PODCAST TRANSCRIPTION SESSION NO. 117-PATRICIA VORHEES

Welcome to the Lend Academy podcast, Episode No. 117. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt.

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Peter Renton: Today on the show, I'm delighted to welcome Patricia Vorhees, she is a Director at the Alta Group and they're an advisory firm that focuses on the equipment finance space and Patricia has spent a good chunk of her career in this space and knows it intimately. So I wanted to get her on the show because we're now 117 episodes in and we've never covered this huge asset class, it's well over a trillion dollars and I felt like it was time so I got Patricia on the show. We wanted to talk about just how large the market is, the kind of performance that these loans have, who is financing equipment, how the industry is changing, how it's adapting to technology, what are some of the fintech players that are really coming up and innovating in this space and also where she feels like the industry is going. It was a fascinating interview and I hope you enjoy the show.

Welcome to the podcast, Patricia.

Patricia Vorhees: Thank you, thank you for having me.

Peter: Okay, so I'd like to get these things started with giving the listeners a little bit of background about yourself. Can you just share sort of what you've done before the Alta Group and what you've done over your career?

Patricia: I'd be happy to. You know, it's an interesting when I look back on my career. I've ended up primarily focusing on a couple of things that I really actually do love which is technology, financing and putting creative deals together because I actually began my career at IBM. At IBM, I worked on their large accounts and initially I worked on things like artificial intelligence, this was quite a while ago, and relational database technology so I worked with large clients and also was recruited by one of them, GE Capital.

I spent most of my career at GE Capital in various marketing roles. I actually led a team that did private label alliances for their vendor finance group and then from there I went on to the mergers & acquisitions team at a time when GE was very acquisitive and was fortunate to lead many acquisitions for GE Capital and through there went to lead the Office Imaging Finance Group so I learned a lot about small ticket finance and what happens selling the small business through the channel.

From there, I actually led pricing across all of GE Capital product lines and joined The Alta Group a couple of years ago, 2.5 years ago now and at the Alta Group I focus on two things. One is working on strategic consulting with clients and from my part that is often in conjunction with mergers & acquisitions or alliance related types of activities.

Peter: Okay, so then can you just tell us a little bit about what The Alta Group does overall, what is the mission of the company?

Patricia: Sure, well the mission of the company is to be the most trusted advisor in the asset finance space. The company was started I want to say 25 years ago, 1992 and it was started by a couple of principals who had run a leasing company so it started very much focused on the equipment leasing marketplace and doing strategic consulting for senior level executives in that space. From there a number of additional capabilities have been added on. We certainly still continue to do strategic consulting across all sorts of things; it could be looking at new market entry or benchmarking or any issue or opportunity a client might have.

We also do things like in asset management we work on evaluation and sale of all sorts of assets from computer equipment to barges to aircrafts. We do due diligence support, expert witness type of work and then where I spend a fair amount of my time is in mergers & acquisitions advisory group where we advise clients in acquisitions and sales and capital raising and alliances specific to the asset finance space and we have a newer practice over the last couple of years, it's been working to-date typically with our more traditional bank and independent leasing companies. Helping them look at their level of digitization and areas of opportunity. That's what we do, there are about 60 of us around the globe, about half from the US and then we have a decent concentration in Western Europe and in South America and a couple in China.

Peter: Okay, so I'm curious about the equipment finance space, we've actually never had...we haven't really focused on it here, on the podcast, and that's one of the reasons why I wanted to get you on, but can you just give us a sense of how big the equipment finance market is in the US?

Patricia: Yes, I can. You know it's interesting, I was just looking through this data for a client and the US market for equipment this past year, 2016 and actually the forecast for the current year is $1.6 trillion, so it's a huge market and if you look at that there is data that the Equipment Leasing & Finance Association tracks about how much of that is financed in some way and about a trillion of that trillion-six is financed in some way.

Peter: So the other $600 billion, I take it, is bought in cash, is that fair to say?

Patricia: Absolutely cash, yeah, for a variety of reasons, but yes cash.

