"WHAT'S HOT, WHAT'S NOT IN
EQUIPMENT LEASING FOR 2006"
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In late December of 2005, Independent Equipment Company ("IEC"), with the assistance of the Equipment Leasing Association ("ELA"), conducted a confidential `internet survey of approximately 400 equipment managers and consultants throughout the United States, regarding what's hot and what's not in equipment leasing for 2006. The results were tabulated in January. A total of eighty-two (82) responses were received, of which 60% were lessors, 6% were asset based lenders, and 34% were service providers.

COMPOSITION OF RESPONDENTS

Lessors reported that they added the following amounts of equipment to their portfolios in 2005: 16% added up to $10 million; 10% added $10 to $20 million; 2% added $20 to $50 million; 14% added $50 to $100 million; 22% added $100 to $500 million; 14% added $500 million to $1 billion; 10% added $1 to $3 billion; and 12% added over $3 billion. Thus, this survey was heavily influenced by the 72% of lessors who added $50 million or more of equipment to their portfolios in 2005.

SURVEY RESULTS AND FUTURE LEASING BUSINESS VOLUME

This survey consisted of six questions. One of the most important was Question VI(B), which asked, "Total dollar amount (volume) of business per specific equipment type *expected* to be booked by your firm, (in the future) 2006 compared to 2005?" Respondents were simply asked to "click" on either the "increase," "about the same," or "decrease" box for any of the 15 equipment types of which they were knowledgeable.

Total responses for each equipment type were then converted into the percentage of "increase," "about the same," and "decrease," with the final score representing the net difference between percentage increase (+) and decrease (-) for each type. **Chart I** illustrates the results of the 15 equipment types surveyed. Medical equipment scored the highest (+75), closely followed by construction equipment (+69), then truck/trailer (+55). However, lessors also expect to be gearing up in oil/gas/energy (+50), machine tools (+42), marine/intercoastal (+36), and aircraft (+34). On the other hand, FF&E (furniture, fixtures, and equipment) (-16), is not expected to fare well.
In comparison to past years, a response of about +20% or greater indicates a strong preference for adding equipment to the portfolio over the coming year, while a response

of -20% or greater indicates a strong preference for not adding a specific type of equipment to the portfolio over the same period. **Chart I** shows there is a strong preference for adding 11 of the 15 types of equipment (the same number as last year), while none showed a strong preference for not adding (also the same as last year). Thus, this part of the survey shows a solid outlook and preference to add volume among most equipment types during 2006.

Using the same scoring methodology, Question VI (A) asked, "The total (current) amount of business (volume) booked by your firm per specific equipment type as of year end 2005 versus 2004?" The responses to this question, illustrated in **Chart II**, indicate that for 2005 the leasing industry had a strong preference for nine equipment types (a slight increase from eight types in last year's survey), a moderate preference for two types (the same number as last year's survey), and little or no preference for four types (a slight decrease from five types in last year's survey). This reflects a continued change in industry fundamentals from decidedly pessimistic and contracting three years ago, to optimistic and growth-oriented today.

