Active M&A Cycle Continues:
Strategies to Improve the Chances of Completing a Transaction

BY BRUCE KROPSCHOT & JAMES JACKSON

The Alta Group's Bruce Kropschot and James Jackson provide an update on M&A activity in the equipment finance industry and an outlook for 2017. They offer strategies for sellers and buyers to move a transaction from a letter of intent to a successful closing.

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A strengthening economy and generally favorable financial results in 2016 helped continue the very active M&A market that the leasing and finance industry has experienced in recent years. Sellers in 2016 were principally motivated by a change in the strategic focus of parent companies and, in the cases of independent leasing companies, the desire to sell while valuations remained relatively high.

Notable 2016 Sales

In April 2015, General Electric announced it would be divesting most of GE Capital's business units. After a flurry of sales in 2015, GE completed sales to Wells Fargo in early 2016 of its global Commercial Distribution Finance, North American Vendor Finance and Corporate Finance platforms and the remaining railcar leasing business. CIT also continued a strategic restructuring in 2016, selling its Canadian equipment finance business and signing a definitive agreement in October to sell its commercial aircraft leasing business.

Other transactions in 2016 included the sale of NewStar Financial's equipment finance division to Radius Bank, Pacific Western Bank's equipment finance business to BofI Federal Bank and Banc of California's equipment finance division to Hanmi Bank. In December, Icahn Enterprises agreed to sell American Railcar Leasing to a unit of Sumitomo Mitsui Banking Corporation.

Sales of independents in 2016 demonstrated the continued interest of private equity firms. PE-controlled Navitas Credit acquired Liberty Financial Group, and PE firm Atalaya Capital Management acquired CG Commercial Finance. PE-controlled ENGS Commercial Finance purchased Connext Financial, an independent which also served as a captive for its majority owner. PE firm Warburg Pincus acquired one of the largest and fastest-growing independents, Ascentium Capital. Another notable transaction was Hitachi Capital America's purchase of independent Creekridge Capital.

Acquisitions of two banks with substantial equipment leasing and finance units — TIAA's acquisition of EverBank and TD Bank's purchase of Scottrade Bank — were

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As 2016 ended, a number of equipment leasing and finance companies were going through a sale process, several of which were under letters of intent. Thus, indications remain favorable for considerable leasing company M&A activity during the first half of 2017.

M&As in US Equipment Leasing and Finance

A Look at Select Deals in 2016

ACQUIRER	TARGET	CLOSING
CORPORATE RESTRUCTURINGS		
Wells Fargo	GE Capital businesses (Commercial Distribution Finance, North American Vendor Finance, Corporate Finance, remaining railcar leasing business)	First Quarter
BofI Federal Bank	Pacific Western Equipment Finance (certain assets)	March
Hanmi Bank	Banc of California (Commercial Specialty Finance Unit)	October
Radius Bank	NewStar Financial (equipment finance division)	December
Avolon Holdings Ltd.	CIT Group (commercial aircraft leasing)	Pending
Sumitomo Mitsui Banking	American Railcar Leasing (owned by Icahn Enterprises)	Pending
PRIVATE EQUITY PLAYS FOR INDEPENDENTS		
ACQUIRER	**TARGET**	**CLOSING**
Navitas Credit Corp.	Liberty Financial Group, Inc.	January
Atalaya Capital Management	CG Commercial Finance	July
Engs Commercial Finance Co	Connext Financial, Ltd.	September
Warburg Pincus (Funds affiliated with the firm)	Ascentium Capital	November
OTHER INDEPENDENTS SOLD		
ACQUIRER	**TARGET**	**CLOSING**
Hitachi Capital America	Creekridge Capital	June

Source: The Alta Group thealtagroup.com

announced in 2016 with completion expected in 2017.

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The Current Market

The M&A market, like the stock market, is very cyclical. In periods of high business confidence and optimism for the future, valuations can become very high. Conversely, if business conditions and/or stock market levels deteriorate, valuations can plummet, even for companies that have outstanding financial results and prospects. We have been arranging the purchase and sale of equipment leasing companies for 31 years, and this is one of the best periods we have seen for M&A valuations. Of course, a contributing factor has been the pent-up demand from buyers and sellers after the relatively quiet period for M&A during the financial crisis and Great Recession.