Peter: Right, and so you touched on it a little bit there a few minutes ago you...I'm interested in a type of equipment, I mean, $1.6 trillion, that's a massive number and it's one of the biggest verticals there is and we just don't really talk about it. Obviously things like aircraft is probably a very big part of that, but can you just give us some sense of all the different types of equipment we're talking about here?

Patricia: Sure, so it really spans a gamut of anything that…if I look at the top concentration Peter across the board it is transportation is first up, followed by things like agricultural equipment used for agriculture, and construction, technology and software and telecom and office imaging are big groups as you said aircraft or corporate air and commercial that tends to be larger ticket things. If you look specifically at the smaller ticket space that is transactions that are under a half a million dollars in size, the top for, rounding that out would be agriculture, construction, office imaging, IT and then rounding out the bottom of that and would be medical.

Peter: Right.

Patricia: Also furniture or kiosks or any kind of tangible assets that can be financed.

Peter: Right, right, okay, so let's talk about that smaller end of the market, I'm curious in that because obviously a plane is going to have a very…there's going to be a limited number of companies or entities that are going to be interested in financing that, but obviously if you have a $200,000 piece of equipment and you're a small business owner you've probably got lots of options so what are the typical ways today that small business owners are financing their equipment?

Patricia: So if you look at data for the last year there's about, call it for smaller ticket items, you're looking at under $25,000 or up to $250,000 in purchase size, it's somewhere between 20% and 40% of transactions are done through leases and somewhere between 10% and 20% are done through secured loans, about 10% is in cash, somewhere between call it 20% and 30% is line of credit and somewhere between 15% and 30% is a credit card purchase.

Peter: Okay, so then like who are the companies that are providing these loans? I shared this with you earlier that I used to run a small business, I ran a printing company and I have financed my equipment. It was actually…my original one was through Wells Fargo and then ended up being through Hewlett Packard, which was the equipment that I was actually buying. Are most of them like these captive finance companies like Hewlett Packard had Hewlett Packard Financing something, obviously Wells Fargo is a bank...who are the main companies that are doing this financing?

Patricia: Sure, I'll do it in categories. The three biggest categories of types of companies are ones that provide direct financing and so an example of that would be a very large ticket transaction, maybe even a commercial aircraft transaction between a finance source and an investment grade customer.

So those are direct deals that are large deals, they are done by like Bank of America and some of the larger banks, US banks that have direct commercial finance reps that work with these large companies. The largest combined category besides direct however, is captive [inaudible] so you mentioned on the captive side, that is people like HP, IBM Global Finance, John Deere Finance , CAT so companies that really use financing to facilitate the sale of their equipment and facilitate the flow of it through their distribution channel.

There's another category which is vendor finance so if you look for example that was one of the largest businesses that GE Capital was in and in that business, and I had a team of people that did just this, that went out in the medical space, in office imaging and furniture and fixtures and material handling and worked with the largest manufacturers who didn't themselves have captives and setup either exclusive, if they were quite large, potentially private label or referral relationships with these manufacturers and sometimes those were coupled with marketing incentives and things for businesses to purchase. So those are the three main categories.

Now in the vendor space, GE Capital, people like Wells Fargo and Key Bank and you have U.S. Bancorp that are large in the vendor space.

Peter: Okay, so I'm curious about...I know you shared this slide at LendIt, I would like you to share it here about the loan performance. Obviously, these are coming off balance sheets, for the most part I guess in those companies, but loan performance...because my particular loan I got was a very low interest rate, I think it was like 5.5% or something, and this was 15 years ago, but I'm curious...obviously these loans are for the most part they are captive, these are secured loans or even with a bank, are they going to take a lien on the equipment, so how do these loans perform?

Patricia: They actually perform excellent and as I highlighted at the LendIt conference, if you look at the last 20 years, the only tracked asset class that performed better than equipment leasing is the US Treasury. So they tend to perform very well, there are some reasons for that.

One you mentioned is that unlike a small business loan where there tends to be a general lien that's taken against the business, this is a specific UCC placed against that particular piece of equipment. Secondly and more importantly, I think, in terms of performance is often the equipment that is financed is essentially used for the business. So if you own a small construction company and you are out leasing some construction equipment, you will make sure that you make that construction payment because without it you can not generate revenue.

