Executive Outlook: Equipment Finance in 2020

Newsline spoke with four leading equipment finance executives in December 2019 to hear their perspectives on how the equipment finance industry performed in 2019 and to gain their insights on what factors will impact the industry and their organizations in 2020.

Newsline: How would you describe business activity in terms of new business volume generation in 2019, and what were the primary factors that had an impact on this activity?

G. Paul Fogle: The new business volume for 2019 increased by 20 percent at Quality Leasing. This year we focused on more growth in non-Class 8 trucking assets, including construction, medical, specialty vehicles, manufacturing equipment and materials handling assets. Additionally, small business optimism in 2019 remained positive, even with all the trade and negative media headwinds.

Terey Jennings: When all is said and done for 2019 Financial Pacific Leasing will have modest growth for the year, which looks to mirror some of the industry statistics we follow. It's been an interesting year from an interest rate perspective. At the beginning of the year, a lot of people were forecasting a slightly rising interest rate environment but what we got was the opposite. That led to a pretty competitive market in 2019 as pricing was lowered and margins were compressed.

Brad Peterson: 2019 was a great year at Channel Partners Capital, growing just over 90 percent versus 2018 to over $50 million in the fourth quarter. Our growth was a result of three things: 1) better penetration into existing partnerships with equipment finance companies (EFCs), 2) continued recognition/adoption of working capital products by EFCs to support equipment finance customers, and 3) enhanced technologies (online capabilities for EFCs) along with expanded products (monthly payments, line of credit, app-only, etc.). Many of our partners recognize small businesses are using working capital and that expanded product offerings lend themselves to enhanced customer service levels, increased customer retention and income diversification.

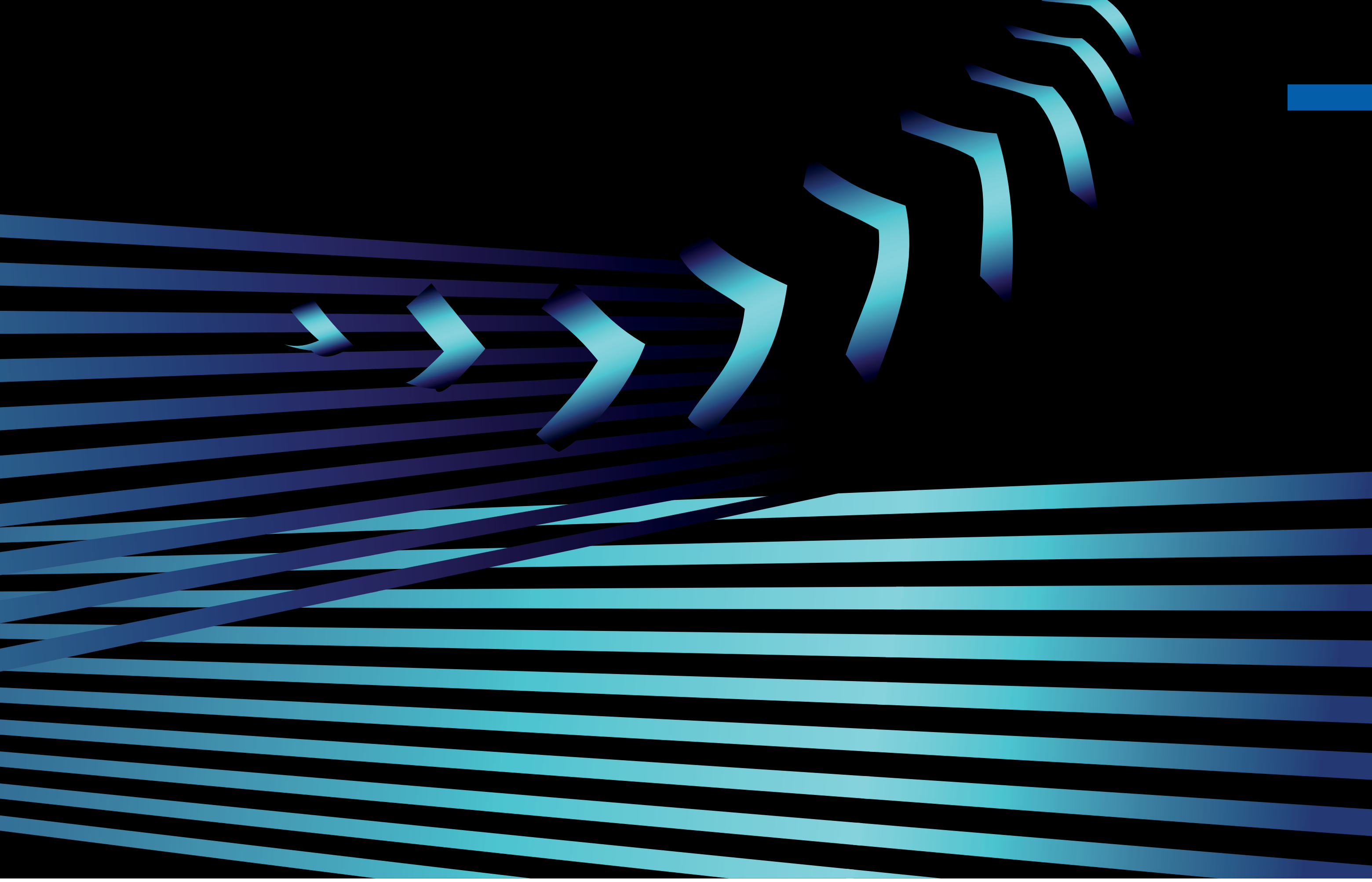
Donald Wampler: I am proud to say 2019 will be FirstLease's highest production year in the history of the company. Volume is up over 50 percent from 2018 and it is primarily due to us narrowing our focus coming into 2019. By this I mean, we entered the year with a focus on improving our level of service to our top broker partners and vendor relationships. We cut the number of brokers we were working with at the end of 2018 down to almost half. This allowed us to provide a better quality of service to those brokers who produced more, which increased our overall third-party volume. On the vendor direct side, we entered into exclusive industry partnerships where we focus on providing rates and terms so those vendors can be more competitive than their competition in the industry. The "Less is More" concept really paid off for us in 2019.

