lenders don't want to bother with this… We cannot compete with the captives. But, we can work with manufacturers making specific types of ag equipment and, in effect, be their finance company."*

Interviewees frequently spoke of their focus on working in areas in which most banks and captives are simply not interested: "We look for niches that do not attract the participation of a large number of vendors, so the potential volumes are limited. Also, the credits need to be specialized enough that banks don't find the area attractive."

Banks and captives often want large volume opportunities to justify their time and "move the needle." Most independents do not have that requirement. One executive commented, "We don't need 25% market share," meaning his company can pick sub-segments to focus on and not stretch for deals. Independents also believe that competitors want areas offering high NBV: "We live in our niches. There is often not enough volume in them for banks or captives to bother with."

Multiple verticals. While emphasizing verticals is an effective strategic approach, leaders of independents are aware of issues related to concentration risk and proactively manage their exposures to avoid too much dependence on any one vertical. For example, one independent focuses on IT, healthcare, and material handling as its three areas of particular focus. Another independent states that it focuses on 20 verticals to avoid possible concentration risk; "You need to be in multiple industries to take out some cyclicality." They also focus where others do not: "We have success in industries that everyone else is shying away from."

Most focus on structure in addition to industry. While usually maintaining an industry emphasis, many independents focus on transactions that involve complex structures, an area that banks will usually avoid except when working with a top tier credit: "We want to do a nonbank friendly asset. We will do nonstandard equipment with little liquidation value and some airball. A bank won't do that." But, management is also aware of the risk involved in this type of transaction and seeks to mitigate credit issues: "We lend to a redlined industry... We know the equipment; we structure it with a security deposit; and, we have corporate guarantees. We make money because we may ask 20 or more questions than the banker. For example, we will ask for a list of our borrowers' customers and check with them."

The willingness to structure deals also makes independents valuable to partners: *"We are the last chance for a vendor; others have already turned our clients down."*

Not just industry focus as differentiator. Some independents play a generalist role related to industries but define themselves based upon their credit approach: "We are a niche player in our credit profile." They focus on "B-" credits and "occasionally the "B" that a bank will not do.

New verticals. Independents are continually considering new verticals for growth opportunities. Some firms have ongoing new opportunity processes in place to evaluate new areas; other firms evaluate new niches on an opportunistic basis in which serendipity plays a role.

One of the companies with a structured approach to evaluating opportunities spoke of this activity as being part of the company's fabric: "We look at a possible new niche at least once a year. We have a person who looks at product development in that niche. The business and sales leaders evaluate its size and attractiveness and risk people also have a view. We discuss this at planning meetings, considering the attributes versus risks and other investment options. You should be doing this as a matter of course; it takes five-six years to build a niche." Another company, Commercial Equipment Financial International (featured in a case example on *Managing Through a Crisis*) also focuses on analytics: "We added an industry in the last year. We had the opportunity to expand because of the nature of the business. We looked at the industry's credit profile, and it was strong; we evaluated the size of the industry, and it was both large and growing. We also had staff that had some prior expertise in this industry, so we did not need to hire new people to handle it."

While it may take years to evaluate and start up a niche from the ground up, other companies exploit their industry contacts and jump-start new lines through acquisitions. Taking advantage of unexpected opportunities can also result in new businesses. In one case a company focusing on segments within transportation learned of the availability of a specialty company that management believed complemented its current offers: "We agreed on a deal in two weeks. Before we started talking to them, we had no intention of entering that area, but it made sense strategically."

Another company described the reason for entering a new business area as, “We knew a guy.” Management explained that the company was approached by a segment leader at another firm who was frustrated with his inability to get deals done. His unsolicited email resulted in the company adding on a new business area, again, one that fits within its overall focus. We heard similar comments such as “We found a guy or “A guy approached us” from several companies that expanded into new fields.

Exiting verticals. Just as independents review new niche opportunities, they also evaluate current verticals frequently to reassess their attractiveness: “We formally review each industry quarterly and get info on a monthly basis.” Interviewees cited multiple examples of dropping out of certain specializations. The main drivers of exiting a business were rate and credit performance.

Rate and quality:	“In the past few years, we pulled out of two-three vertical markets because the underwriting quality was not that great and there was some compression in rates.”
Collateral issue:	“We tried transportation, but it did not work for us. We don’t like equipment that can disappear. A tow truck can be moved out; a machine is a lot harder. Also, with transportation, you need to be highly focused on technology.”
Poor strategic fit:	“Several years ago, we entered the solar equipment business. We found it required longer-term leases than we wanted to write and that the banks were putting in cheap money.”
Intense competition:	“We got out of medical equipment because banks will do term debt with a balloon for this group. We need residuals for a return on our capital. “
Rate:	“We are out of copiers due to rate.”

One company that has been in business for decades summarized its continual review process for verticals: “We have been in 74 verticals since we started. Now, we are in about 20 significantly.” Importantly, getting out of a vertical does not seem to involve defensiveness or internal recriminations. Business leaders seem to look at the numbers, in particular, competitive dynamics, and make a joint decision in the best interest of their company.

Concern about verticals. So long as independents avoid depending too heavily on one or two segments and continue to monitor the competitive environment, they believe this strategic approach is sustainable over the long term. Independents do not expect deep-pocketed banks to compete in their bread and butter areas: “If banks went into the niche businesses independents are focusing on, it would be trouble for us. But they won’t because they want higher volume areas.” Most interviewees believe, “Generalists are going away.”

Relationships Based on Value Still Matter

The days of the salesperson who ingratiated himself with business customers by force of personality alone rather than substance is long gone. Yes, relationships continue to depend on people and may get a salesperson in through the door, but as interviewee comments underscore, the basis of a relationship is *value*, the value one or more company staff provide to an end customer.

What is value? In short, it is a differentiator. First, proving value to a customer allows an independent to avoid being a commodity provider and more than compensates for a higher cost to customers: “Value is worth more than a lower price. If I can process a transaction more efficiently, it will save time. That creates value. If I can provide a more integrated offer with the vendor, that creates value. If I can develop a program to help the customer sell more and if the customer is happy, that creates value as well. If our billing is clear and error free and if our dispute resolution is fast that creates value. This approach has allowed us to build long-term relationships with our vendors.” Other interviewee echoed a similar approach: “We are selling value, not rate”; “We focus on value rather than being a commodity provider.”

The value on which a relationship is based is specific: information, integration, speed, quality, etc. Vendors and other customers may have their own view of an independents’ value: “Service, speed, and ease of use are key. The vendor wants the deal off the table as soon as possible.”

How independents offer value varies widely. Some customers benefit from the information that independents can provide in segments such as fleet management. Information-based value is described below in the technology section. Another independent describes his customer value as “providing a cradle to grave approach for the segments they serve unlike what others offer.” Providing value often entails developing a consultative approach that competitors may find difficult to offer: “Maybe we should, but we do not worry about new entrants. The value we offer through our technology locks out many other companies.” But not all companies see IT as a value-added; “We cannot play on technology.” Instead that company focuses on more complex deal structures to mid-sized companies.

Increased competition, particularly from banks trying to build assets, has made relationship value more difficult to prove for some independents, and interviewees disagree on the strength of relationships today. One said pricing often dominates over relationships: “Relationships do not matter today as much as they did a few years ago…Pricing issues can dissolve a relationship.” Others see things 180 degrees differently: “I see a shift from companies sending out RFPs aimed at price to focusing more on value. They may want the lowest price, but they realize that finance and business expertise can add value to their business and its sales.”

