



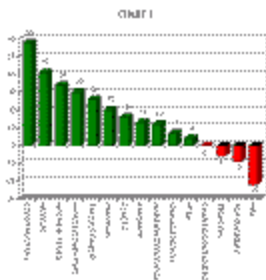
**"WHAT'S HOT, WHAT'S NOT IN EQUIPMENT LEASING FOR 2003"**  
**By Carl Chrappa, A.S.A., C.R.A.**

In January 2003, Independent Equipment Company ("IEC") conducted a survey of approximately 300 equipment managers and consultants throughout the United States. Forty responses to the survey were received, of which 90% were lessors, 3% were brokers, and 7% were appraisers.

**COMPOSITION OF RESPONDENTS**

Lessors reported that they added the following amounts of equipment to their portfolios in 2002: 7% added up to \$10 million; 10% added \$10 to \$20 million; 5% added \$20-\$50 million; 3% added \$50-\$100 million; 28% added \$100-\$500 million; 30% added \$500 million to \$1 billion; and 17% added \$1-\$3 billion. Thus, this survey was heavily influenced by the 75% of lessors who added \$100 million or more of equipment to their portfolios in 2002.

**SURVEY RESULTS AND FUTURE LEASING BUSINESS OPPORTUNITIES**



This survey consisted of six questions. One of the most important was Question VI (B), which asked, "Total dollar amount of business per specific equipment type expected to be booked by your firm, in the future, 2003 compared to 2002?" Respondents were asked to simply mark "+" (increase), "x" (about the same), or

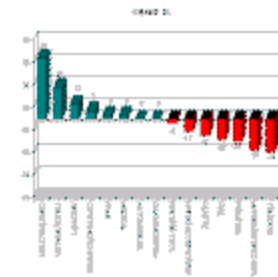
"-" (decrease) for any of the 15 equipment types they had knowledge of. Responses for each type of equipment were then converted into the percentage of "+" (increase), "x" (about the same), and "-" (decrease). Next, a survey score for each equipment type was determined by discounting the percentage of 'about the same' responses, and calculating the remaining difference between the increase and decrease percentages. Simply put, a positive "+" result (score) indicates a greater net percentage of respondents felt the subject equipment type would experience an increase in the leasing business over the coming year, while a negative "-" result indicates a net decrease in leasing business is expected for 2003. The results for each equipment type can be compared to others by the net percentage of respondents expecting an increase or decrease in leasing business for a certain type of equipment. [Chart 1](#) illustrates

the results of the 15 equipment types surveyed. Construction scored the highest, with medical equipment in solid second place. However, notice that lessors also expect to be gearing up in the machine tool, hi-tech/computer, truck/trailer, and printing sectors. On the other hand, telecom, automobiles, and rail equipment leasing are not expected to fare well.

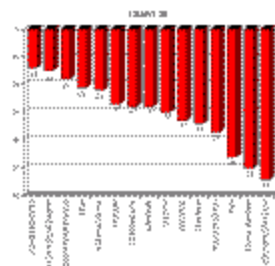
In comparison to past years, a response of about +20% or greater indicates a strong preference for adding equipment to the portfolio over the coming year, while a response of -20% or greater indicates a strong preference for not adding a specific type of equipment to the portfolio over the same period. [Chart I](#) shows there is a strong preference for adding six of the 15 types of equipment (a sharp increase from only two in 2002), and for not adding only one type (an sharp decrease from four in 2002), thus, this part of the survey shows an improvement in this year's outlook.

Using the same scoring methodology, Question VI (A) asked, "The total (current) amount of business booked by your firm per specific equipment type as of year end 2002 versus 2001?"

The responses to this question, illustrated in [Chart II](#), indicate that for 2002 the leasing industry had a strong preference for only two equipment types (the same as last year but a stunning drop from ten the year before), a moderate preference for two equipment types (an decrease from three types in 2001), and little or no preference for eleven types (a slight increase from ten types last year). This reflects the mediocre year most leasing companies had in 2002.