2020 INDUSTRY EXPECTATIONS

Newsline: How do you expect the equipment finance industry will perform in 2020 compared to 2019?

Fogle: In 2020, I believe there will be plenty of opportunities in the equipment finance industry just like there were in 2019. However, as specific segments underperform, there will be a flight to quality credits and a tightening of credit. The best credits will have lenders tripping over themselves to book the business to keep volume growth. This fighting over the better credits, of course, will result in downward pressure on lender yields, benefitting the best customers. The year 2020 will, or I should say, "may be" impacted positively given it is an election year. Well, at least until November. After that, all bets are off!

Jennings: Always the optimist, I think the industry will be fine for the first half of the year and continue to look like 2019 with modest growth opportunities. The second half of the year will



be the wildcard with potential election uncertainty and triggers that may or may not be used related to tariffs.

Peterson: My expectation would be for continued expansion and growth in the first half of 2020, however, we always seem to have an "uncertainty slowdown" each presidential election year. I believe the EFCs' success in 2020 will be enhanced by, and perhaps dependent on, how effective they are in helping current customers with new equipment or other financing requests that will help offset a third and fourth quarter lull. Regarding Channel Partners Capital, we are expecting another good growth year in 2020 (over 30 percent) fueled by ease-of-use technologies for EFCs and new products. We believe in the progress and growth of America's main street small businesses and their need for easy-access financing. Channel Partners' business strategy mirrors the equipment finance markets; we trust and will continue to invest in the expansion of the small business space.

Wampler: I would expect volume to drop slightly in 2020. The financial crisis of 2008 is obviously still fresh in many small business owners' minds and, many economists are forecasting some sort of dip in the economy in late 2020, or possibly 2021. This will lead to a decline in consumer confidence which will affect equipment sales.

KEY ISSUES OF CONCERN

Newsline: From a broader perspective, what are the issues that concern you most about the equipment finance industry's performance for 2020?

Fogle: From the broader perspective, what concerns me most are recessionary fears that could become a self-fulfilling prophecy, despite relatively sound economic fundamentals. There is no doubt that the economy has slowed, as evidenced by the reduction in GDP from 3.12 percent in 2018 to just over 2 percent in 2019. However, unemployment remained low, and consumer spending continued to be healthy. I am similarly concerned that freight rates will continue to be depressed, which will create more defaults in the heavy-duty trucking space.