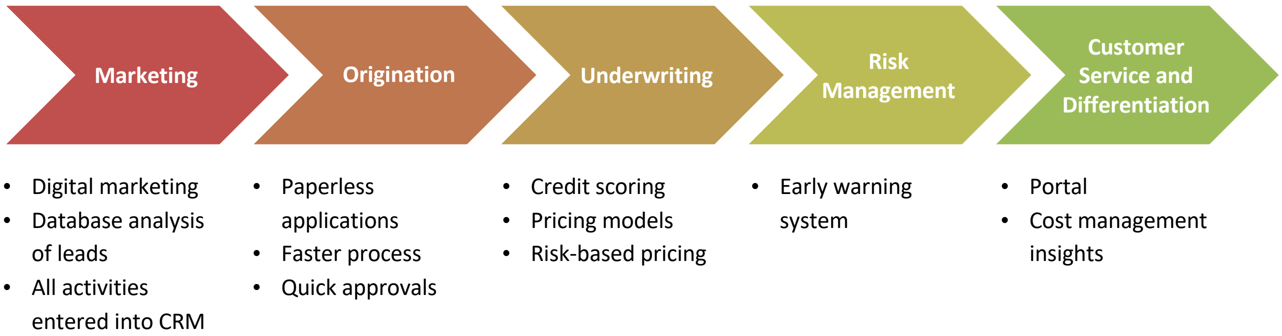
Technology May Separate the Excellent from the Mediocre

One theme that appears multiple times throughout this report is the degree of differentiation that exists among independents. No area illustrates this better than this group’s approach to and use of technology. IT-related comments range from “We’re all in on technology” and “We are betting our company on technology” to frustration about the current state of one company’s IT: “I would like to use eSignatures and get rid of paper files” as well as the overall independent segment: “It is a super laggard industry.” Another suggested that a reality gap exists in how companies assess the quality of their IT: “Everyone thinks they have great technology, but most have not seen great technology.”

Most view themselves at an advantage in their internal IT technology versus banks. One company commented that they are in a good position related to IT because “We have no legacy systems.” Another went further, saying that because of third-party IT providers, “Our systems capabilities rival the banks.... IT needs to be nimble.”

In recent years, IT budgets and management time spent on technology issues has increased significantly. Several interviewees commented along the same lines: “Technology is our largest spend after wages.” The AP Equipment Financing case example describes how a 30-year old company works to use technology to reduce costs while differentiating itself with customers. An increased number of independents appear to view themselves as technology dependent, while there are still a few companies, in general, smaller firms, that have yet to achieve the internal efficiencies and customer linkages that other independents benefit from. Figure 22 summarizes some of the use of IT across the independents’ business system.

Figure 22: Technology Application - Examples



Internal benefits. Independents apply IT to streamline internal processes, reduce fraud, and enhance targeted marketing and customer service.

- **Fraud**: “We use data sciences to review our portfolio, particularly related to fraud detection.”
- **Cybersecurity**: “We use IT to improve our data sciences, for electronic docs, for outward bound calling. Also for inward bound calling where we focus more on fraud detection. Also for cybersecurity.”
- **Internal costs (and customer benefits)**: “Our technology investment is a competitive necessity. Technology requirements involve everything from eSignature to DocuSign to development of a customized asset management system.”
- **Sales efficiency**: “We can do instant financing for deals less than $15,000.”
- **Customer service**: “We differentiate ourselves by service, and our service is technology based. You need to be highly integrated with your partners. This is a big barrier to entry.”

Customer linkage and stickiness. Versus five years ago, more companies are leveraging IT as a competitive tool based in part upon providing information and analysis that allows vendors and end customers to manage their businesses more effectively and save money. Using IT well can deepen a company’s relationship with a customer and allows the independent to position itself as more than a financing source, being viewed as a consultant and advisor, something the industry believes banks are ill-equipped to do.

In one case, leveraging data analytics and technology allows an independent to inform its customers about their total cost of ownership. An asset management system, accessible over the cloud, lists all equipment, including dates of lease expiration. Customers can go online to choose preferred methods for invoicing and timing payments, customizing those areas to their specific needs. This company's technology and the flexibility it allows has resulted in increased business: "We provide our clients with transparency, and they appreciate that." The technology and the customized information it provides "has positioned us as trusted advisors."

"We provide our clients with transparency, and they appreciate that." The technology and the customized information it provides "has positioned us as trusted advisors."

IT also allows companies to give value-added data and analysis to customers: "We provide dealers with technology and give them the ability to look inside their flow of applications. We make it easy for the vendor and the end customer." One comment presented his technology dependence in clear terms: "If we had not invested in IT early on, we would be dead."

A competitive necessity and cost of admission. Small ticket equipment finance companies believe they must use IT as an information and integration tool: "We have to use technology to be integrated with our vendors. It is a competitive necessity." This interviewee and others stressed that companies like his had no choice: "Necessity, not an advantage because integration has become an industry standard with vendors in the small ticket space. Without it, you cannot be in the game."

Some resistance continues. While most interviewees view IT as an essential tool, some companies continue to doubt the need to focus on this area. Ironically, one independent that works with its end customers on IT-related financing referred to itself as being "like the shoemaker's children," saying that state-of-the art technology was not necessary for his firm: "We don't need it. What the customer needs is our innovative funding approaches." Other independents might disagree with that individual and see his clients as ripe targets.

Another independent, small ticket-oriented, believes transaction structuring ability defines its client value: "We hit the phones a lot. We do not have a customer or vendor portal. Having a portal will not drive volume for us; our customers don't care. What matters for them is a well-structured deal at a good rate." A third company suggested their transactions were too sophisticated for IT's use: We may be a laggard with IT because our deals, while small ticket, are deceptively complex." Conversely, other interviewees would doubt that these company's approaches are sustainable without more technology leverage.

More IT dependency in the future. There seems little doubt that IT's importance will increase going forward, related both to internal company management and customer relationship building. Industry comments view IT laggards as facing possible extinction: "There is a growing divide between those with scale and the know-how to invest in technology and other smaller, less sophisticated companies. They are a dying breed."

A relationship approach backed up by technology goes hand in hand. IT can create a barrier to entry that is very difficult to overcome and position a firm for the longer term: “Some say automation drives commoditization. For us, automation drives differentiation. We offer a convenience-driven solution.” Companies that drag their feet in making investments may be at a disadvantage versus committed players: “We cannot be on the fence related to IT. We give our technology to our clients and are very proactive in providing them with insights. In our fleet business, we provide insights into areas that include fuel usage and even driver abuse of the vehicle.”

Increasingly, significant IT investment is not an option. Some independents may need to build their IT capabilities quickly if they are not to be left behind. One interviewee suggested that IT has long been a focus for many top performers: “The best equipment finance companies have been Fintechs for the past 10 years. They just don’t call themselves that.”

“The best equipment finance companies have been Fintechs for the past 10 years. They just don’t call themselves that.”

The Competitive Landscape: Independents and Competitive Challenges

Independents have a complex and multi-faceted relationship with banks. Most depend on banks for funding; many sell a significant portion of the loans they generate to banks; all use banks for cash management and related services. At the same time, independents view banks with their funding advantages and capital strength as their chief competition.

Captives also can be tough competitors on specific deals: "Captives will offer a discount to sell their equipment." As noted in the discussion on niches, independents will often focus on the type of equipment that the manufacturer does not want to finance. In some cases, vendors needs exceed the lending limits that captives are comfortable with, providing an opening for independents. Poor customer service and insufficient technology can also alienate customers: "We can compete with a captive when the vendor is dissatisfied … some captives may be paper-based."

As the Economic Overview showed, most captive's activity occurs within a relatively small number of industries. banks are more omnipresent across multiple industries and geographies and, since their number still exceeds 5,000, their credit appetite and focus can cover a wide range of transactions. Many also want to increase their loan growth.