We are cautiously optimistic that this robust M&A market will continue in 2017. The following are some factors that could positively affect acquisition valuations this year:

- The Equipment Leasing & Finance Foundation's Monthly Confidence Index hit an all-time high in early 2017.
- The stock market reacted positively to the election of President Donald Trump.
- The new administration stated a desire to reduce income taxes and regulations on U.S. businesses.
- Banks, private equity firms, other leasing companies and diversified financial service companies continue to be interested in acquiring equipment leasing and finance companies.
- Competition has increased for acquisition candidates due to the limited number of high quality independent equipment leasing companies available for sale.

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Strategies for Successful Transactions

The Alta Group has seen many sales progress smoothly from initial discussions to letters of intent to successful closings. > >

However, it has also seen some situations where difficulties arose because the buyer or seller did not follow recommended strategies.

While purchase price is often a key factor in selecting the most attractive buyer, it is important to dig deeper. Will the buyer and seller have a successful closing? Will both benefit from the relationship? One of the most important factors to understand is the cultural fit between the prospective buyer and seller. The management teams of many independent leasing companies are often successful because they are able to operate in an entrepreneurial environment and make decisions quickly without a great deal of bureaucracy. Sellers must determine what type of operating environment they will be subject to after a sale. Who will they report to? Which regulatory restrictions will they face? How will policies and procedures change under new ownership, including management decisions, credit quality standards, pricing requirements, lease documentation and residual setting guidelines?

Advice for Sellers

Ideally, a seller will prepare the company well in advance of the proposed sale date. Fortunately, activities a seller performs to make the company more attractive to potential buyers also lead to more profitability and success.

Sellers should recruit and retain strong, experienced senior management teams with one or more members designated as a potential successor to the company owner or president. Management teams that have demonstrated success through both good and bad economic cycles create additional value, and identifying a successor assures a potential buyer that performance will not be impaired if the current owner decides to resign shortly after closing the sale.

Companies that show consistent year-over-year growth in originations and profitability for the periods just prior to the proposed sale will command a higher premium and improve the chances for a successful closing. Having financial statements audited by a reputable CPA firm and being able to demonstrate that the financial statements were prepared using conservative accounting, residual values and credit policies gives a buyer additional evidence that the financial information provided is accurate.

A seller should be able to provide a potential buyer with past and current portfolio performance statistics and trends with respect to delinquencies and charge-offs — particularly companies that sell most or all of their originations to a third-party funding source. To validate its credit standards in these cases, a seller must ensure that funding sources can provide frequent and consistent reports on the payment performance and quality of the originations.

A seller will often have greater success in closing a transaction if it accepts a portion of the sales proceeds in the form of an "earn-out" structure based on the seller achieving certain financial goals and objectives after the sale. These targets are usually determined up front to provide buyers with some price protection if the seller fails to achieve its economic projections after the sale. This can also be an upside for the seller if it meets or exceeds the targets.

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Differentiated products or services always make a seller more attractive as it's both difficult for customers or vendors to exit the relationship and for other equipment finance companies to replicate. This helps to prevent competing strictly on the basis of price or service levels and creates brand loyalty.

Advice for Buyers

A buyer that can offer significant value beyond the purchase price has a distinct advantage. The potential acquirer should articulate why it wants to invest in the space, have knowledge of the industry and a long-term commitment to the investment. If possible, a buyer should also point to similar prior investments that demonstrate past successes.

Other benefits that a potential buyer can highlight in negotiations include its willingness to provide the seller with a lower cost of capital; additional support for tax, accounting, human resources, legal or other services and additional investments to improve the technology platform, business development opportunities or marketing efforts.

The buyer should also determine ways to expand the business in a meaningful way. A buyer will be in a better bargaining position if it has relationships that could benefit the seller and is willing to make business introductions, thereby opening access to new customers, new equipment segments, new financial product types or other business opportunities.

During the sale process, the buyer must communicate the likelihood of closing the transaction quickly and efficiently. Having cash on hand with the need for additional financing improves the chances for a successful closing. Even in cases where financing is required, a buyer with ability to demonstrate an efficient process for obtaining approval for the transaction or due diligence will have distinct advantages.

We advise both potential buyers and sellers to enter the process with a well-thought-out plan to increase the chances for success. Committing to a sale process is an expensive proposition for buyers and sellers in terms of time, capital, resources and opportunity costs. It is difficult for sellers to focus attention on both the sale process and the day-to-day operations of the business, and it is difficult for buyers to invest heavily in a process that may not have a successful outcome. To improve the chances of a successful closing, buyers and sellers must position themselves actively. m

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