CHANGES IN RESIDUAL ASSUMPTIONS IMPROVED AGAIN

Finally, Question VI (C) asked for "Change in the amount of residual value assumed this year (increase/decrease) per specific equipment type in comparison to last year." The results found on **Chart III** show that optimism and increased competition have returned. In this year's survey, lessors increased residuals for nine equipment types; did not change residuals for one type; and reduced residuals for five types. This represents an improvement over last year's survey, which showed lessors had increased residuals for eight equipment types (while the year before that, five equipment types increased, following a year in which *none* of the 15 equipment types recorded an increase in the amount of residual value assumed). Thus, it is clear that the industry has changed from its very conservative approach to booking residuals found three years ago. Overall, on a net basis, a very high 50 percent of respondents increased oil/gas/energy residuals, 26 to 29 percent of respondents increased residuals for truck/trailer, construction equipment, and machine tools; while on the other hand, 17 to 24 percent of respondents lowered residuals for FF&E, plastics equipment, printing, and automobiles, and 32 percent of respondents lowered residual values for telecom equipment. Thus, this year's level of overall results ! both positive and negative ! are slightly weaker than last year's scores (not withstanding oil/gas/energy). This shows that while the leasing industry is still very optimistic, it is becoming a bit more conservative in its residual value assumptions. Also, note that positive results (increases) in residual positions, taken together with positive results of 20% or more in the survey's Future Business Volume section, indicate a strong willingness (or if negative, a lack thereof) on a lessor's part to aggressively seek (or avoid) business within certain equipment types. This year's survey shows a strong willingness to seek business. Specifically, four equipment types showed very positive results (oil/gas/energy, truck/trailer, construction, and machine tools), while only three types (printing, automobiles, and telecom) showed very negative results. This once again shows that the equipment leasing industry is becoming more optimistic and competitive in booking transactions.

MOST AND LEAST FAVORABLE FUTURE EQUIPMENT LEASING OPPORTUNITIES

For correlation purposes, additional questions were asked and a weighted approach to scoring the survey was used (*i.e.*, Questions III and IV), versus the previously discussed unweighted approach (*i.e.*, Question VI). Questions III and IV asked respondents to pick only the *three* best and worst future equipment leasing opportunities (in order, 1 through 3) by specific equipment type.

The results for each equipment type were weighted by assigning a numerical weighting (multiplier) to each 'place' selected, whether positive or negative. For example, a first place vote was assigned five (5) points, a second place vote three (3) points, and a third place vote one (1) point. A score was tabulated for each equipment category by multiplying the actual number of votes for each place by their respective multipliers (+ or -), then adding the total. A final weighted equipment score (net weighted score) was determined by calculating the difference between each equipment type's total positive and negative weighted scores. Note, the weighted results, (see **Chart IV**), show an excellent correlation with the unweighted results, (see **Chart I**), in that the order of equipment types ! best to worst ! is very similar in both approaches (weighted/ unweighted). This lends support to the survey's findings.

The weighted scoring approach amplifies how strong a preference is for a specific type of equipment -- whether positive or negative. The results show that the respondents felt that strong (positive) future equipment leasing opportunities would exist in the construction (+113), truck/trailer (+81), medical equipment (+61), oil/gas/energy (+37), and rail (+23) sectors, while being greatly diminished in the plastic equipment (-26), printing (-31), FF&E (-49), telecom (-57), high-tech/computer (-64), and automobile (-105) sectors. It is interesting to note that this year saw a record high (Construction +113), and a record low (Automobile -105) in the weighted scoring. Thus, respondents have the strongest preference for construction equipment as representing the best future leasing opportunity (in the history of the survey), while identifying the automobile sector as having the worst future leasing opportunity (in the history of the survey). In general, these results indicate that leasing companies are becoming more selective regarding which equipment types to focus their future business development on.

FINAL OVERALL RANKING

Finally, a combined overall score was tabulated by adding each equipment type's place (rank) for survey Question VI -- the amount of future leasing volume - unweighted, and Questions III and IV -- the best and worst future equipment leasing opportunities - weighted. The combined results, shown in **Chart V**, indicate for the third year in a row there is a very strong preference for construction equipment, medical, and truck/trailer -- all having excellent scores, followed by oil/gas/energy, marine/intercoastal, rail, machine tools, aircraft, and container/chassis; while on the other hand, printing, plastics equipment, high-tech/computer, telecom, FF&E, and automobiles had poor showings. The lower the numeric score, the better the ranking. For instance, aircraft, which has a combined score of 16, indicates an average of eighth place in the two future leasing business opportunity questions (weighted and unweighted). Similarly, the automobile score of 29 indicates an average of 142 place (out of 15 possible) for the same two questions.