Independents view banks as the 1,000-pound gorilla, but only in selected circumstances:

- **Bigger transactions**: "Banks have moved off small ticket to larger transactions."
- **Higher quality borrowers**: "Banks do a great job with excellent companies and offer a great price. But they also offer a bad customer experience."
- **Rate-sensitive customers**: "If you want the lowest rate, go to a bank."
- **Relatively straightforward transactions**: "Banks have become so rigid." "Banks don't want residuals."

How Do Independents Position Themselves Versus Banks?

Risk and residual focus. Independents view the banks' reticence to take on more risk as a major growth opportunity for them: "Independents can take credit and residual risk that a bank can't. A bank could do it, but they will not take a tough credit, for example, one that merits an 18% interest rate. We are very comfortable with that business."

Expertise and solutions orientation. "We can provide solutions that banks cannot. We evaluate a client's assets, introduce an efficient process to manage down their total cost of ownership, and provide a tailored financing solution to meet their needs. No bank can do that… banks are good for financing only."

Vendor financing: "Banks are crushing it due to pricing, but the vendor experience with banks is negative."

Customer service: Organizational changes at some banks may create a further opening for independents: "Some banks are putting small business and equipment finance together… That's a mistake if the banks want to continue to serve their vendors…banks are being pressured internally to do more volume with less overhead. This will result in reduced customer service." Another independent also focused on the superior customer service he believes firms like his provide: "At an independent, the vendor gets good customer service that they pay for through the rate. With an independent, the customer gets a person who knows the vendor's business and who understands how the equipment works, its life cycle, and value."

Line authority: "Banks have super talented people who do not have a voice anymore. Decisions are made from above. Our people can say yes and negotiate."

"Banks have super talented people who do not have a voice anymore. Decisions are made from above. Our people can say yes and negotiate."

Speed and flexibility. Several executives commented on the ability of their companies to outmaneuver banks: "Banks are dominating the industry, but a lot of people who work at bank subsidiaries are not happy. It is much more difficult to get a deal done."

Another comment: "We can be creative... Our CEO is an entrepreneur. We can take a longer-term view and can tailor transactions to our clients more than most banks can do." Contrast this positive perspective with the view of a former banker reflecting on his recent experience before joining an independent: "The OCC mandated that banks operate with three lines of defense against losses. To some banks, this has turned into six lines of defense. You have five-six people Monday morning quarterbacking. They are all asking about deals, but not in a coordinated fashion. Everyone is very cautious."

Less bureaucracy and internal checks. Tied to speed and flexibility as well as customer service, an interviewee stated, "While independents are hardly free of regulatory requirements, banks operate in a highly rules-based world and more regulations and compliance drove environment than banks." Another independent supported that view: "By their nature banks are bureaucratic, and they take longer to make decisions."

Consistency and commitment. While banks would disagree, independents questioned the extent of bank commitment to this space: "Banks will always be in and out."

Banks and captives may remain the dominant players in the equipment finance space with independents finding success with those segments that these competitors either cannot or will not work with.

Management Practices: Factors Determining Independents' Success

So far, this report has focused primarily on the strategic choices that independents make to demonstrate value and differentiate themselves from competition. This section addresses areas that management considers on a daily basis: funding, pricing, risk, and the regulatory environment. As in other areas, the attitude concerning each of these topics and the intensity of focus placed on them by management differs substantially from one independent to another, based upon their size, business mix, experience during the downturn, and other elements.

Availability of Funding

The number and complexity of funding sources differ dramatically across independents. Company size is not necessarily an indicator of an independent's funding sophistication. Further, their preparation for a downturn and their view of its potential impact on their ability to funding operations also varies.

While all independents had to address funding issues during the downturn, some were pushed out by their banks: "We had a revolving credit with just one bank. We had been with them for 20 years, but they had a big fraud and decided to get out of the business even though we had had a fine relationship." Fortunately, that bank continued with them through their move to a new lender.

Another independent operated with banks to avoid being dependent on any one lender. That approach was not sufficient during the downturn: "We had four funding sources. All of them dropped us during the recession. We had to shrink our portfolio and work with hedge funds. Now we have two banks in our group." While banks remain a fundamental funding source for all, many companies want multiple options: "We have a conditional sale agreement with a private equity firm, a line of credit with two banks, and we sell some loans to another bank, earning a quick spread and reducing funding needs."

> *"We had four funding sources. All of them dropped us during the recession…"*

How available is bank funding today? Some larger independents say, "Lenders call every day" while one smaller player commented, "Banks never call us." In speaking with several banks, their funding appetite depends on the history and size of the company, its financing focus, and the degree to which the banks possess relevant industry expertise. But, in general, a favorable environment for independents exists as "We [banks]want to get our assets to work… The banking industry is looking for assets."

Beyond bank and private equity financing, independents also pursue some securitizations, and others sell off some of their portfolios: "We syndicate and make 4-12% on a sale." While many pursue syndications, some companies see activity becoming more complex due to bank compliance requirements: "We need a larger and more diverse number of potential funding partners. Some banks have tightened up due to KYC [Know Your Customer] and do more due diligence on us and the transactions."

Based on our interviews, the key components of a "Funding Check List" include lines of credit, conditional sales contracts, securitizations, syndications, and of course, equity and cash flow. In addition, one interviewee stressed what he viewed as the critical importance of hedging interest rate risk: "If you are borrowing on a floating basis and lending fixed as most independents do, you are putting yourself at risk if rates rise significantly."

Pricing Practices: Technology-based to High Touch

Pricing practices among independents range from being almost totally technology-based to a virtually no tech-high touch approach.

Small ticket pricing has increasingly moved to an IT-based approach, with the methodology often developed internally. One independent uses formula-based risk-based pricing: "We created a customized rate card with the pricing tied to the credit score." Another company has developed similar matrices but with more segment specificity: "We've developed our risk-based pricing matrices for each industry." Beyond designing the matrix for specific segments, its approach also allows for some pricing flexibility: "We allow for exceptions to the pricing matrix in about 30% of the cases, but people know not to abuse it." Part of their internal pricing controls potential abuse by sales staff ties into pricing: "The yields that our salespeople get impacts their compensation."

One company emphasized its knowledge of internal costs as a key pricing input: "We know the cost of each deal. We know the cost to do documentation, underwriting., booking, servicing, all areas. We apply basis points based upon our historical average, and then we adjust based on our knowledge of our five segments."

Other small ticket players use models but supplement them with additional information: "We built a proprietary pricing model. We hired a [top college] grad to do it. But, we, also have lots of internal conversations about pricing with investors and industry people. We are small enough to do that."

Residual lenders incorporate multiple factors into their pricing: "Pricing is as much an art as a science. Because we are residually focused, we look at the equity we will put in and also customer behavior. For example, does the customer have a history of returning the equipment on the last possible day." As part of this process, the company will also analyze equipment price trends.

One mid ticket lender believes that models do not add value to his area. Instead, he relies on the experience of his sales and credit people: "Pricing takes us about 30 seconds."

While some companies avoid reliance on technology as part of their risk process, the trend appears to be toward more data-driven decisions related both to credit and pricing becoming the norm, particularly with smaller transactions. Increasingly, data analysis is a key factor in pricing across all equipment types and size of transactions, allowing management to build off its prior actual risk and pricing experience to determine the best risk/reward tradeoff.

Risk Management

Like pricing, risk management approaches vary based on transaction types and size. Small ticket companies appear to rely on credit scoring linked to pricing models with the goal of streamlining processes, standardizing decisions, and increasing operating efficiencies. However, some independents continue to have a credit expert review all applications. They use a short form for transactions less than $250K that goes through a briefer underwriting process with a full underwriting process above that: "We are just more comfortable doing it that way."

