Equipment Management Essentials





Industry pros highlight which segments to watch in 2017.






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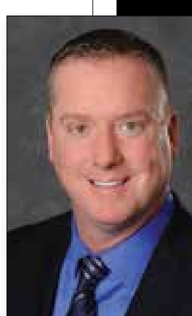
THINK ABOUT THE BLAZING PACE OF TECHNOLOGY, the gyrations of many large markets and the unknowns of a new presidential administration, and it doesn't take a savant to understand that skilled equipment management is vital to equipment finance. What *does* require serious smarts is the management itself: selecting and analyzing the most appropriate variables to help determine a company's equipment strategies.

"Over the last several years, globalization and regulation have made industries and collateral values much more volatile and difficult to predict," says Kevin Sensenbrenner, Senior Vice President and Head of Asset Management at Stonebriar Commercial Finance in Plano, Texas. "Markets can shift quickly, and having strong equipment management expertise to navigate these changes is very valuable to finance companies." Because equipment managers are involved in both offensive and defensive sides of the business, "We're critical to the development of sound investment practices and portfolio management, and in the planning and implementing of exit strategies," Sensenbrenner says.

"As the world gets more complex and there's more volatility in general, finance companies increasingly rely on equipment management experts to work their way through the more complicated transactions," adds Terese Kramer, Vice President of Equipment Management at BMO Harris Equipment Finance in Milwaukee. And because the competitive environment is robust with new players, "Lots of companies are going after a small set of transactions," she says. "It makes the equipment component more important than ever."



Sensenbrenner and Kramer are spot-on in their observations about growing complexity. Even the data available for just one aspect of equipment management—determining current equipment values—have increased exponentially in the last decade. "That information comes from market values published on the Internet and from technology embedded in new equipment that can transmit engine hours and operating conditions," says Wade Whitenburg, Strategic Accounts Manager, Finance & Insolvency at Ritchie Brothers in Cypress, Texas.

Access to data from embedded technology can also dramatically improve the quality of equipment maintenance. "But the challenge many companies face is managing the increased volume of data," Whitenburg says. "There's access to so much more data out there than ever before that the question becomes, can you make sense of it all?"

Adding more intricacy is the growing specialization of certain markets. "You can't simply conclude that the construction segment will grow," explains Kramer. "For instance, certain types of construction equipment used in oil and gas or mining didn't do well in 2016 and may have a slow recovery."

Kramer says the same principle applies to agricultural equipment. Machines used to harvest certain types of citrus fruit will likely be less valuable this year due to weather issues and a consumer movement away from some citrus products. But equipment used to harvest nuts and other fruits is expected to be in demand as consumption of these items rises. Says Kramer, "When you have competing dynamics occurring in markets, it behooves equipment managers to be able to understand the nuances."

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—**Kevin Sensenbrenner,** Stonebriar Commercial Finance

Forecasts for a Mixed 2017

Equipment managers who spoke for this story gave 2016 mixed reviews, some calling it "bumpy" while others described it as "intensely busy" and a great time to be in their profession. The same managers also vary in their outlooks for 2017, but generally expect equipment values to remain soft as assets released into the market over the last several years are absorbed.

Kim Esposito, Managing Director, Asset Management Services at Independent Equipment Company in Clearwater, Florida, says she expects this year to be "interesting," and points to the advancement of FinTech companies, or technology-based finance companies, some of which are partnering with large banks to fund business-equipment finance transactions. "Because of this, there may be a new mode of financing commercial equipment on the menu soon, followed by regulation to protect businesses and consumers," she says.

Esposito believes demographic shifts are likely to bring additional disruption to the industry as Baby Boomers retire en masse and a shortage of experienced replacements ensues. "With the anticipated future retirement waves, digitization of some processes within the industry may soon become necessary," she says.

Tom Hazelhurst, President of Machinery Management LLC, in South Elgin, Ill., says that new-equipment sales in the manufacturing-equipment market were expected to be down about 8% in 2016 from 2015. "Aggressive builder discounts are driving new machinery sales, and this discounting is having a negative impact on the value of used equipment," he says. Hazelhurst expects sales growth in this market to be flat in 2017.

Whitenburg sees growing pressure on renewable energy, which will negatively impact alternative-fuel vehicles. "Two-dollar-a-gallon gas doesn't make natural-gas vehicles very attractive," he says. "I think these markets will be dependent on government subsidies to be even marginally profitable." Wind and solar markets are also expected to suffer if tax credits end.

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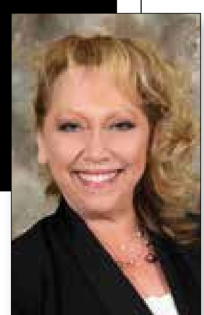


The Oil and Gas Impact

At the same time, however, equipment managers predict increasing stability in oil and gas markets—but little or no growth. "Current production continues to exceed our utilization rates," Whitenburg explains. "And production can be ramped up quickly if the need arises from either increased consumption or a supply source going off the grid."

In the past, long lag-times occurred—years, actually—between an increased need for oil and gas and the time it took to turn up production. "But today, because of new, recently identified reserves, fracking technology and other new efficiencies, production can come online in as little as 12 to 18 months," Whitenburg says.

Despite dramatic contractions in the oil and gas markets over the last three years, Whitenburg notes that spending on technology and improved recovery methods has continued—and even expanded. "This trend will continue," he says. "Even if oil stays at $40 per barrel—and I'm not suggesting that's where it will stabilize—the major players will find a way to be profitable at that level. They'll put their money into research and development until it's profitable for them to produce at that level."