The essential use element of much of these assets really helps drive that performance and it continues if you look over the last year delinquencies across the entire market is…or the trend in the last month was at 1.4% of average receivables and losses are at just under 40 basis points.

Peter: Wow, 40 basis points, that's fantastic. So do you have any stats about the recession...the financial crisis obviously defaults spiked across pretty much every category, do you have any stats on the numbers there?

Patricia: Yes, during the recession, the high water mark and it varies greatly in terms of collateral type and ticket size but it at its worst it was right around and under 4%.

Peter: Right, so it went up significantly, but still compared to credit cards or just about any other kind of loan...it still stayed fairly low. So then I'm curious about the small business owners that are taking out these leases or these secured loans, I mean, how has that changed? I mean, we've seen a lot of change in the small business space with companies like Kabbage and OnDeck coming in and really automating the process. In the case of Kabbage, it's a 100% automated. Obviously, leasing is a little bit different, but can you give us a sense of how small business owners are changing when it comes to their expectations of these types of loans?

Patricia: Sure, well actually to do that I'll just back up and talk about exactly how small businesses access this type of financing and often it is as I mentioned through a captive that might have programs that are available through a dealers. So if you go to your John Deere dealer they have financing that they can provide for you and if you are a manufacturer like Komatsu you have a program with one of the vendor finance companies who your sales folks or your dealer can offer to someone who is financing. Interestingly when when you look at small businesses however and look at the reach of leasing as a percentage of the financing. I mentioned it before, let's call it around a third of all the equipment that's financed is done through leasing and so that means there are actually a fair amount of smaller businesses to whom the reach of captive and to whom the reach of vendor programs don't necessarily reach so that's one piece of it.

Another piece of it is the fact when you're buying a piece of equipment there are three parties in the transaction and not two like with a small business loan, you have the lender and you have the small business. In an equipment lease you have the vendor, you have the lender and you have the small business and that has operational implications and it has implications in terms of the interests of the parties. It also has had implications in terms of how quickly equipment lending has come up the curve for innovation and I think for those reasons it's actually lagged behind other pieces of the overall fintech space.

However, one of the trends that is really beginning to change that dynamic is about how customers or small business, how they're buying equipment. If you look at the most recent Forrester research on B2B e-commerce for equipment and supples, they talk about a number of just under $900 billion going to $1.2 trillion being done over e-commerce and now that's not just for equipment, that's for supplies and some other components but all B2B. If you look at that trend together with what we've tracked in leasing that shows more and more financing is happening through captive and through vendor relationships and increasingly the financing decision is being made at point-of-sale and more of that is being sold online with strong mobile tech capabilities. That's driving behavior, driving where small businesses look for financing, it's driving where they want to see the financing solutions displayed and it's beginning to drive innovation in this space overall.

Peter: So that's interesting to me because...I'm curious about how the captive finance companies, even the banks that are providing these kinds of equipment loans, are they becoming more automated? We spoke on the same panel out at the CEMC event in California a couple of months ago and I was talking to people around there, around at that event and I was struck by how many...a lot of them were fairly small companies and they're all paper-based and they are providing financing pretty much the same way they provided it 25 years ago. So how much innovation is actually happening today?

Patricia: There's pockets of it so if you look at the more traditional players that have been around 10 plus years, for example if you look at Ascentium Capital earlier this year they were given a breakthrough award for the Best Business Lending Fintech Platform and they've spent a lot really automating especially on the front end to their dealers and customers. If you look at someone like IBM in Global Finance, their CEO Ginni Rometty has been very clear that one of the places that they're applying blockchain is in their global finance company looking at global asset and lease reconciliation.

So I think there are pockets of it where there are more traditional companies that are deciding where they really want to focus and try to accelerate technology, but if you were to look at curve I think what you heard at the CEMC is probably the majority that most have some legacy systems in place, and it's not only systems but it is processes because if you think about how vendor finance companies have organized operationally and in their own sales teams to be synergistic with the sales and operational organizations of the manufacturers, there's a whole lot of legacy systems and processes there and so when you think about selling equipment entirely online and integrating the financing at the point-of-sale, that's a whole different species in terms of how you have to apply technology and how you have to make it available. So I think we're beginning to see some models work, as fintech models enter the space, but by and large, the biggest portion of and it's not that equipment leasing companies haven't always invested in technology for credit and asset management but really having that automated end-to-end and having each of the pieces integrated, there's a long way to go.