Jennings: It's easy to say we should expect some presidential election impacts to the economy in 2020 with uncertainty in the results of the election. This may end up happening, but in the recent past our experience has been mixed. We didn't see much impact in our activity in 2016 but we did notice a slowdown in the second half of 2012. Potential impacts from the election are

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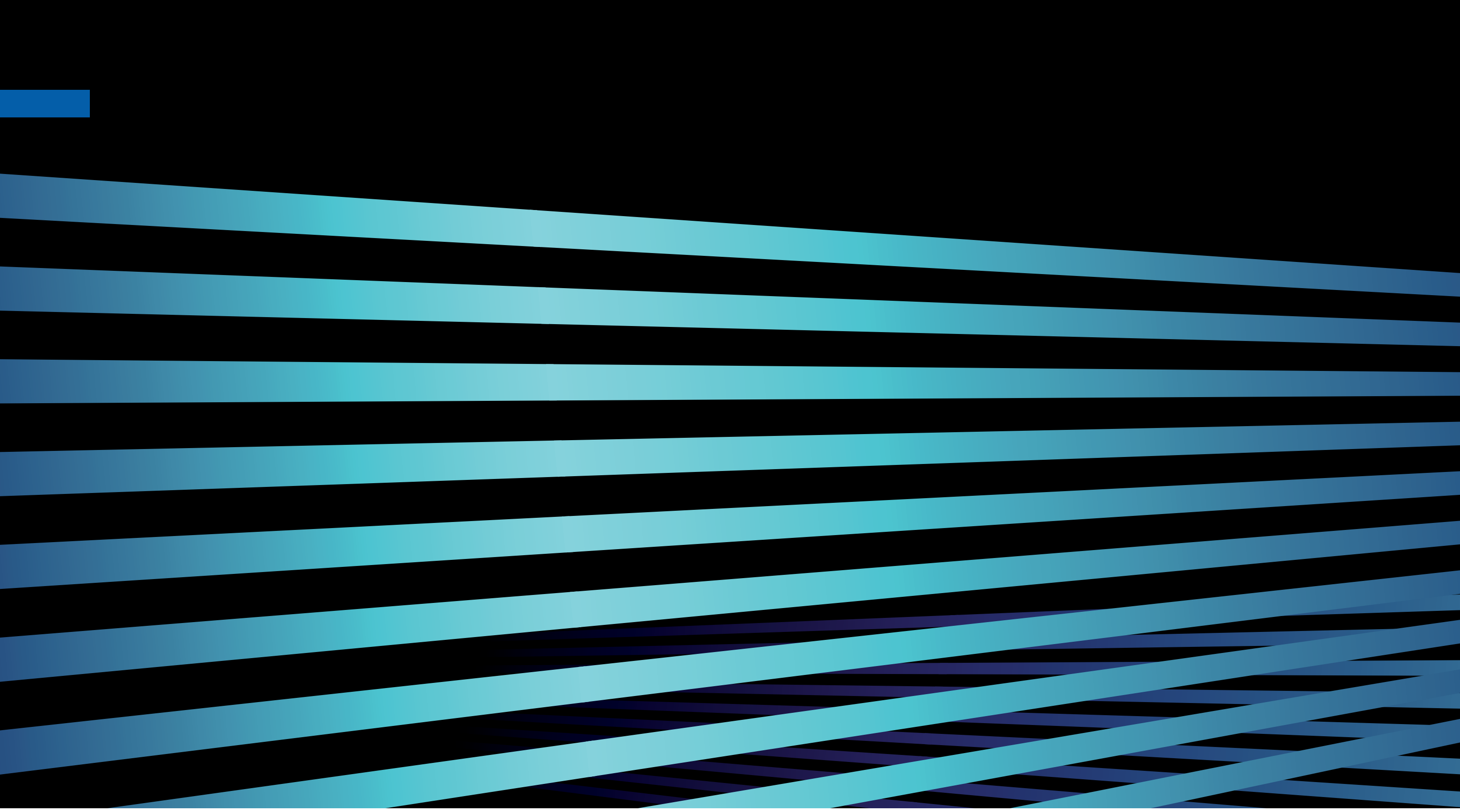


just one of many macroeconomic conditions that will ultimately drive how the economy behaves in 2020.

Peterson: Continuing into 2020, we will have to deal with political unrest while the economy shows unprecedented strength. The political landscape and upcoming election will surely cause distraction throughout the year, including some businesses to "wait and see" prior to making any significant moves. However, the majority of small businesses have experienced 11 consecutive years of expansionary cycle, paving a confidence in the U.S. economy. Low interest rates and critical tax relief continue to be accessible to the small business owner providing them opportunities to make equipment investments.

Wampler: Interest rates will become extremely competitive in the marketplace. Bank-owned finance companies, with lower cost of funds than most other lenders/brokers, will typically get extremely thin on margins to maintain volume levels. This traditionally makes competing for volume in certain industries/equipment types (such as medical, new yellow-iron equipment, large industrial machinery, etc.) very difficult for non-bank-owned finance companies. The election will also clearly have an impact on volume in the second half of 2020. As we get closer to the election in November, consumer confidence will sway based on political affiliation. It happens every election year.

