State of the Equipment Finance Industry

2015

Competing in a Changing Market

EQUIPMENT LEASING & FINANCE
FOUNDATION
Your Eye on the Future

The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.

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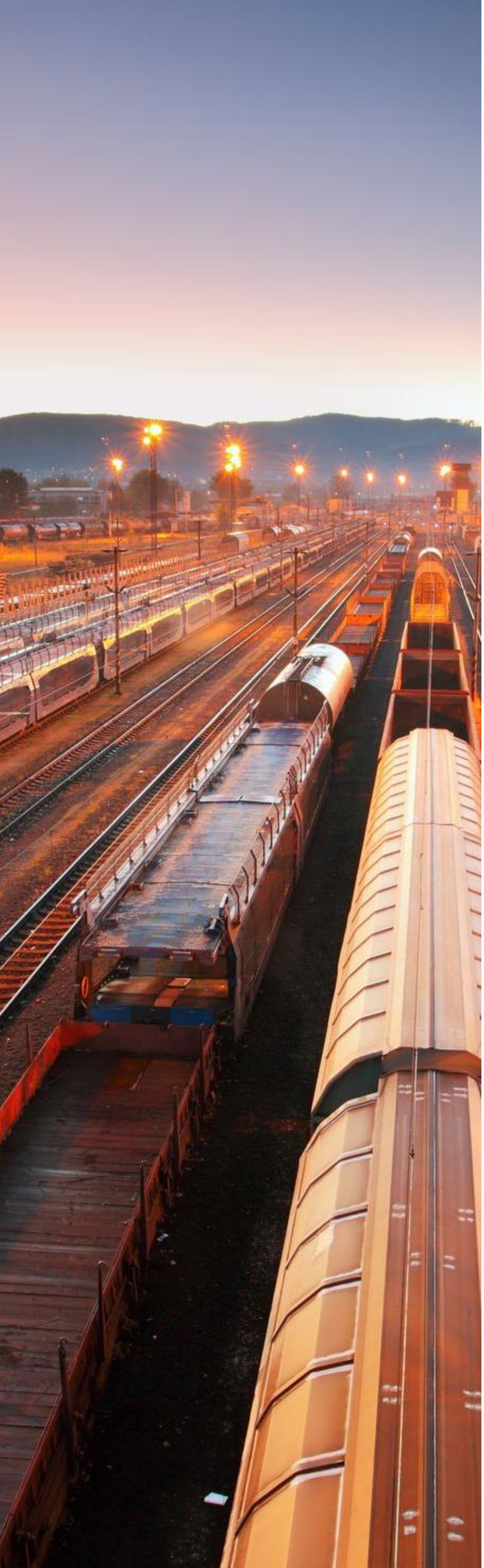

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OVERVIEW

message from the chairman

On behalf of the Equipment Leasing & Finance Foundation, we are pleased to present the 2015 State of the Equipment Finance Industry ("SEFI"). Using data from the 2015 Survey of Equipment Finance Activity ("SEFA"), this year's report covers key trends in new business volume, yield and funding, portfolio performance, financial performance, and business operations. In addition, the report highlights and explores emerging opportunities and risks that will shape the industry over the next decade.

The report finds that many of the previous year's trends intensified in 2014. Industry growth slowed but remains above its 10-year average, while competition increased and margins tightened. Equipment finance continues to outpace the U.S. economy, and both profitability and financial performance remained at healthy levels in 2014. Portfolio performance was particularly strong, and both delinquencies and charge-offs are currently near all-time lows.

Many industry leaders characterize the current state of equipment finance as one of "constant change." The industry continues to adapt to several major shifts, including evolving customer preferences, the growing popularity of alternative financing, volatility in global commodity markets, the prospect of rising interest rates, and new lease accounting standards (to name just a few). Each of these shifts presents equipment lessors with both challenges and new opportunities for growth.

As in past years, this year's SEFI offers a variety of economic data and analytical tools to identify and interpret trends in the equipment finance industry. Macroeconomic data on the U.S. and other major economies provide context for key industry themes, while the Foundation-Keybridge quarterly Propensity to Finance Equipment Index ("PFEI") and monthly Equipment Investment Momentum Monitors highlight shifts in business investment and equipment financing trends.

On behalf of the Board of Trustees, I hope you enjoy this year's SEFI and the Foundation's many other research publications. We would like to thank the contributors to this report, including the executives who participated in interviews and the companies and individuals who provided data for ELFA's Survey of Equipment Finance Activity.

Richard D. Gumbrecht
Chairman, Equipment Leasing & Finance Foundation

a year in review

Continued Growth, Strong Portfolios

Growth slowed in 2014 but remained above the 10-year industry average, as steep competition and moderate business investment limited expansion in the equipment finance industry. As measured by new business volume, industry growth decelerated from 9.3% in 2013 to 6.7% in 2014. Profitability remained healthy but not stand-out, as intense competition further compressed margins. Meanwhile, portfolio performance improved.

Key findings from the 2015 State of the Equipment Finance Industry report include:

Continued Growth: New business volume growth slowed for the third consecutive year in 2014; however, at 6.7%, growth remained above the 10-year average of 4.4%. Independents outpaced Banks and Captives for the second straight year. At a robust 17.6%, Independents' new business volume growth was little changed from the previous year, while Banks' growth picked up from 6.2% to 7.4% in 2014, and Captives' growth fell sharply from 11.3% to 1.3%.

Intense Competition: As predicted last year, a hypercompetitive environment caused companies to compete on price and accept razor-thin margins, pushing spreads lower. The weighted average pre-tax spread slipped from 2.94% in 2013 to 2.80% in 2014. The Federal Reserve has kept interest rates at zero throughout 2014 and most of 2015. However, the Fed is expected to raise short-term rates in late 2015 or early 2016 — which will increase the cost of funds but also provide an opportunity to expand margins.

Record Portfolio Performance: A healthier economy and rising corporate profits allowed companies to maintain strong portfolios in 2014. Delinquencies, charge-offs, and non-accruals were little changed from 2013 levels. Additionally, industry players retained stringent credit standards last year, despite Keybridge's expectations for a slight loosening of standards.

Solid Financials: On net, profitability was stable in 2014, as operating profits ticked up from 35.2% to 36.2%. Return on Equity dipped, Return on Assets was unchanged, and Earnings Before Taxes increased. Low interest rates kept costs low, and interest expense as a share of both revenue and debt generally held steady.

Improved Productivity: New business volume per sales full-time equivalent ("FTE") increased nearly 4%, driven by gains in all three organization types. While competition has encouraged companies to maximize productivity and efficiency, it has also pushed them to develop competitive advantages. Banks tend to compete on price, while Independents offer niche services and more flexible deals to their customers.

A Mix of Uncertainties: The equipment finance industry faces several unknowns, both at home and abroad. Regulation is an ongoing concern, particularly for Banks, and government dysfunction (including threatened government shutdowns and debt ceiling fights) remains a threat on the horizon. Meanwhile, turmoil in the global economy could hurt growth in the U.S. and dampen business investment.

Incoming Accounting Standards: After decades of negotiations, the Financial Accounting Standards Board is set to finalize new lease accounting standards in the coming months. However, the standards are unlikely to be implemented before 2018, providing the industry time to adapt and prepare. Among other changes, the new accounting standards will move operating leases onto customers' balance sheets. While complying with these new rules may cause disruption for some industry members, at least initially, the new standards may also offer equipment lessors the opportunity to better advise and assist their customers.

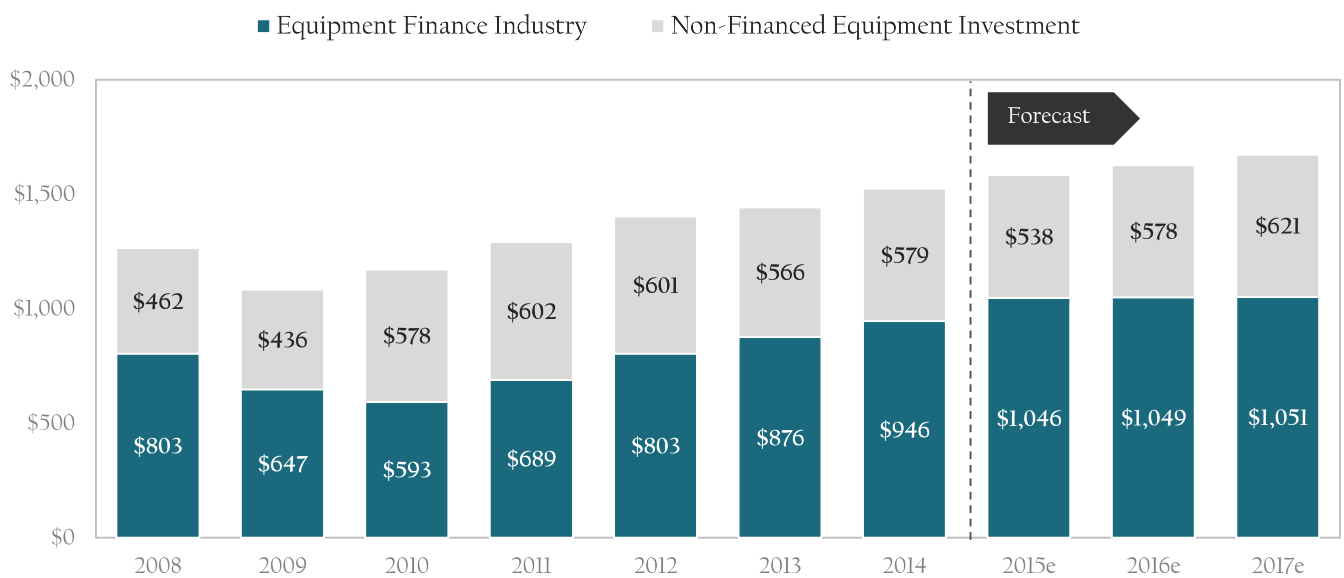
key figures

Cautious Optimism

Despite continued uncertainty and hyper-competition, the equipment finance industry found new ways to grow in 2014. Leasing remained an attractive way for businesses to replace equipment and expand operations, and the propensity to finance steadily increased throughout the year. As a result, the industry grew to $946 billion in 2014 and is set to reach the trillion-dollar threshold in 2015. The industry is exhibiting stable, if unspectacular, expansion so far in 2015, held back by the waning replacement cycle and businesses' continued hesitancy to expand their operations. As predicted last year, the industry seems to be entering a new phase of solid but slower growth, encouraging cautious optimism from industry participants.

Equipment Finance Industry Size

(in billions of dollars)



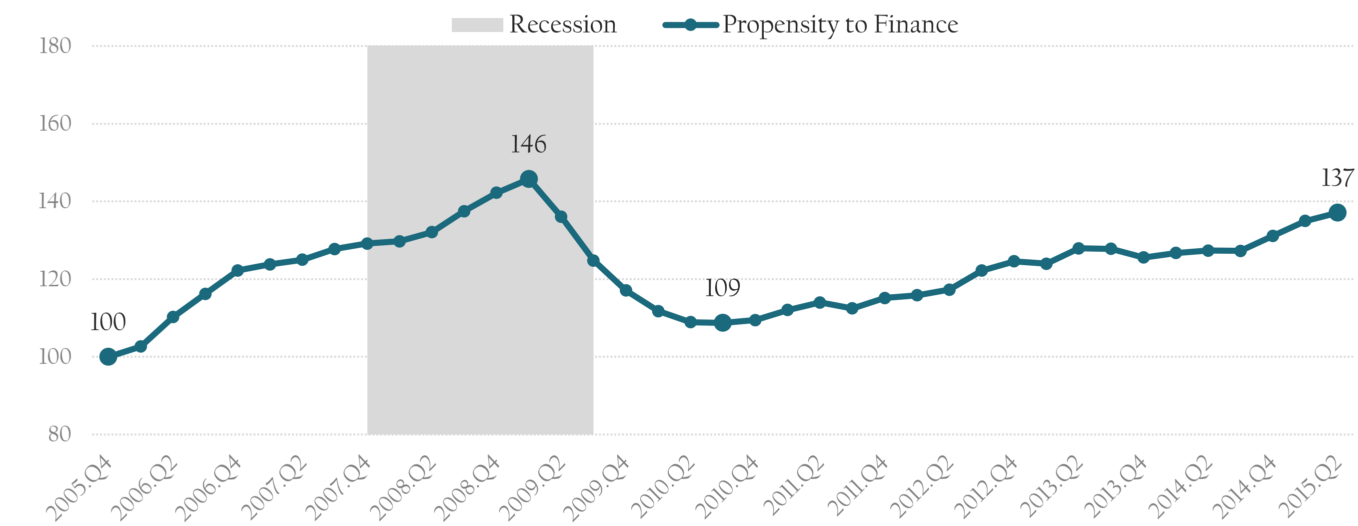
Sources: 2012-2013 Foundation U.S. Equipment Finance Market Study, Macrobond Financial, ELFA, Keybridge LLC

Why have the industry size figures changed since the 2014 SEFI?

The estimate of the equipment finance industry's size is based on two main components: total public and private sector equipment and software investment, and the propensity to finance those equipment investments. Investment figures are estimated by the Bureau of Economic Analysis, and are subject to revisions on a regular basis. Every five years, the propensity to finance has been measured through a Foundation-sponsored survey — the last survey being conducted in 2012 on 2011 investment and financing activity. Historically, the SEFI's industry size estimates were based almost entirely on these survey results and on certain assumptions made about the propensity to finance in interim years. Last year, Keybridge incorporated a new measure of the propensity to finance — the Propensity to Finance Equipment Index, or "PFEI" — for the 2014 calendar year. Keybridge incorporated the index in the industry size estimates again this year. The index and its methodology are summarized below.

The PFEI is a composite of two separate measures. The first measure estimates the share of commercial and industrial ("C&I") loans that goes towards equipment purchases, and compares that to total equipment and software investment. The second measure compares trends in the ELFA MLFI-25 New Business Volume to trends in total equipment and software investment. Both measures are converted to an index and then averaged to produce the final PFEI.

Foundation-Keybridge Propensity to Finance Equipment Index (PFEI)



Sources: ELFF, Macrobond Financial, Keybridge LLC

Interpreting the PFEI

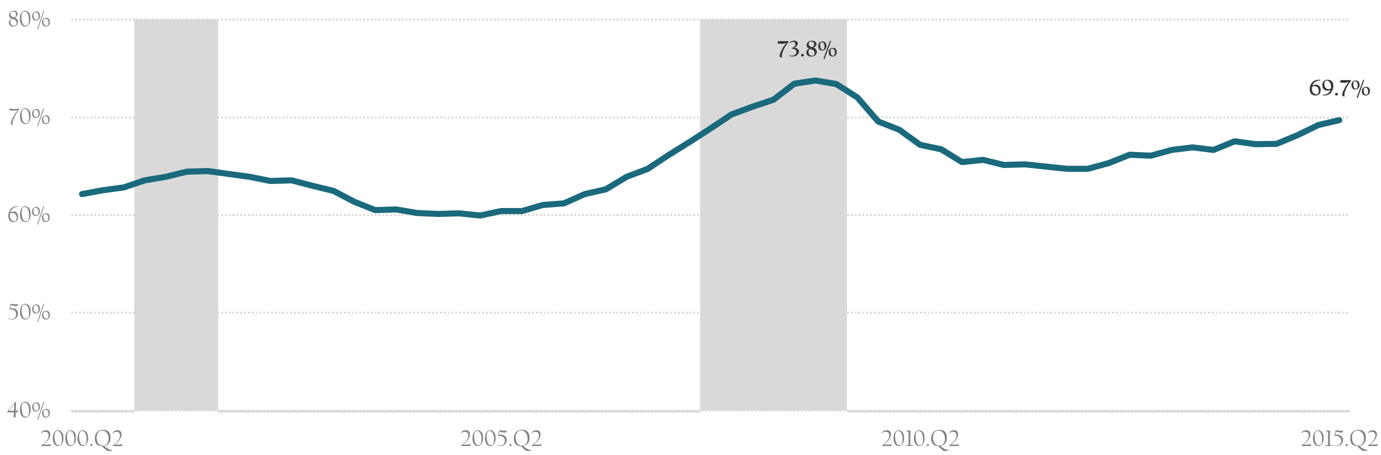
Until the Great Recession of 2008-09, private companies took on increasingly more debt to finance their capital expenditures. The PFEI clearly shows this trend, as the index increased 46% from Q4 2005 to Q1 2009. As the financial crisis reached its peak, businesses began to deleverage their balance sheets — not only by paying down or writing off debt, but also by financing a smaller portion of their capital spending. As a result, the propensity to finance hit a low point in the 3rd quarter of 2010 as the economy struggled to gain a solid footing and there was a high degree of policy, regulatory, and economic uncertainty.

As the second round of quantitative easing began in November 2010, deleveraging in the nonfinancial corporate sector ended and reversed course. The trend in the PFEI over the past several years suggests that the propensity to finance has increased steadily since hitting a post-recession low in late 2010. A combination of low interest rates and rising corporate profits has enabled private companies to take on more debt. Data from the corporate sector show a similar trend. Nonfinancial corporate sector liabilities as a share of nominal GDP rose rapidly in the mid-2000's, peaking at 73.8% in early 2009. After the financial crisis spurred a sharp reduction in debt, corporate sector liabilities rebounded to 69.7% of GDP in Q2 2015.

Although the PFEI is not forward looking, it does provide a guidepost for the conditions in which the propensity to finance would rise or fall. For example, in an environment of steady growth and rising interest rates, the propensity to finance is likely to increase as businesses try to lock in lower rates. In addition, customers' growing preference for flexibility and convenience — rather than ownership — could also drive consistent increases in the propensity to finance in coming years.

Nonfinancial Corporate Sector Liabilities

(percent of nominal GDP)



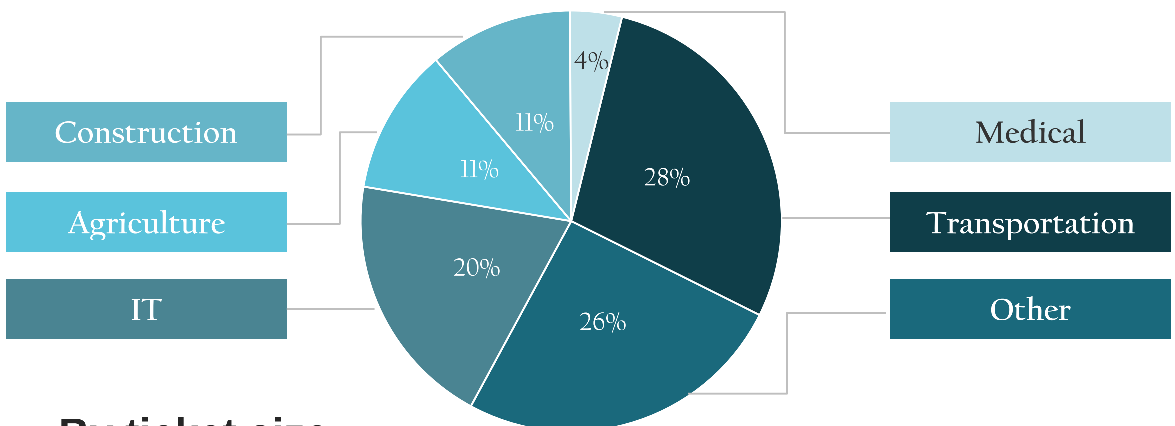
Sources: Macrobond Financial, Keybridge LLC

New Business Volume

(percent of total)

By business model

By equipment vertical

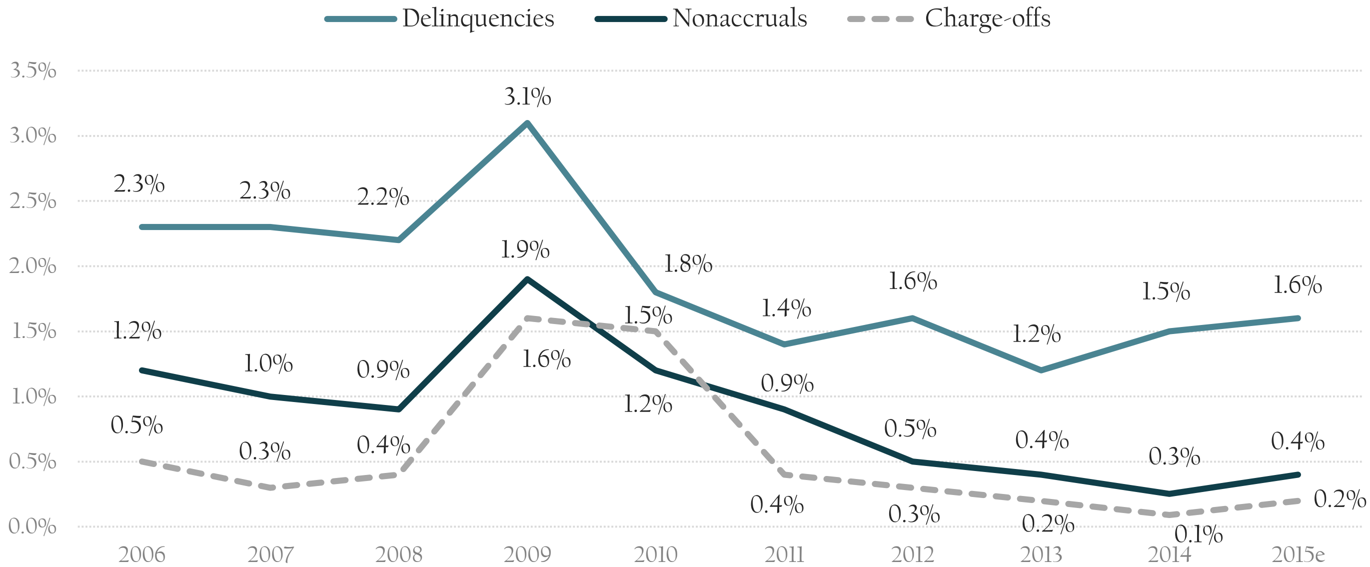


By ticket size

Source: 2015 ELFA Survey of Equipment Finance Activity

Portfolio Performance

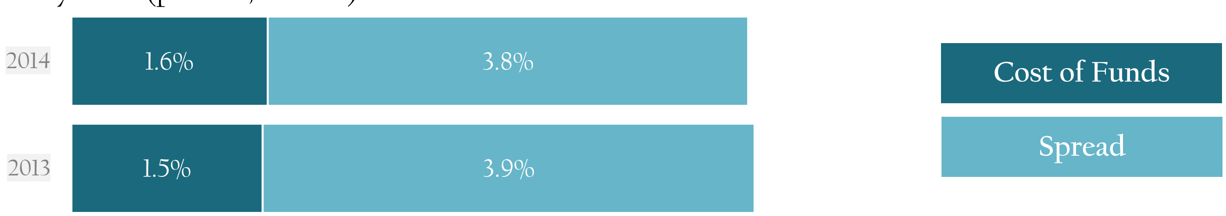
Industry-wide (percent of assets; weighted average)



Source: 2008 – 2015 ELFA Surveys of Equipment Finance Activity

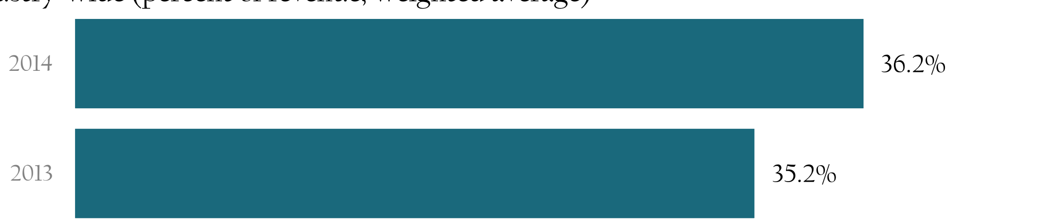
Yield & Funding

Industry-wide (percent; median)



Operating Profit

Industry-wide (percent of revenue; weighted average)



Source: 2015 ELFA Survey of Equipment Finance Activity

INDUSTRY

industry & growth drivers

Constant Transition

In many ways, the equipment finance industry is a mix of continuation and change. Many of 2013's trends continued in 2014, including slowing growth, hyper-competition, and strong portfolio performance. Similarly, several of the previous year's risks — including regulation and weak global growth — also remain at the forefront of industry participants' minds this year. At the same time, major shifts are likely to reshape the industry over the next decade, disrupting normal business operations and generating opportunities to capture market share. In a period of changing customer preferences and needs, "equipment on demand" contracts and alternative financing are two trends to watch in 2015 and future years. Looking ahead, the equipment finance industry can capitalize on these growing shifts to access new business and better serve its customers.