Peter: Right, so you mentioned point-of-sale and mobile, I mean, where are you seeing applications that are really...what kinds of industries, what kinds of places are you seeing the real innovation when it comes to point-of-sale because I imagine that if you can do something on an iPad in an efficient way, you're going to make more sales so I imagine that there is some innovation. What areas are you seeing that?

Patricia: So it's in the few spaces and one is one that I wouldn't have if I was calling it probably have guessed was going to be among the first but it is actually is in yellow metal in construction and ag tech where there is not only a strong primary but a strong secondary market which helps kind of with the credit side of that. And then it's in technology and just broad B2B types of equipment so people like eBay who are selling pretty broad swaths of equipment have financing capabilities.

Peter: Right, right, and it's funny because I also, just as an aside, I ran into an old friend of mine who works at Caterpillar and we were actually at the airport, we just run into each other and he was on the phone and I heard him talking about machine learning and big data and doing data analytics and it was like...it was funny because I felt like this could have been on a fintech call for all the different terminologies he was using. So are the big companies, are they really, you know, starting to adapt in taking the technology that's been developed in other industries and applying it to their own?

Patricia: Yeah, Peter, I think they are and I think the other thing that's really affecting this is the smartness of the assets themselves, you gave the example of Cat and if you took a look at Cat and Deere, who are a couple of the biggest players in the ag space. If you look at a combine or a tractor, they're not the combine or tractor of ten or twenty years ago, they're very smart devices that are highly automated and gather all sorts of data and information about usage and operations.

That was not the case years ago so that changes a lot of things, certainly the way the equipment is used, but it also changes the way in which you can finance it. It really does enable things like thinking about usage base types of financing solutions where you could do that real-time because you're getting through the Internet of Things data that's telling you exactly how equipment is being used. In the commercial fleet financing space right now that type of information and data is very much a part of the overall financing and solutions that are out there.

Peter: Right, no that makes sense and even in the printing industry from ten years ago. I remember when we had our printing press that they would connect into HP servers and they would know exactly how we were using that printing press. I imagine that was ten years ago, it's gotten a lot better so that makes perfect sense to me. So then what is the opportunity here for new companies entering the market, for fintech companies, I mean, where is the opportunity for disruption in this asset-based finance market?

Patricia: Well, it's in a few places and I'll call it three of them. One is just really just access and awareness, Peter. We are finding that the further you go down in terms of size of business, understanding that equipment leasing is an option that they have, and where and how to get at it and how it may be an attractive option for them versus a loan or using their corporate credit card or working capital or cash. So I think there is lots of big numbers and the numbers I mentioned before were big numbers so $300 billion of a trillion that is financed is leases. Then there's a whole lot right now that's opportunities if you're looking to do equipment leases that you have some runway, not to mention taking a percentage of the captives. So getting at these markets is one, Peter and leveraging technology to do that in smart ways.

The second thing that I would say is at point-of-sale because the mobile purchase of equipment. If you look at where buyers or end users and demographic changes I think that trend is only going to accelerate so the opportunity to really have innovative and accessible financing at point-of-sale is important. Especially early clients we have spoken to in this space that are partnering in that way with sellers of equipment online are finding that there's real advantages for customers in terms of the size of the sale that is done and the likelihood that it actually is sold.

The third one and this is a trend across the equipment leasing marketplace, is the trend for more bundled and usage based solutions. In the industry we call that an MST or a managed solutions transaction and we were commissioned last year to do a research white paper on that topic and there is are five or six of us that participated in doing that and we reached out to 85 different companies in this space and our research tells us that all of the companies regardless of industry that they played in were getting more and more involved from bank customers on bundled solutions with services, software, supplies and more usage based offerings and the overall estimate was that about 20/22% of the market in the next couple of years will be that type of product. So I think there is financing product innovation on its way that will be distinct from what has been in place from a risk standpoint for years in equipment leasing which is a "hell or high water" lead which is frankly going to have some interesting implications in terms of how one can play in the market, like banks for example, how they get their heads around changes that might mean for them.

