Look for an updated version of this article to be published by the Monitor in the March/April 2017 issue – co-authored by Jim Jackson and Bruce Kropschot.

M&A Activity Still Brisk: Are There Clouds on the Horizon?

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The GE Capital divestiture alone created a slew of M&A activity in 2015. The Alta Group's Bruce Kropschot recounts the M&A highlights of 2015 and examines the current seller's market. Due to economic slowdown, political uncertainty and a myriad of other potential adverse factors, Kropschot says gloomy days may be in store for 2016 M&A activity.

Merger and acquisition activity for equipment leasing and finance businesses continued to be very active in 2015. Of course, the big news was General Electric's April 2015 announcement that it would be divesting most of GE Capital's business units, and the sales of a number of these businesses that GE announced during the year. Though the GE divestitures attracted the most headlines, there were many other notable transactions affecting the equipment leasing and finance market in 2015. The year's M&A activity fell into the following categories:

- GE Capital divestitures
- Market entry acquisitions by small banks
- Market expansion by large banks
- New market investments by foreign companies
- Private equity investment
- Lift-out teams joining financial backers

Notable Transactions in 2015

GE has done a good job of expediting its divestiture plan. Of course, speed was important in order to minimize the risk of losing employees, customer relationships and vendor relationships. In October, GE announced that it agreed to sell GE Capital's global Commercial Distribution Finance, North American Vendor Finance and Corporate Finance platforms to Wells Fargo. The sale includes about $32 billion of assets and was completed on March 1. GE Capital completed the sale of its U.S. fleet services business to Element Financial in August. The sale of GE Railcar Services' owned fleet of railroad tank cars to Marmon Holdings/Union Tank Car was completed in September. The sale of the Transportation Finance unit to BMO Financial Group was completed in November, and the sale of the remaining railcar leasing business to Wells Fargo was completed in January.

Several small banks having assets less than $10 billion entered the equipment leasing and finance business in 2015 through acquisitions of small-ticket leasing companies, continuing the trend established in 2014. In 2015, Berkshire Hills Bancorp acquired Firestone Financial, which provides equipment financing for the amusement, vending, laundry and fitness industries. CBank acquired Commercial Industrial Finance, and State Bank and Trust Company acquired Patriot Capital, a provider of equipment financing to the retail petroleum industry.

Large banks also continued to be active acquirers of equipment finance businesses. As previously noted, Wells Fargo and BMO Financial Group acquired substantial businesses from GE Capital. Huntington Bancshares expanded further in the technology financing business by acquiring Macquarie Equipment Finance.

A number of foreign companies have been exploring the U.S. equipment finance market, and two notable transactions took place in 2015 in addition to Canadian-based BMO and Element acquiring GE Capital units. Australia's Macquarie Group, after selling its technology unit in the U.S., acquired a specialty vehicle financing business, Advantage Funding, from Japan's Marubeni Group. Also in 2015, major Japanese lessor Century Tokyo Leasing acquired a 35% equity interest in technology lessor CSI Leasing.

Private equity firms have had substantial new capital to invest, and several private equity firms have been active investors in the equipment leasing sector. In 2015, Aquiline Capital Partners, which had previous leasing investments in Tygris/US Express Leasing and CSI Leasing, acquired ENGS Commercial Finance, a vendor-based lessor and lender specializing in trucks and trailers.

Through the years, a number of successful equipment finance companies have launched thanks to teams of executives who left other organizations. They have obtained their financial support from private equity firms or sponsoring financial services companies that view such "lift-outs" as an alternative to acquiring an existing company. Two impressive organizations formed through lift-outs in 2015. A team of senior managers left AIG Commercial Equipment Finance to join bank holding company Wintrust Financial Corporation in forming Wintrust Commercial Finance. Another seasoned management team formed Stonebriar Commercial Finance with the backing of Security Benefit Corporation, an insurance business owned by investment firm Guggenheim Partners.

The Current M&A Market

After the decline in merger and acquisition activity that occurred during the financial crisis and great recession, interest in equipment finance acquisitions increased considerably in 2014 and 2015. Several transactions were announced in early 2016, and we know of other transactions that will likely be completed in the coming months. Most of the sellers are independent equipment leasing and finance companies. The owners of these companies have decided that the strong M&A market, coupled with favorable financial results, makes this an opportune time to monetize their investment.

Banks continue to be the most aggressive buyers of equipment finance businesses. Many banks have high liquidity due to weak loan demand, so they are looking for opportunities to add assets. Banks have the lowest cost of funds and can provide the greatest leverage, which often enables them to justify higher valuations than non-bank acquirers. As previously noted, several smaller banks with assets under $10 billion have entered the equipment finance market through acquisitions in the past two years. A number of other banks of this size are currently exploring acquisition opportunities.

We are seeing mid-sized and large independent leasing companies that are interested in making acquisitions in new markets. The equipment finance market is also attracting more attention from private equity firms, some of which see small ticket leasing as complementary to their fintech investment strategy. Although private equity firms are generally at a disadvantage regarding cost of funds, they may offer terms that can be more attractive to independent leasing company owners, including retention of a minority interest in the business and/ or potentially lucrative earn-out arrangements.

With a dwindling supply of attractive independent equipment finance companies, and strong demand from a variety of interested buyers, valuations continue to be high. Thanks to these conditions, early 2016 has continued to be a seller's market.

Looking into the Future

Since economic factors and business confidence levels heavily influence M&A activity, the following potential negative events could result in reduced demand for acquisitions of equipment finance companies and a reduction in valuations:

- A slowdown in the economy
- Reduction in capital equipment investment
- Rising interest rates
- Stock market declines
- Reduced price/earnings multiples of finance companies and banks
- Uncertainty over the presidential election
- Increased regulatory pressure and reduced liquidity in the banking sector
- Reduction in profitability of equipment finance businesses
- Increased credit losses for equipment finance businesses

We have seen a declining stock market in early 2016, and there are concerns that the economy is not growing as fast as expected. The general outlook for economic activity, measured by the Equipment Leasing & Finance Foundation's Monthly Confidence Index, dropped to an index level of 48.3 in February 2016 as compared to 60.2 only two months earlier and a four-year high of 72.1 in March 2015. The February 2016 confidence index level was the lowest since September 2011.

While M&A activity for equipment finance companies continues to be brisk in early 2016, there are a number of potential clouds on the horizon that may adversely impact M&A activity and valuations before the year is over. m

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