Window of Opportunity for Independent Finance and Leasing Operations

The equipment finance industry is undergoing a transitional period, providing independent equipment finance companies with a variety of opportunities, provided they prepared for market changes in advance.

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The commercial equipment finance and leasing industry thrives because of the flexibility, creativity and responsiveness of its participants. As we enter 2024, independent finance companies with access to capital are well-positioned to outperform their competitors. Aggressive independents are establishing relationships and program business that in the recent past were unattainable to non-institutional players. For years, pro-active management teams within independent industry participants have established business plans to gain a competitive advantage. And now current market conditions are prime for those plans to be aggressively executed. As a result, relationships established over the coming 12 to 24 months will provide the strongest foundation for independents to grow and prosper over the coming decade.

The commercial equipment finance and leasing industry is in its first transitional period in 15 years. Prior to 2008, the industry experienced a transitional period every five to seven years – a needed industry reset. Every transitional period requires institutional players to take a pause and to re-evaluate their strengths and weaknesses within the commodity world. Typically, savvy industry independents can transition faster, be more creative, provide flexibility and attract stronger relationships based upon value-added services. Independents that truly provide non-commoditized services distinguish themselves as premier providers of commercial equipment financing and leasing products that offer cash flow savings to the strongest end-users and vendors. Additionally, management teams of independents are usually more decisive than institutional players, allowing independents to turn from the past to the future more quickly; they adopt innovative technology, capture new opportunities and quickly become lean mean marketing machines.

Over the past 18 months, strong independent participants in the industry have shown their ability to act quickly and prudently. Strong independents led the industry in increasing their yield requirements aggressively in the initial stages of the rising interest rate environment. Strong independents also increased their credit criteria early in the cycle and focused on quality assets and bottom-line profits rather than strictly on growth. The strong independent participants also used the capital markets early in the cycle to rebalance their portfolios and reduce their low-yielding legacy assets. They anticipated a rise in delinquencies and prepared for collection challenges from a position of equipment expertise and determination to mitigate the impact of delinquencies and write-offs. The consistent prudent decisions of the independent management teams allowed balance sheets to strengthen and funding options to be solidified. This entrepreneurial spirit among strong independent management teams, over the past 18 months, has helped to position the strongest independents to lead the way out of the transition. And while many industry participants continue to lick their wounds and retract from new opportunities, the strongest independents are proactively attracting opportunities for future growth.

One of the greatest lessons learned from the 2008 downturn is that the equipment matters. These lessons have not been forgotten by the strongest independent industry participants. They fully understand equipment values and are industry and equipment centric. They are willing and capable of structuring transactions to protect their collateral positions for the entire term of their leases and finance agreements. Their collateral positions are based upon long-term trends and personal experience that are substantiated by up-to-date data. These savvy independent management teams do not use their internal funds to participate in non-proven trends that they personally have no, or little, expertise in. Before entering a new arena, strong independents use syndication partners (which possess the expertise) to gain the required experience and knowledge to be a prudent participant. However, once they possess significant equipment knowledge, they use the knowledge as a competitive advantage to smartly participate in a chosen arena. These strong industry participants use their equipment knowledge to aggressively pursue specific opportunities and equally use their equipment knowledge (and substantiated data) to withdraw from markets that no longer align with their long-term objectives. They have spent significant time and resources affirming their equipment knowledge and are well prepared to use this knowledge to capture additional business and return to a growth mode in 2024 and beyond.

The commercial equipment finance and leasing industry is normalizing. The risk/reward matrices are aligning with historical levels. Vendors and end-users were initially reluctant to accept the normalization of credit and yield requirements but are currently adjusting to market conditions. Over the past year, all participants have attracted stronger credits with higher yields (margins). This transition period forced institutional participants to pull back greatly; therefore, independents have attracted and won transactions which would have been easily satisfied by institutional players just a year ago at significantly lower yields. When yields were at historical low levels, commoditized products and programs easily attracted above-average transactions. With higher yields, strong independents are best positioned to offer creative structures and products to provide cash flow savings for commercial clients. Market conditions have encouraged an increase in non-commoditized products which were prevalent in previous decades including, but not limited to fair-market-value leases, second addendum leases, third-party recourse agreements, etc. Veteran professionals (especially within independents) are reasserting their past structuring skills to win stronger transactions and offer superior products to both end-users and vendors.

Application-only offerings remain the dominant industry product for small-ticket (and even lower-middle-market) transactions. The limits for application-only transactions significantly rose over the last decade from $75,000 to $300,000 (and higher). However, those limits have dropped over the past year as delinquencies increased and credit requirements tightened. These lower application-only thresholds have created a significant void in the market for transactions between $100,000 and $500,000 (which require additional information beyond an application-only process – full disclosure transactions). Most small-ticket originators who entered the industry over the past decade, were trained as application-only processors rather than professionals who can analyze financial statements and be meaningful conduits between clients and credit departments. Savvy industry participants, especially independents, are filling this void and training their originators to pursue, negotiate and win transactions which require a full-disclosure process.

The single largest opportunity in the market is for organizations and originators that are capable and willing to build deeper relationships (beyond a single transaction) with their vendors and end-users. Deeper relationships are built by knowing the client fully, by understanding the financial condition of a client, and by having the capacity to create a complete credit package which includes the strengths and potential weaknesses of a client. Strong participants are capable and willing to elevate a $100,000 transaction for an end-user into a $1 million relationship. They are also capable and willing to elevate a vendor relationship from annual volume of $X into a relationship producing five times more volume. The means of building significantly stronger relationships is by understanding the financial condition of a vendor and end-user and being prepared to offer meaningful solutions which will enhance the viability of every client.

During every transitional period, savvy originators and independent industry participants have thrived because of their prompt execution of the basics; their ability to go beyond commodity processing; and their willingness to offer financial expertise and customize their products and services to meet the needs of both vendors and end-users. The strongest independents are flaunting their financial skills, and their willingness to build comprehensive relationships, and they are filling the voids that commodity-driven institutional players are unable to fill in the near term.

Windows of opportunity have the capacity to open and shut quickly, and no one knows how long the current opportunity will last. However, history confirms that transitional periods create significant opportunities for independents and other industry participants that are willing to aggressively pursue both vendors and end-users with value-added products and services. History confirms that meaningful relationships established during transitional periods are long lasting and can significantly enhance the trajectory of independents willing to embrace new opportunities and lead the industry into the next cycle of significant growth.

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