**CHANGES IN RESIDUAL ASSUMPTIONS WERE THE MOST PRONOUNCED IN THE HISTORY OF THE SURVEY**



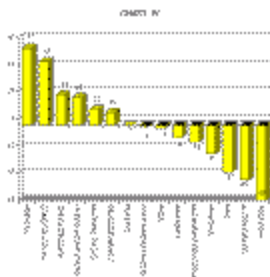
Finally, Question VI (C) asked for "Change in the amount of residual value assumed this year (increase/decrease) per specific equipment type in comparison to last year." The results found on [Chart III](#) are quite remarkable and for the second year in a row are of historical significance. For the first time in the

14-year history of this survey, none of the 15 equipment types showed an increase in the amount of residual value assumed, while three showed moderate decreases, and twelve showed strong decreases in residual value assumed. Thus, it is clear that the leasing industry has turned much more conservative in booking residuals due to current secondary market conditions and the economy. Overall, on a net basis, 30% to 40% of respondents

lowered residuals for telecom, printing, and construction; 46% of respondents lowered residuals for rail equipment; and 50% or more lowered residuals for machine tools and hi-tech/computer. The most affected equipment type was hi-tech/computer, of which 54% of respondents lowered residual values. While this is significant, it does not break last year's record of 69% of respondents who lowered residuals for the truck/trailer segment, which was an extremely negative reading. Nonetheless, it is interesting to note that all of the equipment types that had their residual values lowered most (with the exception of telecom and rail) were among the equipment types that scored the best in future opportunities. Therefore, it is clear that leasing companies are becoming much more conservative in booking residuals, since not even one equipment type showed an increase. This marks a very pessimistic outlook of used equipment markets in the near-term. Also, note that positive results (increases) in residual positions, taken together with positive results of 20% or more in the survey's future business opportunities section, indicates a strong willingness -- (or if negative results, a lack thereof) on a lessor's part to *aggressively* seek (or *avoid*) business within certain equipment types. This year marks the second time (last year being the first) in the history of this survey that not even one equipment type showed strong overall positive results. However, one type -- in particular rail -- showed very negative results. This, once again, shows that the equipment leasing industry is becoming much more selective and conservative in booking transactions.

**MOST AND LEASE FAVORABLE  
TYPES OF EQUIPMENT FOR FUTURE BUSINESS**

For correlation purposes, additional questions were asked and a weighted approach to scoring the survey was used (*i.e.*, Questions III and IV), versus the unweighted approach previously discussed (*i.e.*, Question VI). Questions III and IV asked respondents to pick only the three best and worst future equipment leasing opportunities (in order, 1-3) by specific equipment type.

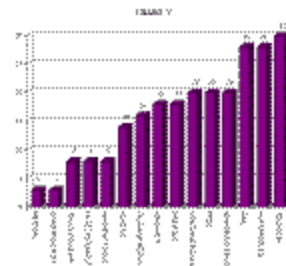


The weighted results for each equipment type were determined by assigning a numerical weighting (multiplier) to each 'place' selected, whether positive or negative. For instance, a first place vote was assigned 5 points, a second place vote 3 points, and a third place vote 1 point. A score was tabulated for each equipment category by multiplying the

actual number of votes for each place by their respective multipliers (or -), then adding the total. A final weighted equipment score (net weighted score) was determined by calculating the difference between each equipment type's positive and negative weighted score. Note, the weighted results ([Chart IV](#)) showed a good correlation with the unweighted results ([Chart I](#)) in that the order of

equipment types, best to worst, was quite similar in both approaches (weighted/unweighted). This led to ties in five places (first, third, eighth, tenth, and 13th) in the final combined scoring (see [Chart V](#)).

The weighted scoring approach amplifies how strong a preference is for a specific type of equipment, whether positive or negative. The results show that the respondents felt that strong (positive) future equipment leasing opportunities would exist in the medical equipment, construction, truck/trailer, and hi-tech/computer sectors, while being greatly diminished in the printing, rail, automobile, and the telecom equipment sectors.