Larger ticket transactions usually require multiple signatures and a formal review. One independent visited some of the large lenders in its revolver and conducted interviews about how they managed risk: "We visited some of our bank lenders and asked them about their risk management processes. We learned from them and copied some of their methodologies. They were very willing to share their approach and insights." Other independents have adopted risk practices used by their prior bank employers.

Particularly as the business cycle has matured, companies are placing more focus on detailed portfolio reviews.

Smaller ticket lenders look for leading indicators of a downtrend with several independents mentioned the importance of uncovering problems as soon as possible: "Every quarter we have a risk management review. We look at a number of performance and quality indicators. Our people know that they should identify any potential problems as soon as possible rather than hide them or hope they go away." Some are using third-party data sources such as PayNet to evaluate their industry exposures. Evaluation of potential concentration risks has also increased.

Collateral lenders monitor and track moves in equipment values and work to minimize losses by actively assessing the market for residual values. Even if a loss occurs, it can be reduced by this process: "When we take a loss, we lose at worst 30-50% of the equipment value, not 70% We know the collateral and how to dispose of it if we need to."

Overall, independents appear to view their vertical expertise and experienced staff as fundamental to their ability to manage through a deterioration in customer performance: "If you know your industry, you can ride through a downturn." In the section below on the industry's future, however, we quote several company leaders who question the thoroughness of the credit and risk management processes of some newer players, expressing concern that they have stretched credit and risk management criteria to generate faster growth.

Managing Through the Regulations

Concerns about the regulatory environment exist with most independents, and the majority see increased regulatory requirements: "The risk of more regulation looms large." They also all agree that the situation they face pales versus what the banks must deal with.

- Firms operating in California mentioned the proposed lender licensing requirements; none viewed it positively: "Almost 20% of our business is in California. The California rules are not good for business."

- Others mention state tax requirements and “jurisdiction requirements for our servicing portfolio.” A few mentioned the need to be SOX compliant as well as following KYC.
- Small ticket lenders express concern about proposed rules related to a borrower’s race and national origin: “We certainly do not ask for this information as part of the application process. We don’t know how to provide this information.”
- Those independents that syndicate loans to banks mention increased scrutiny by the banks of them and their clients: “Banks test us to operate as a bank. So, we are tight with policies and procedures.”
- One company that provides a payments portal for its customers has found itself operating much like a bank: “We set up a payments portal. In order to get approval as a payment processor. It requires the same policies and procedures as a bank.”

Others state they have few regulatory requirements or are simply not addressing them:

- “Don’t tell anyone, but we are largely unregulated, particularly in comparison with banks.”
- “Some independents just ignore the most onerous regulations.”

Expectations are that regulation related to small ticket transactions are likely to increase. In addition, certain states, most notably California, will continue to increase their regulatory burden on the industry. Many expect the cost of regulation to increase over the near future.

Short Takes: Brief Perspectives on Other Areas of Interest to Independents

Interviews for this study touched on a number of topics that, while of interest, were of varying degrees of importance to independents.

Managed Solutions

The 2017 Equipment Leasing & Finance Foundation report, *Managed Solutions: Evolutionary or Revolutionary?* ("Managed Solutions"), evaluated the characteristics and growth potential of Managed Solutions. While the specifics characteristics of this type of transaction may differ based on end-user requirements, the report defines these transactions as "bundled solutions agreements, pay-as-you-go or pay-per-use contracts… 'Everything as a service'". Independents differ in their knowledge of managed solutions, its applicability to their industry verticals, and their current interest and willingness to further explore its use. Some go so far as to view it as inappropriate for their customers.

Three industries, in particular, were mentioned as most likely users of this service: IT, transportation, and printing. One interviewee commented: "We do that to a small degree in our IT business." Several areas of transportation are also exploring managed solutions: "We may do more of that in our fleet management business, said one company while another commented, "There may be some need in tractors trailers, but I do not see it much elsewhere."

Another independent noted "some small" interest in pay-per-use contracts. In other cases, interviewees say either this approach does not work for their industry ("A lot of our equipment gets heavy use, so managed services does not apply."), or they do not see a demand ("I've heard a lot of noise about this, but have not yet seen a need.")

Several company leaders view managed solutions with limited enthusiasm. One went so far as to describe it negatively: "It is a marketing gimmick… We don't view it as the best way to serve a company." Another stated his concern that a managed solutions approach "could result in a customer paying more. Costs include minimum obligations; there are some hidden costs that the customer may not realize…This initiative is driven by vendors who want to focus credit and residual driven companies into a whole new risk area. You can only pursue this business with a creditworthy company on the hook."

Summary: These are early days for Managed Solutions. Independents are already pursuing its use for selected sub-segments, but others are in the very early stages of evaluation. The bigger question is the extent to which over the next few years Managed Solutions may emerge as a major financing choice that customers demand and which hesitant independents must include in their solution set. One interviewee highlighted a change that may push more of the industry in the direction of Managed Solutions: "As equipment gets smarter, more of the equipment's value is software driven, encouraging more of an emphasis on pay per use."

Brokers

Interviewees state that they are putting more constraints on brokers or are using them less. However, recent SEFA numbers continue to show significant NBV is "sourced through third parties." Charts 34a and 34b show NBV from third parties ranges from 21.2% to 33.1%.

Comments suggest continued pressure on brokers: "Brokers are getting squeezed; there is less need for them"; "We stopped buying brokered loans last year. In some cases, they had been re-brokered"; "They need to better manage their application flow"; "Brokers are too removed from the customer." One independent, in effect, turned its brokers into partners with them participating in transactions: "Brokers need to make an equity investment in our company. We have 10 brokers who generate 25% of our business."

Summary: Brokers will continue to play a role, in particular, for larger transactions. An increasing number of independents appear to be actively limiting their use of brokers, in part to reduce origination costs.

Online Marketing

This report provides multiple examples of the role of technology to obtain efficiencies and build competitive advantages in all areas of the business system, including origination. One area in which skepticism remains high involves direct online origination of financing opportunities. One interviewee summed up what we heard from others: "I am skeptical when I get an inquiry over the website. We still want to see people, visit facilities, and make decisions more traditionally."

Summary: Digital marketing techniques are being adopted by more players, resulting in soliciting pre-screened targets. Independents are hesitant to encourage unsolicited borrowers, often a source of fraud. However, On Deck's recent announcement that it will focus on equipment finance will require other companies to focus on their online capabilities.

Artificial Intelligence (AI) and Blockchain

Currently, the use of AI and the Blockchain are barely on the radar of most independents, but some expect that to change rapidly. One IT-oriented executive commented: "There is no machine learning in the industry right now, but new lenders are bringing it in. Today, less than 10% of the equipment finance lenders are fully automated; maybe 1-2% have machine learning." This interviewee and other see a quick buildup of AI activity: "The use of AI will double every year over the next 10 years."

Summary: While currently an area of emerging focus, all independents should expect to invest more resources in these areas over the next three-five years.

Future: Continued Opportunity for the Best Independents, But…

Recent performance for independents shows strong returns and low delinquencies and losses. While industry trends need to be peeled back to evaluate the sub-segments in which independents operate, the general outlook for economic fundamentals also remains positive.

Cautious optimism. While the future looks good, experienced independents know that good times cannot last indefinitely and are preparing for a downturn: "It's a cycle. These are the hay days. We are looking at how to prepare for a downturn. That involves reviewing our portfolio, looking at internal limits, making sure we have an early warning system, and not being afraid to slow down growth if quality growth is not there." Several even view a downturn as positive for their companies: "We do better when credit is rapidly expanding or shrinking. We would like a little more turbulence so that the banks pull back."

Many independents express caution about the nearer-term environment for the industry: "We've had a good run for the past five years, but as interest rates rise and higher inflation is on the horizon, we may see some flashing red lights and, even though most of our customers are investment grade, more customer defaults."