Stuck in below-average growth, the U.S. economy contributed to moderate equipment & software investment in 2014. Real GDP growth rebounded from a paltry 1.5% in 2013 to 2.4% last year, yet 2014 marked the ninth consecutive year of growth below the long-term average of 3%. Real equipment & software investment growth also improved in 2014, rising from 3.2% in 2013 to 6.0%. Amidst this backdrop of moderate investment growth, equipment finance new business volume grew 6.7% in 2014 — down from 9.3% the previous year.

While 2014 was the best year for growth since the end of the recession, the U.S. economy encountered several speed bumps in early 2015. A mix of harsh winter storms, labor disputes at West Coast ports, low oil prices, and a strong U.S. dollar brought growth to a near-standstill in the first quarter. Real GDP expanded just 0.6% (annualized rate) in Q1 before picking up to a more robust 3.9% pace in the second quarter. At the same time, real equipment & software investment increased 3.9% and 1.7% in the first two quarters of 2015, as businesses held back on spending. Barring a major downturn in the world economy, GDP growth should register around 2.6% in 2015, a slight improvement from last year.

Slowing Industry Growth

Like the U.S. economy, equipment finance is "plugging along" and shows underlying health despite multiple headwinds. After several years of slowing growth, the industry remains cautiously optimistic. Some industry experts mentioned a pick-up in business volume this year, while others described 2015 as "more of the same." Replacement demand fueled much of the accelerated growth seen in 2011 and 2012 (16.5% and 16.4%, respectively), yet the industry must now find new business to achieve faster growth. Crucial to a growth pick-up is business expansion. Capacity utilization will be an indicator to watch; at 77.6% in August, capacity utilization remains below the 80% threshold that usually triggers a new round of business investment. Overall, while the industry is not experiencing an explosion of new business, it has seen healthy, moderate growth this year and last.

Stellar Portfolios

Record-level portfolio strength has also defined the equipment finance industry in recent years. Delinquencies, charge-offs, and non-accruals all remained at historical lows or fell further in 2013 and 2014. However, we may now be seeing a gradual "normalization" of portfolios, and delinquencies and charge-offs are likely to slowly increase. Several factors are at play here, including the fading scars of the financial crisis, steep competition for new business, and continual improvement in the economy. These factors may entice some lessors to accept higher risk than they have in the past few years.

Regulatory & Policy Climate as Obstacles

Regulation and government dysfunction remain sources of frustration and uncertainty for many equipment finance industry executives. The ongoing implementation of Dodd-Frank is largely viewed as a burden to Banks, with trickle-down effects on Captives and Independents that raise the cost of funds. Fears of regulatory overreach by the Consumer Financial Protection Bureau and the impact of forthcoming lease accounting standards were also cited as risks that may discourage industry confidence and expansion. However, others noted that regulation creates standards and process controls for the industry and can be a boon for companies that implement it most efficiently.

While industry experts noted some improvement in political dysfunction, the federal government is still seen as a hindrance to the industry, particularly with respect to policy uncertainty (e.g., annual high-stakes battles over appropriations, the ongoing debate over long-term funding for infrastructure improvements, and the threat of another showdown over the debt ceiling). Looking forward, neither the outcome nor the impact of the 2016 elections is clear. Expectations for a lasting change in the policy climate were muted, yet some interviewees mentioned corporate tax reform as a potential opportunity for bipartisan compromise.

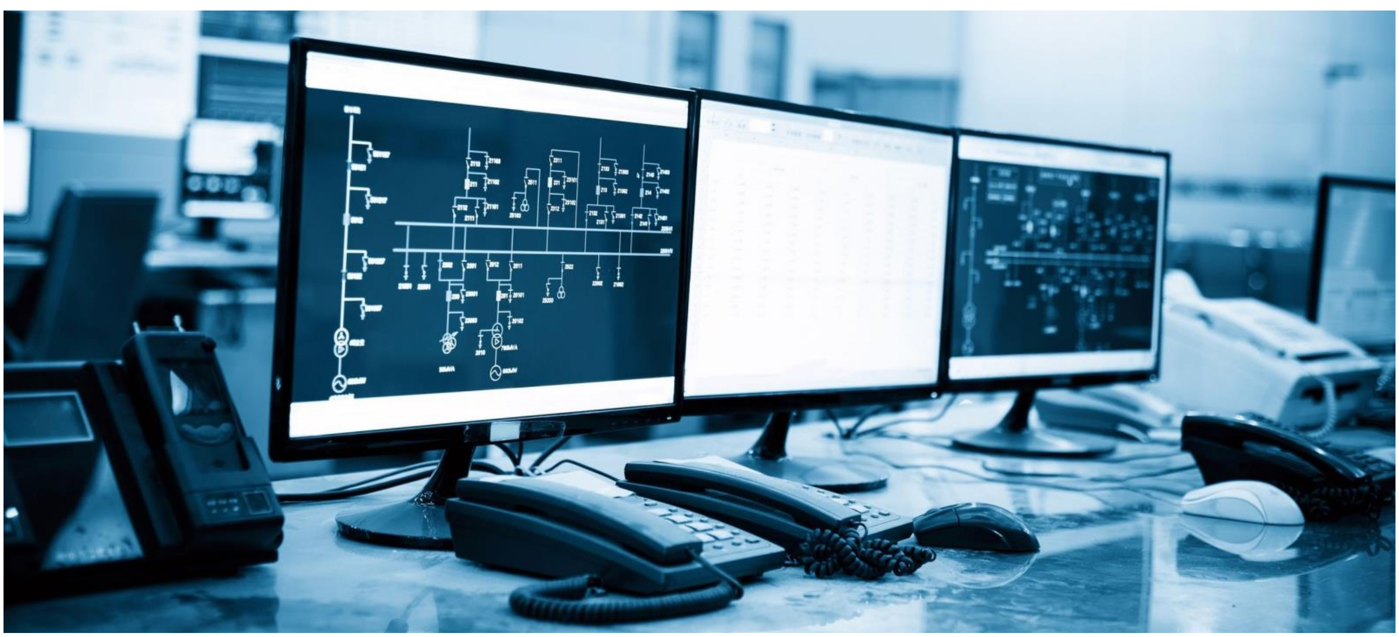
Changes Ahead

Despite the continuation of last year's major themes, there are several nascent shifts poised to impact the industry. First, customer preferences are changing. "Flexibility" and "convenience" are two terms often mentioned during interviews with industry executives, particularly among Independents. Non-standard financing structures in which financing, set-up, and disposal are wrapped up into one contract are already well-established in the IT field and are beginning to gain traction in other equipment verticals, including agriculture and construction. Relatedly, customers are increasingly demanding shorter-term, project-driven, and "pay-per-use" equipment leases — particularly for small-ticket transactions. While the long-term impact of this shift on the industry is still uncertain, it presents opportunities to companies with the capability and willingness to adapt.

Another developing trend is alternative financing, which could fill a "credit gap" for small businesses that are otherwise unable to get funding when they need it. Just as "equipment on demand" models increase flexibility, alternative finance (e.g., peer-to-peer lending, crowdfunding) could make obtaining credit easier and faster for businesses. This emerging trend incites a variety of reactions from the industry — ranging from enthusiasm to concern — and could bring changes to the small-ticket market segment in particular.

key performance indicators

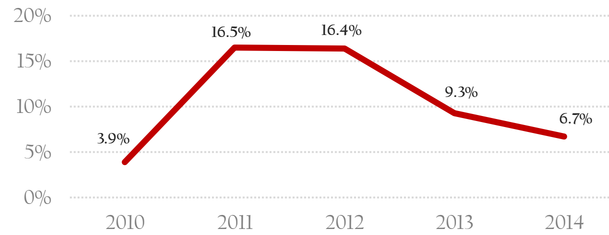
All data sourced from the 2011-2015 ELFA Surveys of Equipment Finance Activity



Business Volume Performance Indicators

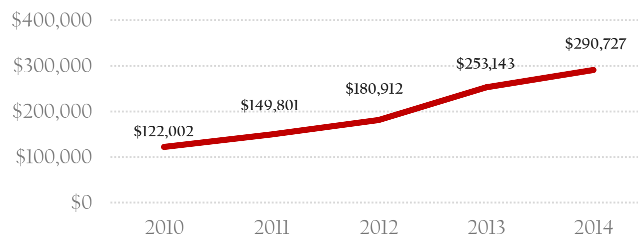
Growth in New Business Volume

Growth eased for the third consecutive year, yet business continues to expand.



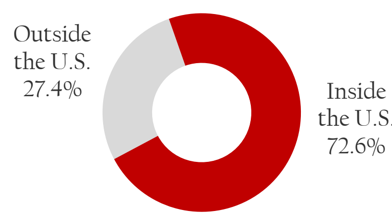
Median New Business Volume per Lessor ($000s)

Median new business volume continued to climb, but at a slower pace than in 2013.



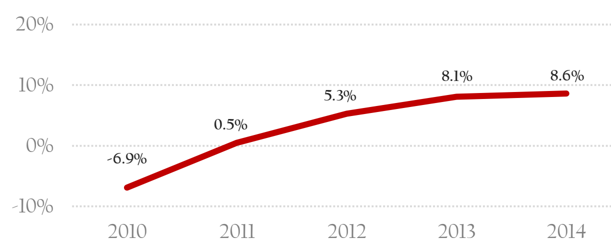
New Business Volume Originated by Region

A slightly smaller share of new business was sourced outside of the United States in 2014 (27.4%) compared to 2013 (28.5%).



Growth in Assets Under Management

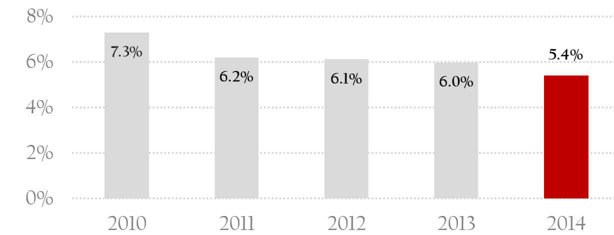
Assets under management growth ticked up in 2014, marking the fourth straight year of stronger growth.



Yield & Funding Performance Indicators

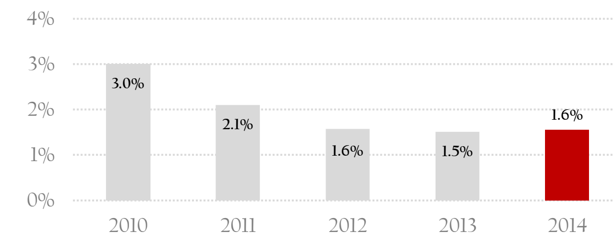
Pre-Tax Yield (median)

Reflecting steep competition, yields fell further and are down nearly two percentage points from 2010 levels.



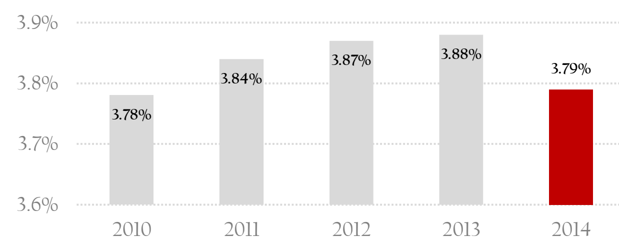
Cost of Funds (median)

The cost of funds ticked up in 2014, yet remains at historically low levels.



Pre-Tax Spread (median)

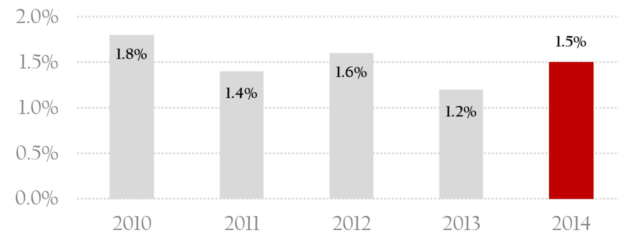
Spreads compressed to their lowest levels since 2010, as yields continued to decline.



Portfolio Performance Indicators

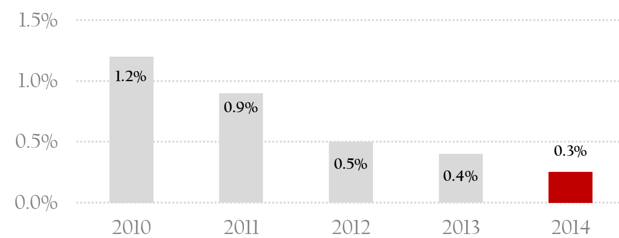
Delinquent Portfolio Over 30 Days (weighted average)

Delinquencies increased from 2013 levels, yet continue to reflect strong portfolio performance.



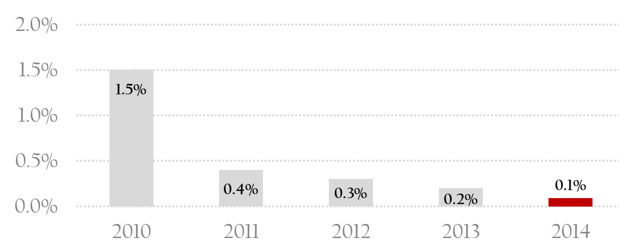
Non-Accrual Assets as a Percent of Receivables and Non-Accrual Assets (weighted average)

Non-accruals fell for the fifth straight year and may be bottoming out.



Net Full-Year Loss (Charge-Off) as a Percent of Full-Year Average Receivables (weighted average)

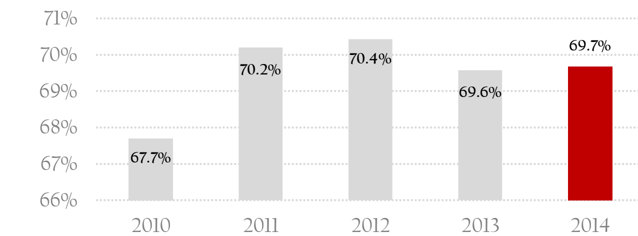
In 2014, charge-offs declined for the fifth consecutive year and were near zero.



Business Operations Performance Indicators

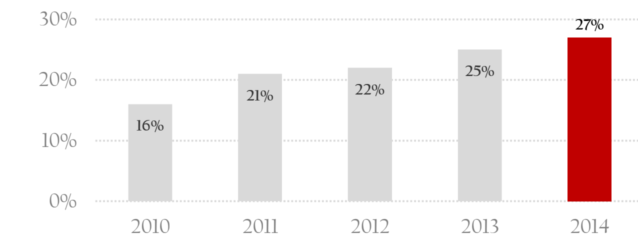
Applications Booked & Funded/Sold as a Percent of Approved (based on $ amount)

With respect to booking contracts, business efficiency was little changed in 2014.



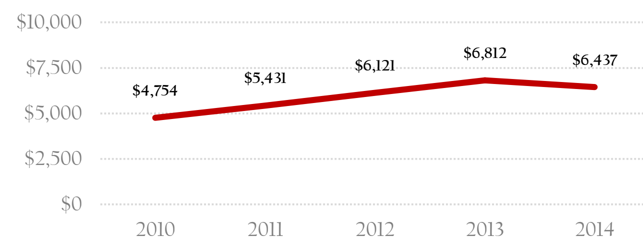
Residual or Salvage Position as a Percent of Original Equipment Cost

Residual values increased for the fourth straight year in 2014.



New Business Volume per Full-Time Equivalent ($000s)

After peaking in 2013, New Business Volume per FTE fell for the first time since 2010.



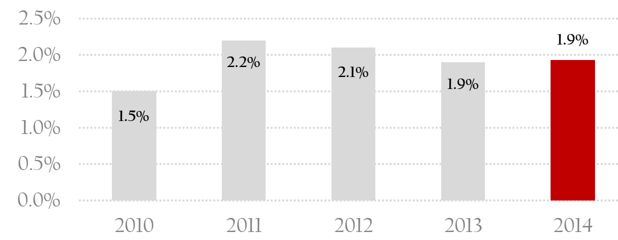
Sales, General & Administrative Expense per Full-Time Equivalent ($000s)

Expenses per FTE slipped following small gains in 2012 and 2013.

Financial Performance Indicators

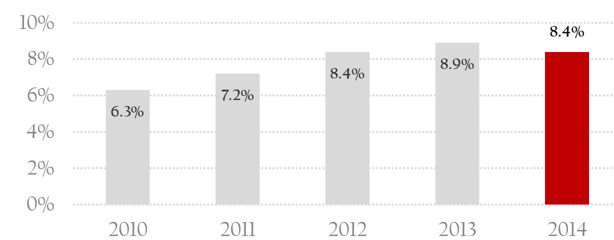
Return on Average Assets (median)

Return on assets held steady in 2014 and suggests solid financial performance.



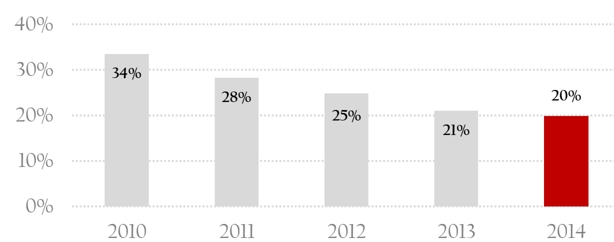
Sales & Marketing Expense as a Percent of Total Revenue (median)

For the first time in four years, sales and marketing expenses declined as a percentage of total revenue.



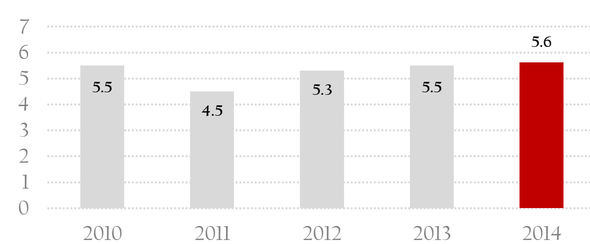
Interest Expense as a Percent of Adjusted Revenue (median)

As a percentage of adjusted revenue, interest expenses fell for the fifth consecutive year.



Debt to Equity (median)

Continued increases in debt to equity suggest that companies are willing to take on more debt.



financial review & analysis

New Business Volume

Growth in the equipment leasing & finance industry slowed for the third consecutive year in 2014, yet still points to solid expansion following the breakout growth of recent years. New business volume increased 6.7% in 2014, down from 9.3% in 2013, 16.4% in 2012, and 16.5% in 2011. Despite slowing growth, both the equipment finance industry and equipment & software investment continued to outpace the overall economy. Nominal equipment & software investment increased 6.5% in 2014, compared to 4.1% for nominal GDP. Mirroring last year, Independents grew at the fastest rate of the three organization types, driven by their focus on small-ticket transactions. Meanwhile, Captives' growth decelerated sharply, curbed by slower growth in Agriculture. The Construction and Industrial end-user industries exhibited the fastest new business volume growth in 2014, buoyed by a strengthening economy. Among equipment types, Amusements led growth, followed by Construction and Transportation equipment. So far in 2015, new business volume down slightly from the pace seen last year, and the industry may be reaching a "steady state" of slower (yet solid) growth. Looking ahead, the industry is on track for moderate growth through 2015 and 2016.

Thousands of Dollars or Percent	Industry	Banks	Captives	Independents
2014 Median New Business Volume	$290,727	$476,499	$293,965	$115,328
Growth in Total New Business Volume, 2013-2014	6.7%	7.4%	1.3%	17.6%
Growth in Assets Under Management, 2013-2014	8.6%	8.5%	6.0%	14.3%
Five-Year Growth in Median NBV	89.1%	107.2%	8.5%	53.8%

Source: 2010 – 2015 ELFA Survey of Equipment Finance Activity

Total equipment and software investment outpaced the overall economy for the fourth straight year in 2014. Compared to 2.4% growth in real GDP, real equipment and software investment expanded 6.0% last year — an acceleration from a sluggish 3.2% pace in 2013. Investment got off to a slow start in 2014 (4.6% annualized growth in Q1) before surging at a 14.9% annualized pace in the third quarter. However, real investment contracted 2.5% in the fourth quarter of 2014 and has shown weak growth so far in 2015 (3.9% in Q1 and 1.7% in Q2).

Overall, real equipment and software investment growth is likely to slow in 2015 as it gradually converges with real GDP. However, investment is likely to outpace the overall economy again this year. Reflecting slowing real investment growth, the equipment finance industry should see stable or slightly slower growth this year. According to the August ELFA MLFI-25, year-to-date new business volume is up 6.0% from the same time last year, down slightly from 2014's 8.1% pace.

A Waning Replacement Cycle

A pick-up in several major equipment verticals, including Construction, Materials Handling, Trucks, and Software, fueled faster investment growth in 2014. However, last year's growth remained below the strong pace seen between 2010 and 2012. While a replacement cycle fueled investment immediately after the 2008-09 Recession, the cycle is now waning, leading to steady, moderate growth in business investment. Going forward, higher levels of business expansion may be needed for a resurgence of breakout growth.

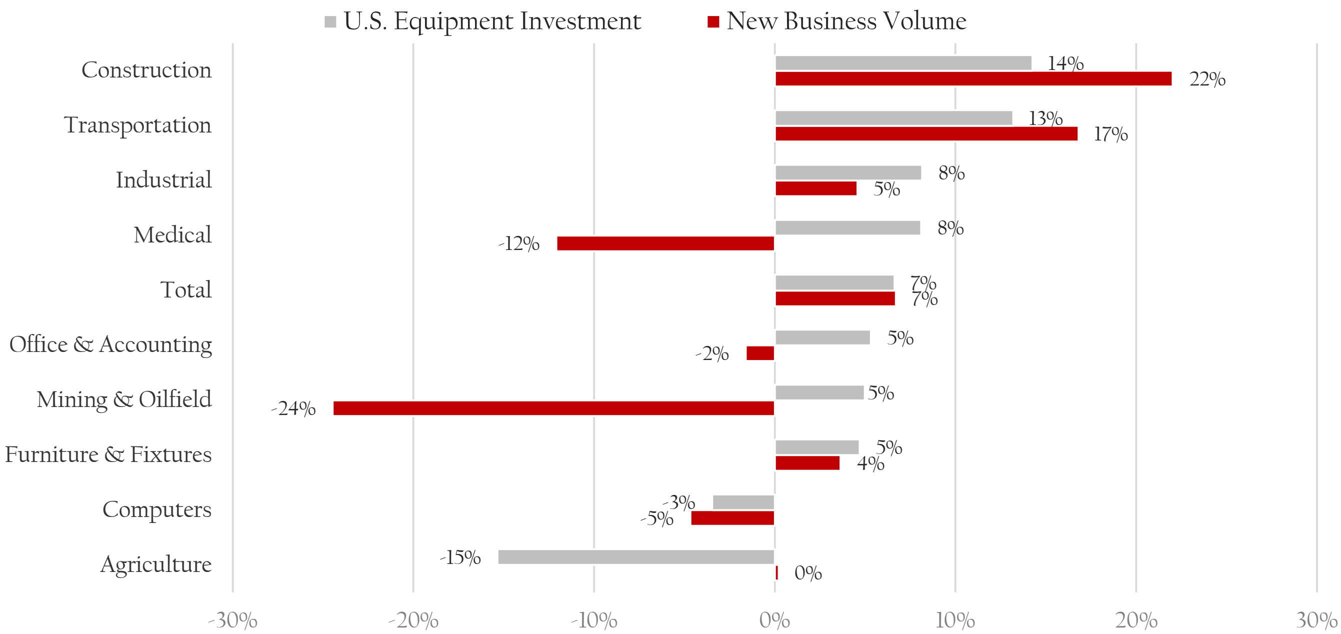
Out of the 12 equipment verticals tracked by Keybridge and the Foundation, 10 experienced positive growth in 2014. Ships & Boats and Trucks led real (inflation-adjusted) investment growth, expanding 16.8% and 16.4%, respectively. Meanwhile, Aircraft (13.3%), Construction machinery (13.3%), Materials Handling (12.8%), and Railroad equipment (11.1%) all experienced double-digit growth. On the other side of the ledger were Computer equipment, which contracted 3.2%, and Agriculture machinery, which plummeted more than 16% in 2014.