Peter: Right, right, so then you mentioned one or two names already, but I'd like to get your sense on who are the more interesting companies that are innovating, that are really doing interesting things in this space?

Patricia: Sure, I'll throw out two of them, one of them and we talked about point-of-sale so one I'll throw out is Currency Capital, and Currency is very much focused on integrating financing at point of sale, and so they have and are working on adding more flagship customer relationships, one that they highlight is with eBay and so you're a business customer and you're looking at pieces of business equipment and you look at a financing option it is actually Currency in the background who is financing that. They have a model where they do some financing on their balance sheet and also manage a marketplace, an automated marketplace so they would be an example.

There are others, for example, one that is focused more on the subscription-base is a company called LiftForward and they actually have a relationship with Microsoft for their Surface tablet. And there are some that are focused on very specific verticals, there is a company out there called Sparkfund and what Sparkfund does is they work with resellers and implementers of solutions for energy efficiency, whether that's LEDs or HVAC and they put together financing solutions that upgrade and save on energy, they match the payment to the actual timing of the savings and there is another one out there called LeaseQ that has looked at different lease verticals or industry verticals and allows customers directly or through vendors to get multiple quotes for financing and then have those routed to financing sources. So there is a few and we're beginning to see more interest in the space from not only traditional lenders who have been around quite a while, but some of the more fintech entrants that came in, in other products.

Peter: Right, right. So are we seeing some real partnerships happening between these new fintech companies you mentioned and some of the legacy players?

Patricia: So I mentioned one, one is LiftForward and their partnership with Microsoft for the Surface, I think that's an interesting one and, you know, many of these companies, when I speak with their CEOs, they are very much focused on, if not a single, a dual-leg strategy, one of which is going out and partnering with legacy companies to leverage their fintech capability and do it in a white label kind of way. And similarly I've had conversations with our large clients that are captive finance organizations or independent finance organizations that might look to align rather than build or even have a referral for some of their declines. So we're starting to see them, but I think the pace is going to pick up Peter.

Peter: Okay, so we're almost out of time, but just one last question here about the equipment finance space. If we get together again in like two or three years, what will have changed, what do you think is coming down the track the next couple of years?

Patricia: Well, you know I think three things are going to change. One, we will see a lot more of the leasing not being done in traditional leasing but being done in some sort of bundled or usage based so I think there's going to be a movement there on that side of it. I think this trend on point of sale is going to continue so I think that has the potential to maybe even shift the players that are in this, if you look for example, Amazon as an example, then you really have to look at who are the successful sellers of equipment and some of those answers are different than some of the other traditional sellers of equipment so I think we might see some shift there. And the third thing is I think that there will be a little bit more fluidity of products so depending on how a customer is accessed by a vendor, or captive or point-of-sale related solution that the technology allows the finance source to really look at what the right product is, is it in fact an equipment lease or is it loan or is it working capital and is there some migration amongst those products. So I think the space will have more fluidity of products.

Peter: Okay, we'll have to leave it there, but it's going to be fascinating to see, I think it's obviously a massive vertical that I think more people should be paying attention to. Anyway, thanks for being on the show today, Patricia.

Patricia: My pleasure, thank you.

Peter: Okay, see you.

Patricia: Bye.

Peter: That point-of-sale trend that Patricia just talked about is super interesting to me. You've got companies like GreenSky and Affirm that are really transforming point-of-sale, whether it's physically or online, and I think the same thing I could see happening to equipment finance. These are not that much different when it comes to buying a couch as buying a tractor. There certainly are differences, but the reality is the processes can indeed be very similar and I think we're going to see a big movement to point-of-sale in equipment finance and in all other areas of finance. It's going to happen much, much quicker than people think, that's my idea.

Anyway on that note, I will sign off. I would like to very much thank you for listening and I will catch you next time. Bye.

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