

Emerging Opportunities in a Changing World

2005 INDUSTRY FUTURE COUNCIL REPORT



Equipment Leasing &
Finance Foundation

Your Eye On The Future

***2005 Industry Future
Council Report
“Emerging Opportunities in a
Changing World”***

Executive Summary

The equipment leasing and finance industry has overcome major challenges in the past, but never have so many issues combined to re-shape the future of the business. Until changes in tax law and corporate regulation are clarified, lessors will compete on a playing field made uneven by varying interpretations of these rules. Coming capital requirements for international banks will likely spur consolidation among banks and may raise the cost of capital. Changes in federal accounting standards will stanch financial creativity for many lessees until their need for capital outweighs the risk of rousing the regulatory lion. Still in the shadows of Enron, Tyco and WorldCom, lessees will lean toward loans whenever lease products appear too complex, or when lessees are not convinced these products will meet requirements for balance-sheet transparency. In general, throughout the industry, creativity will be rewarded – creative people providing creative solutions.

Although changes in tax law and corporate governance will most influence equipment leasing over the next three to five years, the direction of both the domestic and global economies will influence lessors’ marketing and

operational strategies. Interest rates are expected to continue to rise, benefiting lessors in the small- to middle-ticket markets. But rates could plummet if the dollar continues to lose value against other currencies. Winners in this scenario will be lessors who follow their customers abroad, and can serve additional, foreign entities that will have more dollars to spend in a weak U.S. economy.

The strategies lessors and finance professionals employ to cope with these changes will act as a sort of natural selection, determining who survives in the new world – and who becomes extinct.

Industry leaders believe that the days of the traditional leasing company are numbered; that by 2010, the industry may not even be known as leasing. In the words of one lessor, leasing is becoming part of a bigger solution.

The manner in which individual companies identify themselves is changing, too. Rather than cite ticket size as primary descriptor, lessors and finance professionals increasingly refer to their company’s ownership to describe themselves. Those who formerly saw themselves as small-, middle- or large-ticket players now more commonly describe themselves as banks, captives and independents. The trend seems appropriate, given that lessors believe the number of firms doing business in the large-ticket segment five years from now will almost certainly be half what it is today. The number of independents, meanwhile, will likely have increased.

Yet, a changing identity does not portend a break-up of the industry.

Lessors will continue to feel bound by their identity as creative, intelligent finance professionals who possess entrepreneurial spirit. Shrinking margins will continue to squeeze profitability, but the demand for equipment will not disappear – nor will the need for its financing. To win in the new environment, lessors will have to be far-sighted enough to see declining markets before they emerge into the open. They will also have to possess the discipline to extract themselves from these markets before they decline substantially. What's more, lessors will have to be diverse enough to have other markets in which to grow.

By continually expecting change, lessors will realize that they must reinvent their companies from time to time. Although transparency fosters simplicity, and simplicity favors the loan over the lease, lessors are optimistic that they can create mechanisms and structure that will enable financing by the new rules. In fact, many industry members think continuing consolidation will create new opportunities. Underserved niches still exist, as do opportunities for top performers who can gather capital and deploy it wisely. Ambitious, talented lessors who can originate deals will survive and prosper. Their abilities to return to basics and reinvent their companies will shape the industry's future.

Any successful return to basics requires creativity, and overall opportunities for creativity have permanently shrunk. Lessors who empower themselves with talented and well-trained personnel will be more able than their competitors to redefine their companies and their markets. Excellence of staff is *the* top

requirement for future survival and growth in the leasing business.

To develop such a staff, however, lessors will have to create training programs that not only teach skills, but encourage creativity and instill a historic perspective of the industry. Once the domain of large leasing companies, this task now falls upon current industry leadership. Formal training is vital to future success, lest the industry's hallmarks of adaptability and flexibility succumb to innocent ignorance ushered in by new blood.

In the meantime, the leasing product will continue to evolve: at one end of the barbell will be short-term, true operating leases with their inherent risks; at the other will be long-term financing. In the middle of the barbell will be smart lessors, who'll find new ways to do the heavy lifting.