Mixed Trends in Propensity to Finance

Although the propensity to finance generally increased in 2014, trends by equipment type were mixed. New business volume outpaced nominal investment for several equipment types (e.g., Transportation and Construction) indicating that end-users are growing more likely to finance these equipment types than to purchase them outright. However, other equipment types exhibited slower new business volume growth relative to investment growth. In fact, new business volume contracted for three equipment verticals (Office & Accounting, Mining & Oilfield, and Medical) even as investment exhibited positive growth. These diverging trends underscore the fact that the lease-versus-buy decision can differ significantly between industries.

Equipment Finance Penetration

(2014 nominal growth rate)



Source: 2015 ELFA Survey of Equipment Finance Activity, Bureau of Economic Analysis

Independents Led Growth

Again in 2014, Independents outpaced Banks and Captives in new business volume growth. At 17.6%, Independents' new business volume growth was little changed from 17.7% in 2013, while Banks' growth picked up from 6.2% to 7.4%. Captives' growth, however, decelerated sharply in 2014: following four years of double-digit growth, new business volume growth among Captives slowed to a paltry 1.3% rate last year.

Independents' focus on the small-ticket market continued to benefit them in 2014, while Banks' involvement in large-ticket transactions curbed their overall new business volume growth. Small-ticket growth slowed from 14.3% in 2013 to 9.0%, yet the small-ticket market segment still outpaced the middle- and large-ticket segments for the second straight year. Large-ticket new business volume, meanwhile, contracted 2.4% in 2014, the first decline since the 2008-09 Recession. Given that more than one-third of Banks' new business volume came from large-ticket transactions, this negative growth likely hurt Banks' performance in 2014.

Moreover, Independents are slowly recapturing market share from Banks and Captives. For the second consecutive year, Independents' share of total new business volume increased in dollar terms. While Banks' share of new business volume also ticked up in 2014, it remains below 2012 levels, and Captives' share fell substantially in 2014. Despite these gains made by Independents, it is worth noting that they remain by far the smallest organization type. Banks account for more than half of total new business volume, compared to Captives' 31% and Independents' 14%.

Fast Growth in Construction, Manufacturing, Government

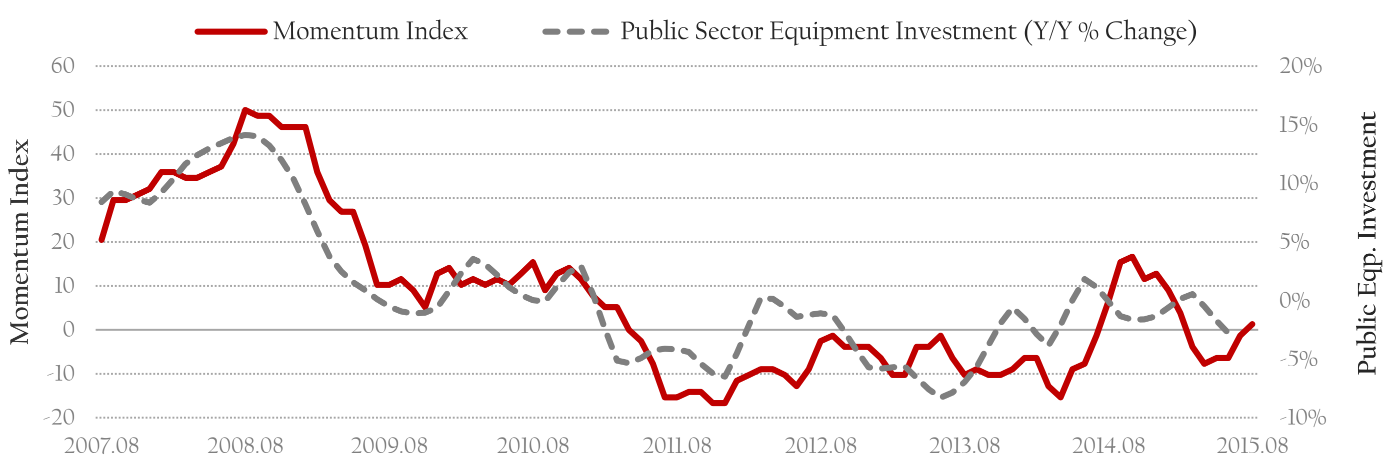
Among end-user industries, 2014 new business volume growth was fastest for Construction (21.5%), Industrial Manufacturing (16.8%), and Government (16.2%). Wholesale & Retail Sales (11.8%), Mining, Oil Extraction, & Pipelines (11.5%), and Transportation (9.7%) also saw solid growth in 2014. Only two industries exhibited negative growth in 2014: Printing & Publishing plummeted 28%, following a surge in 2013, and Utilities new business volume dropped 24%.

A shift in fiscal policy helps explain stronger new business volume from the public sector. Due to sharp budget cuts, the government was a drag on economic growth for several years; between Q4 2010 and Q4 2013, government spending (including federal, state, and local government spending) subtracted 0.56% from quarterly real GDP growth, on average. While still not a major growth driver, government spending is no longer a headwind to economic growth. In Q2 2015, for example, the federal government had a neutral effect on GDP, while state and local government contributed 0.46% to growth. Public sector equipment & software investment also declined for much of 2011 – 2013, reflecting heightened budget uncertainty and across-the-board budget cuts caused by sequestration. However, 2014 saw a modest rebound in public equipment spending, and positive growth has continued into 2015. Similarly, new business volume for the Government end-user jumped 16.2% in 2014, following a sharp 23.1% contraction in 2013.

A similar story regarding public sector investment can be found upon closer inspection of leading economic indicators. For example, the Foundation-Keybridge U.S. Public Sector Equipment Investment Momentum Monitor, which predicts trends in public sector equipment investment with a three to six month lead time, accelerated throughout the first 8 months of 2014 and, after a half-year decline, has rebounded in 2015. This movement suggests continued improvement in public equipment investment growth over the next six months.

Foundation-Keybridge U.S. Public Sector Equipment Investment Momentum Monitor

(index values or percent)



Source: Macrobond Financial, Keybridge LLC

Growth Attribution

All three organization types put small weights on the two weakest end-users (Printing & Publishing, Utilities) and gave relatively high weights to Construction. Strong growth in Industrial Manufacturing benefited Banks and Independents due to its large share of their portfolios (15.7% and 16.0%, respectively). Similarly, Independents' focus on Transportation (28.6% of portfolio) helped propel their new business volume growth, while Captives' emphasis on Agriculture (nearly 40% of portfolio) was responsible for much of their deceleration last year. The charts on the following two pages show the top five end-users (by share of new business volume) for each organization type (Banks, Captives, Independents) and 2014 new business volume growth for each of those end-users, as well as each organization type's top five equipment types and their 2014 new business volume growth.

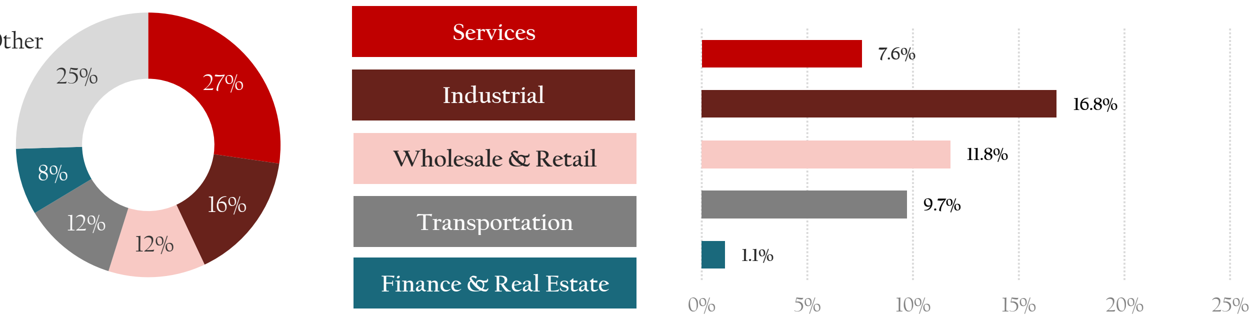
By equipment type, new business volume largely matched trends seen in end-user industries. Amusements (49.0%), Construction (22.0%), Transportation (16.8%), and Materials Handling (13.8%) showed the fastest growth in 2014, while Renewable Energy (-54.4%) and Printing (-25.2%) experienced the largest contractions in new business volume. Interestingly, new business volume for Mining / Oil & Gas Extraction equipment declined 24.5% in 2014, making it the third worst performer, yet the Oil & Gas Extraction end-user industry saw 3.5% growth. This divergence suggests that, while the energy sector continued to expand and invest in new equipment in 2014, it required less oil & gas extraction equipment and more supporting equipment (e.g., trucks, storage). Going forward, this could be an interesting trend to watch.

In 2014, both Banks and Independents benefited by focusing on Transportation equipment (which accounted for 35.2% and 45.4% of their portfolios, respectively). As previously noted, Captives' focus on Agriculture equipment (27.9% of portfolio) likely limited their new business volume growth. Similarly, Banks and Captives both gave significant weights to Computer equipment, which contracted 4.7% last year.

Growth Attribution by End-User

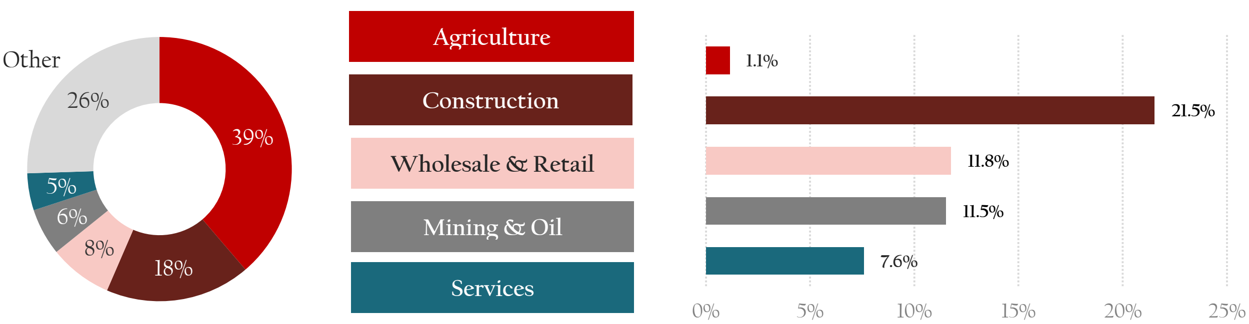
Banks

percent of new business volume *year-on-year new business volume growth*



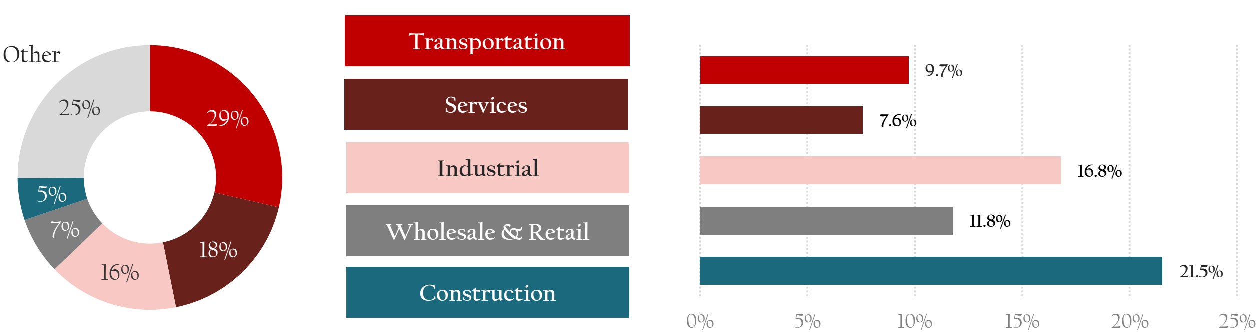
Captives

percent of new business volume *year-on-year new business volume growth*



Independents

percent of new business volume *year-on-year new business volume growth*



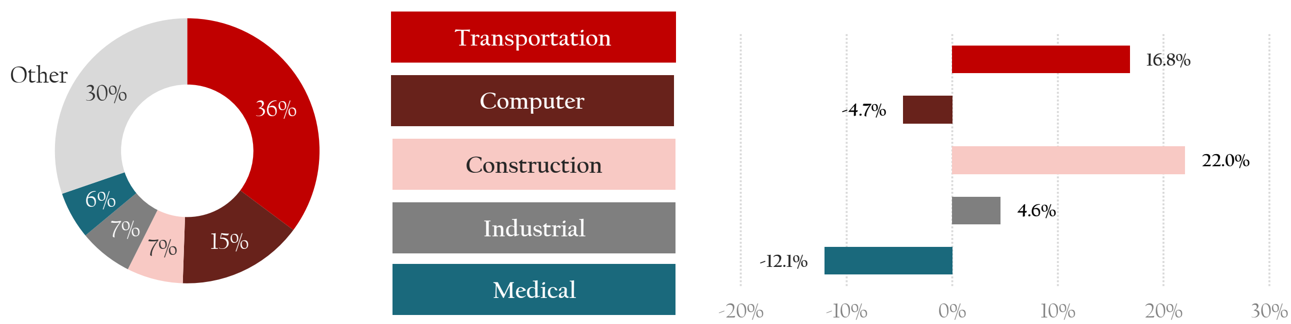
Source: 2015 ELFA Survey of Equipment Finance Activity, Keybridge LLC

Growth Attribution by Equipment Type

Banks

percent of new business volume

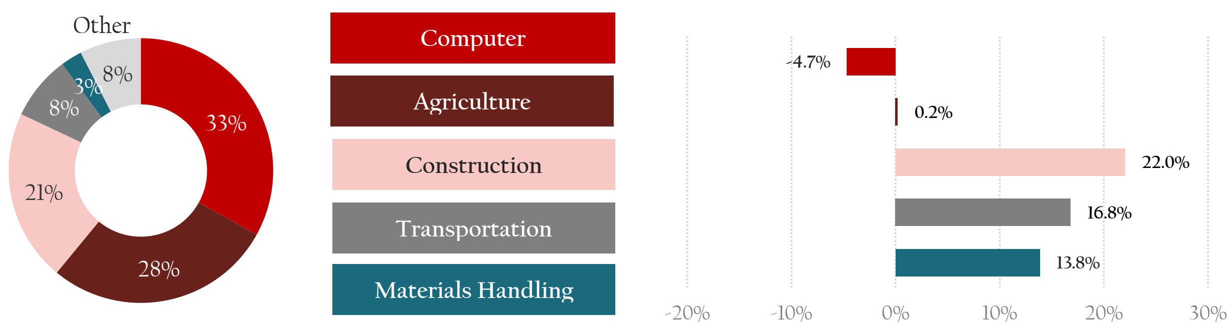
year-on-year new business volume growth



Captives

percent of new business volume

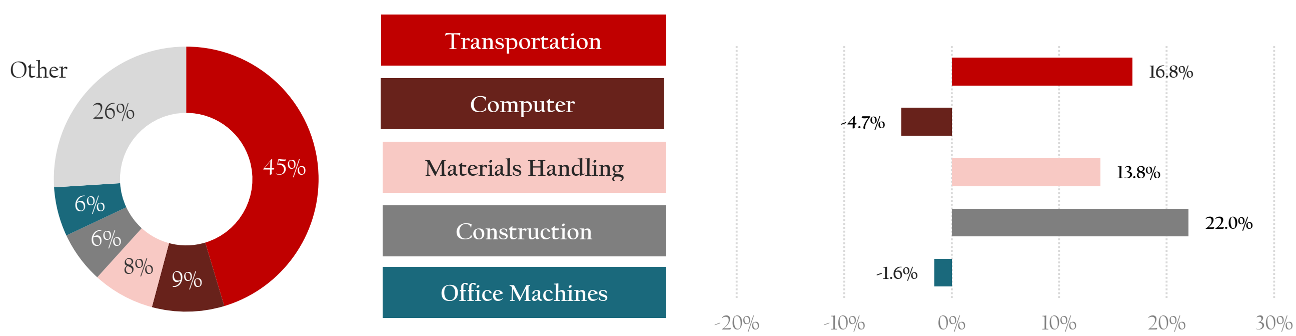
year-on-year new business volume growth



Independents

percent of new business volume

year-on-year new business volume growth



Source: 2015 ELFA Survey of Equipment Finance Activity, Keybridge LLC

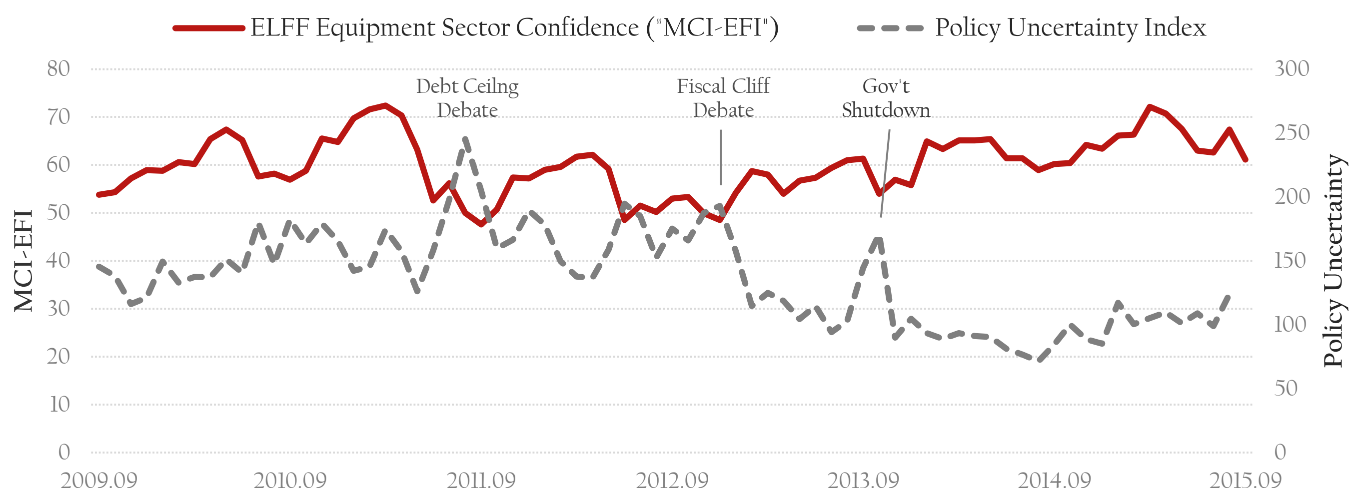
Lower Policy Uncertainty, Elevated Confidence

In 2014, subdued policy uncertainty encouraged business investment and boosted confidence in the equipment finance industry. As shown in the chart below, economic policy uncertainty and the Foundation's Monthly Confidence Index of the Equipment Finance Industry ("MCI-EFI") are inversely related. In other words, industry confidence often falls during periods of heightened uncertainty, such as the debt ceiling stand-off in 2011 or the government shutdown in the fall of 2013. As 2014 witnessed the passing of a federal budget and comparatively few incidents of partisan brinkmanship, low policy uncertainty was one factor pushing industry confidence to multi-year highs.

Although policy uncertainty has declined over the past year, it has not disappeared. Several industry experts noted continued concerns over the federal government's ability to pass legislation and budgets. Moreover, as the 2016 elections heat up and candidates look for ways to differentiate themselves from one another, a spike in partisanship that could increase both policy uncertainty and business apprehension is more likely.

Policy Uncertainty and Industry Confidence

(index values)



Source: ELFF, Macrobond Financial

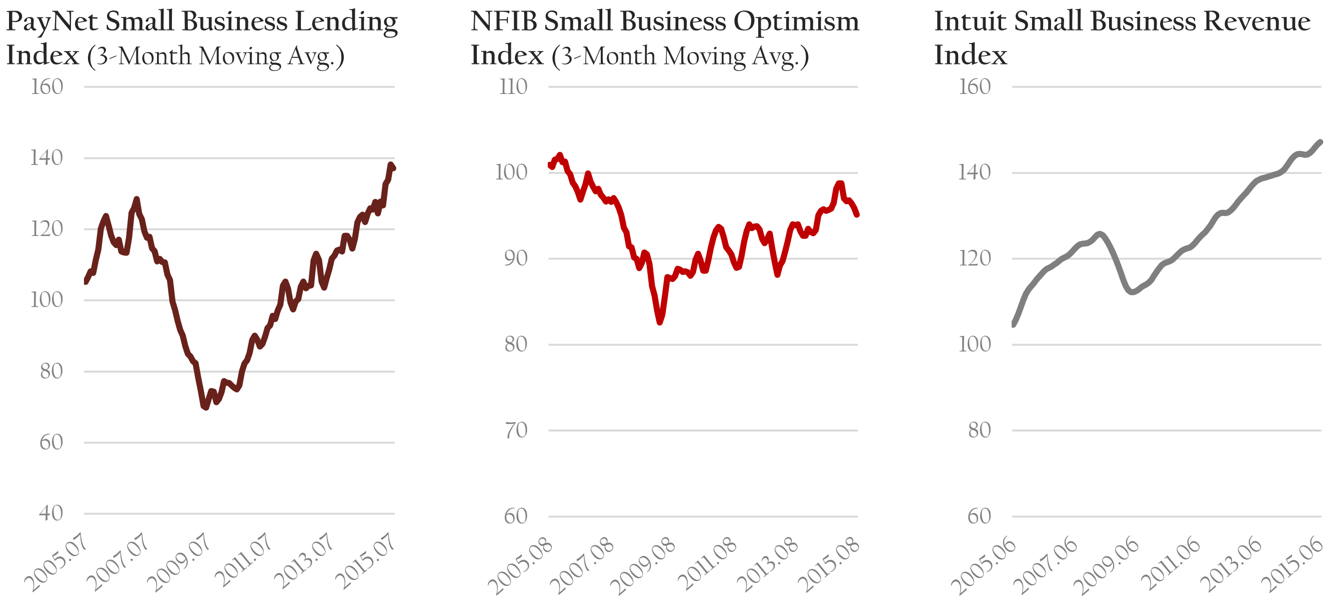
Small-Ticket Segment Drives Growth

The small-ticket market segment continues to be an industry growth driver. As previously noted, the small-ticket market segment led new business volume growth in 2014, expanding 9.0% compared to 7.9% and -2.4% for the middle- and large-ticket market segments, respectively. As expected, data by organization size showed a similar trend. Small organizations (with new business volume between $50 and $250 million in 2014) experienced an acceleration in new business volume growth, which jumped from 7.1% in 2013 to 18.7%. Larger organizations, on the other hand, exhibited slower growth; new business volume grew 15.9% for organizations between $250 million and $1 billion in size and 5.3% for organizations with more than $1 billion in new business volume. New business volume contracted 5.1%, however, for the very smallest organizations (under $50 million).