A recent quarterly report from PayNet may be an early indication of the softening some fear. The PayNet Small Business Lending Index (SBLI) decreased 12 % in September 2018 from August and ended eight-months of consecutive year-over-year increases. For the most recent quarter, small business delinquencies increased by 8.3 basis points for the year, now at 1.43%. While PayNet does not foresee any "sea change" in the small ticket space, Bill Phelan, PayNet's President, wrote: "Lenders should remain vigilant in their assessment of risks and rewards in preparation for a shift that — although subtle now — will have long-term implications and put upward pressure on the cost of credit." His comments suggest that lenders should expect to increase portfolio volatility.

Questioning rapid growth. Just as players are evaluating their own growth plans, some express skepticism about fast-growing rivals, particularly those newer companies that have generated significant volume in recent years. One company executive commented: "The behavior today seems like the same as before the 2008 downturn. Some independents don't view subprime borrowers as much different than prime. And, in recent years the losses from higher risk companies have been low. Some people think there is a 'new normal,' but I don't buy that. Subprime is subprime." Several interviewees mentioned they had observed competitors that, in their view were "stretching for growth." Further, some startups have been operating as if "this time is different" and they can avoid experiencing a downturn; virtually all interviewees say a downturn is inevitable, although its timing and severity is unknown. Another supporting view: "Independents that struggle to increase volumes are going too far out on the risk curve; that's a problem."

More acquisitions? Does the future also involve another round of consolidation of the independent space as banks look to acquire more assets? One potential buyer thought there was little quality to buy: "There are slim pickings on the acquisition front. We're not finding a lot of big independent leasing companies to buy." Our interviews support this view. They spanned the range of companies that have been in operation for decades and want to remain private and independent ("Obviously, we are a potential acquisition target, but we prefer being private. We would be frustrated being part of a bank. banks lack the willingness to take the risk of any kind.") to new companies that want to avoid a near-term sales ("Our owners are thinking about the next generation") to independents owned by private equity (PE) firms. One industry observer commented about these firms, "Most private equity guys want to cash out in five years." In addition to whether a company is available for purchase, price is also an issue: "Right now, the pricing for independents expect is too high."

In addition, independents view acquisition as creating an opportunity for them as some acquired companies change their marketing focus and risk appetites: "There have been lots of acquisitions in recent years. However, the independents that have been acquired often cannot do the same type of business they did before. This is one of the reasons it is a good time for independents."

What could go wrong to undermine independents' success? Interviewees mention several potential problems:

- **Funding**. "Banks could have a bust and reduce funding, but a major fraud is more likely to cause banks to stop funding independents."
- **Credit quality**. "Many companies that have been started up in recent years have been built to sell. Those companies have been focusing on the short term. Some have been growing by giving dollars away. The problems do not show up for several years. If they are lucky, they may never show up."
- **More concern about credit quality**. "There have been a number of new independents in the last three years. Some have grown very fast. I hope their growth is comprised of good business, but I am not so sure."
- **Business segment risk**. "Over the next 10 years, small ticket loans will be commoditized, like the credit card."
- **Interest rates**: "With rates going up, there is an increasing squeeze on spreads. More risk taking has been occurring due to the low-interest rates. This has pushed risk-taking to new heights. There is so much liquidity that people want to put to work. This will come back to haunt some companies."

Will a significant downturn occur? Even experienced business leaders disagree:

Positive views:

- "If the economy keeps rolling, the next three years could be a good time for independents."
- "I don't see as much stupidity as I did a few years ago."

But, some think we are entering a down cycle ("It is hard to get in now. It is a little late in the cycle"), and most interviewees expressed concern about the near-term future:

- "I see the large players loosening up credit standards as they stretch for deals."
- "Many independents may not have the size, ability, and experience to survive over the long term.
- "Independents will be out of business because of poor credit and poor interest rate hedges. If you are borrowing floating and lending fixed, you are making money now, but if rates rise fast..."
- "Some competitors are doing unwise things in underwriting and in the rates they charge. Some seem to be in the feed the beast syndrome. They do not want to pay non-usage fees. People want to lend more than the borrower can use."

- "There will be a shakeout. It will happen, I am just not sure how."
- "Frankly, I am a little curious about some companies' underwriting approach. I wonder if they will survive. Some new players are outstanding while others do not seem to know what they are doing."
- "I think the best days may be over."

But, one statement may be most accurate in considering the next few years for the industry: "Right now, everyone is at a party in the dark. When the lights come back on, we'll see the real picture."

Rules of the Road for Future Success

While a near-term downturn seems inevitable to many, independents see themselves as playing a vital role in financing going forward. Given the resiliency and adaptability demonstrated in recent decades by independents, it is not surprising that most view the future positively, assuming they follow certain rules of the road.

Based upon our client experience and interviews with independents, bankers, and industry service providers, Figure 23 presents ten key factors will continue to distinguish top performing independents.

Figure 23: Ten “Rules” for Long-term Success for Independents

Ten “Rules” for Long-term Success for Independents	
1 Start with the customer needs: “independents can continue to thrive as long as there are unique problems to solve.”	**2** Pick the right spots: Avoid commodity business (pricing disadvantage and no relationship value)
3 Develop and exploit expertise in industry niches or financial structuring	**4** Revisit niches regularly to avoid concentration risk and add/exit, as appropriate
5 Focus on solving unique problems that provide clear value	**6** Pay for success
7 Manage funding sources: avoid liquidity risk	**8** Link risk management groups and sales staff as a collegial team
9 Build a positive culture without silos; “no personal agendas”	**10** Maintain management discipline but also be opportunistic

While companies may emphasize one or more of the above areas, all focus either implicitly or explicitly on customizing each “rule” for their individual companies and long-term success.

Final Thoughts: Summary Recommendations for Equipment Leasing and Finance Companies

This report has shown the resiliency and flexibility of independents. Most recently they survived the Great Recession and prior to that frequent lease accounting changes, increased bank focus on equipment finance, and other disruptive events. Independents have proven themselves to be survivors.

Based on our assessment of the industry economics and our interviews, four areas stand out for continued or additional focus by this sector.

Exploit technology. While some firms say they have "bet the company" or are "all in" on IT, others appear to be putting insufficient resources into this area. IT investments should more than pay for themselves in the cost efficiencies they generate. Some independents believe that their ability to structure complex transaction largely negates the need for IT integration with customers. That may be true today but is likely changing rapidly as linkages become more of the norm.

Build off data analytics. Data is more available now than ever before. Interpreting that data and using it to change management actions is the hard part. Some independents (often newer and small ticket firms) have embraced reliance on data analytics, but all firms should make sure they are putting sufficient energy into this area and differentiating themselves with customer by the value-added information they provide.

Consider getting bigger for scale benefits. Smaller banks have been consolidating in reaction to higher compliance, IT, and other costs. Analysts have been moving the minimum asset size required for sustainable profitability toward $1 Billion in assets. Today, fewer than 800 of about 5,500 banks exceed $1 Billion, resulting in the expectation that many will disappear. While small independent shops can continue to be profitable, they may not have the resources required for IT and data analytics investments or the ability to attract and retain sufficient staff.

Look at disruptors inside and outside your sector. Independents, in particular through meetings sponsored by the Equipment Leasing & Finance Foundation and the Equipment Leasing and Finance Association, share experiences more than many other industries. Independents should be certain to assess the disruptors within the sector (FIC has profiled several in the report), as well as external disruptors. Only one company we interviewed mentioned the need to look at disruptors outside of the equipment finance space.

The future should be strong for independents. The next downturn, when it occurs, will push out players who have compromised credit quality for growth. banks enthusiasm for this type of equipment financing may also decline for a time, further improving the competitive environment for strong independents.

Independents will continue to adapt to changing circumstances in the future as they have in the past. Betting against the independents is a mistake.