LEASED EQUIPMENT TYPE PREFERENCE

Table I shows a comparison between the overall results of the 2006 and 2005 surveys, in order to determine trends (preferences) in leasing towards ("+"), or away from ("-") particular equipment types over the past year. Once again, the overall combined scores taken from the final rankings for each year were used. The lower the score the better, and the larger the year-over-year difference, the greater the trend towards ("+") or away ("-"). In comparing the two surveys, the equipment leasing industry's perception of aircraft (+10), and oil/gas/energy equipment (+8), improved greatly over the past year; while preferences for machine tools (-7), and high-tech/computer (-10) fell significantly since the 2005 survey. It is interesting to note that in last year's survey, aircraft and oil/gas/energy were among the equipment types that fell the most year-over-year, while this year, they are among the most improved. Overall this year, construction equipment finished first for the third consecutive year with a combined score of 3, and thus showed a continued high level of preference. Medical equipment came in second place, with a three-point improvement over last year's third place showing; while truck/trailer finished in third place, falling by 2 points from last year's second-place finish. Also, oil/gas/energy rounded out the top four with an 8 point improvement over last year's seventh-place finish. Thus, the most solid improvement came from the oil/gas/energy sector whose overall score increased by +8 points, and also registered the largest increase in residual value position score (+50). It appears equipment managers feel that prices in the energy market will remain at high levels for some time. However, aircraft showed the greatest overall improvement as its score improved by +10 points.

The perception seems to be that the airline industry is nearing the end of its reorganization phase, and with improving balance sheets, is now able to provide support for equipment values and lease rates. On the negative side, high-tech/computer plunged by ten points year-over-year, most likely due to several recent IT scandals and ever narrowing margins, while machine tools fell seven points year-over-year, probably affected by the weakened financial health of the nation's automakers and suppliers.

DESIRABILITY CONCLUSIONS

Based on the 2006 survey results, equipment managers and leasing companies remain optimistic in their outlooks, as competition grows for business related to most equipment types.

Specifically, construction equipment finished in first place again for the third consecutive year. This ranking may be related to the perception that relatively low interest rates advantageous to the construction industry will continue throughout the year, while the re-authorized TEA21 bill, now called 'SAFETEA-LU' guarantees funding for ever increasing construction awards, and creates additional demand for equipment. Also, it is clear that this type of equipment is rugged and durable, not subject to rapid changes in technology, which tends to benefit leasing companies during downturns. For example, if construction equipment was returned to a lessor during an economic downturn and could not be immediately sold, it could be held and sold at a later date after the market had 'turned around,' which is not the case for high-tech equipment. Construction equipment also received the third-best change (increase) in residual position (+28), after receiving the number one rank last year, which again seems to confirm its number one ranking. Medical equipment finished in second place, showing a +3 improvement of score from last year. This highlights the industry's preference for leasing medical equipment, which seems to go unabated, and continues to be driven by favorable demographics linked to the "baby boomer" generation. Also, primary (new) market sales continue to grow at rates of around 8% to 10% per year, with over half of all major medical imaging equipment presently being leased. Truck/trailer likewise had a very strong showing, finishing third overall, with a score of 5, which is 2 higher than last year's score, which resulted in a first-place tie at that time. This sector logged the second-highest positive change (+29) in residual position. This high ranking is believed related to the perception that there will be a solid domestic economy in 2006 which will yield a strong demand for truck/trailer equipment throughout the year. Sales of Class 8 equipment in 2005 totaled the second highest ever. Furthermore, operators' reluctance to purchase "low-emission" (EPA) engines that will be mandated for 2007, will help "front load" demand during a potential record-setting 2006.

Next, Oil/Gas/Energy finished fourth this year, with the second largest year-over-year increase in popularity (+8). This is probably in response to the rig count increasing by 320, to a record high. In addition, oil refineries were operating at near 100% capacity; but global power generation equipment sales were flat, after increasing by 17% in 2004.