The 2014 SEFI report noted a nascent turnaround for small businesses, and this trend continued into 2015. Several indicators of small business activity and confidence — including the PayNet Small Business Lending Index ("SBLI"), the NFIB Small Business Optimism Index, and the Intuit Small Business Revenue Index — increased sharply in 2014, hitting multi-year highs. In 2015, the SBLI and Small Business Revenue Index improved further, while Small Business

Optimism slipped from last December's 8-year high yet remains elevated. Combined, equipment finance and macroeconomic data indicate that small businesses are growing more confident and, thus, bumping up their investment in equipment and software. Conversely, large businesses may be holding back on capex after leading much of the recovery in business investment. For instance, the Business Roundtable's CEO Economic Outlook Index has declined for two consecutive quarters, and CEO plans for capital spending fell to a two-year low in Q3 2015.

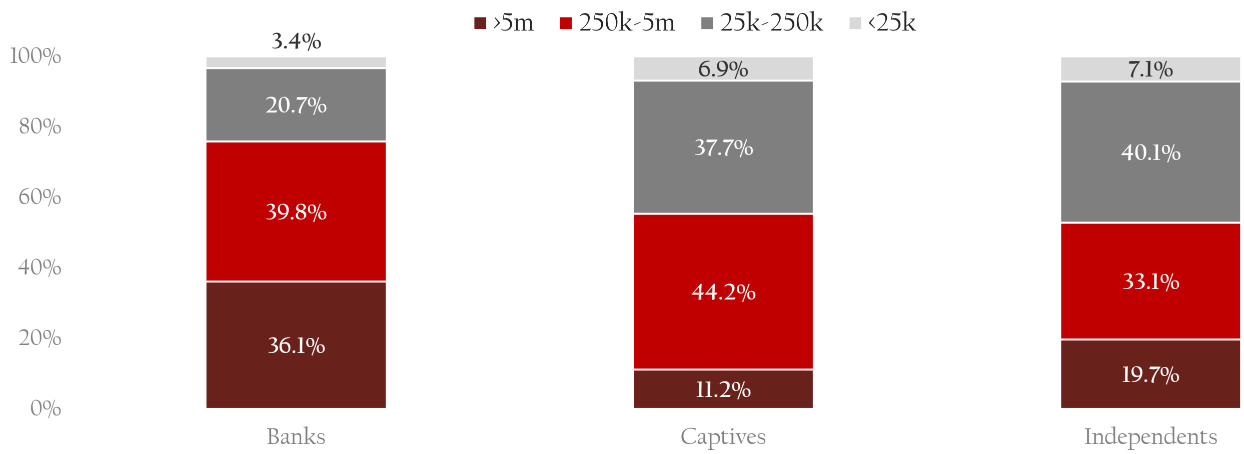
Small Business Dashboard



Sources: Macrobond Financial, PayNet, Inc.

Once again, Independents' larger weight on small- and medium-ticket transactions boosted their growth in 2014. Transactions between $25,000 and $250,000 comprised 40% of Independents' new business volume, compared to 38% for Captives and just 21% for Banks. Conversely, Banks' higher share of large transactions may have limited their growth. Over a third of Banks' new business volume came from transactions greater than $5 million, while 11% and 20%, respectively, of Captives' and Independents' new business volumes were from large-ticket transactions. Of course, transaction size fails to tell the whole story; Captives' new business volume was largely comprised of small- and middle-ticket transactions in 2014, yet they had the slowest growth of the three organization types last year.

Share of Portfolio by Transaction Size
(percent of total portfolio)



Source: 2015 ELFA Survey of Equipment Finance Activity

A Closer Look at Portfolio Make-up & Growth

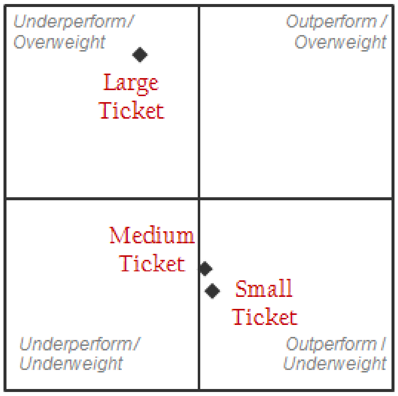
As briefly discussed earlier in the report, an organization's position in the market greatly influences their growth. The charts below attribute the relative growth rates of Banks, Captives, and Independents across three factors: ticket size, equipment type, and end-user industry. The charts display each organization type's relative weighting in various sectors and each sector's new business volume growth relative to the industry average (6.7%). For each organization type, all three ticket size categories (small, medium, and large) were included, along with the two end-user industries and equipment types with the smallest weights of new business volume and the two end-user industries and equipment types with the largest weights. For example, Agriculture equipment transactions accounted for 27.9% of Captives' new business volume in 2014, significantly above 11.3% for the overall industry. New business volume grew only 0.2% for Agriculture equipment, compared to 6.7% for the total industry. Therefore, by over-weighting an under-performing equipment type (Agriculture), Captives curbed their growth last year. On the other hand, by placing more weight on fast-growing sectors and less weight on slow-growing ones, other organizations increased their growth rates. Independents, for instance, over-weighted Trucks & Trailers (29% of new business volume versus 15%), which is a fast-growing industry (25% growth versus 6.7%) that boosted their overall growth.

In general, all three organization types avoided slow-growth industries and transaction sizes, with a few exceptions. As already noted, Captives over-weighted Agriculture, Banks over-weighted Corporate Aircraft, and both Banks and Independents over-weighted Large-Ticket transactions (which contracted in 2014). Conversely, Banks and Independents benefitted from over-weighting Trucks & Trailers, while Captives and Independents helped their growth by over-weighting Small-Ticket transactions.

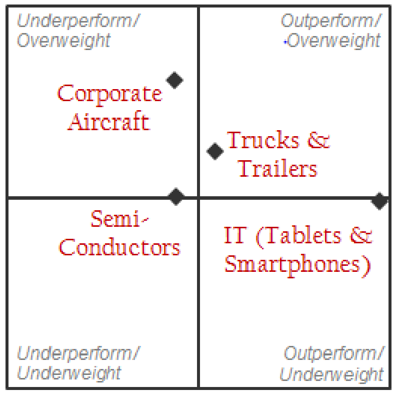
Equipment Finance Industry Performance Attribution Analysis

Banks

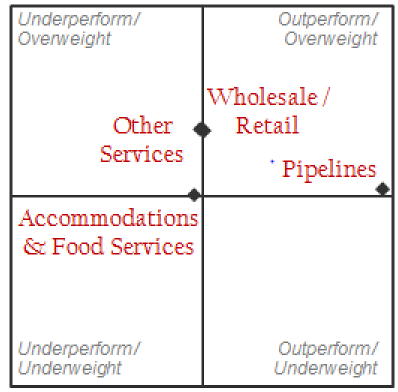
by ticket size



by equipment type

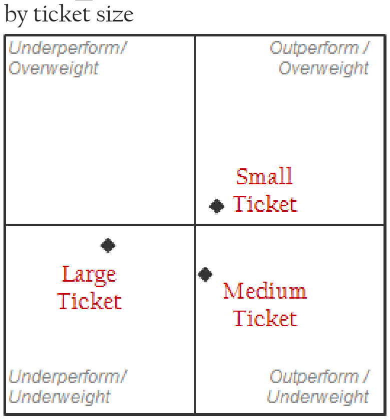


by end-user industry

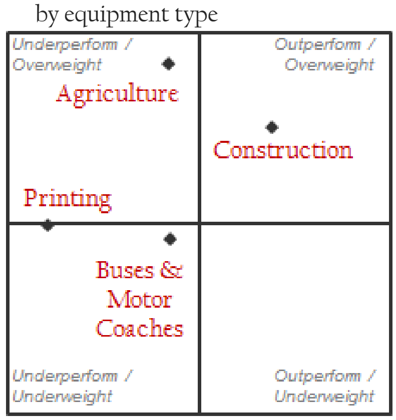


Captives

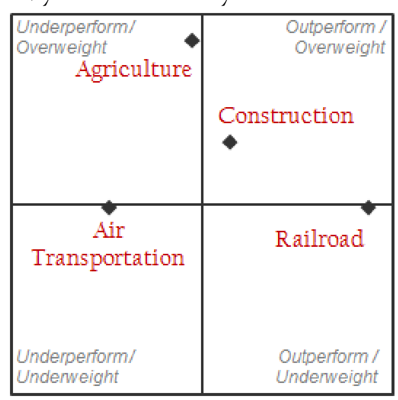
by ticket size



by equipment type

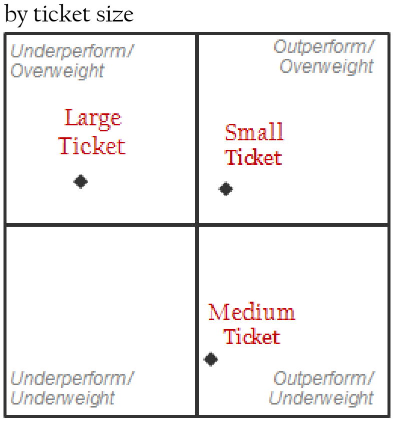


by end-user industry

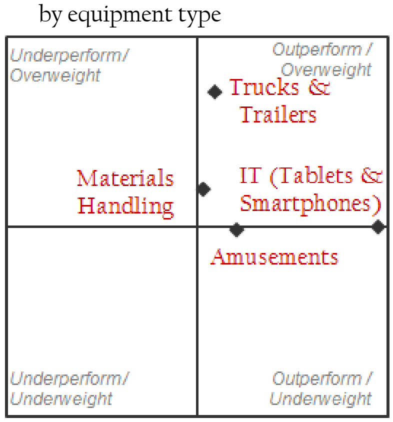


Independents

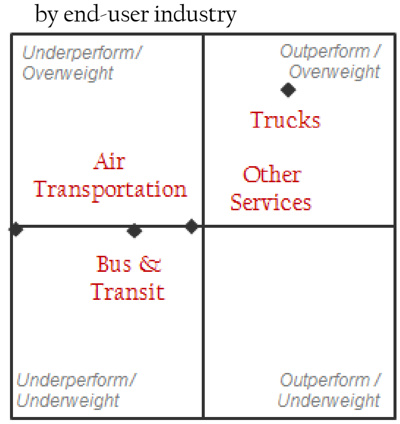
by ticket size



by equipment type



by end-user industry



Source: 2015 ELFA Survey of Equipment Finance Activity, Keybridge

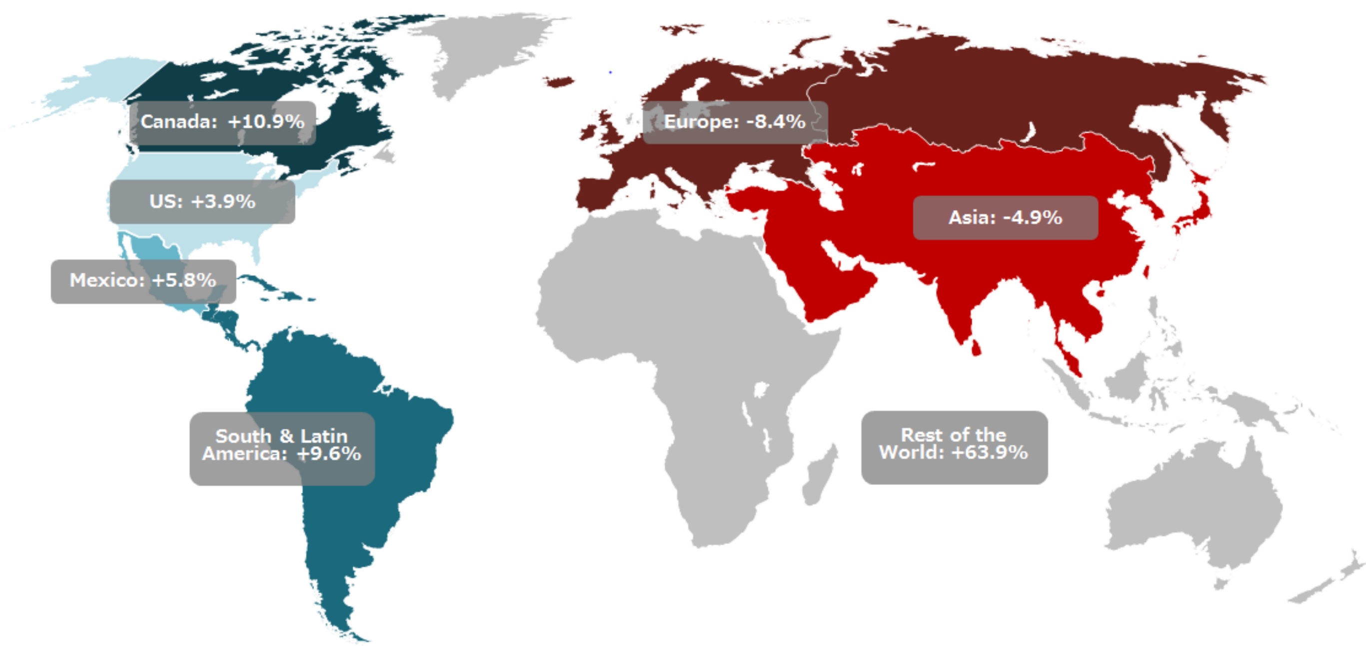
Negative International Growth

For the second year, international new business volume declined both in level terms and as a share of total new business volume. Outside of the U.S., new business volume slipped 1.7% in 2014, as declines in Asia and Europe outweighed gains elsewhere. More specifically, new business volume in South & Latin America rebounded 9.6% in 2014 following a 6.6% contraction the prior year. Conversely, European new business volume dropped 8.4% after growing 6.2% in 2013.

Once again, more than half of Captive respondents sourced new business volume from outside the U.S., compared to roughly one-fourth of Bank and Independent respondents. Nearly one-third of Captives' new business volume came from Europe or Asia in 2014, underscoring their parent companies' dependency on other advanced economies. In comparison, roughly 10% of Banks and Independents' new business volume originated outside of the U.S.

International New Business Volume

(2013-2014 percent change)



Source: 2015 ELFA Survey of Equipment Finance Activity

Tumult in the World Economy

The world economy expanded 3.4% in 2014, the third consecutive year of continuous growth. Growth in advanced economies picked up from 1.4% in 2013 to a still-sluggish 1.8% rate. The U.S. grew at a 2.4% pace, while Canadian growth increased to 2.5%, and the Eurozone grew a paltry 0.9% after two years of decline. Meanwhile, emerging economies' growth decelerated from 5.0% to 4.6% in 2014, according to the International Monetary Fund (IMF).

Myriad headwinds caused slower growth in emerging economies. As China transitions its economy from investment-led growth to a greater focus on consumption, it is undergoing a "great moderation" in growth. China's GDP growth slowed to 7.4% in 2014, its weakest pace since 1990. Other developing nations also face structural challenges; Brazil is currently in recession due to corruption scandals, a waning commodity cycle, and severe drought, while low oil prices and harsh economic sanctions have also put Russia in recession.

2015 has witnessed more tumult in the global economy. In early summer, Greece nearly defaulted on its IMF loans and flirted with exiting the Eurozone, yet continued negotiations with its creditors (the IMF, the European Central Bank, and Eurozone countries) resulted in a new 86 billion euro bailout deal — staving off a "Grexit" for now. As European risks have subsided, however, China's economic slowdown has raised fresh concerns about the global economy, and recent data point to a more severe Chinese slowdown than previously thought. Chinese manufacturing and exports have seen consistent declines: industrial production growth has halved since 2011, while exports have fallen 5.5% (year-over-year) in August and China's manufacturing PMI hit a six-year low in September, signaling contraction. Further, the Chinese stock market plummeted this summer, triggering volatility in global financial markets. Since June, the Shanghai Composite Index has dropped an astounding 40%, as growing fears of a Chinese economic slowdown sparked a sell-off in Chinese stocks. So far, U.S. financial markets have not been significantly hurt by these short fluctuations, but continued tumult could derail stronger growth later in 2015.

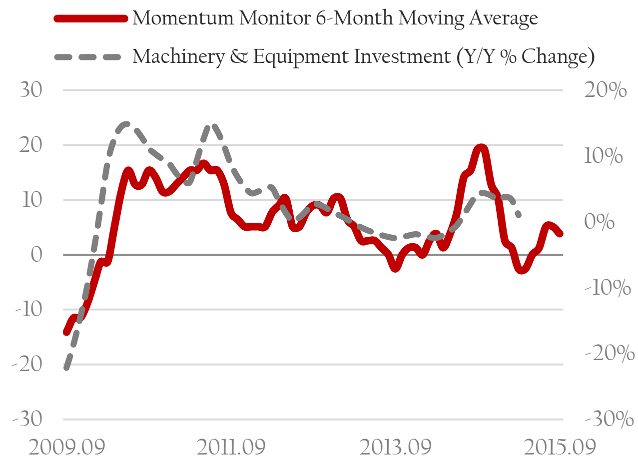
Another year of below-average growth is likely in 2015. According the September *Economist* poll of forecasters, U.S. growth will hold steady at 2.4%, euro area growth will pick up slightly to 1.4%, and China, Brazil, and Russia will all see slower growth or outright contraction in 2015. Similarly, as shown in its July World Economic Outlook ("WEO") update, the IMF expects advanced economies' growth to increase modestly in 2015, led by the U.S., while emerging economies will experience slower growth. Keybridge is somewhat more bullish about the U.S. economy and expects 2.6% growth in 2015. Regardless, while the U.S. economy is steadily strengthening, it cannot lift global growth on its own — and the fragile world economy is a threat to faster expansion in the U.S. This risk was noted by multiple industry experts, who described a global macroeconomic shock as a concern that "keeps them up a night."

Like last year, the 2015 SEFI includes international equipment investment momentum monitors for three major economies: Canada, Europe, and China. The charts on the following page show how equipment investment has fared in these three economies following the global recession of 2008-09 and offer an equipment investment outlook for the next three to six months.

International Equipment Investment Momentum Monitors

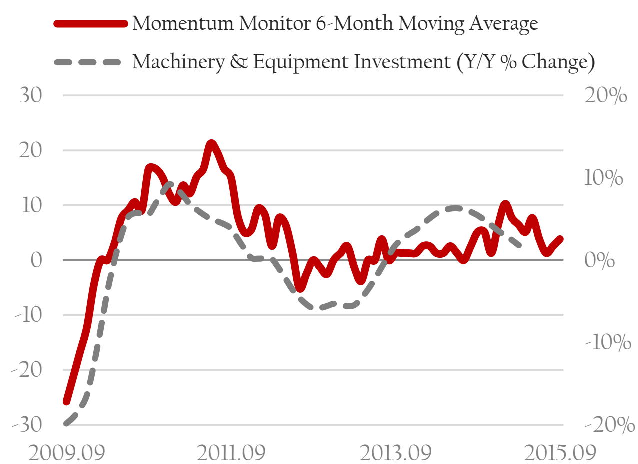
Canada

Following several years of contraction, Canadian machinery and equipment investment turned positive in mid-2014. However, persistent low oil prices have recently hammered the Canadian economy, pushing the country into recession and discouraging new business investment. After picking up in the second half of 2014, investment growth eased to just 1.0% year-on-year in Q1 2015. Correctly predicting the downturn, the momentum monitor's six-month moving average decreased sharply at the end of 2014 and has since partially recovered. Overall, its recent trend indicates continued weak performance in equipment investment in the near term.



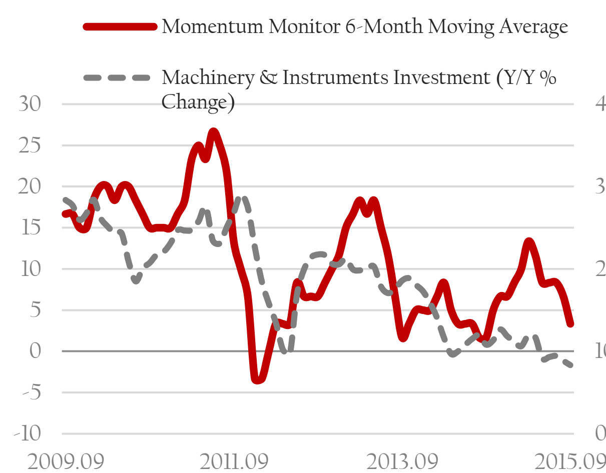
Europe

Machinery and equipment investment in the 28-member European Union rebounded in 2014 following several years of contraction. Investment growth peaked at 6.3% year-on-year in mid-2014 but has since slowed. In the first quarter of 2015, machinery and equipment investment was up only 1.8% from a year prior. The momentum monitor's six-month moving average has gradually increased since 2012 but is not signaling break-out growth. The index's latest movement suggests softer, yet still positive, momentum in equipment investment.



China

China's machinery investment growth has slowed substantially in recent years, as its economy transitions away from investment-led growth. Moreover, recent weak data have underscored the severity of China's economic slowdown, including a struggling manufacturing sector. Reflecting this moderation in growth, the momentum monitor's six-month moving average has declined sharply in the last six months and points to a further slowdown in investment growth over the next three to six months.




66-44
66-51

Yield & Funding

A continuation of trends characterized yield and funding in 2014. The cost of funds remained historically low, while an intensely competitive environment pushed yields slightly lower. As a result, spreads compressed further and cut into equipment lessors' profitability. However, an improving economy and an expected shift in Federal Reserve policy should lift interest rates and allow equipment lessors to expand their margins. After six years of zero interest rates, the Fed could raise short-term rates as early as October 2015. Industry competition has persisted — or even strengthened — in 2015, and will keep yields low over the short-term. Going forward, a combination of intertwined forces (e.g., the faltering global economy, U.S. macroeconomic conditions, Fed interest rate policy, and industry competition) will direct when and how quickly the cost of funds and yields can rise. Absent a major economic shock, the steady strengthening in the U.S. economy and gradual tightening of Fed policy should cause interest rates to rise in 2015 and 2016 and alleviate some pressure on spreads in the equipment finance industry.

Percent	Industry	Banks	Captives	Independents
Weighted-Average Pre-Tax Yield	4.26%	3.92%	4.21%	7.71%
Weighted-Average Pre-Tax Spread	2.80%	2.61%	2.68%	5.11%
Weighted-Average Cost of Funds	1.46%	1.31%	1.53%	2.60%
Median Pre-Tax Yield	5.39%	4.30%	5.56%	8.54%
Median Pre-Tax Spread	3.83%	3.25%	3.80%	5.17%
Median Cost of Funds	1.55%	1.25%	1.86%	3.04%

Source: 2015 ELFA Survey of Equipment Finance Activity

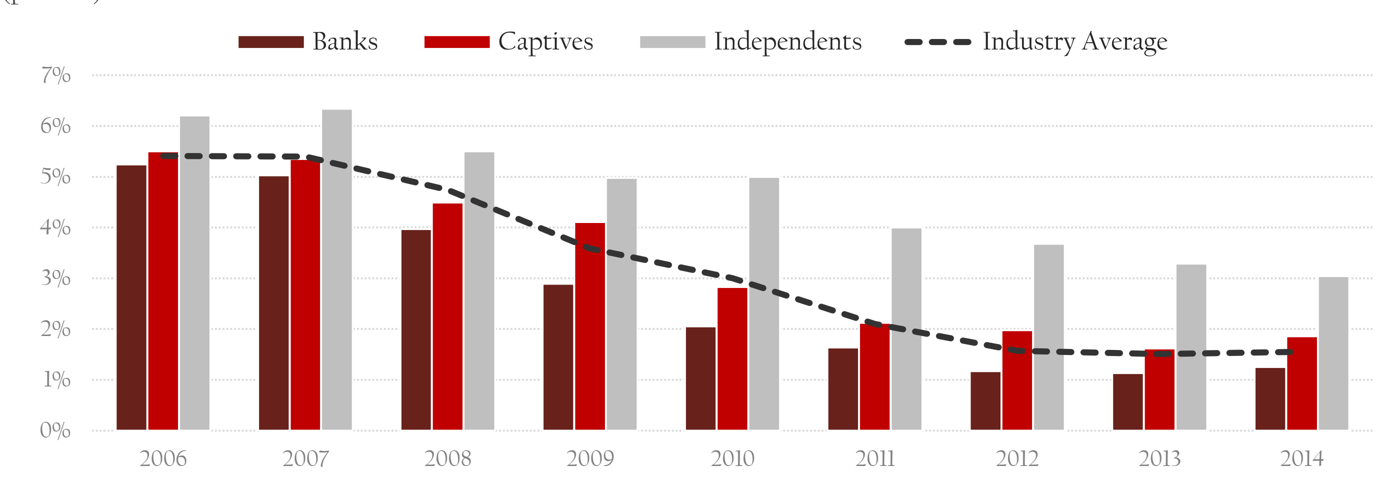
The cost of funds was little changed in 2014 and continued to hover near all-time lows, as the Federal Reserve kept short-term interest rates at zero. Banks and Captives both experienced small increases in their cost of funds (weighted average), while Independents' cost of funds slipped further in 2014. Broadly speaking, the cost of capital remained low in 2014, as the Fed discount rate stayed at 0.75%, unchanged since early 2010. Looking ahead, the cost of funds appears to have hit bottom and should gradually rise in 2015 and 2016.