TOP PRIORITIES

Newsline: As you look ahead, what are the top priorities for you and your management team in 2020?

Fogle: One of our top priorities in 2020 is to continue our growth in specialty vehicles and non-titled assets. We have made a concerted effort to grow in these asset classes so we can further diversify our portfolio, better serve the needs of our third-party originator partners and explore new markets. A second priority is to improve our remarketing of assets in our inventory. We have some excellent equipment that we are motivated to move to the next owner. We offer financing for that transaction too!

Jennings: The priorities for 2020 at a high level don't change from year to year, which is to optimize our activities as a leading equipment finance source for our partners and customers. From an origination standpoint, this means diligently working on serving our customers' needs. For us a customer comes in different forms, such as third-party originators, vendors and partners at our parent, Umpqua Bank. From a portfolio management standpoint, we're striving to always optimize our relationships with our lessee and customer base.

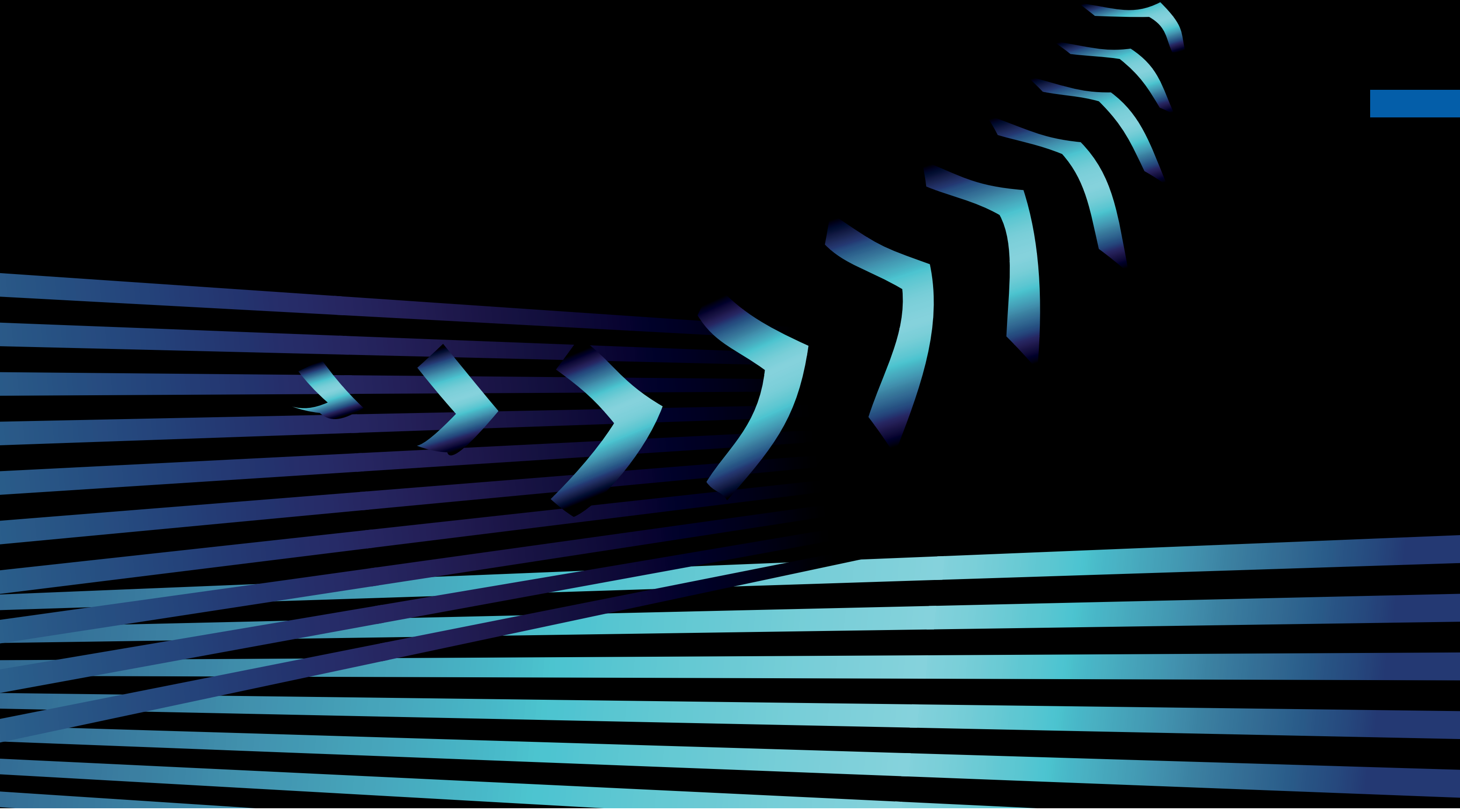
Peterson: Channel Partners Capital will focus on further integrating with existing EFC relationships and expanding by seeking new partnerships. Our company is well-capitalized, providing us the opportunity to invest in the value proposition through 1) technology focused on ease of use and product delivery, 2) new and market relevant products and services delivered under the Channel brand, and 3) enhanced sales training and development programs for EFC partners. We have great data collection, analytics and reporting capabilities which we will continue to leverage into proprietary modeling, products and services deemed valuable to EFCs. Why… technology for ease and speed, products for market relevance, training to maximize the value and data analytics to be "right."