Sidebars

Case Study: Building a Sustainable Culture – GreatAmerica Financial Services

Since Tony Golobic founded GreatAmerica (**www.greatamerica.com**) in 1992, the company has grown to about $2.2B in assets. It is known as a major industry player serving vendors in eight vertical industries, most notably office equipment, which generates close to 60% of company volume. The company and Golobic are widely respected and admired throughout the industry, not only for the quality of assets but perhaps even more for its 26-year record of consistent success driven by the strength of its culture.

When Golobic founded the company, he wanted to avoid his experience at the larger companies he had worked for, "They all talked about the importance of being customer driven and employee focused, but in the end, drive for next quarter's results trumped everything."

Tony views GreatAmerica as "having an unequal culture in the industry" and sees that as a major competitive advantage. "While our competition has size and brands that we can't even dream of," Tony relates, "we have 548 highly engaged, and knowledgeable employees that they can't even dream of." The words he uses to describe the culture paint a very positive picture, "Our GreatAmericans care a lot; no one wants to let the company down; they know they are valued and respected; they are proud to be a part of a company with high integrity that always tries to do the right thing for everyone it touches." He also uses phrases like "winning spirit," "teamwork," "smiles, happiness, celebrations" and "hard work" to describe GreatAmerica. As another example of the competitive advantage, on the company website, Tony talks in a video about GreatAmerica's constant pursuit of innovation and excellence.

The company knows that "success brings complacency.'' Tony says the company talks about how to avoid complacency all the time, particularly given the company's growth. "We have grown every year without fail for the past 26 years, and we plan to continue doing so. However, growth can be the enemy of culture." That is certainly an issue for a company that is at $2.2B in assets. "We know that we are quite good today, our customers tell us so, but we don't measure ourselves against our competition. We measure ourselves against our potential, and there is always room for improvement," he says.

GreatAmerica prizes its position as a family-owned, private company and views that as a substantial advantage, allowing for more creativity and a long-term orientation. "When our customers need something we don't go through a lot of bureaucratic red tape; if it makes sense, we do it. Most companies start up to eventually sell, and they manage themselves that way. We are not for sale; we are family-owned and independent and plan to stay this way."

The company's culture and low employee turnover has helped to make it an employer-of-choice in Eastern Iowa, where the unemployment rate is less than 3%. One challenge the company is addressing concerns millennial employees. It is "wrestling" with the needs of millennials, as Golobic says that generation has "different views of what they want to get out of their lives" and focus more on life/work balance.

Golobic also states that detailed succession plans and up-to-date succession planning are a strong feature of GreatAmerica. "Every leadership position has two backups and while we are very lucky to have many great contributors to our success, no one, including me, is the key to our success."

Millennial management may require increased focus for the next generation of GreatAmerica leadership as the values continue to evolve. Tony Golobic is very optimistic about the future and firmly believes when he says, “The past 26 years were great at GreatAmerica, but the next 26 years will be even better.”

Take-aways: Developing a positive culture requires leadership, consistency and a strong customer focus.

Case Example: Currency Capital – Managing Millennials

In recent years Currency Capital (**www.currencycap.com**), based in Los Angeles, has experienced substantial growth. 2017 transaction volume was about $160MM with 2018 volume expected to hit $250MM. The company views itself as highly technology dependent (“We are all-in with technology”) and provides both commercial financing to end-users as well as technology platforms to banks operating in this space.

With increased volume and a proactive marketing effort has come the need for more staff. In January 2014, the company had 12 employees; today, it totals close to 200 staff in California and Arizona. The average employee age is in the late 20s and growing and retaining the best and brightest is critical to the company’s success.

Charles Anderson, CEO, and Co-Founder of Currency Capital, views millennials as a group with specific requirements for an employer. “They have options, lots of choices,” Anderson commented. “It is easy for them to find a job. All they need to do is go on LinkedIn, and they can get hired.”

Currency operates what it terms a “high-performance human environment that demands a lot” of its employees. At the same time, they want a relaxed working environment, with more of the qualities of a Silicon Valley tech firm than a financial institution.

“Millennials are fundamentally different in the way they digest and process information.” In Anderson’s view, Millennials have easy access to information, unlike 10-15 years ago.” What they value is “synthesizing information. They are more accustomed to having opinions, based upon the information they readily access.”

Given the pace of change and the company’s focus on proactively addressing client needs and emerging opportunities, understandably, working at Currency is not right for everyone. “It is hard for us to attract and retain someone who is craving stability.” Being “generous” with equity helps to keep employees, as does the company’s stated emphasis on delivering “opportunity and growth,” two characteristics important to many millennials. However, it is also important to note that while the employees may be in their 20s, customers are not: “Most of our borrowers are 55-60.” We are working to bridge the gap between the traditional financing methods our borrowers are used to and the millennial way of implementing smarter solutions through technology.

Take-aways: Attracting millennials requires a sensibility to their needs and preferences. Familiarity with and an ability to lever technology is second nature to this group. “Traditional” employers may need to reconsider their management styles if they are to succeed in cultivating millennial hires.

Case Study: Verdant Commercial Corporation – Leveraging Relationships for the Long Term

During our interviews, industry leaders frequently commented on the increased number of start-ups and in some cases suggested those start-ups were ill-designed and unprepared for the long term. An exception to this belief is Verdant Commercial Capital (**www.verdantcc.com**). While only beginning operation in August 2017, Verdant is, in fact, a start-up, but with a long senior management track record. Discipline, experience, and a future-oriented perspective are part of its core. The power of relationships has driven the company since its start, demonstrated in its approach to funding, its vendor business model, client focus, its ability to recruit senior personnel, and even what might be termed its operating horizon.

As with other start-ups, Verdant concentrates on what they know best: providing vendor financing for specific industries and taking advantage of recent technology innovations. 2018 originations should be about $150MM, with $350MM estimated for 2019. Its vertical focus includes IT, office products, energy efficiency, specialty vehicles, and industrials. It leverages data analytics and other technology for risk management and customer interaction. However, the key differentiating factors that Verdant brings to the market may center on the experience and business relationships of its senior founders as well as its focus on capturing the total client relationship.

The three senior leaders of Verdant bring close to 100 years of experience to the company. Mike Rooney, CEO, has 30 years of experience, primarily with Information Leasing Corp (ILC), National City Commercial Capital and PNC; Chris Kelley and John Merritt have another 30+ years each, also with ILC, National City Commercial Capital and PNC, among others.

Mike Rooney said that today, “Anyone can start an independent; “but, if you want to start a true commercial finance company with a balance sheet, you need “a lot of capital,” He went on to stress, “It is important where that capital comes from.” That is where the previous relationships he and his senior team had with investors came into play. Verdant believed that, while they had money to invest, Private Equity firms had a short investment time frame, typically, about five years. Instead of going that route, Verdant linked up with family offices, which involve private investment teams formed to invest the significant capital from the founding families of Fortune 500 companies. In Verdant’ s case, these family offices are run by groups who know the Verdant management team from their previous lives as bankers. In Rooney’s words these investors are “patient, have plenty of money, they are investing for their grandkids, and have no predetermined timeline.” They encouraged Verdant to build “for the long term, and, build enterprise value.” They want “a predictable and sustainable business.”

Verdant’s business strategy is also relationship based and could only be accomplished by executives with extensive industry contacts and a long-term perspective. Verdant says the industry reports that about 70% of vendor-customer applications are approved, but the reverse of that is that 30% of the vendor’s customers are declined. If you ask these vendors what’s most important to them, they will say “getting our customers approved.” These vendors say they spend most of their time and effort trying to get those 30% of customer declines over the finish line. Verdant’s business model is to increase the vendor’s customer approvals to about 95%, utilizing multiple funding partners with a broad range of risk appetites, freeing up their vendor partners’ time, and improving the relationship between the vendor and its customers.