Banks Maintained Cost of Funds Advantage

Due to their direct access to the Fed discount window, Banks had the lowest cost of funds in 2014, sustaining their cost advantage over Captives and Independents. Continuing last year's trend, however, the cost of funds gap between Banks and Independents narrowed further in 2014. For the first time in four years, the cost of funds (weighted average) rose for the equipment finance industry, increasing slightly from 1.35% in 2013 to 1.46% in 2014. An uptick in both Banks' and Captives' cost of funds drove this trend, while Independents' cost of funds improved again in 2014.

Median Cost of Funds

(percent)



Source: 2010 - 2015 ELFA Surveys of Equipment Finance Activity

Continued Spread Compression

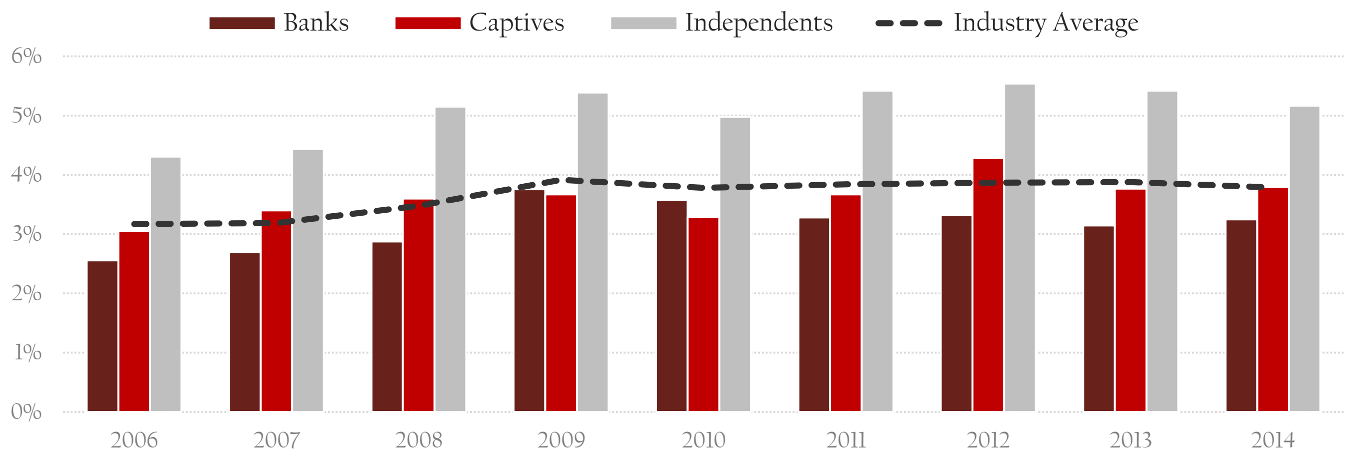
As a greater number of industry players competed for business, spreads (weighted average) compressed further last year. For the overall industry, the weighted-average pre-tax spread declined from 2.94% in 2013 to 2.80% in 2014. Moreover, virtually all industry interviewees named heightened competition as an ongoing trend in 2015, and several noted that competition has actually intensified this year.

All three organization types saw tightened spreads in 2013. Independents' pre-tax spread (weighted average) declined 33 basis points to 5.11%, while Banks' spreads fell 24 basis points to 2.61%, and spreads slipped 6 basis points to 2.68% for Captives. Banks continued to have slightly lower spreads than Captives, while Independents maintained higher spreads — reflecting their higher level of risk tolerance (and higher yields).

In 2014, spreads continued to have an inverse relationship with ticket size. The large-ticket market segment had the lowest spreads, at 1.99% (weighted average), while the small-ticket market segment had the highest spreads, at 3.16%. All three market segments experienced spread compression, with large-ticket spreads dropping more than 50 basis points in 2014. Contributing to lower spreads, the cost of funds (weighted average) inched up for all market segments. In a shift from 2013 — when the large-ticket market segment had a cost of funds advantage — the middle-ticket market segment had the lowest cost of funds, followed by the large- and small-ticket market segments.

Median Pre-Tax Spread

(percent)



Source: 2010 - 2015 ELFA Surveys of Equipment Finance Activity

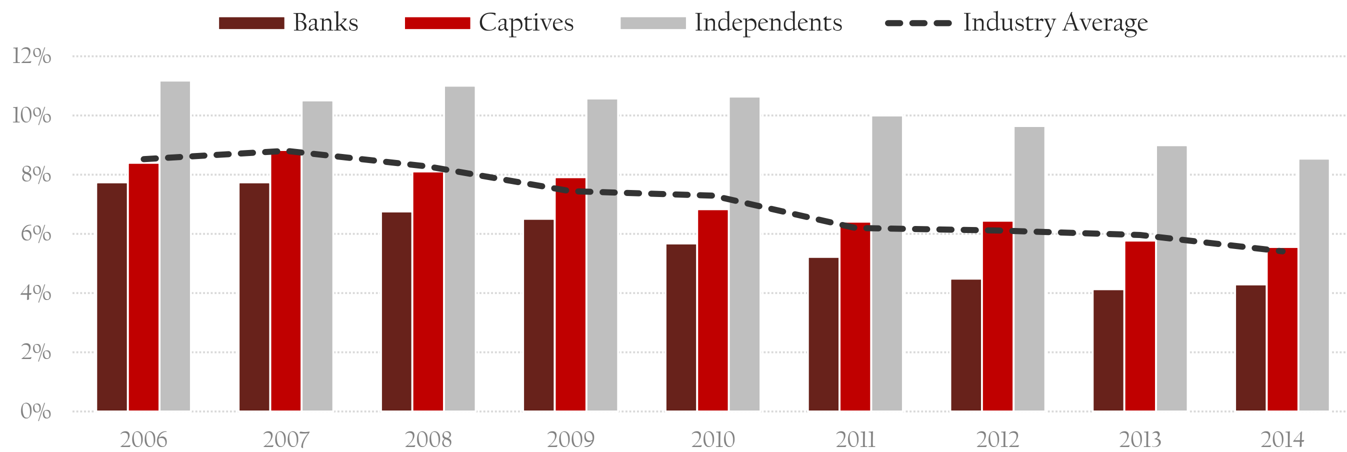
Heightened Competition, Lower Yields

Yields also declined in 2014, another indication of intense competition within the industry. The industry-wide pre-tax yield (weighted average) has nearly halved over the last decade and decreased from 4.35% in 2013 to 4.26% in 2014. Pre-tax yields (weighted average) also declined for all three organization types. In particular, Independents' yields fell 39 basis points to 7.71% in 2014. Meanwhile, Banks and Captives saw smaller declines in their yields, which fell 13 and 3 basis points, respectively.

Despite 2014's sharp decline, Independents continue to benefit from higher yields relative to Banks and Captives. Compared to 7.71% for Independents, pre-tax yields stood at 4.21% for Captives, followed by 3.92% for Banks. As previously noted, Independents are more active in riskier market segments (including small-ticket) allowing them to earn higher yields. Conversely, large-ticket transactions tend to have lower yields than smaller transactions, so Banks' high share of larger transactions kept their pre-tax yields low relative to Captives and Independents.

Median Pre-Tax Yield

(percent)

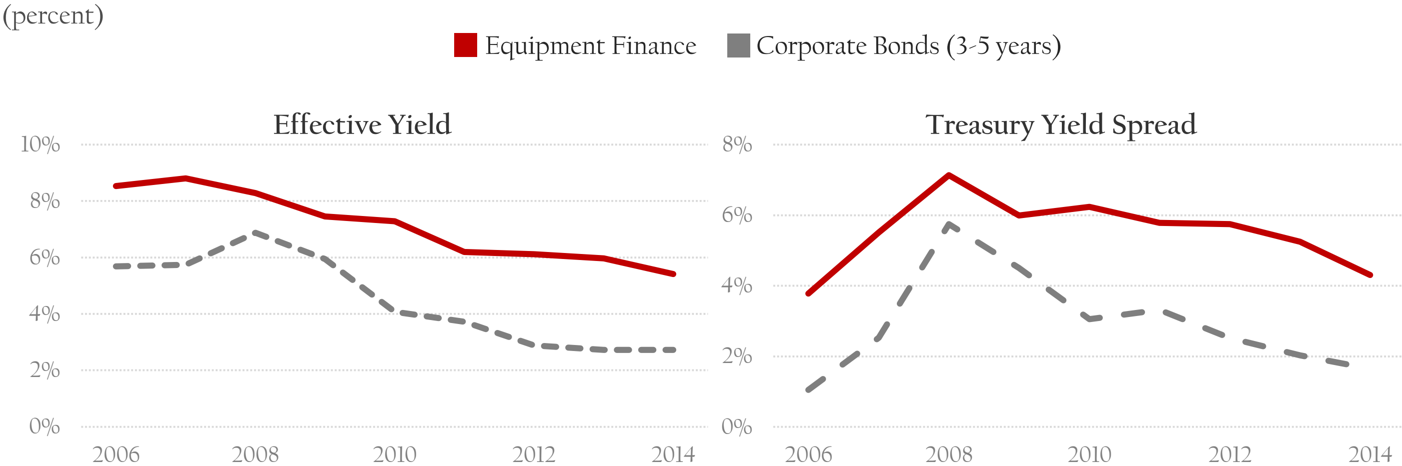


Source: 2010 - 2015 ELFA Surveys of Equipment Finance Activity

Equipment finance continues to return higher yields than corporate debt. While effective yields on both equipment leases and corporate bonds (3–5 years) have consistently declined in recent years, equipment finance yields have maintained their advantage and help explain the flood of new entrants into the industry in recent years. The spread on equipment finance compared to 3-year Treasuries has also remained above the spread on corporate bonds, despite declining since 2008.

Yield & Spread Comparison

(percent)



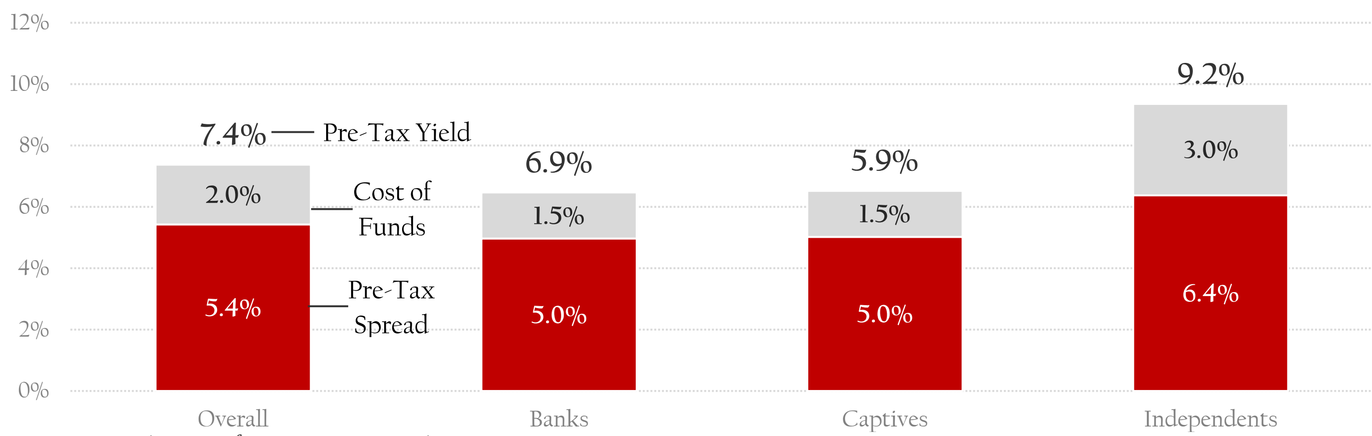
Source: 2011 – 2015 ELFA Surveys of Equipment Finance Activity, St. Louis Federal Reserve, Macrobond Financial, Keybridge LLC

Small-Ticket Spreads Tighten

Within the small-ticket market segment, the cost of funds ticked up and yields slipped, causing the median pre-tax spread to decline from 5.62% to 5.43% in 2014. Independents' pre-tax spread remained higher than Banks' or Captives' small-ticket spreads, due to much higher yields for Independents. However, Independents also experienced a higher cost of funds than Banks or Captives.

Small-Ticket Equipment Finance Yield & Funding

(median; percent)



Source: 2015 ELFA Survey of Equipment Finance Activity

Note: Due to rounding, Pre-Tax Yield minus the Cost of Funds may not precisely equal Pre-Tax Spread.

Portfolio Performance

A streak of record portfolio performance continued in 2014; delinquencies, non-accruals, and charge-offs hovered near multi-year lows or even declined further. Given their emphasis on credit quality, Banks experienced stronger portfolio performance than Captives or Independents again in 2014. Low delinquencies also led several end-user industries — including Truck Transportation, Machinery Manufacturing, and State & Local Government — to be both fast-growth and low-risk in 2014. Strong performance has continued into 2015; the aging of receivables over 30 days remained near 1.0% this summer, while August marked the 18th consecutive month of near-0.2% charge-offs. Portfolio performance, however, is expected to worsen somewhat going forward. Both an improving economy and heightened competition for business volume should encourage equipment lessors to gradually loosen their credit standards. However, few in the industry expressed concern over risky deal structures, as harsh lessons from the 2008–09 financial crisis have not been forgotten.

Percent (weighted average)	Industry	Banks	Captives	Independents
Delinquent Portfolio Over 30 Days	1.5%	0.6%	4.3%	1.2%
Non-accrual Assets as a Percentage of Receivables and Non-accrual Assets	0.3%	0.2%	0.3%	0.6%
Net Full-Year Loss (Charge-off) as a Percentage of Full-Year Average Receivables	0.09%	0.03%	0.12%	0.35%

Source: 2015 ELFA Survey of Equipment Finance Activity

Due to a healthier economy and credit caution, portfolio performance remained historically strong in 2014. Portfolio performance plummeted during the financial crisis, as delinquencies spiked; however, delinquencies have now fallen sharply across multiple sectors of the economy. For example, delinquency rates on C&I, consumer, and credit card loans are hovering near all-time lows, while real estate loan delinquency rates are close to pre-recession levels. Compared to a 2009 Q2 peak of 4.85%, delinquencies on consumer loans fell to 1.96% in 2015 Q2. Delinquencies on C&I loans experienced an even steeper drop, declining from 4.36% in 2009 Q3 to 0.72% at the end of 2014.

Improving Economy, Strong Portfolios

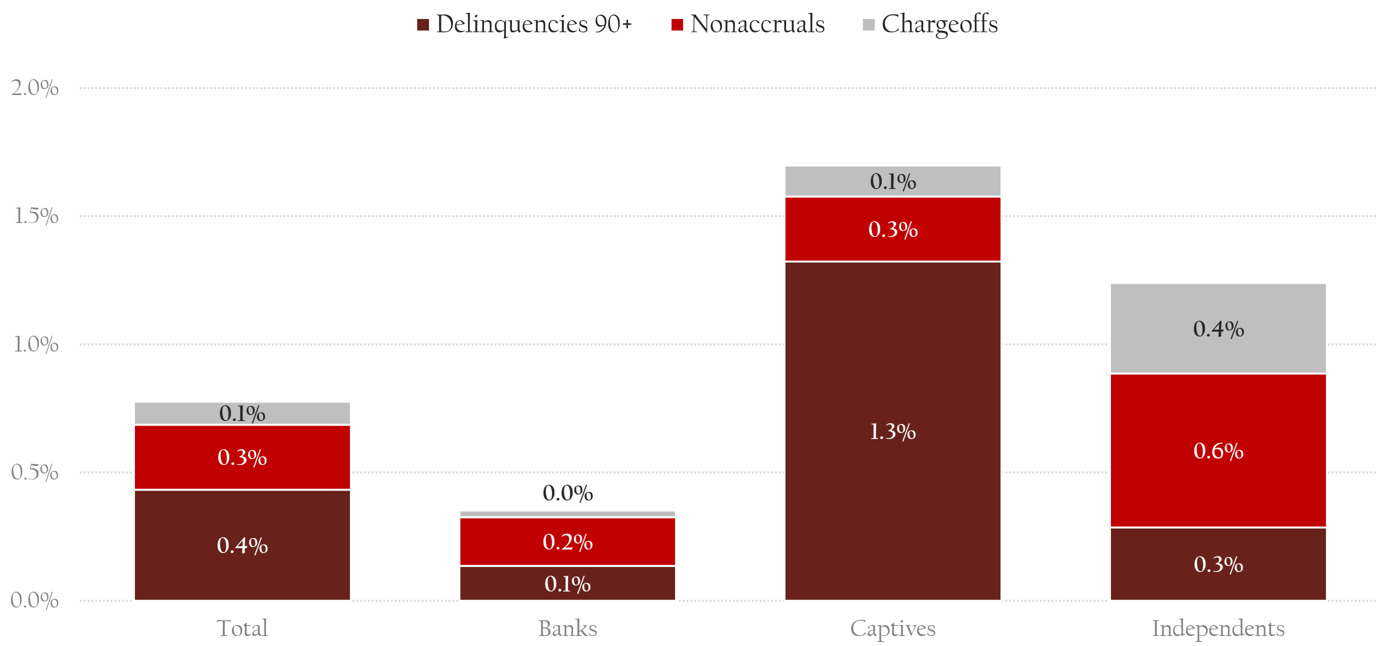
Like the overall economy, the equipment finance industry continues to benefit from record portfolio performance. As of the August MLFI-25 survey from ELFA, average losses (charge-offs) as a percentage of net receivables were little changed from 0.19% in July to 0.22% — the 18th consecutive month of near-0.2% charge-offs. The aging of receivables over 30 days has slipped in recent months and is now at 0.99%, down slightly from year-ago levels. The steady economic expansion has contributed to improved portfolio performance, as businesses are better able to repay their loans. Just as responsible for healthy portfolios is the industry's shift away from risk-taking after the financial crisis. Several industry participants noted a continued focus on high quality credit, and some suggested that equipment lessors have used pricing pressure, instead of looser credit standards, as a way to grow their businesses.

Banks Led in Portfolio Performance

As in recent years, Banks had the lowest levels for all three portfolio performance metrics: delinquencies over 30 days, non-accrual rates, and charge-offs. At just 0.6%, Banks' delinquencies were half that of Independents (1.2%) and roughly a fifth of Captives (4.3%). Similarly, charge-offs were virtually non-existent for Banks (0.03%) but higher for both Captives (0.12%) and Independents (0.35%). As noted in the 2014 SEFI report, different business models help explain these divergences in portfolio performance. While Captives aim to boost sales for their parent companies and Independents seek business in new (and potentially riskier) market niches, Banks tend to be more risk-averse. As demonstrated by both the SEFA data and industry interviews, Banks are more likely to accept lower yields to maintain strong credit quality.

Portfolio Quality by Type of Organization

(weighted-average percent)



Source: 2015 ELFA Survey of Equipment Finance Activity

While both Banks and Independents saw their delinquencies over 30 days (weighted average) fall further in 2014, Captives' delinquencies jumped from 2.7% in 2013 to 4.3% in 2014. In particular, delinquencies over 90 days increased 0.4 percentage point to 1.3% for Captives. This uptick in delinquencies may reflect a downturn in some of Captives' core industries; the Agriculture end-user industry, for example, makes up nearly 40% of Captives' new business volume and saw its 90 day delinquencies double from 0.3% in 2013 to 0.7% in 2014.

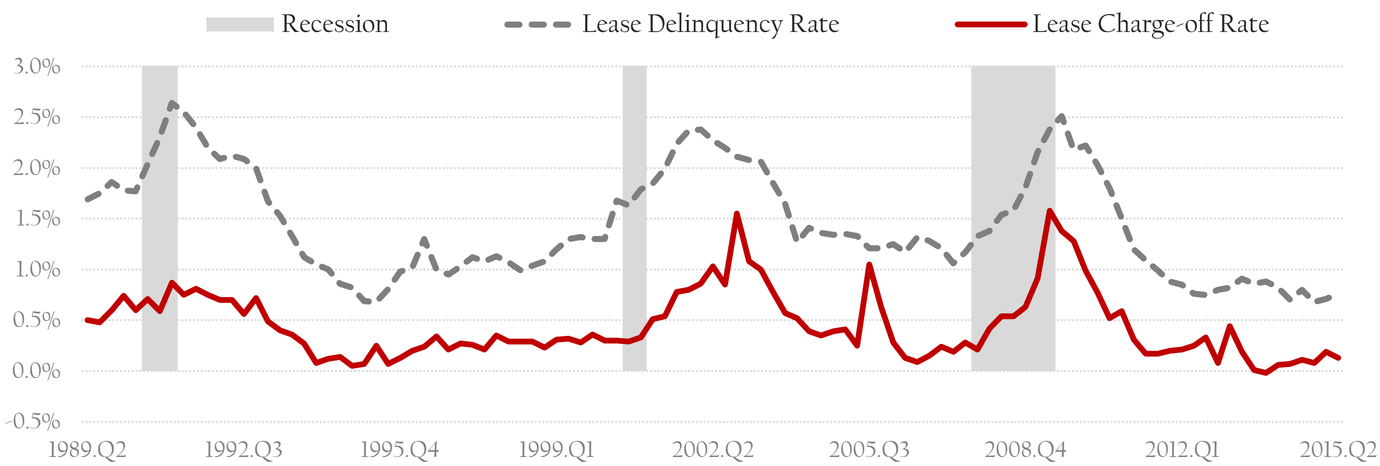
Performance Cycle Poised to Turn

Delinquencies and charge-offs are likely bottoming out and should gradually increase in the years ahead. For all U.S. banks, lease delinquencies and charge-offs rose sharply during the financial crisis, peaking in late 2009, before steadily declining over the past several years. More recently, there are signs of a cycle shift, as lease charge-offs are up slightly from late-2013 lows. Generally speaking, delinquencies and charge-offs follow 9-year "performance cycles," meaning that the next peak occurs roughly nine years after the previous one. Five years after the last peak and ten years after the last trough, lease delinquencies and charge-offs are unlikely to fall any further. As noted by several industry experts, with portfolio performance at record strength, "there's only one direction things can go."