### FINAL OVERALL RANKING

Finally, a combined overall score was tabulated by adding each equipment type's place (rank) for survey Question VI -- the amount of future leasing business - unweighted, and Questions III and IV -- the amount of future leasing business - weighted. The combined results, shown in [Chart V](#), indicate a strong preference for medical and construction equipment, as they tied for first place, followed by truck/trailer, hi-tech/computer, and machine tools; while on the other hand, container/chassis, FF&E, marine/intercostal, rail, automobiles, and telecom equipment had poor showings. The lower the numeric score, the better. For instance, machine tools, which has a combined score of 8, indicates an average of fourth place in the two future leasing business opportunity questions (weighted and unweighted). Similarly, the telecom equipment score of 28 indicates an average of 14th place (out of 15 possible) for the same two questions.

TABLE I

Equipment Type	2003 Score	2002 Score	Difference
MEDICAL	3	3	+0
CONSTRUCTION	3	5	+2
TRUCK/ TRAILER	8	24	+16
HI TECH/COMPUTER	8	11	+3
MACHINE TOOLS	8	4	-4
PLASTIC	14	22	+8
OIL/GAS/ENERGY	16	11	-5
AIRCRAFT	18	28	+10
PRINTING	19	16	-2
CONTAINER/CHASSIS	20	25	+5
FIRE	20	17	-3
MARINE/INTERCOSTAL	20	7	-13
RAIL	28	22	-6
AUTOMOBILE	28	22	-6
TELECOM	30	21	-9

[Table I](#) shows the comparison between the overall survey results of 2003 and 2002, in order to determine trends in leasing towards ("+"), or away from ("-") particular equipment types over the past year. Once again, the overall combined scores for the final rankings for each year were used. The lower the score, the better, and the larger the difference the greater the change in

trend towards ("+") or away ("-"). In comparing the two surveys, the equipment leasing industry's perception of truck/trailer equipment (+16), aircraft (+10), and plastics equipment (+8) improved greatly over the past year, while that of marine/intercostal (-13) and telecom equipment (-7) have fallen significantly since the 2002 survey. Overall, the winners, medical and construction equipment, showed little movement from last year's placing, as medical remained in first place, while construction improved from its third place showing in

2002 to a tie for first place. Meanwhile, machine tools, which finished second in last year's survey, finished tied for third in this year's survey. The most striking improvement came in the truck/trailer sector, which improved by 16 points from 13th position in 2002 to a tie for third in 2003 -- a remarkable improvement and one that was also accompanied by a significant lowering of residual values. Also, just as significant was the fall in the marine/intercostal segment, which dropped by 13 points year over year, from fourth place last year to tied for tenth place in this year's survey. Even more interesting is the perplexing improvement in the aircraft equipment segment (+10), which moved from last place in last year's survey to a tie for eighth place in this year's survey. Apparently, equipment managers feel that perhaps the worst in the aircraft business sector may be behind it.

### **DESIRABILITY CONCLUSIONS**

Based on the results of the 2003 survey, it appears that over the past year equipment managers and leasing companies have become more optimistic in their outlook for almost all equipment types. Over the past few years, there *had* been a move to hi-tech/computer, telecom, and medical equipment. However, this year, only medical equipment and hi-tech/computer remain popular, while telecom equipment plunged to last place in this survey. Specifically, medical equipment finished tied for first place which appears to be due to the perception of the current administration's laissez faire approach to business -- in particular, healthcare and medical insurance, or it may be that this equipment type is also gaining popularity due to the changing demographics of the country's aging population. Whatever the reason, medical equipment is a clear winner once again. Also in a first-place tie is construction equipment, which represents a "big iron" type of equipment. Other "big iron" types, such as machine tools and truck/trailer, also did well in the survey, as they tied for third place. In general, this type of equipment tends to be rugged, durable, and long-lived, and is not subject to rapid changes in technology, which would tend to benefit leasing companies during a significant downturn. For example, construction equipment returned to a lessor this year, that could not be sold immediately, could be held for sale until the market "turned around," which is not the case with hi-tech equipment. It is believed that the construction equipment sector did well due to the continuation of low interest rates and government support for the industry. The truck/trailer sector also performed much better than expected showing the greatest year-over-year improvement of any type (+16), while tying for third place. The improvement in the truck/trailer sector appears to be linked to improving conditions within the industry, which is felt to have

