M&A ACTIVITY REMAINS ROBUST: QUALITY INDEPENDENTS STAY IN DEMAND

BY **BRUCE KROPSCHOT** AND **JAMES JACKSON**

M&A activity has remained robust since 2015, and 2019 is looking like another active year, despite the tightening market for independent equipment leasing and finance companies. Presenting a general overview of the M&A sector, The Alta Group's Bruce Kropschot and James Jackson examine 2018's major transactions, take stock of the current market and make some predictions for the future.

Strong interest in mergers and acquisitions of equipment leasing and finance companies continued during 2018, extending a robust cycle of activity that dates back to 2015, when the GE Capital divesture created a number of significant transactions for opportunistic buyers. Many buyers in 2018 were motivated by the opportunity to obtain additional growth and profitability through quality acquisitions. Many sellers were interested in entering the market while valuation multiples were still high.

We anticipate this trend will continue during 2019, though the number of sizable independent leasing companies remaining is shrinking, limiting the supply of acquisition targets for acquirers. Sellers also face the uncertainty of knowing that, at some point, the favorable valuation cycle will end. This should encourage them to participate in the current market to increase their chances of a successful transaction.

NOTABLE RECENT TRANSACTIONS

Banks continue to be active acquirers and were parties to a number of recent transactions.

United Community Banks acquired NLFC Holdings (Navitas Credit Corp.) in January 2018 for an estimated $130 million in stock and cash. In April 2018, Sterling Bancorp acquired Advantage Funding Management, a specialty vehicle finance company that was owned by Macquarie. Peoples United Bank has also been active in the market, acquiring Vend Lease in July 2018 and VAR Technology Finance in January 2019, though both Vend Lease and VAR will retain their brands and operate under LEAF Commercial Capital, another acquisition that the bank consummated in July 2017. Marlin Business Services Corporation, which owns a bank, acquired Fleet Financing Resources, a specialty vehicle finance company, in September 2018.*

Japanese firms have also been active investors in the equipment finance market with the acquisition of ENGS Commercial Finance by Mitsubishi UFJ Lease and Finance in October 2018. Orix USA acquired NXT Capital, a middle market commercial finance company, in August 2018. In addition, Fuyo General Lease Company made a significant investment in Pacific Rim Capital, an equipment leasing company focused on the material handling equipment market, in January 2019.*

Wafra Capital Partners, an experienced investor in the equipment finance industry, acquired North Mill Equipment Finance in August 2018. Recently formed Verdant Commercial Capital, backed by a family office, bought Intech Funding Coporation in June 2018,* and alternative lender National Funding Inc. acquired Quick Bridge Funding in October 2018.

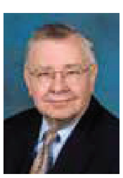
THE CURRENT MARKET

Based on the level of activity at the beginning of 2019, Alta has reason to expect another good year for M&A transactions. Several attractive companies are currently considering a sale or are being offered for sale, and a number of qualified buyers continue to show interest in acquiring quality finance companies. The strength of the M&A market is subject to economic cycles and business confidence levels. Despite some distant rumbles, most economic indicators remain positive, and there is a general feeling on the part of business leaders as well as economists that economic growth will continue through most if not all of 2019.

Company valuations and the level of M&A interest could be influenced by a number of factors during 2019. These factors are generally consistent with business confidence and include, but are not limited to, the following:

- Interest rates
- Stock market trends
- Unemployment rates
- Liquidity and access to credit
- Portfolio quality
- Political uncertainty

Interest rates are one of the most influential factors affecting company valuations and the level of M&A activity. When interest rates rise, acquirers must also increase their hurdle rates on acceptable investments, which generally results in lower acquisition values and fewer successful transactions. While the federal funds rate increased consistently during 2017 and 2018 as the U.S. economy grew, Federal Reserve Chairman Jerome Powell announced in January 2019 that the committee would be patient in its determination of what future adjustments to target rates might be appropriate in light of global economic financial developments and muted inflationary pressures. This was good news for potential buyers and sellers as many had expected interest rate increases throughout 2019. The decision helped calm investors and played a significant role in increasing stock market valuations, which had been priced with anticipated 2019 interest rate increases. Since the valuations of privately owned equipment leasing and finance companies are highly influenced by the price/earnings multiples for publicly-owned companies, this has a very positive impact on the level of expected M&A activity for 2019.



BRUCE KROPSCHOT
Senior Managing Director
The Alta Group

JAMES JACKSON
Managing Director/ Leader, M&A Advisory
The Alta Group

US M&A Notable Recent Transactions

DATE	ACQUIRER / INVESTOR	TARGET
JAPANESE INVESTMENT		
Aug 2018	Orix USA	NXT Capital
Oct 2018	Mitsubishi UFJ	Engs Commercial Finance
Jan 2019	Fuyo General Lease Co. Ltd.	Pacific Rim Capital
ALTERNATIVE FUNDING		
Oct 2018	National Funding, Inc.	Quick Bridge Funding, LLC
PRIVATE EQUITY INTEREST		
Jun 2018	Verdant Commercial Capital	Intech Funding Corp.
Aug 2018	Wafra Capital Partners	North Mill Equipment Finance
BANKS AND STRATEGIC INTEREST		
Jan 2018	United Community Banks	NLFC – Navitas Credit Corp.
Apr 2018	Sterling Bancorp	Advantage Funding Management
Jul 2018	Peoples United Bank	Vend Lease Company
Sep 2018	Marlin Business Services Corp.	Fleet Financing Resources, LLC
Jan 2019	Peoples United Bank	VAR Technology Finance

© 2019 The Alta Group, LLC

It should be noted, however, that the economic factors that influenced the Fed's decision to maintain the federal funds rate in January — including the government shutdown, ongoing trade discussions and the impacts and uncertainly associated with Brexit — can also have a detrimental impact to stock market values and M&A activity.