Although delinquencies and charge-offs are likely to increase, industry experts did not name portfolio performance as a top worry over the next year. This relative lack of concern may reflect continued stringent credit standards by equipment lessors. The equipment finance industry has not forgotten the 2008-09 financial crisis, and few executives interviewed for this report expressed concern over excessive risk-taking in deals. Instead, several individuals cited an economic downturn as the greatest threat to portfolio performance, particularly if it's unexpected. In fact, the severity of the 2008–09 financial crisis — and the federal regulatory response that followed — likely explains much of equipment lessors' continued caution and the length of the current economic and performance cycles.

Lease Delinquencies and Charge-offs for all U.S. Commercial Banks

(annualized percent rate)



Source: Macrobond Financial

Increase in Large-Ticket Delinquencies

Portfolios remained healthy across market segments, although the delinquencies increased for the large-ticket segment. Delinquencies over 30 days (weighted average) ticked up for small-ticket and middle-ticket market segments in 2014, while large-ticket delinquencies increased more substantially from 1.0% in 2013 to 1.8% in 2014. Meanwhile, both charge-offs and non-accruals dropped for middle-ticket transactions and were little changed for the small- and large-ticket segments.

High Delinquencies in Energy Sector

At 4.1%, Oil & Gas Extraction surpassed Printing & Publishing to have the highest delinquency rate among end-users in 2014. The Federal Government and Wood & Paper Manufacturing followed close behind, with delinquency rates of 2.6% and 2.5%, respectively. On the other end of the ledger, Water Transportation had the lowest delinquency rate for the third consecutive year, and several other transportation end-users (including Air, Bus, and Truck Transportation) also had low delinquencies. Interestingly, one of the industries with the highest delinquencies — Wood & Paper Manufacturing — had one of the lowest non-accrual rates, suggesting that this industry may soon see an uptick in non-accruals.

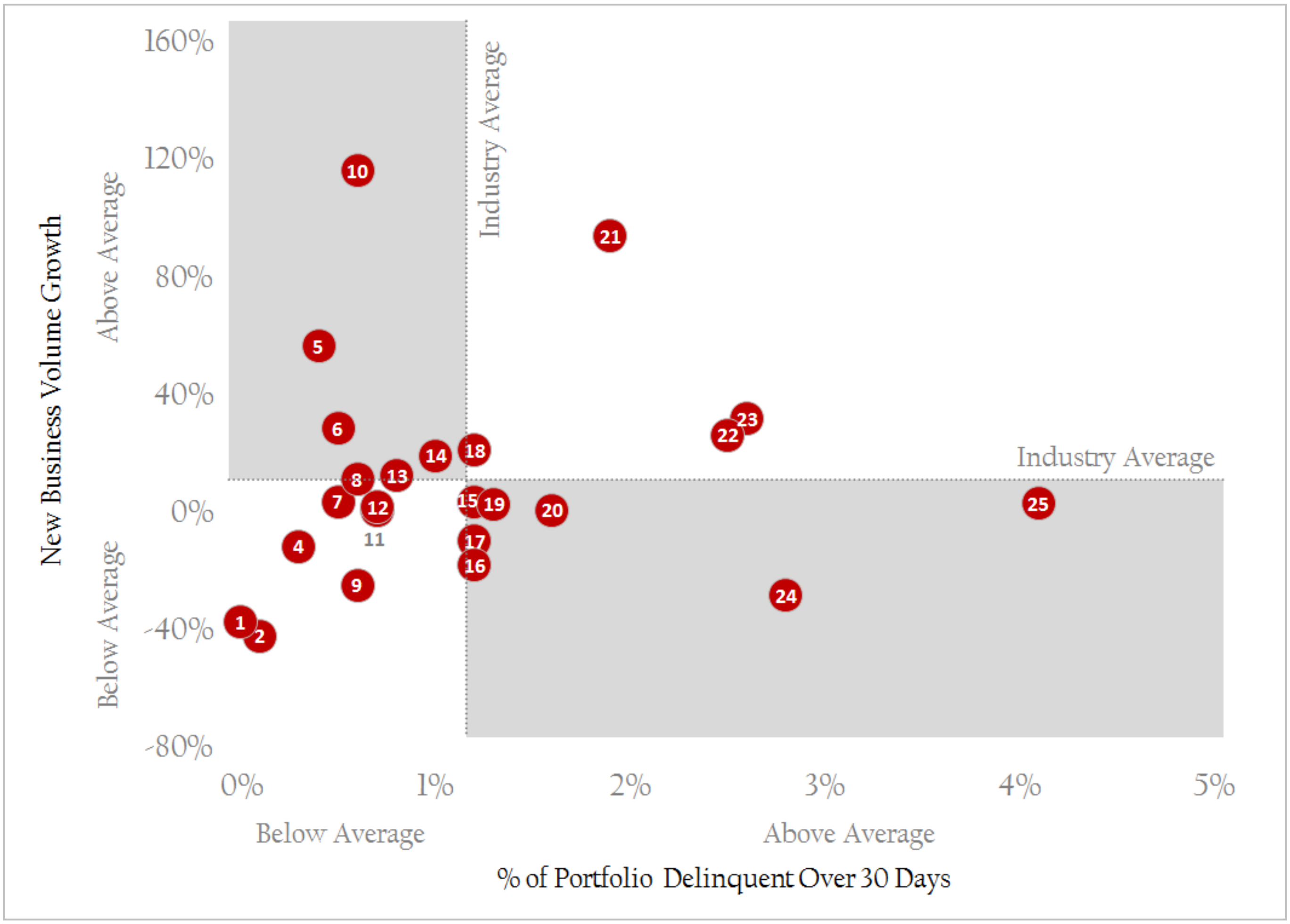
While still relatively strong, portfolio performance weakened for several end-user industries in 2014. Out of 25 industries, 10 showed higher delinquencies, while nine saw lower delinquencies and six saw no change. The two industries with the largest jump in delinquencies were Oil & Gas Extraction and Rail Transportation, both of which were affected by dramatic oil price drops last fall. Similarly, non-accruals increased for 11 end-users yet declined for the other 14. In particular, Printing & Publishing and Water Transportation experienced sharp drops in their non-accrual rates in 2014, while Accommodation & Food Services exhibited a notable increase.

As noted above, the negative turn in the energy sector's portfolio performance is unsurprising given the sharp drops in oil prices seen in the second half of 2014 (and into 2015). After hitting a high of $108 in June 2014, the West Texas Intermediate ("WTI") crude oil price plummeted 50% by the end of the year and was $45 in late September. This major decline in oil prices led to sharp investment reductions in the energy sector. For example, the oil rig count dropped over 60% between October 2015 and June 2015, and real Mining & Oilfield equipment investment has contracted for four consecutive quarters. Moreover, the oil price drops have spurred a "shake-out" in the energy sector, in which some firms operating near their break-even point are now being driven out of the industry. As such, portfolio performance is likely to remain relatively poor and potentially worsen as energy companies struggle to stay profitable and repay their loans.

Insights on Risk & Growth

By pairing delinquency rates and growth in new business volumes, equipment lessors and financers can target the most attractive industries. Differentiation among industries is a crucial focal point for businesses that seek to either increase their business volume in existing markets or to penetrate new markets. With respect to equipment-intensive industries, some continue to grow while others are struggling, and this affects their ability to remain current on loan and lease payments. The figure below, which plots the year-over-year change in new business volume and delinquency rates by end-user industry, summarizes each end-user industry's risk level and growth rate. The matrix offers insight into the movement of industries over the past year and can be instructive for equipment asset allocation and business expansion efforts. Industries in the top left quadrant of the matrix (shaded in gray) were both fast-growing and high-performing in 2014. This group includes Transportation Services, Accommodation & Food Services, Truck Transportation, Metal & Machinery Manufacturing, State & Local Government, and Wholesale & Retail Trade. Industries in the lower right quadrant (also shaded in gray) exhibited slower-than-average growth and higher delinquencies. As expected, this group included the two industries with the highest delinquency rates — Mining / Oil & Gas Extraction, and Printing & Publishing. Agriculture, Telecommunications, and several Service industries (Other, Health, and Entertainment Services) were also in this slow-growth / low-performance category.

Risk-Growth Analysis by End-User Industry



1. Transportation – Water
2. Transportation – Air
3. Pipelines (Not Shown)
4. Transportation – Bus, Transit
5. Services – Transportation
6. Truck Transportation
7. Industrial- Other
8. Wholesale / Retail
9. Utilities
10. Services – Accommodation / Food
11. Services – Educational
12. Finance, Insurance, Real Estate
13. Government – State & Local
14. Industrial – Metal & Machinery
15. Services – Other
16. Services – Health
17. Services – Arts, Entertainment & Rec.
18. Construction
19. Telecommunications
20. Agriculture, Forestry, Fishing
21. Transportation – Railroad
22. Industrial – Wood, Paper, Chem. & Plastic
23. Government – Federal
24. Printing, Publishing
25. Mining / Oil & Gas Extraction

Source: 2015 ELFA Survey of Equipment Finance Activity

Slow Rise Expected for Delinquencies

Delinquencies and charge-offs are unlikely to stay at historical lows. A variety of factors, including the ongoing economic expansion, increased industry confidence, and intense competition for deals, should gradually encourage looser credit standards. However, with the financial crisis not yet forgotten, a spike in risky deals appears unlikely, and multiple industry experts stressed a continued focus on high credit quality. Therefore, a slow rise in delinquencies and charge-offs (rather than a sharp ascent) is most probable in the short term, and portfolio performance should remain strong through 2015 and into 2016. Overall, as several interviewees stated, any dramatic turn in portfolio performance is likely to stem from an economic downturn, should one occur, not from a change in equipment lessors' risk tolerance.

Business Operations

As equipment finance businesses face increasingly intense competition for profits, business operations have shifted towards maximizing efficiency and productivity. New business volume per sales full-time equivalent ("FTE") rose last year, as all three organization types saw productivity gains. Applications booked & funded/sold as a percent of applications approved also ticked up in 2014, driven by a significant jump in Independents' efficiency. In another reaction to heavy competition, equipment lessors are looking for new ways to differentiate themselves. While Banks generally compete on price, some Independents have placed a greater emphasis on customer service, more flexibility in deal structures, and faster credit approval processes. Lastly, equipment finance employment growth picked up slightly to 1.7% in 2014. This modest expansion reflects a slower-growing industry and was driven by Compliance and Portfolio Management new hires.

Thousands of Dollars or Percent	Industry	Banks	Captives	Independents
Booked & Funded/Sold as a Percent of Approved (based on $ amount)	69.7%	65.9%	76.4%	75.9%
Residual or Salvage Position as a Percent of Original Equipment Cost	27.4%	25.4%	39.5%	16.8%
Percentage of Full-Time Equivalents (FTE) in Sales/Origination	23.8%	26.3%	17.6%	28.8%
New Business Volume per Sales Full-Time Equivalent	$22,744	$23,909	$34,083	$5,928
Sales, Gen & Admin Expense per FTE	$290	$195	$232	$719

Source: 2015 ELFA Survey of Equipment Finance Activity

Many of the same forces which shaped 2013 business operations carried over to 2014. Equipment finance companies continued to focus on boosting their efficiency and productivity, as a crowded industry led many to compete on cost. Moreover, several key differences between the three organization types remained in place. For example, given their low cost of funds and larger business volume, Banks are more likely to participate in an array of equipment types and industries. Independents, on the other hand, emphasize on specialization and customer service, and many have carved out new niches in reaction to steep competition. Lastly, Captives' focus on their parent companies permeates their business strategy. Some Captives noted that they face less competition than Independents and Banks, and their ultimate goal is to improve their parent companies' bottom lines.

Data from the SEFA cover a wide range of business operations data, from all stages of the business executed by equipment lessors and financers. This report discusses the most important metrics within the context of broader trends in business operations.

Credit Approvals Dipped

Reversing 2013's trend, the industry-wide approval rate (based on dollar amount) declined from 71.3% to 69.3% in 2014, driven by lower approvals by Banks and Captives. Captives' approval rate dropped by a substantial 5.9 percentage points in 2014; however, at 76.7%, it remained well-above the rates of Banks and Independents. The approval rate for Banks ticked down to 67.6% (from 68.2% in 2013), while approvals for Independents increased from 59.8% in 2013 to 60.9% in 2014. As in previous years, Captives are more flexible on credit quality compared to Banks and Independents in order to generate sales for their parent companies.

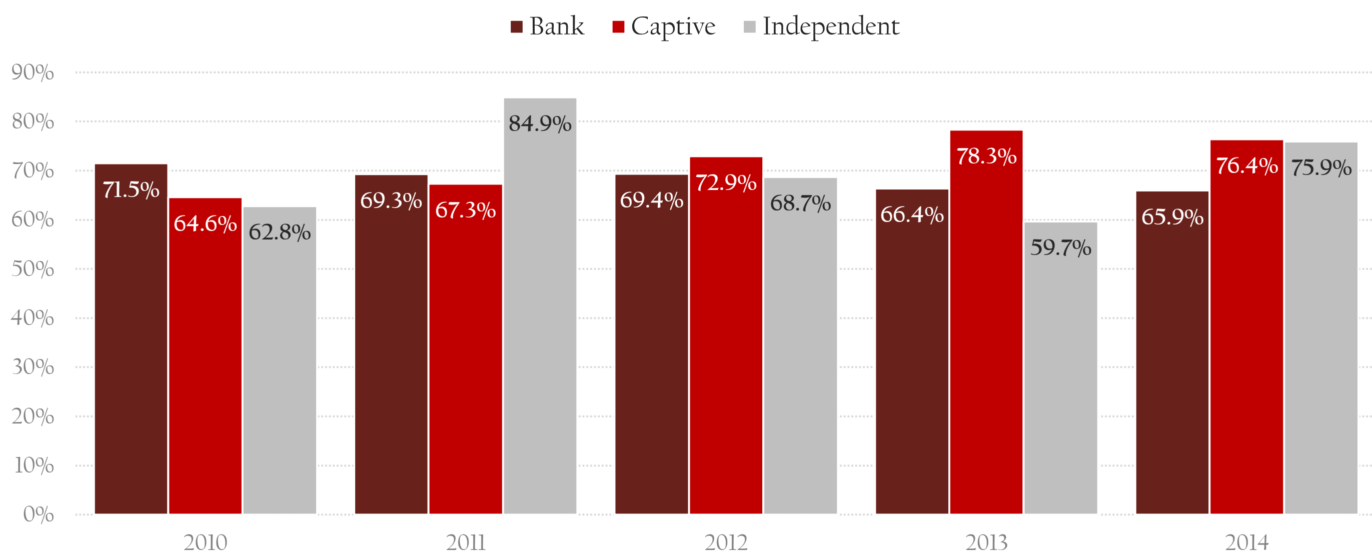
Although approval rates were down two percentage points as measured by dollar value, approvals were essentially flat based on the percentage of total applications received. Specifically, the overall approval rate slipped from 76.0% to 75.8% in 2014. As before, Captives led the way, with 91.6% of applications approved in 2014 (up from 91.5% in 2013). These divergences suggest that equipment lessors, on aggregate, scrutinized applications with above-average business volumes more closely than smaller applications.

Captives Led in Efficiency

In 2014, applications booked & funded/sold as a percent of approved slipped for Banks and Captives, but surged for Independents. Captives continue to have the highest "booked/funded/sold-to-approved" ratio out of the three organization types — once again, this trend reflects Captives' efforts to bring in business for their parent companies. Independents, however, are quickly catching up to Captives; their "booked/funded/sold-to-approved" ratio increased from 59.7% in 2013 to 75.9% in 2014, just below Captives' 76.4% ratio. Conversely, applications booked & funded / sold were the lowest for Banks, at 65.9%, and declined in 2014 for the fourth time in five years. Overall, the data suggest that Independents made significant strides to increase their efficiency and improve customer satisfaction in 2014, while Banks may be more focused on business volume than on efficiency.

Applications Booked & Funded/Sold as a Percent of Approved

(based on dollar amount)



Source: 2011 through 2015 ELFA Surveys of Equipment Finance Activity

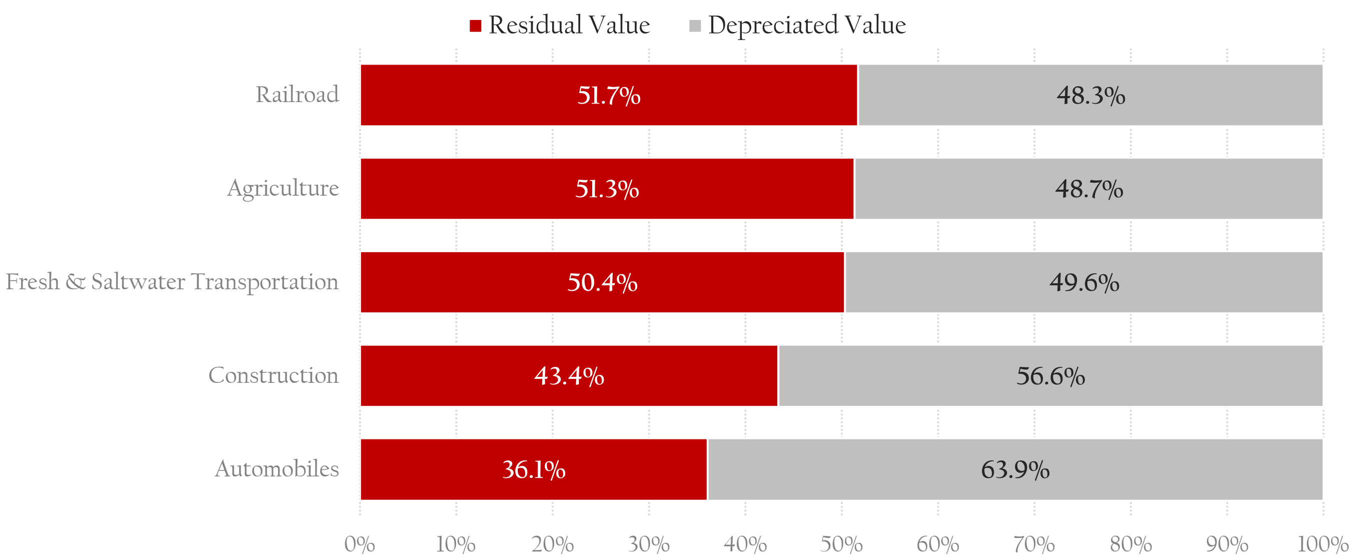
Higher Residual Values

As a percentage of original equipment cost (OEC), the average residual position increased from 25.4% in 2013 to 27.4% in 2014, its second consecutive gain. Both Banks and Captives saw increases in their residual values, while Independents' average residual position declined for the second straight year. Captives continued to have a higher residual value than Banks or Independents. In fact, Captives' average residual position (39.5%) was more than double that of Independents (16.8%). Captives' advantage largely reflects the equipment types in which they specialize. Specifically, two of the equipment types with the highest residuals positions are Agriculture and Construction, which make up nearly half of Captives' new business volume — compared to 12% and 7% of Banks' and Independents' new business volumes, respectively.

As shown in the chart below, the five equipment types with the highest residual positions (as a percentage of OEC) are Railroad, Agriculture, Fresh & Saltwater Transportation, Construction, and Automobiles (Commercial Fleet). Despite a decline from 2013, Railroad maintained the top residual value, while a drop in Corporate Aircraft's average residual value pushed it out of the top five in 2014. On the other end of the spectrum, three IT equipment types continued to have the lowest residual values: Software (9.8%), Networking (10.4%), and Storage (10.9%).

Top Five Equipment Types with Highest Residual Value

(based on dollar amount)



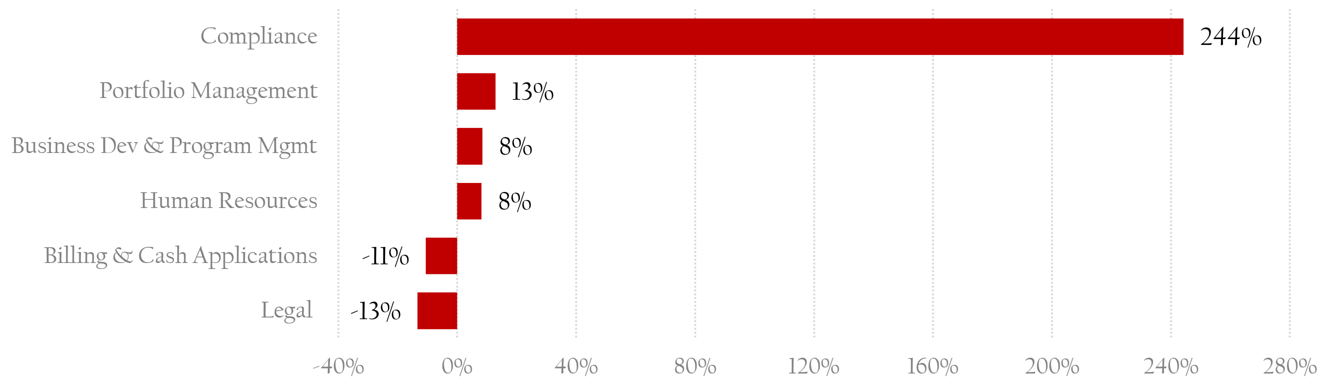
Source: 2015 ELFA Survey of Equipment Finance Activity

Uptick in Industry Employment

Mirroring trends in the overall economy, industry employment growth picked up in 2014. Compared to a 0.3% uptick in 2013, industry employment rose 1.7% in 2014. Once again, 2014 employment growth was not evenly dispersed. Employment increased in 16 sub-categories yet declined in the other eight. The chart on the following page shows the six sub-categories with the largest employment shifts in 2014. By far, the greatest change came from Compliance employment, which surged 244% in 2014 (although Compliance still only accounts for 0.5% of total industry employment). Portfolio Management, Business Development & Program Management, and Human Resources also saw significant employment gains from 2013, while Billing & Cash Applications and Legal employment experienced the largest declines. Unsurprisingly, these employment shifts match up with some key industry risks going forward. First and foremost is regulation, which many industry interviewees said "keeps them up at night," and explains the rapid growth in Compliance positions. Further, as the industry adjusts to heightened competition and what some call a "graying workforce," it is not surprising that business development and human resources are receiving more attention.

Changes in Employment: Select Sub-Categories

(year-over-year percent change)



Source: 2015 ELFA Survey of Equipment Finance Activity.

After a small pick-up last year, industry employment growth has accelerated in 2015, and according to the August ELFA MLFI-25 data, employment was up 7.4% year-on-year. The U.S. economy continues to create jobs at a steady pace. Despite slowing somewhat from 2014, monthly nonfarm employment growth has averaged 212,000 through August this year. Combined, the industry and economy-wide data suggest solid employment growth for the equipment finance industry.

Going forward, the equipment finance industry faces the challenge of recruiting a new generation of workers and successfully integrating them into the industry. Multiple industry executives cited a need for new talent as a key focus for the industry, as many of the industry's leaders are preparing for retirement following decades of experience in equipment leasing and finance. A broader concern is the industry's ability to adapt as millennials enter the workforce — which could mean altering business operations to better meet changing consumer demand, as well as attract new talent.