Marine/intercoastal finished fifth this year, with an improvement of 4 points over last year's score, when it finished in a tie for seventh-place. This high ranking is believed related to the industry's red-hot market for new equipment, and "sizzling" secondary market, wherein many five-year-old vessels are still selling for over 100% of cost new. In addition, used intercoastal and off-shore equipment has also shown tremendous gains in demand and values. Next, rail equipment finished in sixth place, which was a slight decline from its fifth place showing last year. Lessors remain optimistic about the continued strong carloading and intermodal statistics, and the sharp turnaround in the secondary market, which over the past two years has begun to provide support for residual positions maturing in the near-term. In addition, respondents also confirmed their positive outlook by increasing assumed residuals (+13).

Machine tools finished in seventh place this year, having fallen three places since last year. This, along with the (-7) year-over-year decline in total score, indicates a decrease in lessor popularity for this equipment type. However, respondents interestingly increased residual value positions the fourth most of any type (+26), showing support for the equipment type, albeit at a lower level. It is believed this decline in popularity can be traced back to several significant equipment returns related to automobile industry supplier bankruptcies. Aircraft, which finished tied for 12th place last year, showed a solid improvement, finishing in eight place this year, with a year-over-year 10 point improvement in score. This may be related to lessors' perception that the worst now could be over for the airline industry, as many of the domestic carriers have reorganized, cut expenses, and right-sized their fleets while under bankruptcy protection. In addition, the secondary market for aircraft and engines improved, which has provided support for near-term residual value positions, as confirmed in the residual value portion of this year's survey.

Next, the container/chassis segment showed a slight decline in popularity (-1) from last year's survey. This seems to be related to a 21% decline in new container sales, severe manufacturing over-capacity, and declines in new and used equipment prices. However, survey participants increased residual values for container/chassis by +9, which shows continued, but not growing, support for this equipment type.

Printing equipment showed no improvement in score from last year. This is believed to be linked to the 3.3% decline in printing shipments during 2005, and an equipment utilization rate of 75%. However, this equipment market has finally turned around, with prices firmer, on both the primary and secondary markets. Lessors have also showed a loss of confidence in this sector by lowering residual values related to printing equipment the third most of any type (-22), thus providing themselves with a cushion in case their underlying assumptions are wrong.

Plastics equipment experienced a moderate decline in popularity (-5) over last year's score. This decline is believed to be linked to the perception that although this equipment market has finally bottomed and turned around, its overall size has been greatly reduced, due to off-shore moves by many companies who use this type of equipment. In addition, residual values for plastic equipment fell the fourth most of any type (-18). Next, high-tech/ computer declined sharply in popularity from last year, falling (-10). This steep decline is believed to be related to the feeling that much of business has already purchased new computers which will take them through the next cycle. In addition, prices for new desktop and laptops continue to fall every year, creating extreme pressure on residual values.

Finally, telecom, FF&E, and automobiles finished at the bottom of this year's survey, just as they did last year. Telecom finished in third to last place, with an overall improvement of +1 from last year's score. Even though the industry logged its second increase in equipment sales (+2.9%) since 2001, this segment continues to present little opportunity for growth over the near-term or in residual realization. In addition, lessor support appears so weak for this sector that respondents lowered residuals for telecom the most of any equipment type (-32). Part of this industry has been affected by new rules which have, in effect, reversed the 1996 Telecommunications Act, and have put competitive local exchange carriers (CLECs) at risk for their very existence. Next, FF&E finished in second to last with a drop of one point from last year's score. One possible explanation for this continued poor showing may be the perception that, although the outlook for job creation -- and thus office space -- remains positive, most of the new jobs that will be created will be in retail, or small- to micro-type companies, where the credit risks associated with such business does not adequately compensate lessors who lease this type of equipment. In addition, much of this equipment tends to be sold wholesale, due to its very nature, which causes a significant part of its resale value to be in storage, delivery, deinstallation, and reinstallation charges. Finally, automobiles finished in last place for the third year in a row, with a score of (29). There continues to be little, if any, interest expressed by respondents for this type of equipment. This is in spite of the fact that the lease penetration rate within this industry actually increased for the first time in five years, after having fallen from 32 percent to 21.5 percent in 2004, before climbing to 22.0 percent in 2005. It is felt that as long as 'low' or 'no interest' rate sales promotions exist, there will be little need for leasing, except for the high-end luxury car sector. Also, a significant portion of the industry's vicarious liability problems were settled to its benefit in 2005. Finally, assumed residual values for this industry continue to decline. For example, on a 36-month lease, residuals dropped from an average of 50.8 percent in 1997 to 40 percent today. This is also reflected in the automobile sector's second-to-last place showing in the residual value section of this year's survey, with a score of (-24).