Therefore, Verdant offers a multi-funder model to, in effect, be a one-stop shop for their key vendors. In Rooney’s words, “What independent out there, in the vendor space, can do a $50K transaction, a $10MM transaction, or an unlimited number of transactions with a single customer? We can!" First, they accomplish this by using their own balance sheet to fund, or "warehouse" leases and loans. This is a key element to Verdant' s strategy, as it allows Verdant to approve a transaction upfront without waiting for approvals from additional bank partners. This speed gives the vendor partner the service they need. Second, Verdant uses a retained servicing strategy, managing all of the billing and collecting. Through an inter-creditor agreement with a single lock box, the vendor's customers not only always sign the same lease/loan agreements, but they also remit all of their payments to the same "remit to" address, every time. This simplifies the process for both the vendor and the customer. Third, Verdant, after booking the transaction, utilizes the management's previous experience in the banking sector, to package transactions for banks or other investors, continuously offloading exposure, and thus creating a virtually unlimited ability to continue to approve a single vendor customer. This flexibility eliminates the response most vendors hear from their funding partners that "we are maxed out on this credit." Since all the paperwork is streamlined and consistent, the customer experience is also consistent throughout, and the funding immediate and unlimited, vendor customers are happy, and a happy vendor customer makes Verdant' s customers, the vendors themselves, very happy.

A company with top executives each of whom has 30+ years experience might be viewed as a likely acquisition target over the foreseeable future. Verdant was founded with a structure that allows the company to continue beyond the timeframe of the three key founders. Rooney said, "We are driven to build Verdant as a predictable and sustainable commercial finance company long into the future. Beside our customer focus, our priority is to attract the best and the brightest future leadership team to lead the way when the founders are ready to go. We look for industry leaders who want to take responsibility for the segments they specialize in and build something meaningful. We like to think Verdant is super attractive to both vendor partners and future leaders".

A relationship focus by itself may not be sufficient for success in today's competitive environment. However, when combined with marketing discipline, credit rigor, technology, and a clear mission, the result is a start-up that may have a unique position over the long term.

Take-aways: Experience and contacts count but are not sufficient for success in themselves, but experience and contacts with a niche focus and strong client orientation can be leveraged to provide a distinctive offer and quick impact, even for what might be considered a "start up."

Case Example: Leveraging IT

AP Equipment Financing (**www.apfinancing.com**) focuses on providing its direct customers and vendor partners with small ticket financing. Its primary industry focus includes tree & arbor, geospatial instruments, and parcel delivery contractors. Its 60+ employees will generate about $130MM in volume this year. Chris Enbom, who founded the company 20 years ago, describes AP as "totally digital, resulting in better customer service and greater efficiency."

Raquel O'Leary, COO, joined the company seven years ago and helped to develop its current approach to systems and technology. The company invested in Salesforce as their primary platform in 2014. Before starting down the path with innovating with technology in 2013, the company operated with multiple systems on the front end. O'Leary said, "It was too labor intensive to get one deal through multiple systems. and we knew we had a great opportunity to develop a platform to enable us to scale and create countless efficiencies for our business."

Since the company "did not want to depend on an outside partner to run the business," the AP team became its own expert and system administrator, developing architecture, managing fields, rules and creating dashboards from the out of the box solution that Salesforce provides. Today, AP leverages that technology from marketing automation to end of the servicing cycle.

Beginning with origination, the platform captures all activities, including marketing automation, all communication with the customer, application, documentation, funding to filing the UCC. The entire process is paperless with applications being approved electronically as well as documentation from request to counter-signatures. (AP has implemented eDocs and eSignature technology.) After the funding stage and the contracts are booked in the accounting system (LTi Technology's Aspire) data is synced daily and brought back into Salesforce for more robust reporting and analytics.

Technology and data analytics usually go together as is true at AP. O'Leary: "We are big data people – it is the holy grail for us; it tells us a story and helps us make better decisions about our business." The data analytics process began with ensuring that the architecture of the database was designed to assess the relationship between major operating metrics, some of which include evaluating various pricing and quality areas. And, it requires two-three years of data accumulation before the data can become transformative for a company.

For AP, analytics has resulted in identifying new growth areas and the company going deeper into some subsegments in which delinquencies are lower than expected. They also allow the company to target internal areas when some performance metrics appear to be outliers, for example, time to close a loan. The analytic exercises are intended to result in management action related to efficiency, coaching, staffing needs, and similar areas. O'Leary: "We need insight into our business, and the data holds the key."

AP management uses its data analytics not only for internal process management but for priority setting and decision making both internally and for customers: "We use it to help identify who to market to and how to make better credit decisions… Our platform provides work queue analysis that determines the priority order for customer service and highlights those customers who require a quicker response." The company can also bring its technology expertise to those vendors that lack sophisticated systems: "Some don't have an operations team that can help them with reporting. We can quickly give partners access to internal information and provide them with a portal to access it on an ongoing basis." This allows vendors to know the status of their equipment and, potentially, improve their inventory management.

In short, the company's focus on technology, combined with its industry expertise and credit discipline, provides its competitive advantage. Sales staff can go to a trade show and fund an approved deal "within an hour"; vendors may be able to better manage equipment; company management can have a data-driven input into its day-to-day and strategic decisions.

Enbom summed up the critical role technology plays at AP, given the competitiveness of the small ticket area: 'If we had not invested in technology, we would be dead." And this process can be complicated. O'Leary: "Systems scare people. It is like learning a foreign language." However, for those concerned about time and the cost of an IT effort, O'Leary says, "It costs a lot, but you will see a return tenfold if you make the investment… It allows you to know your business and customers better and scale up… Operationally, it is our lifeblood."

Take-aways: Strong IT, reducing costs and improving customer service, has now become the norm in the small-ticket space. More independents will be leveraging IT both for internal operations and competitive advantage.

Case Study: Commercial Equipment Finance Corporation (CEFI) – Managing through a Crisis

CEFI (**www.cefipr.com**) was founded in 2009 to focus on meeting the financing needs of local and multi-national companies operating in Puerto Rico. When CEFI was founded, Ricardo A. Rios Bolivar, CEFI's co-founder had 27 years' experience in equipment finance, primarily with Associates and GE Capital. CEFI's industry focus has been mainly in transportation, construction, and health care with those three industries representing about 70% of its volume. Other focus includes printing, golf and turf, IT, and renewable energy. Three years ago, the company expanded into the US (first in Florida and, later, Texas) where they focus on construction and transportation lending, with an emphasis on helping their vendors serve the needs of the Latino segment.

In late September 2017, Hurricane Maria arrived in Puerto Rico. As they have during previous storms, management sent employees home the day before Maria was to hit, expecting everyone to return to the office the next day, a Friday. Due to the effects of this "once in a lifetime" hurricane, the office was unable to open until the following week.

Issue one: No electricity. CEFI identified two remote locations and moved some employees to Coral Gables, Florida, to ensure business continuity. Fortunately, all its systems were Cloud-based, allowing the Company to maintain operation.

Issue two: Managing customers. As CEFI began to reestablish operations, it reached out to hundreds of its 600 borrowers to assess their situation. Some requested payment extensions of one-three months. As part of this process, the Company's sales staff shifted focus to visiting customers to check collateral and inspect equipment.

Ricky Rios, COO, commented, "Approximately 10 of 1,200 accounts had some equipment losses." CEFI accommodated the payment requirements of its clients, virtually all of which remain going concerns today. One group of CEFI's customer base, printing, was temporarily shut down by lack of electricity. "It took one to two months for generators to be in place and power restored. All the signage had been blown away." Printers reestablished themselves as they "resigned" the island.