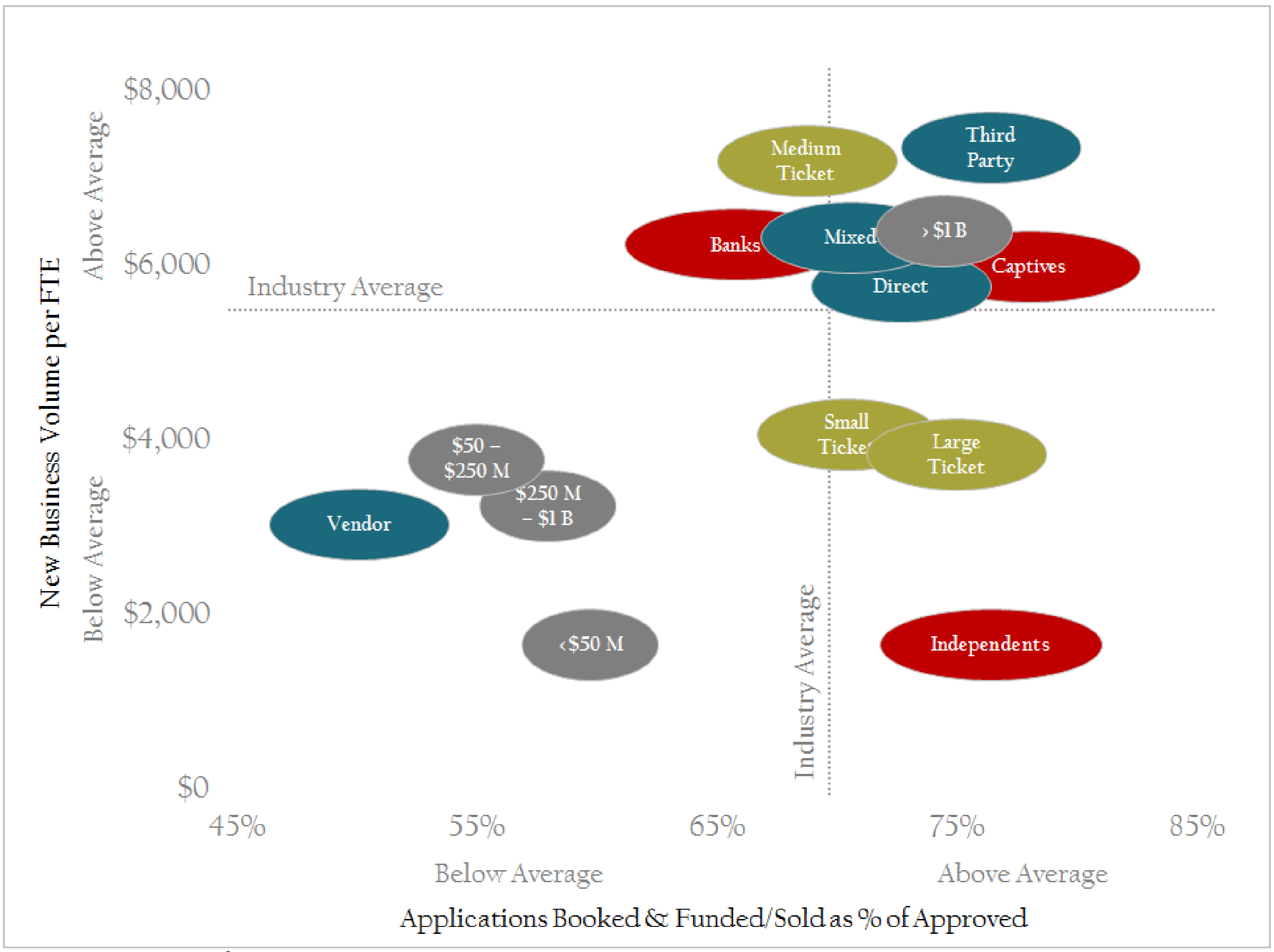
Widespread Productivity Gains

Like other business operations indicators, new business volume per sales full-time equivalent ("FTE") points to a greater emphasis on productivity. New business volume per sales FTE rose across all three organization types in 2014, following gains in 2013. Captives once again had the highest new business volume to sales to FTE ratio, at $34,083, followed by $23,909 for Banks and a much lower $5,928 for Independents. Sales employees account for a large share of Independents' and Banks' workforce (29% and 26%, respectively), while only 18% of Captives' employees work in Sales — a trend which partially explains Captives' high ratio. As seen last year, continued gains in productivity are likely a reaction to the hyper-competitive industry environment. Given that industry competition is not likely to ease in the near future, it's expected that the industry will find new ways to improve the efficiency and productivity of its businesses.

Analyzing Efficiency & Productivity

The efficiency-productivity matrix offers a breakdown of organizations by business operations performance. As shown below, the matrix is a two-by-two plot of productivity (defined by new business volume per FTE) and efficiency (defined by applications booked & funded / sold as percentage of approved). The red ovals inside the matrix denote organization type in red (Banks, Captives, and Independents), while the yellow ovals indicate ticket size (small, medium, and large), the blue ovals show origination channels (direct, vendor, third-party, and mixed), and the gray ovals show lessor size (under $50 million in new originations, $50 million to $250 million, $250 million to $1 billion, and over $1 billion).

Efficiency & Productivity Matrix



Source: 2015 ELFA Survey of Equipment Finance Activity

Several industry groups had both above-average efficiency and above-average productivity in 2014: the Third Party, Mixed, and Direct origination channels, Captives, and Organizations over $1 billion. Additionally, both Banks and the Medium-Ticket market segment had above-average productivity and slightly below-average efficiency. On the other hand, a few groups showed weak productivity and efficiency, namely Vendors and lessors under $1 billion. Unlike 2013, no clear relationship exists between organization size and efficiency and productivity. Although new business volume per FTE generally rose with organization size, the same could not be said of applications booked & funded / sold.

Efficiency was a common theme in this year's industry interviews. In an environment of heightened competition, equipment lessors are looking to improve efficiency and lower costs. However, much of the demand for greater efficiency is coming from customers, many of whom are looking for more flexibility and convenience in their lease contracts. In fact, the equipment finance industry may experience a broader shift towards "one-stop shop" deals that wrap equipment leases and supporting services into a single contract.

Sources of Improved Efficiency: Technology & Credit Turnaround Time

Like last year, industry experts named technology as one way to improve their business operations, in terms of both efficiency and customer service. Applications of technology include (1) using big data and analytics to better anticipate customer needs and (2) enabling customer interactions through multiple channels (e.g., video conferences). Some equipment finance companies are also using electronic documents to track business volume, but the majority has yet to make this transition. In 2014, 30% of SEFA respondents used electronic documents for some of their new business volume, while the other 70% did not use this technology.

While still viewed as a disrupter by some, technology is mostly seen as a way to innovate, compete, and grow as customer preferences change. As the industry strives to improve the customer experience, technology offers ways to increase convenience, improve customer access, and track business volume efficiently.

Another way to improve efficiency is to speed up credit decisions. As expected, larger transactions typically require a longer turnaround time compared to smaller transactions. Across four timing methodologies, credit decision turnaround time (weighted average) was the shortest for the smallest transactions (under $25,000) and the longest for the largest transactions (over $5 million). Credit decision turnaround time shortened for all transaction sizes in 2014, pointing to a more streamlined approach from equipment lessors. For example, for transactions over $5 million, the average time between the completion of the customer's application and the final credit decision declined from 7.3 days in 2013 to 6.0 days in 2014.

Industry interviews highlighted that Banks may have an efficiency disadvantage in terms of credit decision turnaround time, in part due to greater regulatory requirements. Several interviewees noted that Independents could make credit approval decisions faster than Banks and had more flexibility in approving applications.

Independents Faced Higher Costs

Costs also differed among organization types. For example, the median sales & marketing expense as a percent of revenue was much higher for Independents (11.6%) than for Captives (7.0%) or Banks (6.8%). While several factors impact cost ratios, this divergence may highlight Banks' focus on minimizing costs and Independents' efforts to find new areas of business. Similarly, Independents experienced higher sales, general, & administrative expense per FTE than Captives and Banks; at $719 in 2014, Independents' expense was more than double the other two groups.

Financial Performance

A continuation of the previous year's trends led to stable, and still strong, financial performance in 2014. Key profitability measures were mixed in 2014, as return on assets held steady, return on equity dipped, and income to revenue rose. While compressed margins weighed on profitability, low interest rates kept costs down. Interest expenses were unchanged as a percent of total debt, yet ticked up as a share of total revenue. Steady new business volume growth, a stronger economy, and rising interest rates should all benefit the equipment finance industry's financial performance over the next two years. However, intense competition and low interest rates will continue to compress margins.

Percent (Median)	Industry	Banks	Captives	Independents
Return on Total Average Assets (ROA)	1.9%	1.4%	3.4%	2.5%
Return on Average Equity (ROE)	13.9%	13.0%	15.2%	14.1%
Sales & Marketing Expense as Percent of Total Revenue	8.4%	6.8%	7.0%	11.6%
Debt as Percent of Total Assets	78.9%	83.5%	67.6%	78.0%
Debt to Equity	5.6	7.8	2.3	4.0
Liabilities to Equity	6.1	9.4	2.5	4.2

Source: 2015 ELFA Survey of Equipment Finance Activity

As profitability measures mostly held steady in 2014, corporate profits continued their post-recession rise. In the second quarter of 2015, corporate profits (without inventory or capital consumption adjustments) climbed to a new high of $1.84 trillion, reflecting the strengthening economy. While several headwinds — notably the strong U.S. dollar and global economic concerns — could hurt U.S. companies' performance this year, underlying strength in the U.S. economy should push profitability higher. Looking ahead, steadily increasing profits may encourage business expansion and benefit the equipment finance industry. However, a spike in business uncertainty — due to either global or domestic concerns — could leave businesses hesitant to invest. Fierce competition is likely to limit profitability in the equipment finance industry through 2015 and 2016; so a key question is now, "to what extent will business expansion help 'grow the pie' for the overall industry?"

Lower Profitability for U.S. Banks

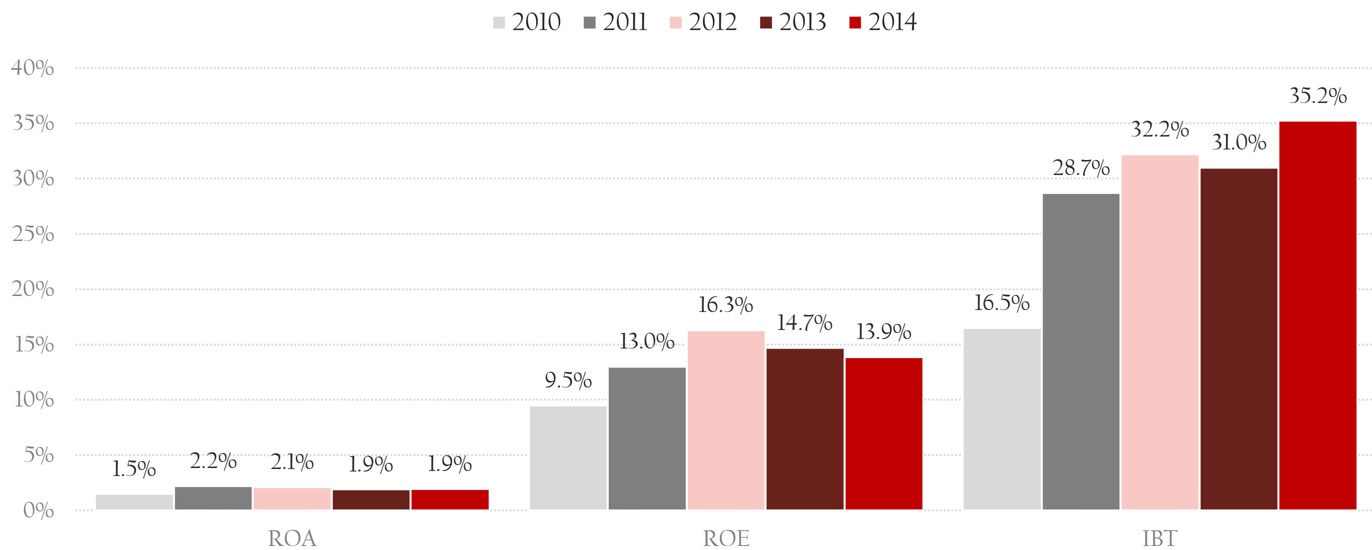
In traditional financial services, profitability slipped in 2014. Return on Assets ("ROA") for all U.S. banks ticked down from 1.09% in Q4 2013 to 0.95% at the end of 2014, while Return on Equity ("ROE") fell from 9.76% to 8.47% over the same period. Like the equipment finance industry, however, bank profitability remains at healthy levels. Both ROA and ROE are below their pre-recession highs, but they have recovered from the sharp drops seen in late 2008.

Stable Profitability in Equipment Finance

Similarly, profitability ratios reflected a healthy equipment finance industry in 2014. Return on average assets was unchanged at 1.9%, and pre-tax income as a percent of total revenue ("IBT") jumped from 31.0% to 35.2% in 2014, surpassing 2012's record high. Return on equity slipped from 14.7% to 13.9% in 2014, yet remained well above its ten-year average (11.4%). Despite intense industry competition, the 2014 data underscore continued strength in equipment finance and leasing, and the industry still offers profitable investment opportunities. Below is the five-year historical trend for these three ratios:

Profitability Ratios, Five-Year History

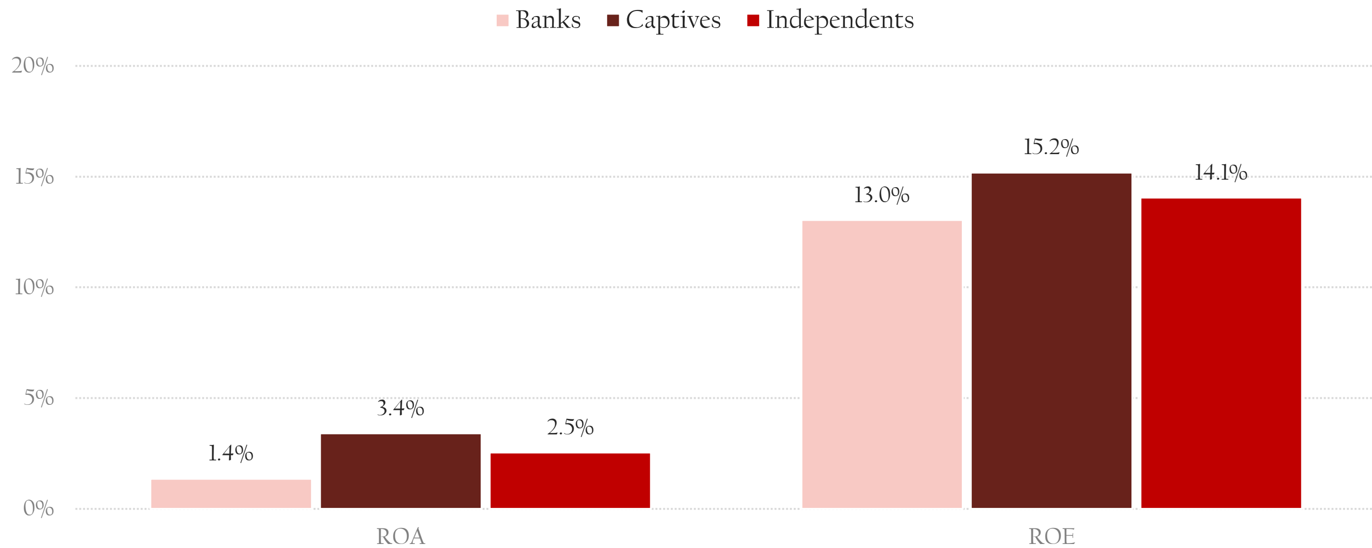
(median)



Source: 2015 ELFA Survey of Equipment Finance Activity

In a shift from 2013, Captives and Independents surpassed Banks in terms of return on average equity. Captives had the highest ROE (median), at 15.2%, followed by Independents (14.1%) and Banks (13.0%). Captives also led Banks and Independents in return on average assets. In 2014, the median ROA was 3.4% for Captives, 2.5% for Independents, and 1.4% for Banks. Moreover, both Captives and Independents saw improvements in both profitability ratios, while Banks experienced declines. Captives' higher profitability could reflect slightly lower competition faced by Captives relative to Banks and Independents, and it will be interesting to see if this performance gap widens in 2015.

Profitability Ratios, By Business Model
(2014; median)



Source: 2015 ELFA Survey of Equipment Finance Activity

Coverage Ratios Remained Low

Coverage ratios were little changed in 2014 after recording consistent declines in recent years. Interest expense as a percent of total debt held steady at 1.9% in 2014, and interest expense as a percent of total revenue ticked up from 16.8% to 17.4%. Both ratios remained at historically low levels, reflecting the industry's strong financial performance.

The Federal Reserve's accommodative interest rate policy has kept rates low over the past several years, pulling down coverage ratios. However, the Federal Open Market Committee (the Fed's chief policy-making committee) is set to raise short-term interest rates later this year or in early 2016, after seven years of maintaining a zero interest rate policy. Given steady employment gains and an improving economy, the Fed could raise rates as early as October. Importantly, Fed officials have repeatedly stressed that they will raise rates gradually, meaning that interest rates are likely to remain at historically low levels for months (or even years) after the first rate hike.

Although higher interest rates will increase coverage ratios and the cost of funds, industry participants generally view higher rates as a positive development as long as the increases occur gradually. Like last year, several interviewees noted that a rapid rise in interest rates could cause the cost of funds to increase faster than yields and compress spreads further. However, this risk is largely seen as short-term and marginal, and most participants predict that higher interest rates will ease competition within the industry and ultimately benefit profitability. Additionally, some executives are seeing evidence of customers bumping up their investment now to "lock in" lower rates before they increase; as one industry expert stated, rising interest rates could act as a "release valve" for additional investment.

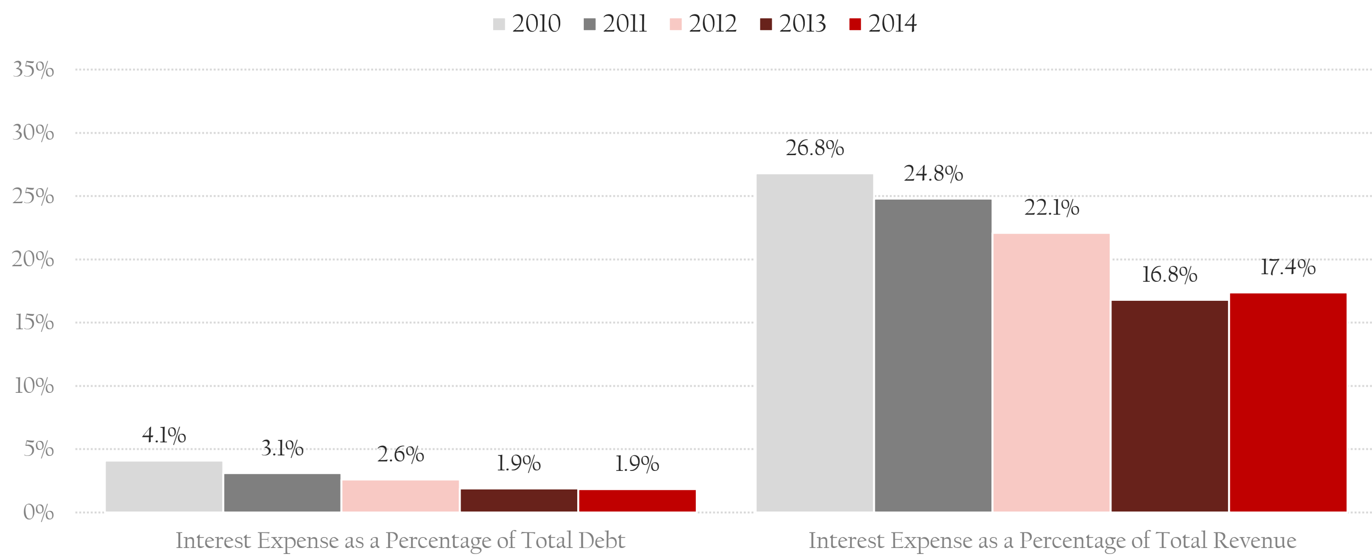
Healthy Profitability Ahead

In 2015, steady business growth should keep profitability at healthy levels. According to the ELFA MLFI-25, new business volume increased 8.1% in 2014 and is on track to maintain a solid (yet potentially slower) pace of growth in 2015. With moderate new business growth indicating underlying strength in the equipment finance industry, 2015 should be another year of solid financial performance, and as of August, new business volume is up 6.0% from the same period last year.

Looking forward, many of the same factors driving past performance should continue into 2016. Namely, (1) hyper competition — described by many as even more intense in 2015 compared to past years — will continue to exert downward pressure on prices; (2) rising interest rates should slowly allow more "breathing room" for margins; and (3) trends in business confidence could trigger a new round of investment or, conversely, greater hesitancy to spend. Although global factors could derail expected Fed rate hikes or dampen business confidence, the U.S. economy is exhibiting moderate strength and should contribute to higher interest rates and confidence going forward.

Coverage Ratios, Five-Year History

(median)



Source: 2015 ELFA Survey of Equipment Finance Activity

MLFI-25 New Business Volume

(billions of dollars)

Source: ELFA

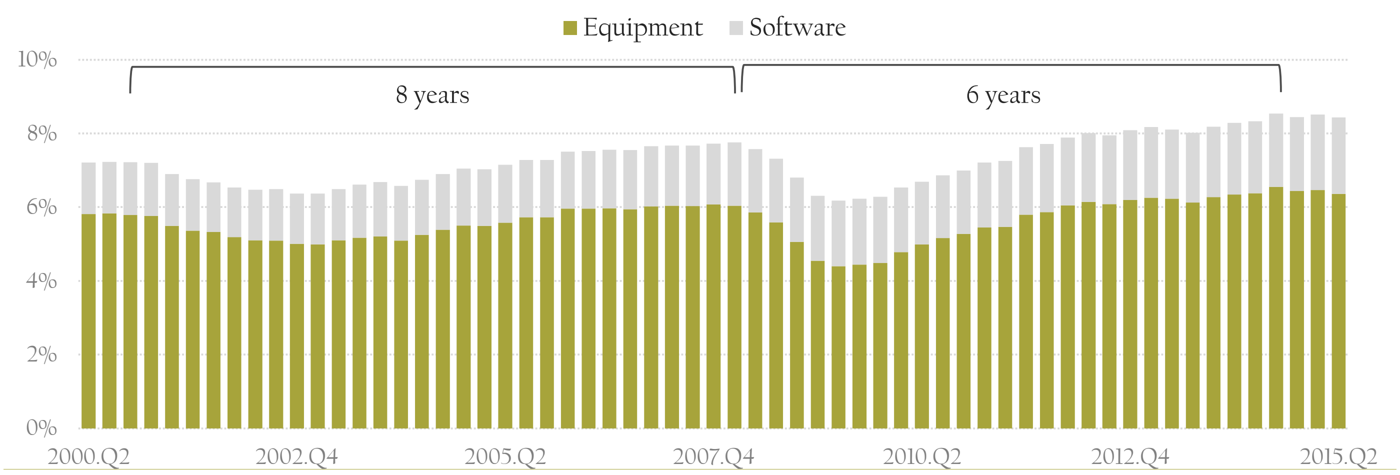
FUTURE

long-term equipment Investment trends

Following the Great Recession of 2008–09, equipment and software investment rebounded faster than other sectors of the economy, fueled by businesses' pent-up demand. Now, equipment and software investment appears to have peaked as a share of GDP, and investment growth is unlikely to significantly outpace GDP over the next few years. Other broad industry trends have major implications for certain equipment verticals. For example, the end of the agriculture super-cycle has reduced demand for agricultural equipment and could hurt portfolio performance in equipment finance. Additionally, excess global oil supply will likely limit investment and encourage greater efficiency in the energy sector. On the positive side, however, a rebound in the housing market could revive the construction industry and drive economic growth. This section highlights the key long-term trends affecting the equipment finance sector as a whole, as well as particular verticals.

Equipment Investment Cycle

(percent of real gdp)



Source: Macrobond Financial, Keybridge LLC

As a share of real GDP, real equipment and software investment climbed further in 2014 and has since hovered near an all-time high of 8.5%. In the previous cycle, equipment and software investment peaked at 7.8% of GDP in the first quarter of 2008. Last year's SEFI suggested that the equipment investment cycle was nearing a peak, and recent data indicate that the cycle is now at — or just past — that peak. Equipment investment comprised 6.4% of real GDP in the second quarter of 2015 (down from 6.6% in Q3 2014), while software investment increased to 2.1% of real GDP in the second quarter, an all-time high. Going forward, equipment and software investment appears to have stabilized as a share of real GDP and may moderate in the next year, although continued gains in software investment may partially offset this downward trajectory.