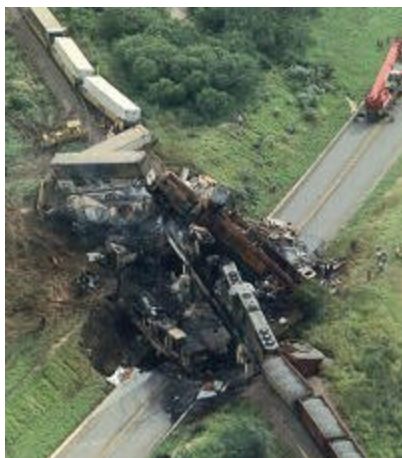


bottomed during the year. However, residual positions for this sector were lowered by 22% of respondents this year and 69% of respondents last year. Thus, the overall level of commitment here seems a bit tepid. Machine tools also tied for third place, showing a small drop in popularity over last year (-4). Most of this drop can be attributed to a sharp fall in the sale of new machine tools for the fourth year in a row, while wholesale prices for used equipment bottomed over the past year. Hi-tech/computer improved somewhat over the past year due to a turnaround in primary market sales, albeit slight.

Next, plastics, oil/gas/energy, aircraft, and printing, finished in the middle of the pack. Plastics equipment finished in 6th place, with an improvement of +8 in its overall score from last year. This improvement is felt to be in recognition of a paradigm shift within the industry, wherein sales volume in the primary market will be permanently adjusted to a lower level, concurrent with a bottoming in the wholesale used plastics equipment market. The oil/gas/energy equipment segment declined by five points overall from last year. This decline is believed to be linked to poor conditions in the wholesale energy market, which have caused cancellations of many projects, and impacted values both in the primary and secondary markets. Surprisingly, the aircraft sector improved the second most of all types (+10) over last year's score. This improvement is believed to be related to equipment managers' belief that perhaps the worst in the aircraft industry is behind it. Whether this is wishful thinking or not will become apparent as we move through 2003 -- with two of the nation's top airlines teetering on the brink of failure and their outlook very clouded at this time. Additionally, the printing equipment sector once again finished in the middle of the pack, probably because of the durability of the printing press, which lends some support to lessors in spite of the poor current market conditions and a muted outlook for 2003.

Meanwhile, container/chassis, FF&E, and marine/intercostal appeared in the lower half of the survey. All three of these types tied for tenth place with scores of 20. The container/chassis segment showed an overall improvement of five points from last year. The improvement in score is believed to be related to a general improvement in the primary market, which boosted sales substantially over 2001 levels, in combination with a bottoming in used container prices over the past year. FF&E finished somewhat lower than last year, with an overall decrease of three points. This is believed to be due to the current *'no-job-growth economic recovery'* which has caused a significant build-up of used furniture, fixtures, and equipment in the secondary market, which is saturated and is expected to remain so until the economy starts "growing" jobs. Next, the marine/intercostal equipment sector also finished tied for tenth place with a much lower score (-13) than last year's. This sharp drop in popularity is thought to be due to severe over-capacity that exists in both the primary and secondary markets, combined with a sluggish global economy, which has significantly impacted marine vessel values *and* charter rates. This is one of the few industries

where it is believed that falling equipment values *have not yet bottomed*.



Rail, automobiles, and telecom finished at the bottom of this year's survey. For rail, the tie for 13th place shows an overall drop of six points from last year's score. This drop is believed to be related to the industry's near-term outlook, which shows values may have bottomed during 2002, but remain so low as not to present business opportunities that make economic sense. For example, some lease rates have fallen so low that they do not even cover interest payments. Automotive also tied for 13th place, and likewise

fell six points from last year's survey. Its continued poor showing seems once again to be related to problems with volume and pricing in the primary market, which have crushed prices in the secondary market. Some values for same-age, same-type of car have dropped over 15% in just the past year, while the average time to sell a used car has increased dramatically; thus the negative outlook. Finally, telecom equipment showed a decline of seven points from last year. The telecom industry still suffers from severe financial problems and extreme over-capacity, which present little opportunity for growth or residual value realization for some time to come. In addition, the potential impact of pending legislation in Congress could all but kill competitive local exchange carriers (CLECs), thus dealing a crippling blow to the secondary market. The implications of this are ominous.