With its focus on transportation, construction, and health care, and strong client and vendor relationships in Puerto Rico, CEFI was in a unique position to help finance the recovery and benefit from sudden needs for new equipment. In Rios words, "There had been little growth on the Island, so there was not a lot of construction equipment available. It needed to be imported and financed."

One year later, volumes are up 50% from 2017 as money from $20B in insured losses and FEMA dollars flow in, and Puerto Rico rebuilds. Maria was a perfect storm in two senses. Its force ravaged Puerto Rico in an unprecedented way. Ironically, on the positive side, at least in the short term, it has also brought a wave of business opportunities for companies like CEFI.

Take-aways: CEFI stayed close to its customers during the crisis, often anticipated their needs, and looked through the island's crisis to its turnaround. Fortunately, their prior choice of verticals (in particular, construction and trucking) was in line with recovery needs.

Appendix

Research Methodology

FIC's approach for researching and writing this report involved several components. We began by conducting "desk" research of available reports, research, and articles accessible over the Internet. We reviewed multiple publications and from the Equipment Leasing & Finance Foundation, Equipment Leasing and Finance Association, Monitor, U.S. Bureau of Economic Affairs, PayNet, and other sources. In particular, Jeff Jensen of Keybridge was helpful in providing data and reviewing the Economics Overview.

We also conducted interviews with more than 20 independent company Equipment Leasing and Finance Association members. Prior to this project FIC already was familiar with independents. Over the past 25 years, FIC has consulted to independent equipment finance and commercial finance companies, completing projects related to growth strategies, productivity, organizational redesign, and M&A.

Acknowledgments

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Interviewees

In preparing this report, FIC accessed an extraordinary cross-section of independent company leaders. As expected, interviewees were frank and direct in their comments. This group represented a variety of company sizes, longevity, and strategic approaches, together providing an in-depth and robust perspective on their business segment.

Only three interviewees overlap with those interviewed for the 2011 independent report: Tony Golobic, Debbie Monsoon, and Dave Schaefer with many of the other 16 having retired or now at companies acquired by others.

Our interviewees included:

Martha Ahlers, United Equipment Leasing Vale
Aroyan, VCHG-Meridian USA
Charles Anderson, Currency Capital
Chris Enbom, AP Equipment Financing
Brian Eschmann, Trans Lease
Tony Golub, Great America Financial Services
Steve Hamilton, CSI Leasing
Brian Holland, Fleet Advantage
John Kemp, Lease Corporation of America
Dan Krajewski, Sertant Capital
Willis Kleinjan, Northland Capital Equipment Finance
Greg Lomonaco, Sirius Computer Solutions
Richard Matte, Encina Capital
Deborah Monosson, Boston Financial and Equity Corporation
Bob Neagle, Ascentium Capital
Ricardo Rios Bolivar, CEFI Commercial Equipment Finance International
Ricardo E. Rios Flores, Commercial Equipment Finance International
Eduardo Sobrino, Commercial Equipment Finance International
Mike Rooney, Verdant Commercial Capital Dave
Schaefer, Mintaka Financial
Bob Seeds, IFS
Vernon Tirey, LeaseQ

Interview Topics

Section 1. Background Information:

- Years with company.
- Focus of your position.
- Prior experience with independents or others.
- Company size (assets, volume, and employees), growth rate, and segment focus.
- Define your company's culture.

Section 2. Overview Industry Perspective:

- Overall, please assess the position of independents today versus five years ago? Improving status? Flat? In decline?
- Why has this change occurred? Please comment on changes related to the customer, funding, IT, or other areas of importance. Where these changes independent segment wide or more focused on certain segments?
- What has been the impact of external factors, for example, the economy, competitors, regulations, etc.?
- Following up, many believe that the last five years have been very positive for independents. Do you agree? Why?
- What do independents provide (innovations and benefits) that others (banks, captives) do not? How do they impact the customer experience?
- How have bank competitors impacted the independents' performance? What is their appetite for the type of transactions that independents focus on and why?
- Do independents approach risk management differently from banks and captives?

Section 3. Focus on Your Company:

- How does your company differentiate itself from other independents and other types of competitors?
- Describe the advisory and other non-lending services you provide.
- What is your origination process: direct, vendor, broker, other? Please estimate percentages from each adding to 100%.
- Re: Sales management. Is the sales head from inside or outside the industry? What about sales reps? How many and what are their tiered volume level requirements? For example, how many are at $5MM+ and how many at $20MM+?
- How does your company lever technology to offer strategic differentiation?
- How does your company encourage the adoption of innovative approaches?

- Discuss the key profit area. Please list and rank them for your company, e.g., net interest margin, residuals, asset management, syndications, other.
- What role is managed account activity playing at your company?
- What barriers to new competition do your company have?

Section 4. Your Customer:

- Re: Customers. Who makes leasing decisions for deals under $1MM? Over $1MM? What issues encourage companies to lease versus buy?
- How critical is the age of assets in generating business opportunities for your company?
- Overall, how is the customer changing either in their requirements or how they view an equipment finance partner?
- Has your company made key process changes to provide an improved customer experience? Examples.

Section 5. Role of Technology:

- What have been your major technology investments and why?
- How do you lever technology and/or process changes to: 1. Reduce costs 2. Enhance the customer experience 3. Improve credit and risk management 4. Other areas?
- What role does data analytics and "enhanced" risk management play for your company and other independents in supporting a specific segment need or focus?
- How do they leverage third-party software solutions providers both to increase efficiency and enhance the customer experience?
- How much focus does your company have in emerging areas such as the Internet of Things (IoT), Blockchain, and AI?

Section 6. Funding:

- Outline your finding mix. Who heads the funding effort?
- Please discuss how current funding options and availability have changed.
- Are certain types of funding now more available now and from what sources?
- Other trends?

Section 7. Pricing:

- How does the company determine pricing? Main components?
- Do you use a pricing model?

Section 8. Regulations:

- What key city, state, or federal regulations are most critical for governance?
- Have regulations become more burdensome? How?
- Can you use technology to address regulatory requirements?

Section 9. Personnel:

- How does your company attract and retain staff?
- Any comments on Millennial hires?
- From a hiring/retention perspective, what are your pros and cons versus a bank or captive? What can you offer that banks and captives cannot?

Section 10. Digital Initiatives:

- How important to your customers is digitalizing your offer?
- What resources has the company put to this effort?
- Are there specific third parties you are working with and how?

Section 11. The Future:

- What niches may be emerging that independents might focus on?
- What's required to be a "winner" over the next five years? What are key internal challenges that your company needs to address?

About FIC Advisors, Inc. (FIC)

For 25 years FIC, a Miami-based management consulting firm, has provided fact-based analysis and advice on issues related to growth and profitability to financial services clients around the world. FIC emphasizes practical, bottom-line results. We provide specific and targeted recommendations and work with our clients to ensure their successful implementation.

In preparing this report, FIC leveraged our extensive client experience over the past 25 years in the equipment and commercial finance segments, as well as the industry contacts we developed in working with the Equipment Leasing & Finance Foundation and the Equipment Leasing and Finance Association.

Our equipment finance related consulting work includes:

- Evaluating expansion opportunities in new segments, markets, and geographies.
- Recommending and implementing process redesign changes to increase lessor and commercial banker productivity.
- Assessing acquisition opportunities.
- Providing insights on adopting industry best practices.
- Developing strategic plans with detailed implementation plans.

FIC has also completed projects in commercial finance, inventory finance, franchise finance, timeshare finance, factoring, among other areas. We tailor how we work with our clients to their needs; our approach may involve a formal engagement, targeted workshops, and/or ongoing retainer-based counseling to clients.

Visit **www.ficinc.com** for more information about our consulting and advisory services.

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