Overall, the 2006 survey results reveal that lessors continue to remain optimistic, and based on increases in preference for more equipment types, along with increasing residual positions, equipment leasing seems to have entered a more competitive phase. This could lead to an expansion within the industry.

FINAL COMMENTS

After three punishing years, last year's survey was a promising one, which seemed to make the statement,*"we have recovered at last."* This year marks the second straight year of recovery, to which can be added, *"and let the growth begin*." This survey confirms that the equipment leasing industry has fully recovered after going through a downturn and consolidation stage, and is now ready for growth. Many used equipment markets are expected to show improvement over the next year, as residual values have returned to historic norms, and in some instances, considerably above. However, knowledgeable operating lessors with solid marketing experience may take a contrarian view to parts of this survey, and consider a "sharp erosion" or low popularity of a given equipment type to be the opening for future business success.

Perhaps the industry's perception can best be summed up in some of the following survey comments received about the greatest threats to the secondary market:

- "economic meltdown;"
- "continued scrutiny of the leasing product, and therefore, leasing in general;"
- "manufacturers' back-end controls of the secondary markets for their respective equipment;"
- "rapid change of technology;"
- "terrorist events driving markets into a recession;"
- "lower pricing on new equipment;" and
- "aggressive residuals in the construction industry."

The concerns enumerated in this year's survey seem to be collectively summed up in final comment received, which is as follows: "The greatest near-term threat to the secondary market is the ever-increasing cost of fossil fuels and commodities, causing a synchronized global slowdown, which would negatively impact new and used equipment markets, as well as leasing volume."

After two years of continued improvement, it is hoped that 2006 will prove to be the solid year that it has been forecast to be. However, as we are sitting at or near a cyclical equipment value high, you are encouraged to remember the old adage, "All glory is fleeting." I hope the information provided in this article will be beneficial to you as you chart your course towards success this year.

BIOGRAPHY

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Carl C. Chrappa is President and CEO of Independent Equipment Company, the nation's oldest equipment management outsourcing firm, headquartered in Clearwater, Florida. He is a registered auctioneer and tested and accredited senior equipment appraiser with over 30 years of experience.

Mr. Chrappa is uniquely qualified for this presentation, since he actively trades in equipment markets, and provides appraisals and equipment consulting services to companies throughout the world. He is also a member of the ***National Association of Business Economics***, where he serves as Vice Chair of the Association's Manufacturing Roundtable.

He is a current and founding member of ***The Equipment Leasing Association's*** **Equipment Management Committee**, he also serves on the Board of Directors of the ***Commercial Finance Association, ELA Business Services, Inc.,*** and is a past technical director of the ***American Association of Cost Engineers***. He has co-authored a book entitled "A Leasing Company's Guide to Equipment Management" and is the author of several columns devoted to equipment management. In addition, he is a regular content provider to the ELA's web-based ELAonline.com. Mr. Chrappa is a graduate of the University of Massachusetts at Amherst.

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