Another factor that could influence M&A activity is business leaders' perceptions of current and future business conditions in the industry. The Equipment Leasing & Finance Foundation's 24-month confidence index for the equipment finance industry stood at a 24-month low of 53.4 in January 2019. The index improved slightly in February 2019 to 56.7 but was significantly lower than the 75.3 recorded in January 2018. This index, which is designed to reflect a qualitative assessment of industry leaders' perceptions of current and future business conditions, has been generally declining over the past year. This may suggest that the strong M&A cycle is in its later stages.

QUALITY INDEPENDENTS GENERALLY OPEN TO AN ACQUISITION

Consistent throughout Alta's many years of providing M&A advisory services, the majority of equipment leasing and finance company sales have involved independent companies. One important factor has been competitive pressure, particularly from banks that have a lower cost of funds and are increasing their penetration of the equipment finance market. Also, many successful independent companies reach a point where they need more equity to expand. Often the only viable alternatives for such a company to obtain needed capital are to sell the business to a larger entity or to seek an investment from a private equity firm.

Many independent equipment leasing and finance companies are owned by the entrepreneurs who founded them. These owners usually have the majority of their net worth tied up in this illiquid investment, and eventually thoughts of retirement, estate planning, diversification of investments, health considerations or a change in lifestyle leads them to consider a sale of the business. The active acquisition market has enabled many of these entrepreneurs to convert their investment to cash and enjoy the fruits of their labor.

Valuations are also influenced by simple economics, including the available supply and demand for quality equipment finance companies. Many of the larger and more successful independent equipment leasing and finance companies have been sold in recent years. Referring to the *Monitor*'s annual lists of top private independent companies ranked by new business volume, five of the top eight companies on the 2007 list, four of the top seven companies on the 2010 list and seven of the top 11 companies on the 2014 list have been sold. On the list published in 2018, #4 ENGS Commercial Finance was sold in 2018 and #13 VAR Technology Finance was sold in January 2019. The resulting shortage of sizable quality independents available for sale generally increases demand for the remaining companies and their resulting valuations.

Excess liquidity in the market combined with generally strong portfolio performance over the past several years has led to continued margin compression throughout the industry. This has created a need for many independents that do not have access to ample low-cost capital to syndicate or sell off a portion of their originations or even exit certain high credit quality, thinly priced customer relationships, resulting in lower profitability and decreased market share. Many of these independents see a significant opportunity for growth if they were provided access to low cost capital, allowing them to hold more assets on balance sheet and expand their offering to high quality credits at market competitive rates.

Advances in technology are changing rapidly and the technology platforms required to provide an easy-to-use, customer-focused equipment financing platform and servicing environment represent a significant upfront and ongoing investment. The costs to implement and maintain these platforms can be prohibitive for some independents. Successful implementations also require a significant time commitment that some independents cannot afford. As such, many independents see a significant advantage to being acquired by a larger organization that either already has access to a quality technology platform or can provide assistance in the costs and development of one.

SUMMARY AND CONCLUSION

Current levels of M&A activity and future economic indicators generally point to another successful year of acquisition activity in 2019. Barring the occurrence of the potential risks outlined earlier in this article, we expect the M&A market to remain active during 2019 and for valuations of quality equipment finance companies to remain strong.

The decision for a company to remain independent or to seek a larger acquirer is an important one. Independents must continue to focus on the business and economic environment to determine when the benefits of being part of a larger organization outweigh the freedoms and flexibility of remaining an independent. •

**The Alta Group initiated these transactions and was the exclusive financial advisor to one of the parties listed.*

BRUCE KROPSCHOT IS SENIOR MANAGING DIRECTOR OF THE ALTA GROUP. HE HAS PROVIDED M&A ADVISORY SERVICES FOR 33 YEARS AND HAS BEEN ACTIVE IN THE EQUIPMENT LEASING INDUSTRY SINCE 1972, HAVING SERVED AS A SENIOR EXECUTIVE WITH THREE LARGE EQUIPMENT LEASING COMPANIES.

JAMES JACKSON IS A MANAGING DIRECTOR AND LEADER OF THE MERGER AND ACQUISITION ADVISORY PRACTICE OF THE ALTA GROUP. JACKSON HAS OVER 30 YEARS OF EXPERIENCE IN THE EQUIPMENT LEASING AND FINANCE INDUSTRY AND HAS SERVED AS A SENIOR FINANCIAL EXECUTIVE AT MICROFINANCIAL/TIMEPAYMENT, DEUTSCHE FINANCIAL SERVICES, AT&T CAPITAL – LEASING SERVICES AND SIGNAL CAPITAL