Overall, the 2003 survey results reveal that lessors appear to be somewhat more optimistic, but are clearly in defensive positions as characterized by the drops in residual value for every type of equipment surveyed. This could lead to increased opportunities in leasing various types of equipment, albeit with reduced residual values -- and in some cases *sharply reduced* residual values, which could lead to improved rates of return for the industry.

### **FINAL COMMENTS**

The results of this year's survey again seem to shout, "*let's take much lower residual value assumptions and be more selective in the equipment we lease.*" However, knowledgeable operating lessors with solid marketing experience may take a contrarian view to this survey, and consider the "sharp erosion" in the popularity of a certain equipment type as a great opportunity for future business.

Perhaps the industry's perception can best be summed up in some of the following survey comments received about the *greatest threats* to the secondary market:

- ◆ "Price deflation, oil price increases, economic stagnation."
- ◆ "No turnaround in the near future; oil shortage and higher fuel prices, falling new equipment prices."
- ◆ "Continued high surplus of used equipment -- deep discounting of new equipment."
- ◆ "Poor economy and lack of capex."
- ◆ "Growing levels of returned equipment in inventory, and poor remarketing strategies that result in equipment sales at depressed values."
- ◆ "High default rates and returned equipment."
- ◆ "Depressed commercial aircraft values and over-supply negatively impacting end-of-lease."
- ◆ "Bonus depreciation could flood the market with new equipment relative to demand -- adversely affecting the secondary market."
- ◆ "Large supplies of quality used equipment."
- ◆ "Manufacturers force-feeding product to customers; and leasing companies that have made stupid equipment investment decisions going out of business."
- ◆ "The recession has caused a flood of equipment in the secondary market that will continue for the next 12 to 18 months until the excess capacity is absorbed."

The concerns enumerated above seem to be collectively summed up in a final comment received, which is as follows:

- ◆ "The greatest threat to the secondary market over the next three years is a continued poor economy with the cloud of war hanging over the U.S. and the world, leading to no job growth and no commitment from the business sector to invest in new *or* used equipment. If the situations in Iraq, Korea, and Venezuela are not resolved soon, we could be in for big trouble!"

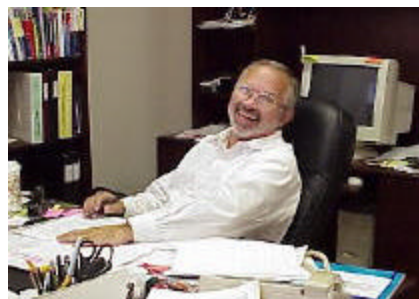
It is hoped that lessors continue to develop market awareness, including the secondary markets throughout 2003, with an eye toward the future, remembering that, "what goes down, comes up."  
Happy new year!



## BIOGRAPHY

### CARL C. CHRAPPA, A.S.A., C.R.A.

Carl C. Chrappa is President and CEO of Independent Equipment Company, the nation's oldest equipment management outsourcing firm, headquartered in



Clearwater, Florida. He is a registered auctioneer and tested and accredited senior appraiser with over 30 years of equipment experience.

Mr. Chrappa is uniquely qualified for this presentation, since he regularly trades in equipment markets, and provides valuation and technical consulting services to companies throughout the world. He is also a member of the **National Association of Business Economics**, where he serves on the Association's International Roundtable.

He is a founding and current member of **The Equipment Leasing Association's Equipment Management Committee**, he also serves on the Board of Directors of the **Commercial Finance Association, ELA Business Services, Inc.**, and is a past technical director of the **American Association of Cost Engineers**. He has co-authored a book entitled [A Leasing Company's Guide to Equipment Management](#) and is the author of several columns devoted to equipment management. He has recently been interviewed and quoted by such news media as the L.A. Business Times, TheStreet.com, and CNBC MoneyLine. In addition, he is a major content provider to the ELA's web-based Asset Management Central. Mr. Chrappa is a graduate of the University of Massachusetts at Amherst.