Sensenbrenner, meanwhile, looks for absorption of now-idle construction and transportation equipment as oil and gas markets gain stability. "We're seeing businesses tied heavily to oil and gas infrastructure having to diversify and redeploy or sell assets to other markets, which takes time," he says. "But we're already seeing lower inventories and improvements in the more versatile asset classes impacted, such as wheel loaders, utility equipment, truck tractors and cranes."

Hazelhurst is not as confident about the values of manufacturing equipment used in energy. He's seeing a dramatic increase in repossessions and machine surrenders from the sector generally. "Machine builders who have a presence in this market have inventories they're willing to discount substantially to drive sales," he says. "This is having a negative impact on similar machines' used values."

Warming Markets

But energy markets don't influence all equipment values. Kramer expects fair stability across most sectors and foresees growth in specific segments of medical equipment, such as imaging and diagnostic devices, due to the continued aging of Baby Boomers. She also believes equipment used for food-processing and packaging will be in demand. "And in transportation, we see intermodal as a bright spot," she says. "We think that's a market to keep an eye on."

Both Sensenbrenner and Whitenburg look for increasing demand for well-spec'd cranes and other construction equipment that can be used to install new power lines, rebuild roads and bridges, and erect multi-story buildings. "Much of this equipment has been negatively impacted by a sluggish economy and the recent dramatic contraction within energy infrastructure activity," Sensenbrenner says. "A new administration targeting increases in infrastructure spending, along with stabilization within energy segments, should provide a much healthier climate for a wide range of construction and transportation sectors." The strong pace of "vertical" construction (large commercial buildings in downtown metropolitan areas) looks as though it will remain steady throughout 2017, adds Whitenburg.

Esposito will be watching to see if pharmaceutical equipment heats up. "New legislation to shorten FDA pharmaceutical trial periods is currently under bipartisan consideration," she says. "If passed, demand for pharmaceutical manufacturing and test equipment should increase." The biopharmaceutical industry may the lead the way, she adds, with test equipment for personalized medicines moving to the forefront. "Handheld ultrasound and other mobile and portable imaging systems may also continue to gain acceptance and move into the mainstream," she says, "and digital medical imaging equipment has all but rendered older systems obsolete."

Medical imaging equipment software licenses are proprietary, and most are not transferable. But the industry is dominated by original equipment manufacturer captives "who should continue to do very well in the future," Esposito says.

Also expected to do well soon are driverless trucks. Successful off-road, closed-track testing by Cummins, Daimler and Navistar indicates that these smart trucks will soon become common on the nation's highways. Last October, one such vehicle transported a load of Budweiser beer from Fort Collins, Colorado to Colorado Springs, two hours away. Says Esposito, "Potentially beginning in 2017 but certainly in the years following, the driverless truck fleet will become a hot item."

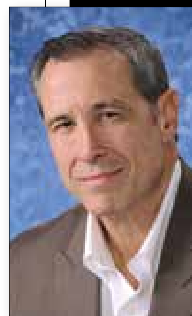
Hazelhurst looks for high-production, tier-one automotive manufacturers to remain busy supplying parts to OEMs (original equipment manufacturers). He joins Esposito and Kramer in thinking that segments of the medical market will also remain strong, and he expects aerospace to do well. Says Hazelhurst, "In general, manufacturing companies are optimistic about the impact of the new administration."

Regulation and Residuals

How government regulation will affect equipment management in 2017 is anyone's guess. "Across the board, regulation typically adds cost without adding value to the product delivered," says Whitenburg, "and it has been one of the biggest issues facing equipment managers."

But the environment could change dramatically under President Trump, and equipment managers will be watching. Kramer believes some of the heaviest requirements on energy production and clean air could be lifted, and Whitenburg thinks coal would be an excellent export commodity. But it's too soon to know how the political pendulum will swing, so the industry waits.

Hazelhurst says that as a service provider, his company has been affected by increased compliance requirements.



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—**Wade Whitenburg**, Ritchie Brothers

"More finance companies are requiring documented qualifications, higher levels of insurance, and a willingness [by their service providers] to have transactions audited," he says.

At Independent Equipment Company, they're already feeling the impact of the new lease-accounting rules. "The frequency of requests for portfolio reviews has increased, particularly from bank lessors," says Esposito. She anticipates a further acceleration in portfolio reviews as the new accounting rule-compliance deadline grows closer and leasing companies adjust their equipment holdings to comply with the new categories.

In the meantime, residual values hang in the balance. Esposito sees companies setting consistent residuals for equipment in stable markets. "But for other equipment, we're seeing much more conservative residuals than in the past—or companies are leaving entire sectors altogether," she says. An overwhelming change in residual positions has occurred "in equipment sectors operating in industries left decimated by the previous administration, such as rail, mining and energy," she says.

Hazelhurst sees residual values as a percentage of new equipment about the same now as in the past. "But the discounts being offered that affect original equipment cost lower the residual in dollars," he qualifies.

"We consider a host of factors when looking at setting residuals," says Kramer. "For example, we analyze the portfolio equipment mix and determine if we want to grow in a certain sector. We may be more aggressive than a competitor in this case. Or, if we have a large portion of certain types of equipment coming off lease, we will look for transactions that rebuild this section of the portfolio. Our appetite for asset risk will be influenced by these factors as well as how strong we think the secondary market will be in future years."

Sensenbrenner suggests a normalized and measured approach in setting residual values. "You need to plan for industry cycles and normalize your values," he says. "There is never a need to be aggressive in setting residuals. Having a balanced and measured valuation approach helps our risk analysis and lets us be opportunistic when appropriate." May 2017 be rife with opportunity. ■

Susan Hodges writes about equipment finance and other business topics from her office in Wilmette, Ill.