Quarterly growth rates tell a similar story. Relative to GDP, investment in equipment and software fell sharply during the recession, rebounded strongly in 2010 and 2011, and has consistently outpaced GDP growth for most of the last six years. However, growth rates have recently converged, and in two of the last three quarters, real GDP growth was stronger than real investment growth. While several special factors (e.g., low oil prices and the strong U.S. dollar) are currently dampening capital spending, investment growth is likely to continue its pattern of convergence with the overall economy's growth rate.

A waning equipment investment cycle is consistent with the Foundation-Keybridge's outlook for slower growth in the equipment finance industry. After steadily increasing for six years, equipment and software investment is likely to decline as a share of GDP — and although the Propensity to Finance Equipment Index suggests that investments are increasingly likely to be financed, the declining investment growth rate will impact the equipment finance industry. Put in other terms, business investment has been a driver of the economic recovery in recent years, but other sectors of the economy, including housing, are now gaining strength.

Real GDP and Equipment & Software Investment Growth

(percent change q/q, saar)

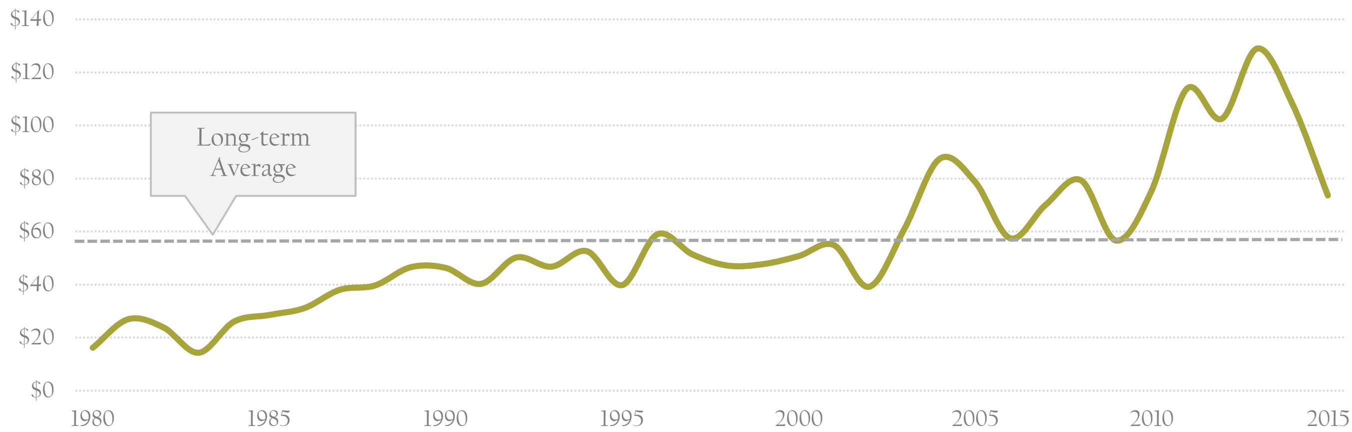
Source: Macrobond Financial; Keybridge LLC

Is the agriculture super cycle over?

Beginning in the mid-2000's, the U.S. agriculture industry experienced a decade of substantial expansion and prosperity. During the super cycle, U.S. crop production rose dramatically, crop prices and exports climbed to new highs, and net farm income (a key measure of the industry's well-being) more than doubled between 2006 and 2013. This agriculture "super cycle" emerged from a mix of factors. For example, the federal Renewable Fuel Standard, initiated in 2005, set minimum levels of biofuels to be used in transportation and dramatically increased domestic demand for corn (a key input for ethanol). At the same time, the global economy accelerated due to rapid growth and industrialization in emerging economies (particularly China), and rising living standards in developing nations boosted demand for U.S. agricultural products.

Net Farm Income

(billions)



Source: U.S. Department of Agriculture

Now, the agriculture super cycle has ended. Domestic ethanol production has plateaued, while several key global markets (including Brazil, Russia, India, and China) are experiencing slower growth or even recession. Moreover, crop prices have declined sharply since 2012, U.S. agriculture exports have slowed, and net farm income dropped in 2014 and is expected to fall further this year.

Following a period of booming prosperity, the cycle's cresting presents a major shift for both the agriculture industry and lessors of agricultural equipment. Real investment in Agriculture machinery is now down 32.7% from a year prior. SEFA data also point to a turn in the agriculture cycle, as new business volume increased just 1.1% for the agriculture end-user industry in 2014, while delinquency rates (more than 30 days overdue) jumped from 1.1% to 1.6% and may continue to rise. Combined, these trends suggest that farmers are now more hesitant to invest in new equipment — and some may struggle to repay their existing equipment loans. As a result, agricultural equipment lessors may want to plan for reduced investment and larger credit losses over the short-term.

What are the implications of low oil prices?

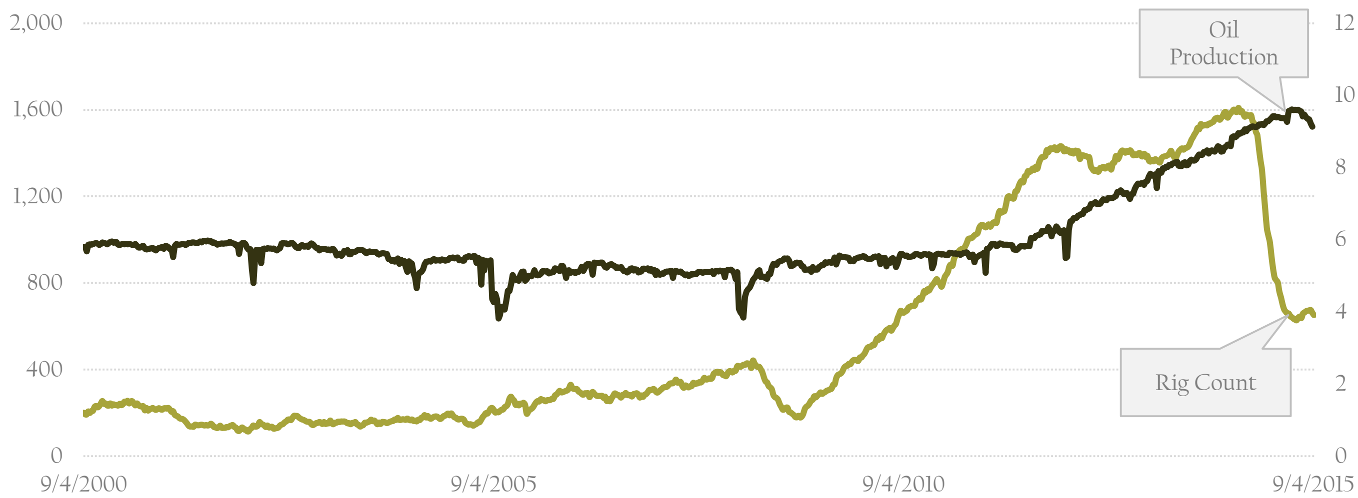
A global supply glut has caused oil prices to drop dramatically over the last year, shaking up the oil industry. Compared to last June's highs, the WTI and Brent crude oil spot prices — two key benchmarks for global oil prices — are both down nearly 60%, and, at $45 as of late September, the WTI price has fallen by half in the last year. As already noted, these steep price declines have lowered the profitability of oil production — causing many energy companies to halt investment, lay-off employees, or even go out of business. As of Q2 2015, real business investment in Mining & Oilfield machinery has contracted for four consecutive quarters and is down nearly 40% from year-ago levels. Similarly, the domestic oil rig count peaked at 1,609 in October 2014, but plummeted 61% to a five-year low of 628 in just eight months before recovering slightly to 652 in September 2015. U.S. crude oil production, however, has only recently slipped and is still up 5.9% year-over-year. This divergence reflects significant efficiency gains on the part of U.S. "frackers," many of whom continue to drill profitably despite substantially lower prices.

U.S. Oil Rig Count

Number of Rigs

U.S. Crude Oil Production

Million Barrels, Per Day



Source: Macrobond Financial

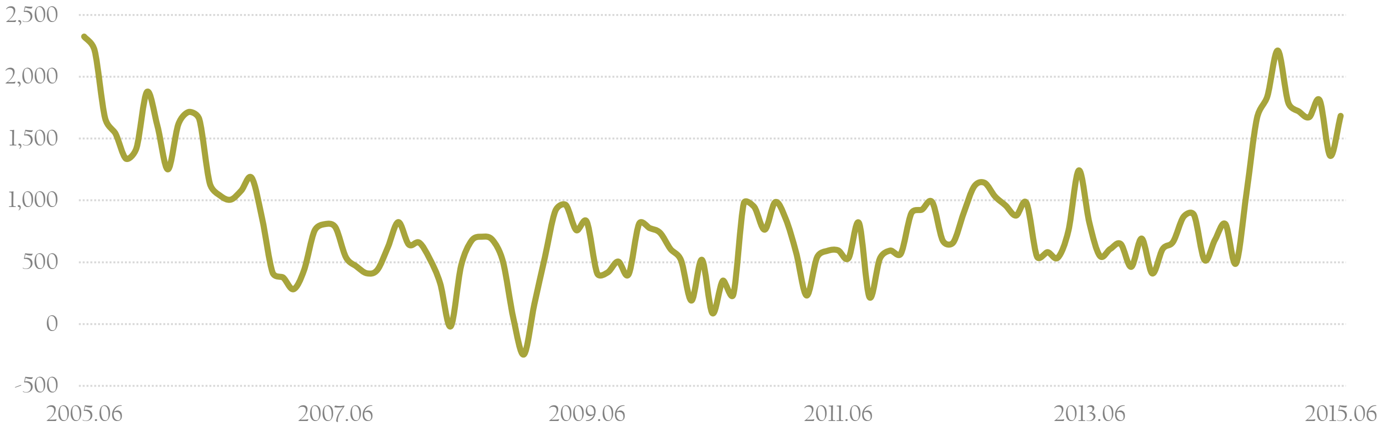
Moreover, developing trends suggest that the world will remain flush with oil over the next several years, keeping global prices low. U.S. oil production is only expected to decline slightly this year, and OPEC oil output is still above its 30 million barrels-per-day target. The Iran nuclear energy deal appears to be on track for implementation and will place additional downward pressure on oil prices, as it will add roughly one million barrels of Iranian oil per day to global markets by 2017. Finally, shale oil extraction techniques are becoming increasingly viable in other countries, including China and Argentina. In short, the combination of a global supply glut and increased extraction efficiency in the United States points to reduced business investment in mining and oilfield equipment for the foreseeable future.

Finally, a sustained revival in housing?

After years of false starts and inconsistent progress, the housing market finally appears to have found its footing and is quickly becoming a key growth driver for the U.S. economy. Recent housing data have been decidedly positive. Construction spending increased 0.7% in July to a post-recession high, and housing starts climbed to a nearly eight-year high this summer. Household formation has also accelerated, echoing steady job growth and improved consumer confidence. Between Q1 2007 and Q3 2014, year-on-year household growth averaged just 627,000, but since the end of 2014, growth has nearly tripled to 1.75 million year-on-year. This rebound in housing activity should serve as a solid foundation for continued growth in 2015 and 2016 and boost investment in construction equipment. Signs of a strengthening construction industry are already emerging, as Construction machinery investment was up 46% in the first half of 2015, compared to the first half of 2014. Moreover, the current U.S. Construction Equipment Investment Momentum Monitor points to solid growth over the next 3 – 6 months.

U.S. Monthly Household Estimate

(year-on-year change, thousands of households)



Source: Macrobond Financial

All images sourced from www.123rf.com

industry scenarios

Sunny Skies or Brewing Storm?

Since the Great Recession, the economic recovery has been characterized by false starts, mixed signals, and uneven progress. Disappointments have often followed strings of strong data, first quarter growth has consistently been weak, and external headwinds have repeatedly derailed expansion. In a continuation of these trends, the U.S. economy appears to have regained its footing in recent months after another weak winter, yet the combination of slow global growth and a strong U.S. dollar are significant threats. Several key economic indicators can shed light on whether the economy is poised for breakout growth or is likely to revert back to first gear (or worse, slip into neutral). By monitoring these indicators, industry professionals are better equipped to determine which scenario the economy is tracking and adapt their business strategies accordingly.

Last year's industry scenarios centered on geopolitical risks, as multiple regions — including Ukraine, Iraq and Syria, and Libya — stood on the brink of greater conflict and threatened global growth. Many of these risks have faded (but not disappeared) in recent months, but a new mix of economic headwinds could disrupt stronger growth. Low oil prices and a strong dollar have hurt industrial activity, business investment, and U.S. exports, while a severe slowdown in Chinese growth poses significant risks for the global economy. In the United States, the labor market is still the foundation of a strengthening economy, and the housing market is rapidly gaining momentum. At the same time, however, new budget battles and upcoming elections could bring a new round of heightened policy uncertainty and the potential for self-inflicted economic wounds. In many ways, the U.S. economy is at a crossroads, and the strength of economic data in the coming months will dictate whether the economy finally achieves breakout growth, remains stuck in second gear, or lurches to a near-standstill.

In assessing the future of the U.S. economy, key questions include:

- Will China suffer a "hard landing" — and bring the global economy down with it?
- Can the U.S. economy accelerate in a world of subpar growth?
- Can housing activity finally take off after years of disappointing growth?
- Will government dysfunction re-emerge as a chief source of uncertainty and frustration as the 2016 election nears?

Of course, future economic trends are unlikely to be wholly negative or positive. The two scenarios discussed in this section (Sunny Skies and Brewing Storm) offer opposing plausible outlooks for the U.S. economy over the next several years. Neither scenario represents an extreme future. Rather, each is comprised of realistic shifts in economic conditions and the domestic policy environment.

Sunny Skies

This scenario presents stronger economic growth, diminished headwinds, and improved confidence. Break-out growth across all sectors of the economy is not required in this scenario; however, consistent improvement in the majority of indicators discussed below is enough to lift the economy to a state of stable, solid expansion of 3–3.5% annual growth.

A soft start to 2015 put the U.S. economy back on shaky ground, while another debt bailout crisis in Greece and tumult in Chinese financial markets sparked uncertainty and even panic. Under "sunny skies," however, the weak data from early 2015 subsides, and the positive trends experienced during the second quarter of 2015 continue and strengthen. Housing activity revives further, the industrial sector climbs out of a rut, and business investment ramps up. Meanwhile, job growth remains robust, wages finally accelerate, and auto sales continue to boom. In this environment, households and businesses feel comfortable spending more and taking on more debt.

This scenario is characterized by a string of positive economic data, reduced uncertainties from both Washington and abroad, and greater confidence from households and businesses. These three broad trends reinforce each other, creating a cycle of increased confidence, investment, and spending that collectively produce robust economic growth.

- After years of false starts, housing finally takes off. Greater household formation ramps up home construction, which in turn boosts jobs and incomes. Housing starts climb back to a 1.4 – 1.5 million annual pace.

- Industrial production steadily increases and capacity utilization climbs towards and eclipses 80%, unleashing a new round of business investment. Businesses seek to expand their operations, rather than just replace outdated equipment, and these expansions drive investment.

- Monthly job growth maintains a 225,000+ pace. Although hiring may not reach the near-record pace experienced in 2014, employment continues to steadily expand in the second half of 2015 and 2016.

- As employers compete for strong candidates and grow more confident in the future, wages finally break out of sluggish growth. The Employment Cost Index's growth surpasses 3.5% year-on-year, while growth in average hourly earnings picks up to +2.5% year-over-year. Solid income and job growth spurs stronger demand for housing and construction activity.

- Responding to robust job and wage growth, consumers are more secure in their finances and increase their spending. Auto sales remain strong and maintain a +17 million annual rate. At the same time, consumer spending sees steady annual growth above 3%.

- Geopolitical risks abate, and, led by U.S. and the Eurozone, the world economy gains momentum — which increases the demand for U.S. exports and lessens upward pressure on the dollar.

- The U.S. Congress successfully negotiates a 2016 funding bill for the federal government, raises the debt ceiling, and resolves other high-profile policy battles (e.g., Iran nuclear deal, Planned Parenthood funding, cybersecurity legislation, year-end tax extenders), thereby avoiding a government shutdown. While interparty relations are by no means perfect, the congressional inaction and political brinksmanship of recent years are less common and both sides of the aisle are more willing to compromise in order to demonstrate an ability to govern as the November elections approach. With domestic policy uncertainty subdued, business confidence improves and investment increases.

As a result, the U.S. economy gains momentum and annual GDP growth eclipses 3% for the first time in a decade, with a corresponding boost to the equipment leasing & finance industry. Evidence of the economy's underlying strength and diminished headwinds are enough to "tip the scale" and encourage businesses to expand. With capacity utilization finally above 80%, businesses invest in new equipment and software to compete in a stronger economy. Moreover, in a "sunny skies" scenario, the Fed would have adequate justification to begin gradually increasing its target interest rate in late 2015 and throughout 2016. For the equipment finance industry, new business volume expands steadily, competition and margin compression ease somewhat, and profitability improves.

Brewing Storm

While the "sunny skies" scenario presents a positive shift in the U.S. economy, the opposite characterizes the "brewing storm" scenario. After several months of mixed messages, a slew of soft data leads to a slowdown in the U.S. economy. Struggling sectors of the economy stagnate or worsen, while others lose momentum. Importantly, the "brewing storm" scenario does not require a negative turn for every economic indicator, but rather a world in which many key indicators fall due to a worsening of overall economic conditions.

In this scenario, a severe slowdown in China drags down U.S. growth. Weak economic data and heightened uncertainty, in part caused by increased political dysfunction, dampen confidence. Businesses and consumers alike pull back on spending.

- The Chinese slowdown proves to be worse than anticipated and sets off a spiral of weakness in the global economy. China's industrial sector falters, reducing demand for commodities and putting heavy downward pressure on commodity prices. Global commodity producers, including Chile, Brazil, and Australia, are particularly harmed, as are China's neighbors and close trading partners. Knock-on effects hurt growth in the U.S. and other advanced economies, and stock markets across the globe experience sustained drops. Business investment in the manufacturing and energy sectors is particularly susceptible to a Chinese "hard landing" scenario, and it causes oil prices to fall further and also reduces demand for U.S. exports.

- Relative to other advanced economies that are more dependent on China and could face recessions if a "hard landing" materializes, the U.S. economy is a beacon of strength (despite weaker growth). As a result, the U.S. dollar appreciates further, making it even more difficult for U.S. manufacturers to compete in global markets. Exports subsequently dip, cutting a full percentage point or more from U.S. GDP, undermining business confidence, and halting investment plans.

- This summer's gains in industrial production and durable goods orders prove temporary. Persistent declines in these indicators signal a weakening manufacturing sector. Capacity utilization stays well below 80%, which discourages businesses from investing in new equipment or facilities.

- As a result of uncertainty and low confidence, businesses also slow hiring. The economy averages less than 150,000 new jobs each month (in some months, near-zero job growth is possible), and the unemployment rate drifts up toward 6% and potentially further throughout 2016. Income growth stalls, as businesses are hesitant to offer raises.

- Consumers hold back on spending, particularly on big purchases. Following four consecutive months above a 17 million annual rate, domestic auto sales slow to a sub-16 million pace. Retail sales slow or potentially stagnate. Consumer hesitancy causes housing activity to lose momentum just as it appeared to be on the verge of accelerating, which hurts construction employment and investment directly and other related industries indirectly.

- Partisan disagreements over Planned Parenthood funding, the Iran nuclear deal, raising the debt ceiling, and other policy issues (e.g., Affordable Care Act implementation, EPA regulations, and executive powers) prove to be too much for Congress to overcome, leading to more budget near-disasters and potentially a government shutdown or debt default. Confidence in government falls and policy uncertainty spikes, leading to further declines in consumer and business confidence as the 2016 elections approach.

In the "brewing storm" scenario, U.S. economic growth slows to 2% or less, and potentially falls to around 1% — hurting the equipment finance industry in several ways. A weak manufacturing sector, a strong dollar, continued tumult in the world economy, and renewed policy uncertainty all discourage businesses from investing. Even as the propensity to finance rises, total equipment and software investment slows to near-zero growth. With nothing to "grow the pie," competition in equipment finance and leasing becomes even more intense and profitability slips. Additionally, the weaker economy causes the Fed to hold off on raising interest rates until 2016, giving the industry little opportunity to expand margins. Lastly, some businesses, particularly those in export-intensive industries, may struggle to repay existing loans, leading to an increase in delinquencies and charge-offs.

Key Signposts

Economic Indicator	Latest Tick	Sunny Skies	Brewing Storm
Chinese Real GDP (year-on-year % change)	7.0%	7 – 8%	4 – 5%
Capacity Utilization (%)	77.6%	80 – 82%	75 – 77%
Nonfarm Payroll Growth (thousands)	173	225 – 250	100 – 125
Auto Sales (millions, annualized)	17.8	17 – 18	15 – 16
Average Hourly Earnings Growth (year-on-year % change)	2.2%	2.6 – 3.2%	1.7 – 2.0%
Housing Starts (thousands, annualized)	1,126	1,500 +	800 – 1,000

Source: Macrobond Financial; Keybridge LLC

Economic Forecasts

Scenario (percent annual growth)	2015	2016	2017	2018
Baseline				
GDP	2.5%	3.0%	3.0%	2.8%
Equipment & Software Investment	4.0%	3.5%	3.2%	3.5%
Sunny Skies				
GDP	2.7%	3.5%	3.3%	2.8%
Equipment & Software Investment	4.2%	5.0%	4.3%	3.5%
Brewing Storm				
GDP	2.3%	1.6%	2.1%	2.8%
Equipment & Software Investment	3.2%	2.0%	2.3%	3.5%

Source: Keybridge LLC

NOTES

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- **Martha Ahlers** - Vice President & COO, United Leasing
- **Aylin Cankardes** - President & Founder, Rockwell Financial
- **Anthony Cracchiolo** - President and CEO, U.S. Bank Equipment Finance
- **Diane Croessmann** - Executive Director, Lenovo Financial Services
- **Mike DiCecco** - President, Huntington Equipment Finance
- **David Gilmore** - Senior Vice President, Region 4, John Deere Financial
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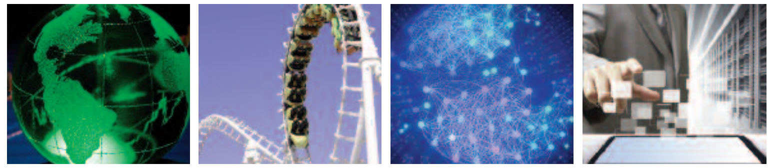

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Established in 1989, the Equipment Leasing & Finance Foundation is a 501c3 non-profit organization dedicated to providing future-oriented, in-depth, independent research for and about the $903 billion equipment finance industry.

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The Foundation provides comprehensive, forward-looking research for business leaders, academics and others interested in the industry. Resources include the State of the Equipment Finance Industry report, Industry Future Council report and strategic market studies available at no cost to donors in the Foundation's online library. **www.store.leasefoundation.org**

Equipment Leasing & Finance U.S. Economic Outlook
This comprehensive report analyzes global and domestic trends impacting capital spending and economic growth in the coming year. It identifies key signposts specific to the equipment finance industry and features Momentum Monitors that identify turning points for 12 verticals in their respective investment cycles. The outlooks are updated quarterly.
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Monthly Confidence Index
Through a monthly survey of the industry's executive leadership, we've established a confidence index related to the equipment finance sector and the U.S. economy. The results provide greater understanding of prevailing business conditions and expectations for the future.
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