

Bringing Value

For captive lessors, it's not just about writing leases anymore.

By Matthew L. Philbin

In the equipment leasing game, captive lessors would seem to hold all the cards. After all, with their low cost of funding, their intimate product knowledge and their presence at point-of-sale, good captives can't miss pulling in all the leasing dollars to be had for their parents' equipment.

All that may be true but, judging by much of the discussion at ELA's 2006 Captive & Vendor Finance Conference at Ponte Vedra Beach, Florida in April, captives still have plenty to worry about. Their parent companies are manufacturers for whom finance is not a core discipline. OEMs may make and sell world-class equipment, but leasing that equipment? So if they have finance company captives, those entities had better be providing value.

The Big Question

And that was really what captive lessors were talking about in Florida—how they provide value. And one fundamental question kept coming up: what's the captive's main goal? What's its reason for being? Captive executives have differing ways

of looking at it, and various ways of providing value.

According to panelist Al Smith, Canon Financial Services, "Our number one goal is to increase sales for the parent." On another panel, Tony Pacchiano of ADP Credit Corp. said his goal is to help ADP "get and retain customers."

Jeff Van Cleve, Diebold Global Finance Corporation, also stressed customer retention. "Captive financing is the most favorable business model for keeping customers," he said. Most favorable, perhaps, but no sure thing. Van Cleve said that the captive marketplace is getting tougher: "Captives today have to be creative in funding and monetizing transactions, while keeping control of customers."

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Pacchiano's main goal is acquiring and retaining customers, he has a secondary goal, as well: "To do that profitably. If we don't grow our bottom line each year, ADP will say that it doesn't make sense to invest in commercial leasing."

"You have to make money on the financing, and not just move product," said Jeffrey Simon, CIT Global Vendor Finance.



Panelists at the Captive and Vendor Conference discuss the ways they provide value to parents and customers.

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Beyond Leases

Beyond the demands of supporting the goals of their parents—and doing it profitably—captives must find other ways of providing value. One thing is certain, writing leases is almost nobody's sole purpose today. Joe Lane, Chairman of the Equipment Leasing and Finance Foundation, made that clear in a presentation summarizing the 2006 Industry Future Council Report. "In 2004, 52 percent of ELA members' business was in loans or loan-like. Only 10 percent were fair market value leases," he said.

Ok, so captive finance companies, like others in the industry, are concentrating less on leasing and more on general financing. (Although, in the same presentation, Lane said, "Companies want more leases done because they're profitable, but they want "leasing" out of their identity.") It's *all* financing. But in seeking to provide more value to their parents, captives face other demands and must move farther a-field. "We've labeled and limited ourselves as finance providers," stated Scott Barber, GE North America Leasing. "But it can't just be about the money,"

Fraud Protection

In a presentation to the Captive and Vendor Financing Conference, attorney Richard Weiner of Aronsohn, Weiner & Salerno, updated attendees on the ongoing NorVergence and AllServe fraud cases—cases in which he predicts "no happy ending." Weiner left his audience with the following "take-aways" to protect themselves from the type of fraud perpetrated in the AllServe case:

1. Know the location of the vendor.
2. Know the accountants and lawyers you deal with on large transactions. Get an outside attorney's opinion letter on the lessee.
3. Do *your own* due diligence.
4. Inspect the site. ("Any lessor who had visited AllServe's facilities would not have done the deal," Weiner said.)
5. Does the amount of equipment leased match the size and purpose of the business? How much staff does the business have?

For more information on the NorVergence and AllServe cases, as well as other important legal issues, go to the legal section of ELA Online at www.elaonline.com/legal/.

he said. "There's a potential for real partnership."

Canon's Al Smith believes captives don't just provide financing. "We're a source of data and intelligence for our parents," he said.

Pacchiano said that ADP Credit

Supporting the parent's sales and customer relationships make up just one half of the equation. Profitability is the other.

makes the most of cross-selling opportunities that go beyond financing. Plus, he said, the captive acts as a credit decisioning center for the entire company, it provides equipment leases to the parent, and offers bundled finance options to customers.

In the drive to provide more value, lessors sometimes have gone too far, according to Marc L. Hamroff of the law firm of Moritt, Hock, Hamroff & Horowitz, LLP. "Bundling," sounds attractive, but "Lessors often try to lease assets that aren't leaseable, to make things fit into the box," he said. "Soft costs," such as service or maintenance contracts don't fit the box. In fact, according to the UCC, they can't be leased.

But, said Hamroff, lessors can offer bundled soft cost financing. "It's not that you can't do it. It's how you do it." He suggested developing alternative structures: such as a software license and service agreement between vendor and lessee; a program agreement between the vendor and

Why All the Pessimism?

Mark Vitner, director and senior economist, Wachovia Corporation Corporate & Investment Bank, doesn't understand why there is "widespread pessimism," about the U.S. economy. It's an economy he characterized as "surprisingly good." In making his case, he cited 10 straight quarters of 3.5 percent or better GDP growth. "In the 4th quarter of '05 growth slowed significantly to 1.7 percent," he admitted. "But a lot of defense spending was not authorized in time to count in that quarter. Also, the growth of gift cards pushed a lot of holiday spending into the first quarter of this year."

Vitner also addressed the so-called "housing bubble," explaining that only about three percent of homes sales is speculation. "The housing boom is driven by demographics and economics, and it's not out of the ordinary. Housing's contribution to GDP is about the same as it has been in previous recoveries," he said. Today, 69 percent of Americans own their own home and Vitner believes that percent hasn't peaked.

What has peaked is home prices, but Vitner predicted only a mild cooling off in the market.

More relevant for the gathered lessors, Vitner predicted that business investment will pick up. "Capacity utilization will rise above its historic average, so investment will go up," he said, although he felt there could be a lull before business investment really heats up.

Not that Vitner doesn't have concerns. Some possibilities he listed as worrying: amore precipitous cooling than expected in the housing market, a slackening in demand for U.S. Treasuries that could cause much higher interest rates, and the looming bankruptcy of Social Security in 2013, which he said would lead to higher tax rates, lower benefits and high interest rates.

But there are other worries that Vitner doesn't share. "Don't fear trade deficits," he told attendees. "We've had a trade deficit for 40 years and we've gotten wealthier and wealthier. Nations with trade surpluses have gotten poorer." Nor is the loss of manufacturing jobs troubling to Vitner, who said that manufacturing employment is declining world-wide as a result of automation.

Finally, he addressed oil prices. "We'll have high oil prices for the rest of this business cycle," he predicted. "Then, in recession, they will come down. Demand will grow less rapidly, refining capacity will increase, and the prices will come down."

lessor to create the ability for pre-paid services to flow through the vendor; and a separate obligation for the lessee to pay the vendor.

Joe Lane believes captive lessors are in a unique position to experiment with bundling and other value adds. Because of their relationship with the

manufacturer and their knowledge of the equipment, "Captives have the ability to create new structures (such as "cost per copy," etc.) That is going to be very important moving forward," he said. **ELT**

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