Wampler: Our top priority in 2020 is to stay the course. It is not uncommon for finance companies to become more aggressive with underwriting, to lower rates to levels that can't be maintained long term, and to cut corners on documentation and processing steps. These examples will always lead to the future failure of a company.

HIRING TALENT

Newsline: When hiring new talent, what is most important to you and your organization?

Fogle: The most critical factor in the hiring process for us is answering the following questions: "Will this person fit within our corporate culture?" "Does this person share our beliefs and our core values?" Do they demonstrate honesty, integrity, passion, commit-



ment and fairness?" "Are they detail oriented and teachable?" In other words, cultural fit first; other factors after.

Jennings: Where we can, we want to create opportunities for career advancement with our existing staff. We have so many examples at Financial Pacific of younger staff members learning and growing with us in multiple roles throughout their FinPac career. We also recognize that in some cases the best fit for us might be to hire outside to bring in new ideas and knowledge to enhance our teams. In the past year or so, with unemployment being at historical lows, hiring from the outside has come with its challenges of finding the right fits in a timely basis.

Peterson: Today we have a very good mix of experienced leaders and younger talents that with thoughtful guidance and mentoring, will translate to organizational consistency and seamless succession of leadership. We have taken the approach to identify what qualities within a specific position are needed to support our growth and strategy plan and recruit the best candidate for the job. Beyond what is noted on the resume is the attitude, aptitude and cultural fit of the candidate.

Wampler: While we are always looking to attract top industry talent, we feel it is important to invest in younger talent that we can train and teach our way of doing business here at FirstLease. Our company is made up of a well-balanced mix of talent that came to us from other leasing companies and those whose first job in the financing industry was FirstLease.

SECTOR OPPORTUNITIES IN 2020

Newsline: From an asset class or industry sector standpoint, what asset classes/sectors represent strong opportunities in 2020 for the equipment finance industry?

Fogle: I believe healthcare-related assets and industry will continue to be a growth area as baby boomers age and advances in medicine cause people to live longer. If the trade issues are resolved by early 2020, agriculture should rebound. In general, I have a positive outlook for the economy in 2020 and for our industry!

Jennings: Rather than focusing on specific industries or equipment types, what has worked best for Financial Pacific through the years has been diversification in the types of equipment we finance to multiple industries. We have to stick with these customers for an average of four to five years through what can be different economic ups and downs so that diversification has worked best for us. This strategy may also serve us well with our focus on small-ticket transactions.

Peterson: We will focus our efforts and analytics on: Transportation, albeit it has shown some historical stress, will perform in step with the strength of the economy. Construction, another key economic indicator, will outpace expectations due to desirable interest rates and steady employment rates. Manufacturing will make investments in equipment as automation technology continues to increase its efficiencies. Lastly, the healthcare industry will invest in cost-saving services and deliverables as the market is being introduced to alternative medicines.

Wampler: I see manufacturing and technology dominating 2020. With more and more companies struggling to fill manual labor positions or starting to feel the crunch of rising minimum wages and increased employee healthcare costs, companies are looking for ways to automate staffing to lower expenses. For example, in the restaurant industry companies like Panera Bread and McDonalds have already started replacing traditionally employee-manned registers with self-serve kiosks. This is a practice that companies like Walmart, Home Depot, Lowes and most larger grocery stores have done for years as an alternative. Another example is larger manufacturing plants, which are looking to AI and machine learning capabilities to increase productivity and efficiency by reducing staff or, at the very minimum, not having to add additional overhead.